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, 2023

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 001-41556

SNAIL, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**88-4146991** (IRS Employer Identification No.)

12049 Jefferson Blvd
Culver City, CA 90230
(Address of principal executive offices) (zip code)
+1 (310) 988-0643
(Registrant's telephone number, including area code)

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

Title of each class	Trading symbol	Name of each exchange on which registered
Class A Common Stock, par value $0.0001 per share	**SNAL**	**The Nasdaq Stock Market LLC**

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, if any, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☒
Emerging growth company	☒		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding Shares as of August 10, 2023

Class A Common Stock, par value $0.0001 per share	**7,901,145**
Class B Common Stock, par value $0.0001 per share	**28,748,580**

SNAIL, INC. AND SUBSIDIARIES
Form 10-Q
For the Quarter Ended June 30, 2023

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q (the "Quarterly Report") contains statements that constitute forward-looking statements. Many of the forward-looking statements contained in this Quarterly Report can be identified by the use of forward-looking words such as "anticipate," "believe," "could," "expect," "should," "plan," "intend," "may," "predict," "continue," "estimate" and "potential," or the negative of these terms or other similar expressions.

Forward-looking statements appear in a number of places in this Quarterly Report and include, but are not limited to, statements regarding our intent, belief or current expectations. These forward-looking statements include information about possible or assumed future results of our business, financial condition, results of operations, liquidity, plans and objectives. Forward-looking statements are based on our management's beliefs and assumptions and on information currently available to our management. Such statements are subject to risks and uncertainties, and actual results may differ materially from those expressed or implied in the forward-looking statements due to various factors, including, but not limited to, those identified described in "Part II, Item 1A. – Risk Factors," of this Quarterly Report. The statements we make regarding the following matters are forward-looking by their nature:

- our ability to re-establish profitable operations, raise additional capital or renegotiate our debt arrangements;
- our growth prospects and strategies;
- launching new games and additional functionality to games that are commercially successful;
- our expectations regarding significant drivers of our future growth;
- our ability to retain and increase our player base and develop new video games and enhance our existing games;
- competition from companies in a number of industries, including other casual game developers and publishers and both large and small, public and private multimedia companies;
- our ability to attract and retain a qualified management team and other team members while controlling our labor costs;
- our relationships with third-party platforms such as Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, the Apple App Store, the Google Play Store, My Nintendo Store and the Amazon Appstore;
- our ability to successfully enter new markets and manage our international expansion;
- protecting and developing our brand and intellectual property portfolio;
- costs associated with defending intellectual property infringement and other claims;
- our future business development, results of operations and financial condition;
- rulings by courts or other governmental authorities;
- our Share Repurchase Program (as defined below), including expectations regarding the timing and manner of repurchases made under the Share Repurchase Program;
- our plans to pursue and successfully integrate strategic acquisitions;
- other risks and uncertainties described in this Quarterly Report, including those described in Item 1A of Part II, "Risk Factors"; and
- assumptions underlying any of the foregoing.

Further information on risks, uncertainties and other factors that could affect our financial results are included in our filings with the Securities and Exchange Commission (the "SEC") from time to time, including in Item 1A of Part II, "Risk Factors," of this Quarterly Report and other periodic reports on Form 10-K and 10-Q filed or to be filed with the SEC. You should not rely on these forward-looking statements, as actual outcomes and results may differ materially from those expressed or implied in the forward-looking statements as a result of such risks and uncertainties. All forward-looking statements in this Quarterly Report are based on management's beliefs and assumptions and on information currently available to us, and we do not assume any obligation to update the forward-looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made.

PART I

Item 1. Condensed Consolidated Financial Statements.

Snail, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2023	December 31, 2022
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,960,160	$ 12,863,817
Restricted escrow deposit	1,025,193	1,003,804
Accounts receivable, net of allowances for credit losses of $19,929 and $31,525, respectively	4,963,566	6,758,024
Accounts receivable - related party, net	11,733,226	11,344,184
Loan and interest receivable - related party	102,745	101,753
Prepaid expenses - related party	2,500,000	-
Prepaid expenses and other current assets	12,216,801	10,565,141
Total current assets	35,501,691	42,636,723
Restricted cash and cash equivalents	1,113,960	6,374,368
Prepaid expenses - related party	5,582,500	5,582,500
Property, plant and equipment, net	4,881,629	5,114,799
Intangible assets, net - license - related parties	326,087	1,384,058
Intangible assets, net - other	272,119	272,521
Deferred income taxes	9,490,241	7,602,536
Other noncurrent assets	180,778	198,668
Operating lease right-of-use assets, net	3,032,069	3,606,398
Total assets	$ 60,381,074	$ 72,772,571
LIABILITIES, NONCONTROLLING INTERESTS AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 8,658,585	$ 9,452,391
Accounts payable - related party	19,611,207	19,918,259
Accrued expenses and other liabilities	2,678,848	1,474,088
Interest payable - related parties	527,770	527,770
Revolving loan	6,000,000	9,000,000
Short term note	2,916,667	5,416,666
Current portion of promissory note	2,845,303	86,524
Current portion of deferred revenue	4,125,505	4,335,404
Current portion of operating lease liabilities	1,437,140	1,371,227
Total current liabilities	48,801,025	51,582,329
Accrued expenses	384,150	457,024
Promissory note, net of current portion	-	3,221,963
Deferred revenue, net of current portion	4,660,343	5,216,042
Operating lease liabilities, net of current portion	2,191,465	2,930,529
Total liabilities	56,036,983	63,407,887
Commitments and contingencies		
Stockholders' Equity:		
Class A common stock, $0.0001 par value, 500,000,000 shares authorized; 9,251,420 shares issued, 7,901,145 and 8,053,771 shares outstanding as of June 30, 2023 and December 31, 2022, respectively	925	925
Class B common stock, $0.0001 par value, 100,000,000 shares authorized; 28,748,580 shares issued and outstanding as of June 30, 2023 and December 31, 2022, respectively	2,875	2,875
Additional paid-in capital	25,708,907	23,436,942
Accumulated other comprehensive loss	(286,173)	(307,200)
Accumulated deficit	(11,914,059)	(4,863,250)
	13,512,475	18,270,292
Treasury stock at cost (1,350,275 and 1,197,649 shares as of June 30, 2023 and December 31, 2022, respectively)	(3,671,806)	(3,414,713)
Total Snail, Inc. equity	9,840,669	14,855,579
Noncontrolling interests	(5,496,578)	(5,490,895)
Total stockholders' equity	4,344,091	9,364,684
Total liabilities, noncontrolling interests and stockholders' equity	$ 60,381,074	$ 72,772,571

See accompanying notes to condensed consolidated financial statements (unaudited).

Snail, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2023	*2022*	*2023*	*2022*
Revenues, net	$ 9,892,253	$ 15,463,522	$ 23,350,741	$ 43,518,113
Cost of revenues	9,335,765	12,259,514	20,196,702	27,973,329
Gross profit	556,488	3,204,008	3,154,039	15,544,784
Operating expenses:				
General and administrative	3,937,234	4,250,882	8,462,985	9,046,094
Research and development	1,200,842	179,050	2,574,639	363,006
Advertising and marketing	168,292	212,039	272,841	370,710
Depreciation and amortization	118,110	138,791	233,170	307,108
Total operating expenses	5,424,478	4,780,762	11,543,635	10,086,918
(Loss) income from operations	(4,867,990)	(1,576,754)	(8,389,596)	5,457,866
Other income (expense):				
Interest income	19,791	17,705	51,264	33,077
Interest income - related parties	499	130,695	992	581,623
Interest expense	(296,237)	(186,213)	(590,820)	(352,268)
Interest expense - related parties	-	(1,496)	-	(3,222)
Other income	-	296,969	8,175	299,653
Foreign currency transaction (loss) gain	(21,845)	7,916	(24,212)	5,510
Total other (expense) income, net	(297,792)	265,576	(554,601)	564,373
(Loss) income before (benefit from) provision for income taxes	(5,165,782)	(1,311,178)	(8,944,197)	6,022,239
(Benefit from) provision for income taxes	(1,081,887)	(327,347)	(1,887,705)	1,202,303
Net (loss) income	(4,083,895)	(983,831)	(7,056,492)	4,819,936
Net (loss) income attributable to non-controlling interests	(4,464)	70,466	(5,683)	63,176
Net (loss) income attributable to Snail, Inc. and Snail Games USA Inc.	**(4,079,431)**	**(1,054,297)**	**(7,050,809)**	**4,756,760**
Comprehensive income statement:				
Other comprehensive income (loss) related to currency translation adjustments, net of tax	18,707	(31,199)	21,027	(82,402)
Total comprehensive (loss) income	**$ (4,060,724)**	**$ (1,085,496)**	**$ (7,029,782)**	**$ 4,674,358**
Net (loss) income attributable to Class A common stockholders:				
Basic	**$ (879,665)**	**$ (1,054,297)**	**$ (1,522,005)**	**$ 4,756,760**
Diluted	**$ (879,665)**	**$ (1,054,297)**	**$ (1,522,005)**	**$ 4,756,760**
Net loss attributable to Class B common stockholders:				
Basic	**$ (3,199,766)**	**$ -**	**$ (5,528,804)**	**$ -**
Diluted	**$ (3,199,766)**	**$ -**	**$ (5,528,804)**	**$ -**
(Loss) income per share attributable to Class A and B common stockholders:				
Basic	**$ (0.11)**	**$ (0.03)**	**$ (0.19)**	**$ 0.14**
Diluted	**$ (0.11)**	**$ (0.03)**	**$ (0.19)**	**$ 0.14**
Weighted-average shares used to compute income per share attributable to Class A common stockholders[(1)]:				
Basic	**7,901,145**	**35,000,000**	**7,914,096**	**35,000,000**
Diluted				

	7,901,145	**35,000,000**	**7,914,096**	**35,000,000**
Weighted-average shares used to compute income per share attributable to Class B common stockholders:				
Basic	**28,748,580**	**-**	**28,748,580**	**-**
Diluted	**28,748,580**	**-**	**28,748,580**	**-**

(1) The shares used for the denominator in the calculation of EPS are the number of shares transferred in the reorganization transaction for comparative purposes. Snail Games USA Inc. did not have Class A common stock as of June 30, 2022.

See accompanying notes to condensed consolidated financial statements (unaudited).

Snail, Inc. and Subsidiaries
Condensed Consolidated Statements of Equity for the Three and Six Months Ended June 30, 2023 and 2022
(Unaudited)

	Common Stock - Snail Games USA Inc.		Class A Common Stock		Class B Common Stock		Additional Paid-In-Capital	Due from Shareholder Loan and Interest Receivable	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock		Snail Games USA Inc. Equity	Non controlling interests	Total Equity
	Shares	Amount	Shares	Amount	Shares	Amount					Shares	Amount			
Balance at December 31, 2021	**500,000**	**$ 5,000**	**-**	**$ -**	**-**	**$ -**	**$ 94,159,167**	**$ (94,353,522)**	**$ (266,557)**	**$ 16,045,231**	**-**	**$ -**	**$ 15,589,319**	**$ (5,537,266)**	**$ 10,052,053**
Loan to shareholder		-	-	-	-	-	-	(450,681)	-	-	-	-	(450,681)	-	(450,681)
Foreign currency translation			-	-	-	-	-	-	(51,203)	-	-	-	(51,203)	-	(51,203)
Net income			-	-	-	-	-	-	-	5,811,057	-	-	5,811,057	(7,290)	5,803,767
Balance at March 31, 2022	**500,000**	**$ 5,000**	**-**	**$ -**	**-**	**$ -**	**$ 94,159,167**	**$ (94,804,203)**	**$ (317,760)**	**$ 21,856,288**	**-**	**$ -**	**$ 20,898,492**	**$ (5,544,556)**	**$ 15,353,936**
Loan to shareholder	-	-	-	-	-	-	-	(130,197)	-	-	-	-	(130,197)	-	(130,197)
Dividend distribution	-	-	-	-	-	-	(81,278,112)	94,934,400	-	(21,856,288)	-	-	(8,200,000)	-	(8,200,000)
Foreign currency translation	-	-	-	-	-	-	-	-	(31,199)	-	-	-	(31,199)	-	(31,199)
Net loss	-	-	-	-	-	-	-	-	-	(1,054,297)	-	-	(1,054,297)	70,466	(983,831)
Balance at June 30, 2022	**500,000**	**$ 5,000**	**-**	**$ -**	**-**	**$ -**	**$ 12,881,055**	**$ -**	**$ (348,959)**	**$ (1,054,297)**	**-**	**$ -**	**$ 11,482,799**	**$ (5,474,090)**	**$ 6,008,709**

	Class A Common Stock		Class B Common Stock		Additional Paid-In-Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Treasury Stock		Snail, Inc. Equity	Non controlling interests	Total Equity
	Shares	Amount	Shares	Amount				Shares	Amount			
Balance at December 31, 2022	9,251,420	$ 925	28,748,580	$ 2,875	$ 23,436,942	$ (307,200)	$ (4,863,250)	(1,197,649)	$ (3,414,713)	$ 14,855,579	$ (5,490,895)	$ 9,364,684
Stock based compensation related to restricted stock units	-	-	-	-	152,595	-	-	-	-	152,595	-	152,595
Repurchase of common stock	-	-	-	-	-	-	-	(152,626)	(257,093)	(257,093)	-	(257,093)
Foreign currency translation	-	-	-	-	-	2,320	-	-	-	2,320	-	2,320
Net loss	-	-	-	-	-	-	(2,971,378)	-	-	(2,971,378)	(1,219)	(2,972,597)
Balance at March 31, 2023	**9,251,420**	**$ 925**	**28,748,580**	**$ 2,875**	**$ 23,589,537**	**$ (304,880)**	**$ (7,834,628)**	**(1,350,275)**	**$ (3,671,806)**	**$ 11,782,023**	**$ (5,492,114)**	**$ 6,289,909**
Return of dividend distribution tax withholding payment	-	-	-	-	1,886,600	-	-	-	-	1,886,600	-	1,886,600
Stock based compensation related to restricted stock units	-	-	-	-	232,770	-	-	-	-	232,770	-	232,770
Foreign currency translation	-	-	-	-	-	18,707	-	-	-	18,707	-	18,707
Net loss	-	-	-	-	-	-	(4,079,431)	-	-	(4,079,431)	(4,464)	(4,083,895)
Balance at June 30, 2023	**9,251,420**	**$ 925**	**28,748,580**	**$ 2,875**	**$ 25,708,907**	**$ (286,173)**	**$ (11,914,059)**	**(1,350,275)**	**$ (3,671,806)**	**$ 9,840,669**	**$ (5,496,578)**	**$ 4,344,091**

See accompanying notes to condensed consolidated financial statements (unaudited).

Snail, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

For the Six Month Period Ended June 30,	*2023*	*2022*
Cash flows from operating activities:		
Net income (loss)	$ (7,056,492)	$ 4,819,936
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Amortization - intangible assets - license	-	250,000
Amortization - intangible assets - license, related parties	1,057,971	3,701,959
Amortization - intangible assets - other	402	448
Amortization - loan origination fees	20,726	12,557
Depreciation and amortization - property and equipment	233,170	307,108
Stock-based compensation expense	385,365	-
Gain on lease termination	-	(122,533)
Gain on paycheck protection program and economic injury disaster loan forgiveness	-	(174,436)
Loss on disposal of fixed assets	-	2,433
Interest income from shareholder loan	-	(580,878)
Interest income from restricted escrow deposit	(21,389)	-
Deferred taxes	(1,887,705)	-
Changes in assets and liabilities:		
Accounts receivable	1,794,458	4,730,110
Accounts receivable - related party	(389,042)	(2,505,580)
Prepaid expenses - related party	(2,500,000)	(4,375,000)
Prepaid expenses and other current assets	234,940	(984,632)
Other noncurrent assets	(2,903)	(15,944)
Accounts payable	(701,488)	1,323,972
Accounts payable - related party	(307,052)	(222,536)
Accrued expenses	1,131,886	363,240
Interest receivable - related parties	(992)	-
Interest payable - related parties	-	1,994
Lease liabilities	(98,822)	(69,188)
Deferred revenue	(765,599)	(3,021,554)
Net cash (used in) provided by operating activities	(8,872,566)	3,441,476
Cash flows from investing activities:		
Purchases of property and equipment	-	(5,256)
Repayment on Pound Sand note	-	1,496,063
Net cash provided by investing activities	-	1,490,807
Cash flows from financing activities:		
Repayments on promissory note	(46,517)	(38,759)
Repayments on short-term note	(2,916,666)	(2,083,333)
Repayments on revolving loan	(3,000,000)	-
Borrowings on short-term note	-	10,000,000
Payments on paycheck protection program and economic injury disaster loan	-	(90,198)
Refund of payments on paycheck protection program and economic injury disaster loan	-	48,305
Cash dividend declared and paid	-	(8,200,000)
Purchase of treasury stock	(257,093)	-
Payments of offering costs in accounts payable	(92,318)	-
Net cash used in financing activities	(6,312,594)	(363,985)
Effect of currency translation on cash and cash equivalents	21,095	(63,694)
Net (decrease) increase in cash and cash equivalents, and restricted cash and cash equivalents	(15,164,065)	4,504,604
Cash and cash equivalents, and restricted cash and cash equivalents - beginning of period	19,238,185	16,554,115
Cash and cash equivalents, and restricted cash and cash equivalents – end of period	**$ 4,074,120**	**$ 21,058,719**
Supplemental disclosures of cash flow information		
Cash paid during the period for:		
Interest	$ 568,908	$ 339,710
Income taxes	$ 270,802	$ 828,012
Noncash transactions during the period for:		
Loan and interest payable - related parties	$ -	$ 103,890
Loan and interest receivable - related parties	$ -	$ (103,890)
Loan and interest from shareholder	$ -	$ 94,934,400
Dividend distribution	$ -	$ (94,934,400)

Noncash finance activity during the period for:		
Refund of dividend withholding tax overpayment	$ 1,886,600	$ -
Gain on paycheck protection program and economic injury disaster loan forgiveness	$ -	$ (174,436)

See accompanying notes to condensed consolidated financial statements (unaudited).

NOTE 1 – PRESENTATION AND NATURE OF OPERATIONS

Snail, Inc. was incorporated under the laws of Delaware in January 2022. The terms “Snail, Inc,” “Snail Games,” “our” and the “Company” are used to refer collectively to Snail, Inc. and its subsidiaries. The Company’s fiscal year end is December 31. The Registrant was formed for the purpose of completing an initial public offering (“IPO”) and related transactions to carry on the business of Snail Games USA Inc. and its subsidiaries. Snail Games USA Inc. was founded in 2009 as a wholly owned subsidiary of Suzhou Snail Digital Technology Co., Ltd. (“Suzhou Snail”) located in Suzhou, China and is the operating entity that continues post IPO. Snail Games USA Inc. is devoted to researching, developing, marketing, publishing, and distributing games, content and support that can be played on a variety of platforms including game consoles, PCs, mobile phones and tablets. The Company is a global developer and publisher of interactive entertainment content and support on video game consoles, personal computers, mobile devices, and other platforms.

On July 13, 2022, Suzhou Snail transferred all of its right, title, and interest to all of the 500,000 shares of common stock of the Company (“Shares”) to Snail Technology (HK) Limited (“Snail Technology”), an entity organized under the laws of Hong Kong, pursuant to the certain Share Transfer Agreement dated July 13, 2022 between Suzhou Snail and Snail Technology. Subsequently, Snail Technology transferred all of its right, title, and interest in the shares to certain individuals per the Share Transfer Agreement. In connection with the reorganization transaction described below the individuals contributed their interest in the Company to Snail, Inc. in return for common stock of Snail, Inc in connection with Snail, Inc.’s IPO. Because the Company and Suzhou Snail are owned by the same shareholders, Suzhou Snail is considered a related party to the Company.

Reorganization Transaction and IPO

On September 16, 2022, Snail, Inc., filed a Registration Statement on Form S-1 with the United States Securities and Exchange Commission in connection with its IPO. On November 9, 2022, effective as of the IPO pricing, Snail Games USA Inc.’s existing shareholders transferred their 500,000 shares of common stock of Snail Games USA Inc. to Snail, Inc. in exchange for 6,251,420 shares of Class A common stock and 28,748,580 shares of Class B common stock of Snail, Inc., and Snail, Inc. became the parent of Snail Games USA Inc. Because the reorganization transaction was considered a transaction between entities under common control, the financial statements for periods prior to the reorganization transaction and the IPO have been adjusted to combine the previously separate entities for presentation purposes. On November 9, 2022, Snail, Inc. priced its IPO, and on November 10, 2022, Snail, Inc.’s Class A common stock began trading on The Nasdaq Capital Market under the ticker symbol SNAL. In the IPO, Snail, Inc. issued 3,000,000 shares of Class A common stock at $5.00 per share and net proceeds from the IPO were distributed to Snail Games USA Inc. in November 2022 in the amount of approximately $12.0 million, net of the underwriting discount and offering costs of $3.0 million. In connection with the IPO, $1.0 million of the IPO proceeds were remitted to an escrow account which is held to provide a source of funding for certain indemnification obligations of Snail, Inc. to the underwriters. The amount in escrow is reported as a restricted escrow deposit in the consolidated balance sheets for 12 months from the date of the offering, at which time the restrictions will be removed and the balance will be reverted to unrestricted cash.

Basis of Presentation and Consolidation

The accompanying condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the SEC and generally accepted accounting principles as promulgated in the United States of America (“U.S. GAAP”) for interim reporting. Accordingly, certain notes or other information that are normally required by U.S. GAAP have been condensed or omitted if they substantially duplicate the disclosures contained in our annual audited consolidated financial statements. Additionally, the year-end condensed consolidated balance sheet data was derived from audited consolidated financial statements but does not include all disclosures required by U.S. GAAP. Accordingly, the unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2022 included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2022, filed on March 29, 2023. The condensed consolidated results of operations for any interim period are not necessarily indicative of the results to be expected for the full year or for any other future annual or interim period.

In the opinion of management, all adjustments considered necessary for the fair presentation of the Company’s financial position and its results of operations in accordance with U.S. GAAP (consisting of normal recurring adjustments) have been included in the accompanying unaudited condensed consolidated financial statements.

Certain comparative amounts have been reclassified to conform with the current period presentation. The common stock of Snail Games USA Inc., as of June 30, 2022, has been reclassified as Class A common stock as the stockholders of the Snail Games USA Inc. common stock had their shares converted to Class A shares of Snail Inc. during the reorganization transaction that occurred amongst a common controlled group. For more information regarding the reorganization transaction see Note 20 - *Equity*.

During the six months ended June 30, 2023, certain comparative amounts have been reclassified due to immaterial errors identified by the Company in its presentation of certain server hosting costs. During the three months ended June 30, 2023, the Company began reporting all of its server hosting costs as costs of revenue whereas they were previously reported within both cost of sales and general and administrative expenses. The Company has assessed the materiality of these errors on its prior annual and interim financial statements, assessing materiality both quantitatively and qualitatively, in accordance with the SEC's Staff Accounting Bulletin ("SAB") No. 99 and SAB No. 108 and concluded that the errors were not material to those consolidated financial statements. However, to correctly present cost of revenues, gross profit and general and administrative expenses, the reclassifications have been made throughout this report and accompanying note disclosures. The effects on the related captions in the condensed consolidated statements of operations and comprehensive income (loss) for all previously reported periods were as follows:

	For the three months ended March 31, 2022		
	As reported	Adjustment	As adjusted
Cost of revenues	$ 14,889,017	$ 824,798	$ 15,713,815
Gross profit	13,165,574	(824,798)	12,340,776
General and administrative	5,620,010	(824,798)	4,795,212

	For the three months ended June 30, 2022		
	As reported	Adjustment	As adjusted
Cost of revenues	$ 11,386,885	$ 872,629	$ 12,259,514
Gross profit	4,076,637	(872,629)	3,204,008
General and administrative	5,123,511	(872,629)	4,250,882

	For the six months ended June 30, 2022		
	As reported	Adjustment	As adjusted
Cost of revenues	$ 26,275,902	$ 1,697,427	$ 27,973,329
Gross profit	17,242,211	(1,697,427)	15,544,784
General and administrative	10,743,521	(1,697,427)	9,046,094

	For the three months ended September 30, 2022		
	As reported	Adjustment	As adjusted
Cost of revenues	$ 11,468,961	$ 955,106	$ 12,424,067
Gross profit	4,145,210	(955,106)	3,190,104
General and administrative	5,434,013	(955,106)	4,478,907

	For the nine months ended September 30, 2022		
	As reported	Adjustment	As adjusted
Cost of revenues	$ 37,744,863	$ 2,652,533	$ 40,397,396
Gross profit	21,387,421	(2,652,533)	18,734,888
General and administrative	16,177,534	(2,652,533)	13,525,001

	For the twelve months ended December 31, 2022		
	As reported	Adjustment	As adjusted
Cost of revenues	$ 49,507,888	$ 3,613,788	$ 53,121,676
Gross profit	24,936,253	(3,613,788)	21,322,465
General and administrative	22,327,746	(3,613,788)	18,713,958

	For the three months ended March 31, 2023		
	As reported	Adjustment	As adjusted
Cost of revenues	$ 9,816,397	$ 1,044,540	$ 10,860,937
Gross profit	3,642,091	(1,044,540)	2,597,551
General and administrative	5,570,291	(1,044,540)	4,525,751

The condensed consolidated financial statements include the accounts of Snail, Inc. and the following subsidiaries:

Subsidiary Name	**Equity % Owned**
Snail Games USA Inc.	100%
Snail Innovation Institute	70%
Frostkeep Studios, Inc.	100%
Eminence Corp	100%
Wandering Wizard, LLC	100%
Donkey Crew, LLC	99%
Interactive Films, LLC	100%
Project AWK Productions, LLC	100%
BTBX.IO, LLC	70%

All intercompany accounts, transactions, and profits have been eliminated upon consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires the Company to make estimates and assumptions that affect the amounts reported in our condensed consolidated financial statements and the accompanying notes. Such estimates include revenue recognition, provisions for credit losses, deferred income tax assets and associated valuation allowances, deferred revenue, income taxes, valuation of intangibles, including those with related parties, impairment of intangible assets, stock-based compensation and fair value of warrants. These estimates generally involve complex issues and require management to make judgments, involve analysis of historical and future trends that can require extended periods of time to resolve, and are subject to change from period to period. In all cases, actual results could differ materially from estimates.

Segment Reporting

The Company has one operating and reportable segment. Our operations involve similar products and customers worldwide. Revenue earned is primarily derived from the sale of software titles, which are developed internally or licensed from related parties. Financial information about our segment and geographic regions is included in Note 3 – *Revenue from Contracts with Customers*.

Liquidity and Going Concern

The Company incurred a net loss of $7.1 million and negative cash flows of $15.2 million for the six months ended June 30, 2023. As of June 30, 2023, the Company had cash and cash equivalents of $3.0 million, restricted cash and cash equivalents of $1.1 million and current debt of $9.0 million.

As of June 30, 2023, the Company's 2021 Revolving Loan (as defined below) and 2022 Short Term Note (as defined below) of $6.0 million and $2.9 million are due in December 2023 and January 2024, respectively. Management intends to renegotiate with the lender to extend the maturity date of the 2021 Revolving Loan. However, there is no guarantee that management will be able to renegotiate the terms of the 2021 Revolving Loan with its lender on terms acceptable to the Company or at all. Additionally, management plans to repay the outstanding amounts under the 2022 Short Term Note pursuant to the terms of the 2022 Short Term Note agreement and to secure an additional debt arrangement. Currently, management expects that the Company will not be in compliance with its quarterly debt covenant for the three months ending September 30, 2023. Management is working with the lender to resolve the expected non-compliance with the debt covenant.

The Company may need to raise additional capital. The need for additional capital depends on many factors, including, among other things, whether the Company can successfully renegotiate the terms of its debt arrangements, the rate at which the Company's business grows, demands for working capital, revenue generated from existing DLCs and game titles and launches of new DLCs and new game titles, and any acquisitions that the Company may pursue. From time to time, the Company could be required, or may otherwise attempt, to seek additional sources of capital, including, but not limited to, equity and/or debt financings. The Company cannot provide assurance that it will be able to successfully access any such equity or debt financings or that the required equity or debt financings would be available on terms acceptable to the Company, if at all, or that any such financings would not be dilutive to its stockholders.

The Company's recent net loss, level of cash used in operations, debt obligations coming due in less than 12 months, potential need for additional capital, and the uncertainties surrounding its ability to raise additional capital and renegotiate its debt arrangements raise substantial doubt about its ability to continue as a going concern. The unaudited condensed consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

In order for the Company to continue operations beyond the next 12 months and be able to discharge its liabilities and commitments in the normal course of business, the Company must re-establish profitable operations in order to generate cash from operations by increasing revenue or controlling or potentially reducing expenses, renegotiate the terms of its debt arrangements, or obtain additional funds when needed.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

The Company's revenue includes the publishing of software games delivered digitally and through physical discs (e.g., packaged goods). The Company's digital games may include additional downloadable content that are new feature releases to digital full-game downloads. Revenue also includes sales of mobile in-app purchases that require the Company's hosting support in order to utilize the game or related content. Such games include virtual goods that can be purchased by the end users, as desired. When control of the promised products and services is transferred to the customers, the Company recognizes revenue in the amount that reflects the consideration it expects to receive in exchange for these products and services. Revenue from delivery of products is recognized at a point in time when the end consumers download the games and the control of the license is transferred to them.

The Company recognizes revenue using the following five steps as provided by Accounting Standards Codification ("ASC") Topic 606 *Revenue from Contracts with Customers*: 1) identify the contract(s) with the customer; 2) identify the performance obligations in each contract; 3) determine the transaction price; 4) allocate the transaction price to the performance obligations; and 5) recognize revenue when, or as, the entity satisfies a performance obligation. The Company's terms and conditions vary by customers and typically provide net 30 to 75 days terms.

Principal vs. Agent Consideration

The Company offers certain software products via third-party digital storefronts, such as Microsoft's Xbox Live, Sony's PlayStation Network, Valve's Steam, Epic Games Store, My Nintendo Store, Apple's App Store, the Google Play Store, and retail distributors. For sales of our software products via third-party digital storefronts and retail distributor, the Company determines whether or not it is acting as the principal in the sale to the end user, which the Company considers in determining if revenue should be reported based on the gross transaction price to the end user or based on the transaction price net of fees retained by the third-party digital storefront. An entity is the principal if it controls a good or service before it is transferred to the customer. Key indicators that the Company uses in evaluating these sales transactions include, but are not limited to, the following:

- The underlying contract terms and conditions between the various parties to the transaction;
- Which party is primarily responsible for fulfilling the promise to provide the specified good or service; and
- Which party has discretion in establishing the price for the specified good or service.

Based on our evaluation of the above indicators, for sales arrangements via Microsoft's Xbox Live, Sony's PlayStation Network, Valve's Steam, Epic Games Store, My Nintendo Store, and our retail distributor, the digital platforms and distributors have discretion in establishing the price for the specified good or service and the Company has determined it is the agent in the sales transaction to the end user and therefore the Company reports revenue on a net basis based on the consideration received from the digital storefront. For sales arrangements via Apple's App Store and the Google Play Store, the Company has discretion in establishing the price for the specified good or service and it has determined that the Company is the principal to the end user and thus reports revenue on a gross basis and mobile platform fees charged by these digital storefronts are expensed as incurred and reported within cost of revenues.

Contract Balance

The Company records deferred revenue when cash payments are received or due in advance of its performance, even if amounts are refundable.

Deferred revenue is comprised of the transaction price allocable to the Company's performance obligation on technical support and the sale of virtual goods available for in-app purchases, and payments received from customers prior to launching the games on the platforms. The Company categorizes the virtual goods as either "consumable" or "durable." Consumable virtual goods represent goods that can be consumed by a specific player action; accordingly, the Company recognizes revenues from the sale of consumable virtual goods as the goods are consumed and the performance obligation is satisfied. Durable virtual goods represent goods that are accessible to the players over an extended period of time; accordingly, the Company recognizes revenues from the sale of durable virtual goods ratably over the period of time the goods are available to the player and the performance obligation is satisfied, which is generally the estimated service period, 30 to 90 days from date of activation.

The Company has a long-term title license agreement with a platform. The agreement was initially made between the parties in November 2018 and valid through December 31, 2021. The agreement was subsequently amended in June 2020 to extend the *ARK 1* availability on the platform perpetually, effective January 1, 2022 and to put *ARK 2* on the platform for three years upon release. The Company recognized $2.5 million in revenue related to *ARK 1's* perpetual license during the six months ended June 30, 2022 and deferred $2.3 million related to *ARK 2* that is included in the long-term portion of deferred revenue.

In November 2021, the Company entered an agreement with a platform to make *ARK 1* available on a platform for a period of 5 weeks in exchange for $3.5 million. The platform launched the 5-week program on March 1, 2022 and the Company recognized the full amount of revenue from this contract during the period ended June 30, 2022.

Estimated Service Period

For certain performance obligations satisfied over time, the Company has determined that the estimated service period is the time period in which an average user plays our software products ("user life") which most faithfully depicts the timing of satisfying our performance obligation.

Shipping, Handling and Value Added Taxes ("VAT")

The distributor, as the principal, is responsible for the shipping of the game discs to retail stores and incurring the shipping and VAT costs. The Company is paid the net sales amount after deducting shipping costs, VAT and other related expenses by the distributor.

Cost of Revenues

Cost of revenues include software license royalty fees, merchant fees, server and database center costs, game localization costs, game licenses, engine fees and amortization costs. Cost of revenues for the three and six months ended June 30, 2023 and 2022 were comprised of the following:

	Three months ended June 30,		Six months ended June 30,	
	2023	2022	2023	2022
Software license royalties - related parties	$ 1,906,786	$ 3,364,849	$ 4,769,799	$ 9,886,027
Software license royalties	254,400	-	606,839	-
License and amortization - related parties	4,862,320	6,350,980	10,057,971	12,701,959
License and amortization	201	100,224	402	250,448
Merchant fees	348,805	596,021	808,276	1,253,557
Engine fees	292,898	502,686	717,125	1,216,679
Internet, server and data center	1,611,047	1,344,754	3,151,737	2,664,659
Costs related to advertising revenue	59,308	-	84,553	-
Total:	$ 9,335,765	$ 12,259,514	$ 20,196,702	$ 27,973,329

General and Administrative Costs

General and administrative costs include rent, salaries, stock-based compensation, legal and professional expenses, internet and server, contractor costs, insurance expense, licenses and permits, other taxes and travel expenses. These costs are expensed as they are incurred. For the three months ended June 30, 2023 and 2022, general and administrative expenses totaled $3,937,234 and $4,250,882, respectively. For the six months ended June 30, 2023 and 2022, general and administrative expenses were $8,462,985 and $9,046,094, respectively. Stock-based compensation of $216,706 and $369,301 was incurred during the three and six months ended June 30, 2023, respectively; no such compensation was incurred in the three and six months ended June 30, 2022.

Advertising and Marketing Costs

The Company expenses advertising costs as incurred. For the three months ended June 30, 2023 and 2022, advertising expenses totaled $168,292 and $212,039, respectively. For the six months ended June 30, 2023 and 2022, advertising expenses were $272,841 and $370,710, respectively.

Research and Development

Research and development costs are expensed as incurred. Research and development costs include travel, payroll, and other general expenses specific to research and development activities. Research and development costs for the three months ended June 30, 2023 and 2022 were $1,200,842 and $179,050, respectively. For the six months ended June 30, 2023 and 2022, research and development costs were $2,574,639 and $363,006, respectively. Stock-based compensation of $16,064 was incurred during the three months ended June 30, 2023; no such compensation was incurred in the three and six months ended June 30, 2022.

Non-controlling Interests

Non-controlling interests on the condensed consolidated balance sheets and condensed consolidated statements of operations and comprehensive income (loss) include the equity allocated to non-controlling interest holders. As of June 30, 2023 and December 31, 2022, there were non-controlling interests with the following subsidiaries:

Subsidiary Name	Equity % Owned	Non-Controlling %
Snail Innovative Institute	70%	30%
BTBX.IO, LLC	70%	30%
Donkey Crew, LLC	99%	1%

Cash and Restricted Cash and Cash Equivalents

Cash is available for use in current operations or other activities such as capital expenditures and business combinations. Restricted cash and cash equivalents are time deposits, that are currently provided as a standby letter of credit to landlords.

Restricted Escrow Deposits

Our restricted deposits held in escrow are to provide a source of funding for certain indemnification obligations of Snail, Inc. to our underwriters in connection with our IPO. The deposit and related interest earnings are restricted for one year from the IPO date.

Accounts Receivable

The Company generally records a receivable related to revenue when it has an unconditional right to invoice and receive payment. Accounts receivable are carried at original invoice amount less an allowance made for credit losses. The Company uses a combination of quantitative and qualitative factors to estimate the allowance, including an analysis of the customers' creditworthiness, historical experience, age of current accounts receivable balances, changes in financial condition or payment terms of our customers, and reasonable forecasts of the collectability of the accounts receivable. The Company evaluates the allowance for credit losses on a periodic basis and adjusts it as necessary based on the risk factors mentioned above. Any increase in the provision for credit losses is recorded as a charge to general and administrative expense in the current period. Any amounts deemed uncollectible are written off against the allowance for credit losses. Management judgment is required to estimate our allowance for credit losses in any accounting period. The amount and timing of our credit losses and cash collection could change significantly because of a change in any of the risk factors mentioned above.

Fair Value Measurements

The Company follows FASB ASC Topic 820, Fair Value Measurements. ASC 820 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined under ASC 820 as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants.

ASC 820 establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Observable inputs reflect market data obtained from sources independent of the reporting entity and unobservable inputs reflect the entity's own assumptions about how market participants would value an asset or liability based on the best information available. Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used by the Company for financial instruments measured at fair value.

The three levels of inputs are as follows:

- **Level 1**: Quoted prices in active markets for identical assets or liabilities that the Company has an ability to access as of the measurement date.
- **Level 2**: Inputs 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 same term of the assets or liabilities.
- **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.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Our financial instruments include cash and cash equivalents, restricted cash and cash equivalents, short-term financial instruments, short-term loans, accounts receivable and accounts payable. The carrying values of these financial instruments approximate their fair value due to their short maturities. The carrying amount of our debt approximates fair value because the interest rates on these instruments approximate the interest rate on debt with similar terms available to us for a similar duration except for the Company's promissory note which has a fixed rate for 5 years, then a floating rate that approximates the Wall Street Journal Prime Rate plus 0.50%. The Company considers the carrying amount of the loan to approximate fair value as the discounted cost in comparison to market rates would not be materially different than the cost to acquire a loan with similar terms. The Company does not have any other assets or liabilities measured at fair value on a recurring or non-recurring basis as of June 30, 2023 and December 31, 2022.

Amortizable Intangibles and Other Long-lived Assets

The Company's long-lived assets and other assets consisting of property, plant and equipment and purchased intangible assets, are reviewed for impairment in accordance with the guidance of Financial Accounting Standards Board ("FASB") Topic ASC 360, Property, Plant, and Equipment. Intangible assets subject to amortization are carried at cost less accumulated amortization and amortized over the estimated useful life in proportion to the economic benefits received. The Company evaluates the recoverability of definite-lived intangible assets and other long-lived assets in accordance with ASC Subtopic 360-10, which generally requires the assessment of these assets for recoverability when events or circumstances indicate a potential impairment exists. The Company considers certain events and circumstances in determining whether the carrying value of identifiable intangible assets and other long-lived assets, other than indefinite lived intangible assets, may not be recoverable including, but not limited to: significant changes in performance relative to expected operating results; significant changes in the use of the assets; significant negative industry or economic trends; and changes in the Company's business strategy. If the Company determines that the carrying value may not be recoverable, the Company estimates the undiscounted cash flows to be generated from the use and ultimate disposition of the asset group to determine whether an impairment exists. If an impairment is indicated based on a comparison of the asset groups' carrying values and the undiscounted cash flows, the impairment loss is measured as the amount by which the carrying amount of the asset group exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary. There can be no assurance, however, that market conditions will not change or demand for the Company's products under development will continue. Either of these could result in future impairment of long-lived assets. Actual useful lives and cash flows could be different from those estimated by management which could have a material effect on our consolidated reporting results and financial positions.

Income Taxes

Income taxes are provided for the tax effects of transactions reported in the condensed consolidated financial statements and consisted of taxes currently due and deferred taxes. Deferred taxes are recognized for the differences between the basis of assets and liabilities for financial statement and income tax purposes.

The Company follows FASB Topic ASC 740, Income Taxes, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the condensed consolidated financial statements or tax returns.

Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates, applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

FASB ASC 740-10-25 provides criteria for the recognition, measurement, presentation, and disclosure of uncertain tax positions. The Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the condensed consolidated financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. The Company recognizes liabilities for uncertain tax positions pursuant to FASB ASC 740-10-25. Such amounts are included in the current and long-term accrued expenses on the accompanying condensed consolidated balance sheets in the amount of $457,024 as of June 30, 2023 and December 31, 2022. The Company accrues and recognizes interest and penalties related to unrecognized tax benefits in operating expenses.

Concentration of Credit Risk and Significant Customers

The Company maintains cash balances at several major financial institutions. While the Company attempts to limit credit exposure with any single institution, balances often exceed insurable amounts. As of June 30, 2023 and December 31, 2022, the Company had deposits of $3,333,946 and $17,929,308, respectively, that were not insured by the Federal Deposit Insurance Corporation and are included in the cash and cash equivalents, restricted escrow deposit and restricted cash and cash equivalents, in the accompanying condensed consolidated balance sheets.

The Company extends credit to various digital resellers and partners. Collection of trade receivables may be affected by changes in economic or other industry conditions and may, accordingly, impact our overall credit risk. The Company performs ongoing credit evaluations of customers and maintains reserves for potentially uncollectible accounts. As of June 30, 2023 and December 31, 2022, the Company had three customers who accounted for approximately 68% and two customers who accounted for approximately 57% of consolidated gross receivables, respectively. Among the three customers as of June 30, 2023 and two customers as of December 31, 2022, each customer accounted for 29%, 25% and 14% as of June 30, 2023, and 29% and 28% as of December 31, 2022 of the consolidated gross receivables outstanding. During the three months ended June 30, 2023 and 2022, approximately 52% and 59%, respectively, of net revenue was derived from these customers. During the six months ended June 30, 2023 and 2022, approximately 56% and 61%, respectively of net revenue was derived from these customers. The loss of these customers or declines in the forecasts of their accounts receivable collectability would have a significant impact on the Company's financial performance.

As of June 30, 2023 and December 31, 2022, the Company had three vendors who accounted for approximately 79% and two vendors who accounted for approximately 55% of consolidated gross payables, respectively. Among the three vendors as of June 30, 2023 and December 31, 2022, each vendor accounted for 55%, 13% and 11% as of June 30, 2023, and 43% and 12% as of December 31, 2022 of our consolidated gross payables outstanding. The loss of these vendors could have a significant impact on the Company's financial performance and regulatory compliance.

The Company had one vendor, SDE Inc. ("SDE"), a related party, that accounted for 44% and 44% of the Company's combined cost of revenues and operating expenses during the three months ended June 30, 2023 and 2022, respectively. During the six months ended June 30, 2023 and 2022, SDE accounted for 51% and 49% of the Company's combined cost of revenues and operating expenses, respectively. Amounts payable to SDE are netted with receivables from them and presented as accounts receivable - related party in the condensed consolidated balance sheets as of June 30, 2023 and December 31, 2022. The loss of SDE as a vendor would significantly and adversely affect the Company's core business.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses*, which replaces the incurred loss impairment methodology in current US GAAP with a methodology that requires the reflection of expected credit losses and also requires consideration of a broader range of reasonable and supportable information to determine credit loss estimates. It also eliminates the concept of other-than-temporary impairment and requires credit losses related to available-for-sale debt securities to be recorded through an allowance for credit losses rather than as a reduction in the amortized cost basis of the securities. For most financial instruments, the standard requires the use of a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses, which generally results in the earlier recognition of credit losses on financial instruments. The Company adopted ASC 2016-13 on January 1, 2023. The impact of adopting the new standard did not have a material impact on the Company's condensed consolidated financial statements.

In August 2020, the FASB issued ASU 2020-06, *Contracts in Entity's Own Equity (Subtopic 815-40) – Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*, to simplify the application of GAAP for certain financial instruments with characteristics of liabilities and equity. The FASB decided to eliminate certain accounting models to simplify the accounting for convertible instruments, reduce complexity for preparers and practitioners, and improve the decision usefulness and relevance of the information provided to financial statement users. The GASB also amended the guidance for derivatives scope exception for contracts in an entity's own equity to reduce form-over-substance-based accounting conclusion and amended the related earnings per share guidance. The Company has elected to delay implementation of this standard until January 1, 2024 based on its emerging growth status. The impact of adopting the new accounting standard is being evaluated.

Employee Savings Plans

The Company maintains a 401(k) for its United States based employees. The plan is offered to all eligible employees to make voluntary contributions. Employer contributions to the plan are reported under general and administrative costs in the amounts of $24,769 and $13,914 for the three months ended June 30, 2023 and 2022, and $51,388 and $27,096 for the six months ended June 30, 2023 and 2022, respectively.

Stock-Based Compensation

The Company recognizes compensation cost for stock-based awards to employees based on the awards' estimated grant-date fair value using a straight-line approach over the service period for which such awards are expected to vest. The Company accounts for forfeitures as they occur. The Company issued restricted stock units ("Restricted Stock Units" or "restricted stock units") during the year ended December 31, 2022. The fair value of Restricted Stock Units is determined based on the quoted market price of our common stock on the date of grant.

The Company's 2022 Omnibus Incentive Plan (the "2022 Plan") became effective upon the consummation of the IPO. The 2022 Omnibus Incentive allows us to grant options to purchase our common stock and to grant stock options, stock appreciation rights, restricted stock, restricted stock units and performance awards and other cash-based awards and other stock-based awards to our employees, officers, and directors, up to a maximum of 5,718,000 shares. Stock options may be granted to employees and officers and non-qualified options may be granted to employees, officers, and directors, at not less than the fair market value on the date of grant. The number of shares of common stock available for issuance under the 2022 Plan will be increased annually on the first day of each fiscal year during the term of the 2022 Plan, beginning with the 2023 fiscal year, by an amount equal to the lesser of (a) 5,718,000 shares, (b) 1% of the shares of the Company's Class B common stock outstanding (on a fully diluted basis) on the final day of the immediately preceding calendar year or (c) such smaller number of shares as determined by the Company's board of directors. As of June 30, 2023, there were 4,517,419 shares reserved for issuance under the 2022 Plan.

Restricted Stock Units

The Company granted restricted stock units under our 2022 Omnibus Incentive Plan to employees and directors. Restricted stock units are unfunded, unsecured rights to receive common stock upon the satisfaction of certain vesting criteria. Upon vesting, a number of shares of common stock equivalent to the number of restricted stock units is typically issued net of required tax withholding requirements, if any. Restricted stock units are subject to forfeiture and transfer restrictions.

Warrants

In connection with the IPO, offering costs related to legal, accounting, and underwriting costs were net with the proceeds and recorded as a reduction in additional paid in capital, in the stockholders' equity section of the condensed consolidated balance sheets. The Company also issued Underwriters Warrants (as defined below) for services provided during the IPO to purchase 120,000 shares of Class A common stock. The Underwriters Warrants are accounted for as equity instruments and are included in the stockholders' equity section of the condensed consolidated balance sheets. The fair value of the Underwriters Warrants has been estimated using the Black-Scholes option pricing model.

Share Repurchase Program

On November 10, 2022, the Company's board of directors authorized a share repurchase program under which the Company may repurchase up to $5 million of outstanding shares of Class A common stock of the Company, subject to ongoing compliance with the Nasdaq listing rules. The program does not have a fixed expiration date. Repurchased shares are accounted for at cost and reported as a reduction of equity in the condensed consolidated balance sheets under treasury stock. No treasury stock was sold during the three and six months ended June 30, 2023. As of June 30, 2023, 1,350,275 shares of Class A common stock were repurchased pursuant to the Share Repurchase Program for an aggregate purchase price of approximately $3.7 million. The average price paid per share was $2.72 and approximately $1.3 million aggregate amount of shares of Class A common stock remain available for repurchase under the Share Repurchase Program.

Earnings (Loss) Per Share

Earnings (loss) per share ("EPS") is calculated by dividing the net income (loss) that is applicable to the common stockholders for the period by the weighted average number of shares of common stock during that period. The diluted EPS for the period is calculated by dividing the net income (loss) applicable to common stockholders for the period by the weighted average number of shares of common stock and common stock equivalents outstanding during the period. The Company's common stock equivalents are measured using the treasury stock method and represent unvested restricted stock units and warrants. The Company issues two classes of common stock with differing voting rights, and as such, reports EPS using the dual class method. For comparative purposes the Company has presented EPS for the three and six months ended June 30, 2022 using the number of shares exchanged in the reorganization of the Company as the denominator. For more information see Note 19 – *Earnings (Loss) Per Share.*

Dividend Restrictions

Our ability to pay cash dividends is currently restricted by the terms of our credit facilities.

NOTE 3 – REVENUE FROM CONTRACTS WITH CUSTOMERS

Disaggregation of revenue

Geography

The Company attributes net revenue to geographic regions based on customer location. Net revenue by geographic region for the three and six months ended June 30, 2023 and 2022 were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2023	**2022**	**2023**	**2022**
United States	$ 8,363,756	$ 13,971,832	$ 20,141,630	$ 40,258,628
International	1,528,497	1,491,690	3,209,111	3,259,485
Total revenue from contracts with customers:	$ 9,892,253	$ 15,463,522	$ 23,350,741	$ 43,518,113

Platform

Net revenue by platform for the three and six months ended June 30, 2023 and 2022 were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2023	**2022**	**2023**	**2022**
Console	$ 3,626,475	$ 5,415,772	$ 9,400,065	$ 23,407,351
PC	3,367,369	6,943,036	8,379,549	13,627,472
Mobile	1,508,203	2,393,878	3,226,235	5,185,198
Other	1,390,206	710,836	2,344,892	1,298,092
Total revenue from contracts with customers:	$ 9,892,253	$ 15,463,522	$ 23,350,741	$ 43,518,113

Distribution channel

Our products are delivered through digital online services (digital download, online platforms, and cloud streaming), mobile, and retail distribution and other. Net revenue by distribution channel for the three and six months ended June 30, 2023 and 2022 was as follows:

	Three months ended June 30,		Six months ended June 30,	
	2023	**2022**	**2023**	**2022**
Digital	$ 6,993,844	$ 12,358,808	$ 17,779,614	$ 37,034,823
Mobile	1,508,203	2,393,878	3,226,235	5,185,198
Physical retail and other	1,390,206	710,836	2,344,892	1,298,092
Total revenue from contracts with customers:	$ 9,892,253	$ 15,463,522	$ 23,350,741	$ 43,518,113

Deferred Revenue

The Company records deferred revenue when payments are due or received in advance of the fulfillment of our associated performance obligations; reductions to deferred revenue balance were primarily due to the recognition of revenue upon fulfillment of our performance obligations, which were in the ordinary course of business. As of June 30, 2023, the balance of deferred revenue was $8,785,848, of which $2.6 million is due to non-refundable payments. The Company is expecting to recognize $0.3 million of the $2.6 million in the next 12 months through the platform releases of certain DLCs and the remaining $2.3 million in the next 24 months through the release of *ARK 2*. The Company expects to recognize $4.1 million of current deferred revenues and $4.7 million of long term deferred revenue as revenue over the next 12 to 60 months. The revenue will be recognized primarily on a straight-line basis, based on our estimates of technical support obligations and activation of durable virtual goods. Activities in the Company's deferred revenue as of June 30, 2023 and December 31, 2022 were as follows:

		2023		2022
Deferred revenue, beginning balance in advance of revenue recognition billing	$	9,551,446	$	20,280,934
Revenue recognized		(3,874,784)		(18,832,396)
Revenue deferred		3,109,186		8,102,908
Deferred revenue, ending balance		8,785,848		9,551,446
Less: short term portion		(4,125,505)		(4,335,404)
Deferred revenue, long term	$	4,660,343	$	5,216,042

NOTE 4 – CASH AND CASH EQUIVALENTS, AND RESTRICTED CASH AND CASH EQUIVALENTS

Cash equivalents are valued using quoted market prices or other readily available market information. The Company has $1,113,960 and $6,374,368 as of June 30, 2023 and December 31, 2022, respectively, as security for the debt with a financial institution (see Note 15 — *Revolving Loan, Short Term Note, and Long-Term Debt*) and to secure standby letters of credit with landlords. On June 21, 2023 the Company amended its revolving loan and $5,273,391 of restricted cash and cash equivalents was released. The following table summarizes the components of the Company's cash and cash equivalents, and restricted cash and cash equivalents as of June 30, 2023 and June 30, 2022:

		2023		2022
Cash and cash equivalents	$	2,960,160	$	14,697,338
Restricted cash and cash equivalents		1,113,960		6,361,381
Cash and cash equivalents, and restricted cash and cash equivalents	$	4,074,120	$	21,058,719

NOTE 5 – ACCOUNTS RECEIVABLE – RELATED PARTY

Accounts receivable — related party represents receivables in the ordinary course of business attributable to certain mobile game revenues that, for administrative reasons, are collected by a related party and that the related party has not remitted back to the Company. The accounts receivable is offset by payables due to the related party for royalties, internet data center ("IDC") and marketing costs. Accounts receivable — related party is non-interest bearing and due on demand. The related party is 100% owned and controlled by the wife of the Founder, Chief Strategy Officer and Chairman of the Company. As of June 30, 2023 and December 31, 2022, the outstanding balance of net accounts receivable from related party was as follows:

		2023		2022
Accounts receivable - related party	$	13,578,520	$	13,519,409
Less: Accounts payable - related party		(1,845,294)		(2,175,225)
Accounts receivable - related party, net	$	11,733,226	$	11,344,184

NOTE 6 – DUE FROM SHAREHOLDER

Other receivables from related party consisted of monies that the Company lent to the Company's Founder, Chief Strategy Officer and Chairman, who is also the majority shareholder of Suzhou Snail. The loan bore 2.0% per annum interest. On April 26, 2022, the Company, with approval from its Board of Directors and in accordance with applicable laws and regulations, assigned the other receivables – related party ("due from shareholder" or the "Shi Loan") of $94,934,400 outstanding including interest, to Suzhou Snail, which assumed the loan as creditor. Simultaneously, the Company declared and paid Suzhou Snail an in-kind dividend with an aggregate amount equal to $94,934,400 on April 26, 2022; see Note 7 – *Dividend Distribution*. As of December 31, 2022, the other receivable was $0 and no longer reflected on the Company's consolidated balance sheets. The loan accrued interest of $0 and $130,197 during the three months ended June 30, 2023 and 2022 respectively. During the six months ended June 30, 2023 and 2022, the loan accrued interest of $0 and $580,878, respectively. The earned interest is reported in interest income – related parties in the Company's condensed consolidated statements of operations and comprehensive income (loss).

NOTE 7 – DIVIDEND DISTRIBUTION

On April 26, 2022, the Company declared an in-kind dividend of $94,934,400 for the assignment of the due from shareholder and a cash dividend of $8,200,000 to pay the related withholding taxes; see Note 6 – *Due from Shareholder.* There were no such distributions during the six months ended June 30, 2023. In April 2023, the Company filed its annual withholding tax return Form 1042 and recognized a refund receivable related to the withholding taxes paid in the amount of $1,886,600. The refund is included in the prepaid expenses and other current assets and additional paid-in capital in the accompanying condensed consolidated balance sheets as of June 30, 2023 and the condensed consolidated statements of equity for the three months ended June 30, 2023.

NOTE 8 – PREPAID EXPENSES - RELATED PARTY

On March 10, 2023, the Company amended its exclusive software license agreement with SDE relating to the *ARK* franchise. For DLC's, the Company plans to release during the term of the agreement, the Company will now have the option to pay the $5.0 million DLC payment in whole or in part, when paid in advance; or in full, upon the DLC release. No payment for any DLC under this agreement will exceed $5.0 million.

During the six months ended June 30, 2023, the Company prepaid $2,500,000 for exclusive license rights for an *ARK 1* DLC to SDE. During the year ended December 31, 2022, the Company prepaid $5,000,000 for exclusive license rights to *ARK 2* to SDE. Prepaid expenses — related party consisted of the following as of June 30, 2023 and December 31, 2022:

	2023	2022
Prepaid royalties	$ 582,500	$ 582,500
Prepaid licenses	7,500,000	5,000,000
Prepaid expenses - related party, ending balance	8,082,500	5,582,500
Less: short-term portion	(2,500,000)	—
Total prepaid expenses - related party, long-term	$ 5,582,500	$ 5,582,500

NOTE 9 – PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consisted of the following as of June 30, 2023 and December 31, 2022:

	2023	2022
Prepaid income taxes	$ 9,894,191	$ 9,822,603
Withholding refund receivable	1,886,600	—
Other prepaids	106,798	80,271
Other current assets	329,212	662,267
Total prepaid expenses and other current assets	$ 12,216,801	$ 10,565,141

NOTE 10 – PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consisted of the following as of June 30, 2023 and December 31, 2022:

	2023	2022
Building	$ 1,874,049	$ 1,874,049
Land	2,700,000	2,700,000
Building improvements	1,010,218	1,010,218
Leasehold improvements	1,537,775	1,537,775
Autos and trucks	178,695	178,695
Computer and equipment	1,821,819	1,821,819
Furniture and fixtures	411,801	411,801
	9,534,357	9,534,357
Accumulated depreciation	(4,652,728)	(4,419,558)
Property, plant and equipment, net	$ 4,881,629	$ 5,114,799

Depreciation and amortization expense was $118,110 and $138,791 for the three months ended June 30, 2023 and 2022, respectively. Depreciation and amortization expense was $233,170 and $307,108 for the six months ended June 30, 2023 and 2022, respectively. The Company did not have any disposals during the six months ended June 30, 2023. During the six months ended June 30, 2022, the Company disposed of $11,615 in computer equipment with an accumulated depreciation of $9,182. The total loss resulting from the disposal of the assets amounted to $2,433. The Company's subsidiary, Donkey Crew, LLC, held net property, plant and equipment outside of the United States in the amount of $6,975 and $13,569, as of June 30, 2023 and December 31, 2022, respectively.

NOTE 11 – INTANGIBLE ASSETS

Intangible assets consist of game licenses, game software underlying intellectual property rights, game trademarks and other branding items. The Company amortizes the intangible assets over its useful life.

The following tables reflect all the intangible assets presented on the condensed consolidated balance sheets as of June 30, 2023 and December 31, 2022:

	June 30, 2023				
	Gross Carrying Amount	Accumulated Amortization	Impairment Loss	Net Book Value	Weighted Average Useful Life
License rights from related parties	$ 136,665,000	$ (136,338,913)	$ —	$ 326,087	3 - 5 years
License rights	$ 3,000,000	$ (3,000,000)	$ —	$ —	5 years
Intangible assets - other:					
Software	$ 51,784	$ (51,784)	$ —	$ —	3 years
Trademark	10,745	(9,512)	—	1,233	12 years
In-progress patent	270,886	—	—	270,886	
Total:	$ 333,415	$ (61,296)	$ —	$ 272,119	

	December 31, 2022				
	Gross Carrying Amount	**Accumulated Amortization**	**Impairment Loss**	**Net Book Value**	**Weighted Average Useful Life**
License rights from related parties	$ 136,665,000	$ (135,280,942)	$ —	$ 1,384,058	3 - 5 years
License rights	$ 3,000,000	$ (3,000,000)	$ —	$ —	5 years
Intangible assets - other:					
Software	$ 51,784	$ (51,784)	$ —	$ —	3 years
Trademark	10,745	(9,110)	—	1,635	12 years
In-progress patent	270,886	—	—	270,886	
Total:	$ 333,415	$ (60,894)	$ —	$ 272,521	

Amortization expense was $362,520 and $1,951,204 for the three months ended June 30, 2023 and 2022, respectively. Amortization expense was $1,058,373 and $3,952,407 for the six months ended June 30, 2023 and 2022, respectively. These amounts are included in cost of revenues in the accompanying condensed consolidated statements of operations and comprehensive income (loss). The weighted average remaining useful life for which amortization expense will be recognized is 0.5 years as of June 30, 2023. Future amortization expense of intangible assets is as follows:

Years ending December 31,	**Amount**
Remainder of 2023	$ 326,489
2024	804
2025	27
2026	—
2027	—
Thereafter	270,886
	$ 598,206

NOTE 12 – ACCOUNTS PAYABLE — RELATED PARTY

Accounts payable due to related party represents payables in the ordinary course of business primarily for purchases of game distribution licenses and also the royalties due to Suzhou Snail. As of June 30, 2023 and December 31, 2022, the Company had $19,611,207 and $19,918,259, respectively, as accounts payable due to Suzhou Snail. During the three months ended June 30, 2023 and 2022, the Company incurred $70,425 and $98,573, respectively as license costs due to Suzhou Snail and included in cost of revenues. During the six months ended June 30, 2023 and 2022, the Company incurred $142,948 and $222,033, respectively as license costs due to Suzhou Snail and included in cost of revenues. During the six months ended June 30, 2023 and 2022, respectively, there were $450,000 and $444,263 in payments to Suzhou Snail for royalties. There were no license cost payments made to Suzhou Snail during the three months ended June 30, 2023 and 2022, respectively.

NOTE 13 – LOAN AND INTEREST RECEIVABLE — RELATED PARTY

In February 2021, the Company lent $200,000 to a wholly owned subsidiary of Suzhou Snail, the loan bears 2.0% per annum interest, interest and principal are due in February 2022. In February 2022, Suzhou Snail signed an agreement with this subsidiary and assumed the loan and related interest for a total of $203,890. Subsequently, $103,890 was offset against the loan and interest payable owed to Suzhou Snail on a separate note. Please refer to Note 14 — *Loan Payable and Interest Payable — Related Parties*. The total amount of loan and interest receivable — related parties was $102,745 and $101,753, as of June 30, 2023 and December 31, 2022, respectively. The Company earned $499 and $499 in interest on the related party loans receivable during the three months ended June 30, 2023 and 2022, respectively. Interest earned on the related party loans receivable during the six months ended June 30, 2023 and 2022, was $992 and $745, respectively.

NOTE 14 – LOAN PAYABLE AND INTEREST PAYABLE — RELATED PARTIES

The Company had a loan amount due to related parties of $400,000 bearing 2.00% per annum interest. $300,000 of the loan is from a wholly owned subsidiary of Suzhou Snail and due in June 2022, and $100,000 is from Suzhou Snail and due in December 2023. The $100,000 loan along with $3,890 interest payable to Suzhou Snail was offset by the loan receivable Suzhou Snail assumed in February 2022. Please refer to Note 13 — *Loan and Interest Receivable — Related Party*. In July 2022, the Company paid off the outstanding principal balance of $300,000. As of June 30, 2023 and December 31, 2022, the total loan payable — related parties amounted to $0 and total unpaid interest amounted to $527,770, as of June 30, 2023 and December 31, 2022. Interest expenses for the loans payable to related parties were $0 and $1,496 during the three months ended June 30, 2023 and 2022, respectively. During the six months ended June 30, 2023 and 2022, the interest expenses for the loans payable to related parties were $0 and $3,222, respectively.

NOTE 15 – REVOLVING LOAN, SHORT TERM NOTE AND LONG - TERM DEBT

	June 30, 2023	December 31, 2022
2021 Revolving Loan - On June 21, 2023, the Company amended its revolving loan agreement ("amended revolver") and decreased the maximum balance to $6,000,000. The amended revolver matures on December 31, 2023 and has an annual interest rate equal to the prime rate less 0.25%. At June 30, 2023, the interest rate on this loan was 8.00%. The revolver was secured by certificate of deposit accounts held with the financial institution and that were released in accordance with the 2023 amendment. Debt covenants of this loan required the Company to maintain a minimum debt service coverage ratio of at least 1.5 to 1. The debt service covenant was temporarily lifted as part of the revolving loan amendment for the twelve month period ended June 30, 2023.	$ 6,000,000	$ 9,000,000
2021 Promissory Note - On June 17, 2021, the Company amended its loan agreement to reduce the principal amount with financial institution for 10 years, annual interest rate of 3.5% for the first 5 years, and then floating at Wall Street Journal rate from years 6 to 10, the loan is secured by the Company's building and matures on June 30, 2031. The note is subject to a prepayment penalty. Debt covenants of this loan require the Company to maintain a minimum debt service coverage ratio of at least 1.5 to 1. The Company was not in compliance with the debt service coverage ratio for the twelve month period ended June 30, 2023 and received a waiver from the lender.	2,845,303	2,891,820
2022 Short Term Note - On January 26, 2022, the Company amended its revolving loan and long-term debt agreements to obtain an additional note with a principal balance of $10,000,000 which was originally set to mature on January 26, 2023. Interest shall be equal to the higher of 3.75% or the Wall Street Journal Prime Rate plus 0.50%. The loan is secured by the Company's assets. In the event of a default, all outstanding amounts under the note will bear interest at a default rate equal to 5% over the note rate. Debt covenants of this loan require the Company to maintain a minimum debt service coverage ratio of at least 1.5 to 1 and will be measured quarterly. The debt service covenant was temporarily lifted as part of the June 21, 2023 revolving loan amendment for the twelve month period ended June 30, 2023. In November 2022, the maturity was extended to January 26, 2024 and the interest rate amended to the higher of the Wall Street Journal Prime Rate less 0.25%, or 5.75%. At June 30, 2023, the interest rate on this loan was 8.00%.	2,916,667	5,833,333
Total	11,761,970	17,725,153
Less: current portion of promissory note	2,845,303	86,524
Less: revolving loan	6,000,000	9,000,000
Less: current portion of short term note	2,916,667	5,416,666
Total long-term debt	$ -	$ 3,221,963

Total interest expense for the above debt and revolver loan amounted to $294,749 and $179,602 for the three months ended June 30, 2023 and 2022, respectively. Total interest expense for the above debt and revolver loan amounted to $588,994 and $339,691 for the six months ended June 30, 2023 and 2022, respectively. Amortization of loan origination expenses of $11,814 and $6,591 are included as part of interest expense for the three months ended June 30, 2023 and 2022, respectively. Amortization of loan origination expenses of $20,726 and $12,557, are included as part of interest expense for the six months ended June 30, 2023 and 2022, respectively. As a result of the amendment to the revolving loan the Company recognized $2,903 as additional amortization of loan origination expenses during the three months ended June 30, 2023. The Company is in compliance with, or received waivers for, its debt covenants as of June 30, 2023 and December 31, 2022.

The following table provides future minimum payments of its long-term debt as of December 31:

Years ending December 31,	Amount
Remainder of 2023	$ 8,540,007
2024	499,414
2025	86,013
2026	89,115
2027	92,329
Thereafter	2,455,092
	$ 11,761,970

NOTE 16 – INCOME TAXES

The Company recognized an income tax benefit of $1,081,887 and $327,347 for the three months ended June 30, 2023 and 2022, respectively. The income tax benefit of $1,887,705 and income tax expense of $1,202,303 for the six months ended June 30, 2023 and 2022, reflects an effective tax rate of 21% and 20%, respectively. As of June 30, 2023 the Company's effective tax rate did not differ from the federal statutory rate of 21%.

The Company assesses all positive and negative evidence in determining if, based on the weight of such evidence, a valuation allowance is required to be recorded against the deferred tax assets as of June 30, 2023. The Company has concluded that the positive evidence of reversing taxable temporary differences, indefinite lived nature of certain tax attributes on hand, level of historical taxable income, projections of future taxable income and cumulative pre-tax book income on a rolling twelve-quarter basis to outweigh the negative evidence of recent losses. Accordingly, the Company has not provided for additional valuation allowance as of June 30, 2023. The realization of the deferred tax assets is contingent upon the Company's upcoming new game releases to generate sufficient future taxable income. In the event that negative evidence outweighs positive evidence in future periods, the Company may need to record additional valuation allowance, which could have a material impact on our financial position.

The Company and its subsidiaries currently file tax returns in the United States (federal and state) and Poland. The statute of limitations for its consolidated federal income tax returns are open for tax years ended December 31, 2019 and after. The statute of limitations for its consolidated state income tax returns are open for tax years ended December 31, 2018 and after. All tax periods for its Polish subsidiary are currently subject to examination since its inception in 2018. While the Company has historically only filed a state tax return in California, the management has accrued income tax liabilities for additional states as of June 30, 2023 and December 31, 2022, respectively and is also undergoing the Voluntary Disclosure Agreement process in additional states.

NOTE 17 – OPERATING LEASE RIGHT-OF-USE ASSETS

The Company's right-of-use assets represent arrangements related primarily to office facilities used in the ordinary business operations of the Company and its subsidiaries. In April, 2018, a commercial bank issued an irrevocable standby letter of credit on behalf of the Company to the landlord for $1,075,000 to lease office space. The standby letter of credit was valid for a one-year term and was amended in January 2021 to extend to January 31, 2026. As of June 30, 2023 and December 31, 2022, the Company's net operating lease right-of-use assets amounted to $3,032,069 and $3,606,398, respectively. The Company had variable lease payments of approximately $15,295 and $8,684 during the three months ended June 30, 2023 and 2022, respectively. Variable lease payments were $39,805 and $27,017 during the six months ended June 30, 2023 and 2022, respectively, which consisted primarily of common area maintenance charges and administrative fees. During the six months ended June 30, 2022 the Company terminated one of its lease contracts and recognized a gain on the lease termination of $122,533. There was no such termination during the six months ended June 30, 2023. The effect of the termination on the related lease asset and liability were as follows:

	Right of Use Asset	Accumulated Amortization	Lease Liability		Gain on Termination
			Current	Long Term	
Lease Terminations	$ (1,301,571)	$ 907,370	$ 442,704	$ 74,030	$ 122,533

Operating lease costs included in the general and administrative expenses in our condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended June 30, 2023 and 2022, are as follows:

	For the three months ended June 30,		**For the six months ended June 30,**	
	2023	**2022**	**2023**	**2022**
Operating lease costs	$ 381,300	$ 424,098	$ 778,862	$ 815,958
Short term lease costs	-	-	-	-
Total operating lease costs	$ 381,300	$ 424,098	$ 778,862	$ 815,958

Supplemental information related to operating leases for lease liabilities as of June 30, 2023 and June 30, 2022 is as follows:

	2023	**2022**
Cash paid for amounts included in the measurement of lease liabilities	$ 770,508	$ 747,474
Weighted average remaining lease term	2.4 years	3.4 years
Weighted average discount rate	5.00%	5.00%

Future undiscounted lease payments for operating leases and a reconciliation of these payments to our operating lease liabilities as of June 30, 2023 are as follows:

	Future lease payments	**Imputed Interest**	**Lease Liabilities**
Years ending December 31,		***Amount***	
Remainder of 2023	$ 778,382	$ 80,306	$ 698,076
2024	1,610,844	105,810	1,505,034
2025	1,453,785	28,290	1,425,495
Thereafter	—	—	—
Total future lease payments	$ 3,843,011	$ 214,406	$ 3,628,605

NOTE 18 – COMMITMENTS AND CONTINGENCIES

Litigation

The Company is subject to claims and contingencies related to lawsuits and other matters arising out of the normal course of business. In addition, the Company may receive notifications alleging infringement of patent or other intellectual property rights. The Company has elected to expense legal costs associated with legal contingencies as incurred.

On December 1, 2021, the Company and Studio Wildcard sent a notice of claimed infringement (the "DCMA Takedown Notice") to Valve Corporation, which operates the Steam platform, pursuant to the Digital Millennium Copyright Act ("DCMA"). The DCMA Takedown Notice concerns a videogame titled *Myth of Empires*, which was developed by Suzhou Angela Online Game Technology Co., Ltd. ("Angela Game") and published by Imperium Interactive Entertainment Limited ("Imperium"). The DCMA Takedown Notice alleges that Angela Game and Imperium misappropriated the copyrighted source code of *ARK: Survival Evolved* and used it to develop the game *Myth of Empires*. The DCMA Takedown Notice requested that Steam cease distributing *Myth of Empires* and remove the game from the Steam platform. Steam complied with the DCMA Takedown Notice and removed *Myth of Empires* from its platform. The DCMA Takedown Notice was also sent to Tencent Cloud LLC ("Tencent"), which hosts the United States servers for users who downloaded the game before it was removed from Steam, but Tencent has not complied with the DCMA Takedown Notice.

On December 9, 2021, Angela Game and Imperium filed a complaint against the Company and Studio Wildcard in the United States District Court for the Central District of California (the "District Court") in response to the DCMA Takedown Notice. The lawsuit seeks a declaratory judgment on non-liability for copyright infringement and non-liability for trade secret misappropriation, as well as unspecified damages for alleged misrepresentations in the DCMA Takedown Notice. Angela Game and Imperium also filed an application for a temporary restraining order asking the court to order us and Studio Wildcard to rescind the DCMA Takedown Notice so that Steam could once again reinstate *Myth of Empires* for download. On December 20, 2021, the Company and Studio Wildcard filed an answer to the complaint, which included counterclaims against Angela Game and Imperium and a third-party complaint against Tencent seeking unspecified damages resulting from the alleged copyright infringement and misappropriation of trade secrets in connection with the *ARK: Survival Evolved* source code. On December 23, 2021 the court denied the application for a temporary restraining order and issued an order to show cause as to why a preliminary injunction should not be issued. On January 31, 2022, a hearing was held on the order to show cause, and the court issued an order denying the preliminary injunction.

On February 3, 2022, Angela Game and Imperium appealed the order to the Ninth Circuit Court of Appeals ("Ninth Circuit"), claiming that the District Court judge abused her discretion in denying the injunction. On October 6, 2022, the Ninth Circuit issued an order affirming the District Court's denial of the injunction.

Meanwhile, the District Court has appointed a neutral expert to compare the parties' computer code and issue a report about the extent of similarities. The parties also retained their own experts to compare the code. The expert served his report and in it detailed the basis for his conclusion that Angela copied substantial portions of the *ARK: Survival Evolved* source code and made extensive efforts to hide its copying. Angela Game moved the District Court to strike the expert reports. The hearing occurred on February 27, 2023 and the District Court denied Angela Game's motion to strike the expert reports. Also on that date, the District Court heard the Company's motion to require that Angela Game file a $3.0 million bond to support an award of costs and fees if the Company prevails on Angela Game's claims. The District Court granted the Company's motion for a bond and ordered Angela Game to post a bond in the amount of $750,000.

At this time, the Company is unable to quantify the magnitude of the potential loss should the plaintiffs' lawsuit succeed and accordingly no accrual for loss has been recorded in the accompanying financial statements.

On March 14, 2023, Bel Air Soto, LLC ("Plaintiff") filed suit in the Superior Court of California, County of Los Angeles, against Snail Games USA Inc. and INDIEV, Inc. ("INDIEV"), an affiliate company that is owned by Mr. Hai Shi, the Company's Founder, Chief Strategy Officer, and Chairman, for breach of contract and related claims arising out of a commercial lease for premises located in Los Angeles County. Plaintiff alleges that the defendants exercised an option to extend the lease and was harmed when defendants instead terminated the lease and vacated the premises. The complaint seeks damages in excess of $3 million. Snail Games USA Inc. disputes the allegations and the amount of damages. The Company has responded to the complaint with an answer and cross-complaint. The cross-complaint seeks return for the $130,000 security deposit. The landlord has answered and denied the allegations of the cross-complaint. The Company intends to vigorously defend against the claims asserted.

On April 21, 2023, Snail Games USA Inc. entered into an indemnity and reimbursement agreement with INDIEV, dated as of April 1, 2023, pursuant to which INDIEV agrees to assume all obligations and liabilities pursuant to the lease and indemnify and reimburse Snail Games USA Inc. for any amounts, damages, expenses, costs or other liability incurred by Snail Games USA Inc. arising under or pursuant to the lease or relating to the premises.

At this time, the Company is unable to quantify the magnitude of the potential loss should the plaintiffs' lawsuit succeed and accordingly no accrual for loss has been recorded in the accompanying financial statements.

NOTE 19 – EARNINGS (LOSS) PER SHARE

The Company uses the two class method to compute its basic earnings (loss) per share ("Basic EPS") and diluted earnings per share ("Diluted EPS"). The following table summarizes the computations of basic EPS and diluted EPS. The allocation of earnings between Class A and Class B shares is based on their respective economic rights to the undistributed earnings of the Company. Basic EPS is computed as net income (loss) divided by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur using the treasury stock method. The restricted stock units and underwriters warrants were excluded from the treasury stock method computation of diluted shares as their inclusion would have had an antidilutive effect for the three and six months ended June 30, 2023. There were no such exclusions made in the 2022 calculation. For the three and six months ended June 30, 2022, the Company has used the number of shares transferred in the reorganization transaction for the denominator in the EPS calculation. The following table provides a reconciliation of the weighted average number of shares used in the calculation of basic and diluted EPS.

	For the three months ended June 30,		For the six months ended June 30,	
	2023	2022	2023	2022
Basic Earnings Per Share:				
Net (loss) income attributable to Class A common stockholders	$ (879,665)	$ (1,054,297)	$ (1,522,005)	$ 4,756,760
Net (loss) attributable to Class B common stockholders	(3,199,766)	-	(5,528,804)	-
Total net (loss) income attributable to Snail Inc and Snail Games USA Inc.	$ (4,079,431)	$ (1,054,297)	$ (7,050,809)	$ 4,756,760
Class A weighted average shares outstanding - basic	7,901,145	35,000,000	7,914,096	35,000,000
Class B weighted average shares outstanding - basic	28,748,580	-	28,748,580	-
Class A and B basic earnings per share	$ (0.11)	$ (0.03)	$ (0.19)	$ 0.14
Diluted Earnings Per Share:				
Net (loss) income attributable to Class A common stockholders	$ (879,665)	$ (1,054,297)	$ (1,522,005)	$ 4,756,760
Net (loss) attributable to Class B common stockholders	$ (3,199,766)	$ -	$ (5,528,804)	$ -
Class A weighted average shares outstanding - basic	7,901,145	35,000,000	7,914,096	35,000,000
Dilutive effects of common stock equivalents	-	-	-	-
Class A weighted average shares outstanding - diluted	7,901,145	35,000,000	7,914,096	35,000,000
Class B weighted average shares outstanding - basic	28,748,580	-	28,748,580	-
Dilutive effects of common stock equivalents	-	-	-	-
Class B weighted average shares outstanding - diluted	28,748,580	-	28,748,580	-
Diluted (loss) earnings per Class A and B share	$ (0.11)	$ (0.03)	$ (0.19)	$ 0.14

NOTE 20 – EQUITY

The Company has authorized two classes of common stock, Class A and Class B. The rights of the holders of both Class A and Class B common stock will be identical, except with respect to voting, conversion and transfer restrictions applicable to the Class B common stock. Each share of Class A common stock will be entitled to one vote. Each share of Class B common stock will be entitled to ten votes and will be convertible into one share of Class A common stock automatically upon transfer, subject to certain exceptions. Holders of Class A common stock and Class B common stock will vote together as a single class on all matters unless otherwise required by law.

On November 9, 2022, in connection with the IPO, the Company entered into an underwriting agreement (the "Underwriting Agreement" with the underwriters (the "Underwriters"), pursuant to which the Company agreed to issue and sell 3,000,000 shares of Class A common stock (the "Firm Shares") at a purchase price of $4.675 per share to the Underwriters and granted the Underwriters an option (the "Over-Allotment Option") to purchase up to 450,000 additional shares of Class A common stock (the "Option Shares") at a purchase price of $4.675 per share. The Underwriters may exercise the Over-Allotment Option at any time in whole, or from time to time in part, on or before the forty-fifth day following the effectiveness of the IPO. The Over-Allotment Option was not exercised by the Underwriters prior to its expiration.

In connection with the Underwriting Agreement, on November 9, 2022, the Company also issued to the Underwriters warrants to purchase such number of shares of the Company's Class A common stock in an amount equal to four percent of the total number of shares of Class A common stock sold in the IPO, or 120,000 shares of Class A common stock (the "Underwriters Warrants"). The Underwriters Warrants may be exercised at a price per share equal to 125% of the IPO price, or $6.25 per share. The Underwriters Warrants are exercisable, in whole or in part, commencing on November 9, 2022, and expiring on the three-year anniversary thereof. The Underwriters Warrants have not been exercised as of the filing of this Quarterly Report.

The Underwriters Warrants and Over-Allotment Option are legally detachable and separately exercisable from each other and from the Firm Shares; therefore, they meet the definition of freestanding and are not considered embedded in the Firm Shares.

The Underwriters Warrants are considered indexed to the Company's own stock. Additionally, the Company concludes that the Underwriters Warrants meet all requirements for equity classification. Because the Underwriters Warrants are issued to the Underwriters for their services and can be exercised immediately (subject to certain transfer conditions) they will be measured at their fair value on their date of issuance and recorded within stockholders' equity. As long as the Underwriters Warrants remain classified as equity, they shall not be revalued. The fair value of the Underwriters Warrants was determined using the Black-Scholes model. The key assumptions used in the valuation were an average expected volatility of 53%, discount rate of 4.49% and remaining term of 3 years.

The Company allocates all the issuance costs to the firm shares as a reduction of proceeds.

Restricted Stock Units ("RSUs")

RSUs granted to directors vest based on the directors' continued employment with us through each applicable vest date, which is generally over one year. If the vesting conditions are not met, unvested RSUs will be forfeited. The following table summarizes our RSU units activity with directors for the six months ended June 30, 2023. There were no activities during the six months ended June 30, 2022.

	Restricted Stock Units	Weighted-Average Grant-Date Fair Values
Outstanding as of January 1, 2023	24,000	$ 5.00
Granted	—	—
Vested	—	—
Forfeited or cancelled	—	—
Outstanding as of June 30, 2023	24,000	$ 5.00

The grant date fair value of RSUs granted to directors is based on the quoted market price of our common stock on the date of grant.

Our RSUs granted to employees vest upon the achievement of pre-determined performance-based milestones as well as service conditions ("PSUs"). The pre-determined performance-based milestones are based on specified percentages of the PSUs that would vest at each of the first five anniversaries of the IPO date if the Company's average annual growth rate ("AAGR") is calculated to be at a target percentage or above during the period between the Company's IPO Date and the annual revenue for each of the anniversary year. If these performance-based milestones are not met but service conditions are met, the PSUs will not vest, in which case any compensation expense the Company has recognized to date will be reversed. Generally, the total aggregate measurement period of our PSUs is 5 years, with awards cliff-vesting after each annual measurement period during the total aggregate measurement period.

Each quarter, the Company updates our assessment of the probability that the performance milestones will be achieved. The Company amortizes the fair values of PSUs over the requisite service period. Each performance-based milestone is weighted evenly and the number of shares that vest based on each performance-based milestone is independent from the other.

The following table summarizes our PSU activity with employees, presented with the maximum number of shares that could potentially vest, for the six months ended June 30, 2023. There were no activities during the six months ended June 30, 2022.

	Restricted Stock Units	Weighted-Average Grant-Date Fair Values
Outstanding as of January 1, 2023	1,197,552	$ 5.00
Granted	—	—
Vested	—	—
Forfeited or cancelled	(20,971)	5.00
Outstanding as of June 30, 2023	1,176,581	$ 5.00

The grant date fair value of PSUs granted to employees is based on the quoted market price of our common stock on the date of grant.

Repurchase Activity

All share repurchases settled in the six months ended June 30, 2023 were open market transactions. As of June 30, 2023, 1,350,275 shares of Class A common stock were repurchased pursuant to the Share Repurchase Program for an aggregate purchase price of approximately $3.7 million. The average price paid per share was $2.72 and approximately $1.3 million aggregate amount of shares of Class A common stock remain available for repurchase under the Share Repurchase Program.

Stock-Based Compensation Expense

Stock-based compensation expense resulting from RSUs and PSUs of $369,301 and $216,706 are recorded under general and administrative expenses included in our condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended June 30, 2023, respectively. Stock-based compensation expense resulting from PSUs of $16,064 and $0 are recorded under research and development expenses included in our condensed consolidated statements of operations and comprehensive income (loss) for the three and six months ended June 30, 2023, respectively. There were no stock-based compensation expenses incurred during the three and six months ended June 30, 2022.

During the three months ended June 30, 2023 and 2022, the Company recognized approximately $50,801 and $0 respectively, of deferred income tax benefit related to our stock-based compensation expense. During the six months ended June 30, 2023 and 2022, the Company recognized approximately $82,877 and $0 respectively, of deferred income tax benefit related to our stock-based compensation expense.

As of June 30, 2023, our total unrecognized compensation cost related to RSUs and PSUs was approximately $1.6 million and is expected to be recognized over a weighted-average service period of 2.8 years.

NOTE 21 – SUBSEQUENT EVENTS

On July 26, 2023, the Company entered into a cooperation agreement with an internet, server and datacenter vendor, Marbis GmbH (“Marbis”). The Company agreed to make Mabis the official server host of *Ark: Survival Evolved* and future iterations and sequels of the game for a period of seven years. In return, Marbis will grant to the Company funding up to the amount of $4,046,932, which includes the outstanding amount of $1,046,932 included in the Company’s accrued expenses and other liabilities as of June 30, 2023. Pursuant to the agreement, Marbis has agreed to provide the Company with funds in cash in an aggregate amount of up to $3,000,000 without discount and free of bank charges and costs to the Company.

On July 27, 2023, the Company entered into a distribution agreement with its retail distribution partner for the distribution of *ARK: Survival Ascended* and *ARK II*. The initial term is two years and will renew each subsequent year unless cancelled. Upon executing the distribution agreement, the Company received $1.8 million as a prepaid royalty that will be reported as deferred revenue until the release of *ARK: Survival Ascended* and *ARK II*.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q (the "Quarterly Report"). This discussion and analysis contains forward-looking statements that involve certain risks and uncertainties. Our actual results could differ materially from those discussed in these statements. Factors that could cause or contribute to these differences include those discussed below and elsewhere in this Quarterly Report, particularly under "Risk Factors," in Part II, Item 1A of this Quarterly Report, and the "Cautionary Statement Regarding Forward-Looking Statements" section of this Quarterly Report.

Overview

Our mission is to provide high-quality entertainment experiences to audiences around the world. We are a leading, global independent developer and publisher of interactive digital entertainment for consumers around the world. We have built a premier portfolio of premium games designed for use on a variety of platforms, including consoles, PCs, and mobile devices. *ARK: Survival Evolved* has been a top-25 selling game on the Steam platform by gross revenue in each year we released an *ARK* DLC. Our expertise in technology, in-game ecosystems and monetization of online multiplayer games has enabled us to assemble a broad portfolio of intellectual property across multiple media formats and technology platforms. Our flagship franchise from which we generate the substantial majority of our revenues, *ARK: Survival Evolved*, is a leader within the sandbox survival genre with 87.2 million console and PC installs through June 30, 2023. See "— Key Performance Metrics and Non-GAAP Measures." In the three and six months ended June 30, 2023, *ARK: Survival Evolved* averaged a total of 240,522 and 258,245 daily active users ("DAUs") on the Steam and Epic platforms as compared to 359,077 and 308,769 DAUs in the three and six months ended June 30, 2022, respectively. We experienced a peak of approximately 1,113,143 DAUs in June 2022. We define "daily active users" as the number of unique users who play any given game on any given day. For the three months ended June 30, 2023 and 2022, we generated 83.0% and 87.5%, respectively, of our revenues from *ARK: Survival Evolved*. For the six months ended June 30, 2023 and 2022, we generated 87.1% and 91.2%, respectively, of our revenues from *ARK: Survival Evolved*.

Our dedication to providing audiences with high-quality entertainment experiences utilizing the latest gaming technology has produced strong user engagement, continued revenue growth, and increased cash flows. Through June 30, 2023, our *ARK* franchise game has been played for 3.3 billion hours with an average playing time per user of more than 162 hours and with the top 21.0% of all players spending over 100 hours in the game, according to data from the Steam platform. For the three months ended June 30, 2023 and 2022, our net revenue was $9.9 million and $15.5 million, respectively. For the six months ended June 30, 2023 and 2022, our net revenue was $23.4 million and $43.5 million, respectively. During the three months ended June 30, 2023, approximately 36.7% of our revenue came from consoles, 34.0% from PC and 15.2% from mobile platforms. During the six months ended June 30, 2023, approximately 40.3% of our revenue came from consoles, 35.9% from PC and 13.8% from mobile platforms. We had a net loss of $4.1 million for the three months ended June 30, 2023 as compared to a net loss of $1.0 million for the three months ended June 30, 2022. For the six months ended June 30, 2023 we had a net loss of $7.1 million, as compared to net income of $4.8 million for the six months ended June 30, 2022.

Key Factors Affecting Our Business

There are a number of factors that affect the performance of our business, and the comparability of our results from period to period, including:

Investments in our content strategy

We continuously evaluate and invest in content strategy to improve and innovate our games and features and to develop current technological platforms. We are currently actively investing in expanding our gaming pipeline as well as developing media and eSports content related to our gaming intellectual property. We also continue to invest to grow our micro-influencer platform, *NOIZ*, by attracting new influencers and brand customers.

Growth of user base

We have experienced significant growth in our number of downloads over the last several years. We have sold 41.5 million units between January 1, 2016 and June 30, 2023. During the three months ended June 30, 2023, we sold 1.0 million units compared to 1.7 million units in the three months ended June 30, 2022. During the six months ended June 30, 2023 and 2022, we sold 2.7 million units and 3.0 million units, respectively. Our video games provide highly engaging, differentiated entertainment experiences where the combination of challenge and progress drives player engagement, high average player times, and long-term franchise value. The success of our franchise hinges on our ability to keep our current players engaged while also growing our user base by innovating our platform and monetizing on new offerings. The degree to which gamers are willing to engage with our platform is driven by our ability to create interactive and unique content that will enhance the game-play experience. We sell DLCs which are supplementary to our master games and expand the gaming universe to continuously evolve the game and retain players. Our master games are the base versions of a specific title, for example, *Ark: Survival Evolved* is our master game and *Ark: Genesis* is a DLC.

While we believe we have a significant opportunity to grow our installed base, we anticipate that our overall install growth rate will fluctuate over time as we continue to release new master games and companion DLCs. Download rates and user engagement may increase or decrease based on other factors such as growth in console, PC and mobile games, ability to release content, market effectively and distribute to users.

Investments in our technology platform

We are focused on innovation and technology leadership in order to maintain our competitive advantage. We spend a portion of our capital on our research and development platform to continuously improve our technological offerings and gaming platform. Our proprietary video game technology includes a versatile game engine, development pipeline tools, advanced rendering technology and advanced server and network operations. Continued investment in improving the technology behind our existing gaming platforms as well as developing new software tools for new product offerings is important to maintaining our strategic goals, developer and creator talent, and financial objectives. For us to continue providing cutting-edge technology to our users and bringing digital interactive entertainment to market, we must also continue to invest in developmental and creative resources. For our users, we regularly invest in user-friendly features and enhance user experience in our games and platforms. As our industry moves towards increased use of cloud gaming and gaming as a service technology, our ability to bring interactive technologies to market will be an increasingly important part of our business.

Ability to release content, market effectively through cross media and expand the gaming group

Establishing and maintaining a loyal network of players for our premium games is vital for our business and drives revenue growth. To grow and maintain our player base, we invest in developing new games to attract and engage players, and in providing existing audiences with proven content in the form of new DLCs. In the near-term, we may increase spending on original content creation with new studios, and on sales and marketing as a percentage of revenue to grow our player network. The scale of our player base is determined by a number of factors, including our ability to strengthen player engagement by producing content that players play regularly and our effectiveness in attracting new players, both of which may in turn affect our financial performance.

Strategic relationship with developers, Studio Wildcard & Suzhou Snail

We have grown and expect to continue to grow our business by collaborating with game studios that we believe can benefit from our team's decades of experience developing successful games. We have strategic relationships with many developer studios that create original content for us. The relationships allow for valuable knowledge sharing between Suzhou Snail, a related party, and the developer studios. We enjoy a long-term relationship with Studio Wildcard, a related party, which develops our *ARK* franchise. We have an exclusive license with Studio Wildcard for rights to *ARK*, and we work with them and our other studio developer partners to provide ongoing support across numerous aspects of game development. Our financial results may be affected by our relationship with game studios, including Studio Wildcard, and our ability to create self-developed titles.

Relationship with third party distribution platforms

We derive nearly all of our revenue from third-party distribution platforms, such as Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, the Apple App Store, the Google Play Store, My Nintendo Store and the Amazon Appstore. These digital distribution platforms have policies that may impact our reachability to our potential audience, including the discretion to amend their terms of service, which could affect our current operations and our financial performance. As we expand to new markets, we anticipate similar relationships with additional distribution partners that could similarly impact our performance.

Seasonality

We experience fluctuations in quarterly and annual operating results as a result of the timing of the introduction of new titles, variations in sales of titles developed for particular platforms, market acceptance of our titles, development and promotional activities relating to the introduction of new titles, releases of expansion packs and DLCs, and to coincide with the global holiday season in the fourth and first quarters of each year. Seasonality in our revenue also tends to coincide with promotional cycles on platforms, typically on a quarterly basis.

Key Performance Metrics and Non-GAAP Measures

Units Sold

We monitor Units Sold as a key performance metric in evaluating the performance of our console and PC game business. We define Units Sold as the number of game titles purchased through digital channels by an individual end user. Under this metric, the purchase of a standalone game, DLC, Season Pass or bundle on a specific platform are individually counted as a unit. For example, an individual who purchases a standalone game and DLC on one platform, a Season Pass on another platform, and a bundle on a third platform would count as four Units Sold. Similarly, an individual who purchases three standalone game titles on the same platform would count as three Units Sold.

Units Sold may be impacted by several factors that could cause fluctuations on a quarterly basis, such as game releases, our promotional activities, which most often coincide with the global holiday season in the fourth and first quarters of each year, promotional sales on digital platforms, console release cycles and new digital platforms. Future growth in Units Sold will depend on our ability to launch new games and features and the effectiveness of marketing strategies. Units Sold decreased by 0.7 million, or 40.5% in the three months ended June 30, 2023, as compared to the three month period ended June 30, 2022. The decrease was due to a sales promotion that was typically ran in the month of April by a significant platform partner of the Company, and did not begin until the end of the period and the anticipated release of *ARK: Survival Ascended*. Units Sold decreased by 0.3 million, or 9.7%, in the six months ended June 30, 2023, as compared to the six month period ended June 30, 2022, due to decreased sales promotions run across the Company's platform partners.

	Three months ended June 30,				Six months ended June 30,			
	2023	**2022**	**Change**	**% Change**	**2023**	**2022**	**Change**	**% Change**
				(in millions)				
Units Sold[1]	1.0	1.7	(0.7)	-40.5%	2.7	3.0	(0.3)	-9.7%

(1) Units Sold include master games, DLCs, season pass and bundles and excludes skins, soundtracks and other items.

Bookings & EBITDA

In addition to our financial results determined in accordance with U.S. generally accepted accounting principles ("U.S. GAAP" or "GAAP"), we believe Bookings and EBITDA, as non-GAAP measures, are useful in evaluating our operating performance. Bookings and EBITDA, as used in this Quarterly Report on Form 10-Q, are non-GAAP financial measures that are presented as supplemental disclosures and should not be construed as alternatives to net income (loss) or revenue as indicators of operating performance, as determined in accordance with GAAP.

We supplementally present Bookings and EBITDA because they are key operating measures used by our management to assess our financial performance. Bookings adjusts for the impact of deferrals and, we believe, provides a useful indicator of sales in a given period. Management believes Bookings and EBITDA are useful to investors and analysts in highlighting trends in our operating performance, while other measures can differ significantly depending on long-term strategic decisions regarding capital structure, the tax jurisdictions in which we operate and capital investments. Management uses Bookings and EBITDA to supplement GAAP measures of performance in the evaluation of the effectiveness of our business strategies, to make budgeting decisions, and to compare our performance against other peer companies using similar measures. We evaluate Bookings and EBITDA in conjunction with our results according to GAAP because we believe it provides investors and analysts a more complete understanding of factors and trends affecting our business than GAAP measures alone. Bookings and EBITDA should not be considered as alternatives to net income (loss), as measures of financial performance or any other performance measure derived in accordance with GAAP.

Bookings

Below is a reconciliation of total net revenue to Bookings, the closest GAAP financial measure.

Bookings is defined as the net amount of products and services sold digitally or physically in the period. Bookings is equal to revenues excluding the impact from deferrals.

	Three months ended June 30,				Six months ended June 30,			
	2023	2022	$ Change	% Change	2023	2022	$ Change	% Change
	(in millions)							
Total net revenue	$ 9.9	$ 15.5	$ (5.6)	-36.0%	$ 23.4	$ 43.5	$ (20.1)	-46.3%
Change in deferred net revenue	(0.6)	(0.4)	(0.2)	59.6%	(0.8)	(3.0)	2.2	-74.7%
Bookings	$ 9.3	$ 15.1	$ (5.8)	-38.5%	$ 22.6	$ 40.5	$ (17.9)	-44.2%

For the three months ended June 30, 2023, bookings decreased by $5.8 million, or 38.5%, compared to the three months ended June 30, 2022, primarily as a result of a decrease in *ARK* revenues and in-game purchases which contributed to $5.3 million of the decrease during the three months ended June 30, 2022. The decrease in *ARK* revenues during the three months ended June 30, 2023 was due partially to fewer sales days in the period and the anticipated release of *ARK: Survival Ascended.*

For the six months ended June 30, 2023, bookings decreased by $17.9 million, or 44.2%, compared to the six months ended June 30, 2022, primarily as a result of decreased *ARK* revenues in 2023 due to decreased average selling prices ("ASPs") and in-game purchases which contributed to $8.4 million of the decrease and no one-time contract payments during the six months ended June 30, 2023 while there was $8.5 million in one-time contract payments and $2.5 million in one-time deferred contract revenue recognized during the six months ended June 30, 2022. These were partially offset by a decrease in the change in deferred revenue of $2.2 million.

EBITDA

Below is a reconciliation of net income (loss) to EBITDA, the closest GAAP financial measure. We define EBITDA as net income (loss) before (i) interest income, (ii) interest expense, (iii) provision for (benefit from) income taxes, and (iv) depreciation and amortization expense, property and equipment.

EBITDA as calculated herein may not be comparable to similarly titled measures reported by other companies within the industry and is not determined in accordance with GAAP. Our presentation of EBITDA should not be construed as an inference that our future results will be unaffected by unusual or unexpected items. We may also incur expenses that are the same, or similar to, some of the adjustments in this presentation. EBITDA decreased by $3.7 million, or 322.0%, due primarily to a reduction in net income of $3.1 million and a decrease in the income tax provision of $0.8 million during the three months ended June 30, 2023 as compared to three months ended June 30, 2022. During the six months ended June 30, 2023, EBITDA decreased by $14.4 million, or 234.8%, due to a reduction in net income of $11.9 million and a decrease in the income tax provision of $3.1 million; which was partially offset by a decrease in interest income and interest income - related parties of $0.5 million as compared to the six months ended June 30, 2022.

	Three months ended June 30,				Six months ended June 30,			
	2023	2022	$ Change	% Change	2023	2022	$ Change	% Change
	(in millions)							
Net (loss) income	$ (4.1)	$ (1.0)	$ (3.1)	-315.1%	$ (7.1)	$ 4.8	$ (11.9)	-245.7%
Interest income and interest income – related parties	-	(0.1)	0.1	86.3%	(0.1)	(0.6)	0.5	-91.5%
Interest expense and interest expense – related parties	0.3	0.2	0.1	57.8%	0.6	0.4	0.2	66.2%
(Benefit from) provision for income taxes	(1.1)	(0.3)	(0.8)	-230.5%	(1.9)	1.2	(3.1)	-259.9%
Depreciation and amortization expense, property and equipment	0.1	0.1	-	-22.1%	0.2	0.3	(0.1)	-27.3%
EBITDA	$ (4.8)	$ (1.1)	$ (3.7)	-322.0%	$ (8.3)	$ 6.1	$ (14.4)	-234.8%

Components of Results of Operations

Revenues

We primarily derive revenue from the sale of our games through various gaming platforms. Through these platforms, users can download our games and, for certain games, purchase virtual items to enhance their game-playing experience. We offer certain software products through third-party digital storefronts, such as Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, the Apple App Store, the Google Play Store, My Nintendo Store and the Amazon Appstore, and certain retail distributors. For sales arrangements through Xbox Live and Game Pass, PlayStation Network, Steam, Epic Game Stores, My Nintendo Store and retail distributors, the digital platforms and distributors have discretion in establishing the price for the specified good or service, and we have determined we are the agent in the sales transaction to the end user and therefore report revenue on a net basis based on the consideration received from the digital storefront. For sales arrangements through the Apple App Store and the Google Play Store, we have discretion in establishing the price for the specified good or service and have determined that we are the principal to the end user and therefore report revenue on a gross basis. Mobile platform fees charged by these digital storefronts are expensed as incurred and reported within cost of revenue as merchant fees.

We record deferred revenue when payments are due or received in advance of the fulfillment of our associated performance obligations.

Our net revenues through our top four platform providers as a proportion of our total net revenue for the three and six months ended June 30, 2023 and 2022 were as follows:

	Three months ended June 30,				Six months ended June 30,			
	2023	2022	$ Change	% Change	2023	2022	$ Change	% Change
				(in millions)				
Platform 1	$ 3.2	$ 6.5	$ (3.3)	-50.8%	$ 8.0	$ 12.7	$ (4.7)	-37.3%
Platform 2	1.2	2.6	(1.4)	-54.7%	3.6	13.6	(10.0)	-73.6%
Platform 3	1.0	1.4	(0.4)	-31.0%	2.2	6.6	(4.4)	-66.1%
Platform 4	0.7	0.4	0.3	101.2%	1.9	0.8	1.1	14630.0%
All Other Revenue	3.8	4.6	(0.8)	-17.0%	7.7	9.8	(2.1)	-22.1%
Total	**$ 9.9**	**$ 15.5**	**$ (5.6)**	**-36.0%**	**$ 23.4**	**$ 43.5**	**$ (20.1)**	**-46.3%**

We expect changes in revenue to correlate with trends in the use and purchase of our games. The decrease in net revenues of Platforms 1, 2, and 3 during the three month periods ended June 30, 2023 and 2022 was due to the decreased ASP of the *ARK 1* franchise due to more sales days in the 2023 period. The increase in net revenues of Platform 4 was due to the remastered version of *ARK 1* being released in the first quarter of 2023.

The decrease in net revenues of Platform 1 during the six month periods ended June 30, 2023 and 2022 was due to the decreased ASP of the *ARK 1* franchise due to more sales days in the 2023 period. The decrease in net revenues of Platforms 2 and 3 were due to one off payments and deferred revenues recognized in the 2022 period, in addition to reduced ASP's. The increase in net revenues of Platform 4 was due to the release of a remastered and upgraded version of *ARK 1* on the platform during the six month period ended June 30, 2023.

Cost of revenues

Cost of revenues includes license royalty fees, merchant fees, engine fees, server and database cost centers, game licenses and license right amortization. For a description of our licensing arrangements, please see Note 2 – *Summary of Significant Accounting Policies* to the unaudited condensed consolidated financial statements. We generally expect cost of revenues to fluctuate proportionately with revenues.

General and administrative

General and administrative expenses include rent expense, outsourced professional services such as consulting, legal and accounting services, taxes and dues, insurance premiums, and costs associated with maintaining our property and infrastructure. General and administrative expenses also include salaries and wages, which consist of compensation we pay to our employees. We expect salaries and wages to increase in a manner that is proportional with the added expenses and expertise of operating as a public company. We also expect salaries and wages to increase as we increase headcount as we expand our product offerings. Future stock-based compensation will be recorded within research and development and general and administrative expense. We also record legal settlement expenses as components of general and administrative expenses. We expect general and administrative expenses will increase in absolute dollars due to the additional administrative and regulatory burden of becoming and operating as a public company.

Research and development

Research and development consists primarily of consulting expenses and salaries and wages devoted towards the development of new games and related technologies. We do not fund or enter into arrangements relating to the research and development activities from third-party developers from whom we license games. We expect our research and development to increase as we develop new content, games or technologies.

Advertising and marketing

Advertising and marketing consists of costs related to advertising and user acquisition efforts, including payments to third-party marketing agencies. We occasionally offer our early access trial, through which we sell our games that are in development and testing. The early access trial allows us to both monetize and receive feedback on how to improve our games over time. We plan to continue to invest in advertising and marketing to retain and acquire players. However, sales and marketing expenses may fluctuate as a percentage of revenues depending on the timing and efficiency of our marketing efforts.

Interest expense and other, net

Interest expense consists of interest incurred under our term loans, 2021 Revolving Loan and promissory notes. We expect to continue to incur interest expense under our debt instruments, although with respect to certain instruments, our interest expense will fluctuate based upon the underlying variable interest rates.

(Benefit from) provision for income taxes

The (benefit from) provision for income taxes consists of current income taxes in the various jurisdictions where we are subject to taxation, primarily the United States, as well as deferred income taxes reflecting the net tax effects of temporary differences between the carrying amounts of assets and liabilities in each of these jurisdictions for financial reporting purposes and the amounts used for income tax purposes. Under current U.S. tax law, the federal statutory tax rate applicable to corporations is 21%. Our effective tax rate of 21% did not differ from the federal rate of 21%.

Results of Operations

Comparison of the three months ended June 30, 2023 versus the three months ended June 30, 2022

	Three months ended June 30,			
	2023	2022	$ Change	% Change
		(in millions)		
Revenues, net	$ 9.9	$ 15.5	$ (5.6)	(36.0)%
Cost of revenues	9.3	12.3	(3.0)	(23.8)%
Gross profit	0.6	3.2	(2.6)	(82.6)%
Operating expenses:				
General and administrative	4.0	4.3	(0.3)	(7.4)%
Research and development	1.2	0.2	1.0	570.7%
Advertising and marketing	0.2	0.2	—	(20.6)%
Depreciation and amortization	0.1	0.1	—	(14.9)%
Total operating expenses	5.5	4.8	0.7	13.5%
(Loss) from operations	**$ (4.9)**	**$ (1.6)**	**$ (3.3)**	**(208.7)%**

Revenues

Net revenues for the three months ended June 30, 2023 decreased by $5.6 million, or 36.0%, compared to the three months ended June 30, 2022. The decrease in net revenues was due to a decrease in sales of *ARK,* partially attributed to a decrease in the number of days on sale in one of our primary platform partners and partially due to the upcoming release of *ARK: Survival Ascended*. *ARK* sales and in-game purchases decreased by $5.3 million. Sales of the Company's smaller titles decreased by a collective $0.6 million. These decreases in the Company's smaller titles were partially offset by an increase of $0.1 million in revenue related to *West Hunt*.

Cost of revenues

Cost of revenues for the three months ended June 30, 2023 decreased by $3.0 million, or 23.8%, compared to the three months ended June 30, 2022.

Cost of revenues for the three months ended June 30, 2023 and 2022 comprised the following:

	Three months ended June 30,			
	2023	2022	$ Change	% Change
	(in millions)			
Software license royalties - related parties	$ 1.9	$ 3.4	$ (1.5)	(43.3)%
Software license royalties	0.3	—	0.3	100.0%
License and amortization - related parties	4.9	6.4	(1.5)	(23.4)%
License and amortization	—	0.1	(0.1)	(99.8)%
Merchant fees	0.3	0.6	(0.3)	(41.5)%
Engine fees	0.3	0.5	(0.2)	(41.7)%
Internet, server and data center	1.6	1.3	0.3	19.8%
Total:	**$ 9.3**	**$ 12.3**	**$ (3.0)**	**(23.8)%**

The decrease in cost of revenues for the three months ended June 30, 2023 was due to a decrease in *ARK* related royalties of $1.2 million, a decrease in merchant fees of $0.3 million, commensurate with the decrease in *ARK* sales, and a decrease in engine fees of $0.2 million. The Company also reported a decrease in license and amortization cost of $1.6 million due to a lower amortizable base that is the result of the age of certain licenses. These were offset by increased internet, server and data center costs of $0.3 million, primarily driven by increased server hosting rates.

General and administrative expenses

General and administrative expenses for the three months ended June 30, 2023 decreased by $0.3 million, or 7.4%. The decrease in general and administrative expenses was primarily due to a decrease in legal and professional expenses of $0.8 million offset by increased public company expenses of $0.3 million and increased insurance expenses of $0.2 million during the three months ended June 30, 2023.

Research and development expenses

Research and development expenses for the three months ended June 30, 2023 increased by $1.0 million, or 570.7%. The increase in research and development expenses was primarily due to additional development of the Company's *ARK 1, Atlas, Last Oasis* and *Agartha* titles during the three months ended June 30, 2023.

Other Factors Affecting Net Income

	Three months ended June 30,			
	2023	2022	$ Change	% Change
	(in millions)			
Interest income – related parties	$ —	$ 0.1	$ (0.1)	(99.6)%
Interest expense	(0.3)	(0.2)	(0.1)	59.1%
(Benefit from) provision for income taxes	(1.1)	(0.3)	(0.8)	230.5%

Interest income

Interest income — related parties was $0.0 million, and $0.1 million for the three months ended June 30, 2023 and 2022, respectively. The decrease was due to the distribution of the Shi Loan to Suzhou Snail in April 2022.

Interest expense

Interest expense is primarily related to our outstanding indebtedness with third-party lenders. Interest expense increased by $0.1 million for the three months ended June 30, 2023 as a result of rising interest charges on the Company's floating rate debt.

(Benefit from) provision for income taxes

The Company had an income tax benefit of $1.1 million and $0.3 million for the three months ended June 30, 2023 and 2022, respectively, representing a decrease of $0.8 million. Our effective income tax rate was 20.9% and 25.0% for the three months ended June 30, 2023 and 2022, respectively.

Comparison of the six months ended June 30, 2023 versus the six months ended June 30, 2022

	Six months ended June 30, 2023	Six months ended June 30, 2022	$ Change	% Change
		(in millions)		
Revenues, net	$ 23.4	$ 43.5	$ (20.1)	(46.3)%
Cost of revenues	20.2	28.0	(7.8)	(27.4)%
Gross profit	3.2	15.5	(12.3)	(79.7)%
Operating expenses:				
General and administrative	8.5	8.9	(0.4)	(6.4)%
Research and development	2.6	0.4	2.2	609.3%
Advertising and marketing	0.3	0.4	(0.1)	(26.4)%
Depreciation and amortization	0.2	0.3	(0.1)	(24.1)%
Total operating expenses	11.6	10.0	1.6	14.4%
(Loss) income from operations	**$ (8.4)**	**$ 5.5**	**$ (13.9)**	**(253.7)%**

Revenues

Net revenues for the six months ended June 30, 2023 decreased by $20.1 million, or 46.3%, compared to the six months ended June 30, 2022. The decrease in net revenues was due to a decrease in sales of *ARK*, additional deferred revenue and one-time payments related to contracts with certain platforms. *ARK* sales decreased by $8.4 million, deferred revenue from contracts decreased by $2.5 million, and one-off payments decreased by $8.5 million. Sales of the smaller titles decreased by a collective $1.2 million. These decreases in the Company's smaller titles were partially offset by an increase of $0.3 million in revenue related to *West Hunt*.

Cost of revenues

Cost of revenues for the six months ended June 30, 2023 decreased by $7.8 million, or 27.4%, compared to the six months ended June 30, 2022.

Cost of revenues for the six months ended June 30, 2023 and 2022 comprised the following:

	Six months ended June 30, 2023	Six months ended June 30, 2022	$ Change	% Change
		(in millions)		
Software license royalties - related parties	$ 4.8	$ 9.9	$ (5.1)	(51.7)%
Software license royalties	0.6	—	0.6	100.0%
License and amortization - related parties	10.1	12.7	(2.6)	(20.8)%
License and amortization	—	0.2	(0.2)	(99.8)%
Merchant fees	0.8	1.2	(0.4)	(35.5)%
Engine fees	0.7	1.3	(0.6)	(41.1)%
Internet, server and data center	3.2	2.7	0.5	18.3%
Total:	**$ 20.2**	**$ 28.0**	**$ (7.8)**	**(27.8)%**

The decrease in cost of revenues for the six months ended June 30, 2023 was due to a decrease in *ARK* related royalties of $4.5 million, a decrease in merchant fees of $0.4 million, commensurate with the decrease in *ARK* sales, and a decrease in engine fees of $0.6 million. The Company also reported a decrease in license and amortization cost of $2.8 million due to a lower amortizable base that is the result of the age of certain licenses. These decreases were partially offset by an increase in internet, server and data center costs of $0.5 million, driven by increased server hosting costs.

General and administrative expenses

General and administrative expenses for the six months ended June 30, 2023 decreased by $0.4 million, or 6.4%. The decrease in general and administrative expenses was primarily due to a decrease in legal and professional expenses of $1.3 million that were partially offset by increased public company expenses of $0.7 million during the six months ended June 30, 2023.

Research and development expenses

Research and development expenses for the six months ended June 30, 2023 increased by $2.2 million, or 609.3%. The increase in research and development expenses was primarily due to additional development of the Company's *ARK 1, Atlas, Last Oasis* and *Agartha* titles during the six months ended June 30, 2023.

Other Factors Affecting Net Income

	Six months ended June 30,			
	2023	**2022**	**$ Change**	**% Change**
		(in millions)		
Interest income – related parties	$ 0.1	$ 0.6	$ (0.5)	(99.8)%
Interest expense	(0.6)	(0.4)	(0.2)	(67.7)%
(Benefit from) provision for income taxes	(1.9)	1.2	(3.1)	(257.0)%

Interest income

Interest income — related parties was $0.1 million, and $0.6 million for the six months ended June 30, 2023 and 2022, respectively. The decrease was due to the distribution of the Shi Loan to Suzhou Snail in April 2022.

Interest expense

Interest expense is primarily related to our outstanding indebtedness with third-party lenders. Interest expense increased by $0.2 million for the six months ended June 30, 2023 as a result of increased interest charges on the Company's floating rate debts and the short-term note issued in January 2022.

(Benefit from) provision for income taxes

The Company had an income tax benefit of ($1.9) million for the six months ended June 30, 2023 and a provision for income taxes of $1.2 million for the six months ended June 30, 2022 representing a decrease of $3.1 million. Our effective income tax rate was 21.1% and 20.0% for the six months ended June 30, 2023 and 2022, respectively.

Liquidity and Capital Resources

Capital spending

We incur capital expenditures in the normal course of business and perform ongoing enhancements and updates to our social and mobile games to maintain their quality standards. Cash used for capital expenditures in the normal course of business is typically made available from cash flows generated by operating activities. We may also pursue acquisition opportunities for additional businesses or games that meet our strategic and return on investment criteria. Capital needs for investment opportunities are evaluated on an individual opportunity basis and may require significant capital commitments.

Liquidity and Going Concern

Our primary sources of liquidity are the cash flows generated from our operations, that are currently available unrestricted cash. Our unrestricted cash was $3.0 million and $12.9 million as of June 30, 2023 and December 31, 2022, respectively.

Our restricted cash and cash equivalents were $1.1 million and $6.4 million as of June 30, 2023 and December 31, 2022, respectively. Our restricted cash primarily consists of time deposits, and is used as security for certain of our debt instruments and to secure standby letters of credit with certain of our landlords.

As of June 30, 2023, our 2021 Revolving Loan and 2022 Short Term Note of $6.0 million and $2.9 million are due in December 2023 and January 2024, respectively. We intend to renegotiate with the lender to extend the maturity date of the 2021 Revolving Loan. However, there is no guarantee that we will be able to renegotiate the terms of the 2021 Revolving Loan with the lender at terms acceptable to us or at all. Additionally, we plan to repay the outstanding amounts under the 2022 Short Term Note pursuant to the terms of the 2022 Short Term Note agreement and to secure an additional debt arrangement. Currently, we expect that we will not be in compliance with its quarterly debt covenant for the three months ending September 30, 2023. We are working with the lender to resolve the expected non-compliance with the debt covenant.

We may need to raise additional capital. The need for additional capital depends on many factors, including, among other things, whether we can successfully renegotiate the terms of our debt arrangements, the rate at which our business grows, demands for working capital, revenue generated from existing DLCs and game titles and launches of new DLCs and new game titles, and any acquisitions that we may pursue. From time to time, we could be required, or may otherwise attempt, to seek additional sources of capital, including, but not limited to, equity and/or debt financings. We cannot provide assurance that we will be able to successfully access any such equity or debt financings, that the required equity or debt financings would be available on terms acceptable to us, if at all, or that any such financings would not be dilutive to our stockholders.

Our recent net loss, level of cash used in operations, debt obligations coming due in less than 12 months, potential need for additional capital, and the uncertainties surrounding our ability to raise additional capital and renegotiate our debt arrangements raise substantial doubt about our ability to continue as a going concern. The unaudited condensed consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

In order for us to continue operations beyond the next 12 months and be able to discharge our liabilities and commitments in the normal course of business, we must re-establish profitable operations in order to generate cash from operations by increasing revenue or controlling or potentially reducing expenses, renegotiate the terms of its debt arrangements, or obtain additional funds when needed. Our current goal is to improve our financial condition and ultimately improve our financial results by increasing revenues through increased sales of existing DLCs and game titles, launches of new DLCs and game titles and reduced expenses.

Cash flows

The following tables present a summary of our cash flows for the periods indicated (in millions):

	Six months ended June 30,			
	2023	**2022**	**$ Change**	**% Change**
		(in millions)		
Net cash flows (used in) provided by operating activities	$ (8.9)	$ 3.4	$ (12.3)	(357.8)%
Net cash flows provided by investing activities	—	1.5	(1.5)	(100.0)%
Net cash flows used in financing activities	(6.3)	(0.4)	(5.9)	(1,634.3)%
Net (decrease) increase in cash and cash equivalents and restricted cash and cash equivalents	$ (15.2)	$ 4.5	$ (19.7)	(432.4)%

Operating activities

Net cash flows provided by operating activities for the six months ended June 30, 2023 decreased $12.3 million as compared to the six months ended June 30, 2022, which resulted primarily from a period-over-period decrease in net income of $11.9 million and a decrease of $3.6 million in non-cash reconciling items, a decrease in accounts payable and accounts payable – related party of a $2.1 million, a $0.8 million decrease in net accounts receivable and accounts receivable - related party, offset by a $2.3 million increase in deferred revenues, an increase of $0.9 million in accrued expenses and an increase in prepaid expenses – related party and prepaid expenses and other current assets of $3.1 million.

Net loss was $7.1 million for the six months ended June 30, 2023 as compared to a net income of $4.8 million for the six months ended June 30, 2022, representing a decrease of $11.9 million. The decrease was primarily due to a decrease in revenue of $20.1 million, an increase in research and development expense of $2.2 million, a net decrease in interest income – related party of $0.5 million, an increase in interest expense of $0.2 million, an increase of $0.5 million in internet server and data center costs; offset by a decrease in royalties of $4.5 million, a decrease in license cost and license right amortization of $2.8 million, a decrease in merchant and engine fees of $1.0 million, a decrease in general and administrative expenses of $0.5 million and a decrease in the Company’s tax provision of $3.1 million.

Non-cash reconciling items were ($0.2) million and $3.4 million for the six months ended June 30, 2023 and 2022, respectively, representing a decrease of $3.6 million. The decrease in the non-cash reconciling items was primarily due to a decrease of $2.9 million in amortization, a increase in deferred taxes of $1.9 million, partially offset by decrease in the interest income from shareholder loan of $0.6 million and an increase in stock based compensation of $0.4 million.

The increase in our net operating assets and liabilities between the six months ended June 30, 2023 and 2022 of $3.2 million was primarily the result of a net increase in prepaid expenses — related party and prepaid expenses and other current assets of $3.1 million primarily driven by timing of payments of federal and state taxes, the withholding tax refund receivable and DLC development costs and an increase in accrued expenses of $0.8 million due to timing of payments increasing in 2023 and a higher amount of accrued payroll due to the timing of the Company's pay period, an increase in deferred revenue of $2.3 million, partially offset by a decrease in accounts payable and accounts payable — related party of $2.1 million resulting from decreased vendor accruals near the end of the period, net decrease in accounts receivable and accounts receivable — related party of $0.8 million due to timing of receipts and payments from customers and a related party.

Our accounts receivable — related party represent revenues attributable to certain mobile games that, for administrative reasons, were collected on our behalf by SDE Inc. ("SDE"), an affiliated entity. SDE no longer collects such payments on our behalf; all such payments are received directly from the platforms through which we offer the relevant games. As of June 30, 2023 and December 31, 2022, the net outstanding balances of receivables due from SDE were $11.7 million. We expect accounts receivables owed to us by SDE will be repaid within a commercially reasonable period of time. In the event we do not receive timely remittance from SDE, we may hold back amounts owed to SDE from future licensing costs payable to SDE pursuant to our existing contractual relationship. See Note 5 — *Accounts Receivable — Related Party* to our condensed consolidated financial statements included in this Quarterly Report.

Investing activities

Cash provided by investing activities for the six months ended June 30, 2023 decreased $1.5 million compared to the six months ended June 30, 2022 due to receipt by the Company of $1.5 million on the Pound Sand note in 2022.

Financing activities

Net cash flows used in financing activities for the six months ended June 30, 2023 were $6.3 million compared to net cash flows used in financing activities of $0.4 million for the six months ended June 30, 2022. Financing activities for the six months ended June 30, 2023 included repayments of $2.9 million on a short term note, repayment of $3.0 million on the revolving loan, and purchases of treasury stock in the amount of $0.3 million. Financing activities for the six months ended June 30, 2022 included $10.0 million of borrowings under our term loan, which was offset by repayments on our short term note in the amount of $2.1 million and a cash dividend declared and paid of $8.2 million.

Registered Offering

In September 2022, we filed a Form S-1 Registration Statement with the United States Securities and Exchange Commission in connection with our IPO. As of the effective date of the Registration Statement, we became the parent company of Snail Games USA and a holding company, with our principal asset consisting of all the shares of common stock of Snail Games USA.

In the IPO, we issued 3,000,000 shares of our Class A common stock and net proceeds from the issuance were distributed to Snail Games USA in November 2022 in the amount of $12.0 million. In connection with the IPO, $1.0 million of the net proceeds were remitted to an escrow account which is held to provide a source of funding for our indemnification obligations to the underwriters. The amount in escrow will be reported as a restricted escrow deposit for 12 months from the date of the IPO, at which time the restrictions will be removed and the balance will be reverted to unrestricted cash.

Capital resources

We primarily fund our operations from our net cash flows provided by operating activities. In addition to these cash flows, we have entered into certain debt arrangements to provide additional liquidity and to finance our operations.

Revolving Loan

In December 2018, we entered into a revolving loan and security agreement with a financial institution for a revolving note in the amount of $5.5 million. On June 17, 2021, we amended and restated our revolving loan and security agreement (the “2021 Revolving Loan”) to increase our revolving line of credit to $9.0 million. As amended, the 2021 Revolving Loan matures on December 31, 2023 and bears interest at a rate equal to the prime rate less 0.25%. Interest is due and payable under the 2021 Revolving Loan on a monthly basis. The 2021 Revolving Loan was partially secured by the certificate of deposit accounts held with the financial institution, and reported as restricted cash, in the amounts of $5.3 million as of December 31, 2022. In June 2023 the Company amended its revolving loan and the certificate of deposit accounts securing the loan were released. As of June 30, 2023, we had borrowings of $6.0 million outstanding under our 2021 Revolving Loan. We intend to extend the 2021 Revolving Loan prior to its maturity date. There is no guarantee that we will be able to extend the 2021 Revolving Loan on terms acceptable to us in the future, or at all.

Term Loan

In June 2021, we entered into a loan agreement with a financial institution providing for a term loan in an aggregate principal amount of $3.0 million (the “Term Loan”). The Term Loan, which was originally set to mature in June 2031, bears interest at a fixed rate of 3.5% for the first five years and then at a floating rate of the Wall Street Journal prime rate until maturity. The Term Loan is secured by our principal headquarters. The Term Loan replaced and refinanced a previously outstanding $3.0 million promissory note due September 2021.

In January 2022, we amended and restated our 2021 Revolving Loan and we executed a promissory note to obtain an additional long-term loan with a principal balance of $10.0 million which was set to mature on January 26, 2023 (the “2022 Short Term Note”). In November 2022, the maturity date was extended to January 26, 2024. Interest is equal to the higher of 5.75% and the Wall Street Journal prime rate plus 0.50%. The 2022 Short Term Note is secured and collateralized by our existing assets.

As of June 30, 2023, we had borrowings of $2.9 million outstanding under the 2022 Short Term Note.

Financial covenants

The 2021 Revolving Loan, Term Loan and the 2022 Short Term Note require us to maintain a minimum debt service coverage ratio of 1.5 to 1.0. The debt service coverage ratio was temporarily removed from the 2021 revolving loan and short term note debt covenants for the rolling twelve month period ended June 30, 2023. We were in compliance with, or had waivers for, all covenants under our debt facilities as of June 30, 2023.

For additional information regarding our indebtedness, see Note 15 — *Revolving Loan, Short Term Note and Long-Term Debt* to our unaudited condensed consolidated financial statements included in this Quarterly Report.

Critical Accounting Policies and Estimates

Our discussion and analysis of results of operations, financial condition, and liquidity are based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and judgements that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We based our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may materially differ from these estimates under different assumptions or conditions. On an on-going basis, we review our estimates to ensure that they appropriately reflect changes in our business or new information as it becomes available. For additional information on our significant accounting policies, please refer to Note 2 — *Summary of Significant Accounting Policies* to our unaudited condensed consolidated financial statements included in this Quarterly Report. We believe that the following critical accounting policies and estimates have the greatest potential impact on our unaudited condensed consolidated financial statements.

Intangible Assets

The Company’s publishing and development business requires significant investments in intangible assets such as licensing rights. The carrying values of these intangibles are periodically reviewed and adjusted, as appropriate, based on estimates of their useful lives, futures cash flows and fair values. Estimates of futures cash flows may vary from period to period depending on market factors such as media and gaming trends and current sales trends. If these estimates result in a reduction in cash flows the Company may recognize an impairment loss on the intangible asset. The Company did not have any material changes in these estimates during the six months ended June 30, 2023 but believe it is reasonably possible that changes may occur in future periods.

Deferred Revenue

The Company recognizes, defers, and classifies the timing of deferred revenues from the sale of its products based on the release date, technical support obligations and timing of its performance obligations. The technical support obligations are estimated based on our estimated service period, as determined below. These estimates will vary by platform and could change from period to period depending on user trends. An increase in use estimate could result in a reclassification of deferred revenues from short term to long term and extend the period over which we would recognize said revenue resulting in a lower net income in future periods. Changes in estimates of our release schedule may also affect the classification of short and long term deferred revenues and the rate at which deferred revenue is recognized, which could have a material impact on the Company's condensed consolidated financial statements.

Estimated Service Period

We consider a variety of data points when determining and subsequently reassessing the estimated service period for players of our software products. Primarily, we review the weighted average number of days between players' first and last days played online. When a new game is launched and no history of online player data is available, we consider other factors to determine the user life, such as the estimated service period of other games actively being sold with similar characteristics. We also consider known online trends, the service periods of our previously released software products, and, to the extent publicly available, the service periods of our competitors' software products that are similar in nature to ours.

We believe this provides a reasonable depiction of the use of games by our customers, as it is the best representation of the period during which our customers play our software products. Determining the estimated service period is subjective and requires significant management judgment and estimates. Future usage patterns may differ from historical usage patterns, and therefore the estimated service period may change in the future. The estimated service periods for virtual goods are generally approximately 30 to 100 days.

Deferred Income Taxes

The Company recognizes deferred income taxes based on estimates of future taxable income and the utilization of tax loss carryforwards. Changes in tax laws or the level of future taxable income could affect the realizability of deferred income tax assets. The Company's deferred income tax assets reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company's estimates of deferred income taxes are based on its assessment of the likelihood of realizing the benefits of the tax assets and are reviewed annually. Changes in these estimates may have a material impact on the Company's unaudited condensed consolidated financial statements.

Recently Issued Accounting Pronouncements

For a description of recently issued and adopted accounting pronouncements, including the respective dates of adoption and expected effects on our results of operations and financial condition, please see Note 2 - *Summary of Significant Accounting Policies* to our unaudited condensed consolidated financial statements included in this Quarterly Report.

Emerging Growth Company and Smaller Reporting Company Status

We are an "emerging growth company," as defined in the JOBS Act. As such, we are eligible for exemptions from various reporting requirements applicable to other public companies that are not emerging growth companies, including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation, and an exemption from the requirements to obtain a non-binding advisory vote on executive compensation or golden parachute arrangements. We have elected to take advantage of certain of the reduced disclosure obligations and may elect to take advantage of other reduced reporting requirements in our future filings with the SEC. As a result, the information that we provide to our stockholders may be different than you might receive from other public reporting companies in which you hold equity interests.

In addition, an emerging growth company can take advantage of an extended transition period for complying with new or revised accounting standards. This provision allows an emerging growth company to delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to avail ourselves of this provision of the JOBS Act. As a result, we will not be subject to new or revised accounting standards at the same time as other public companies that are not emerging growth companies. Therefore, our condensed consolidated financial statements may not be comparable to those of companies that comply with new or revised accounting pronouncements as of public company effective dates.

We will remain an emerging growth company until the earliest of: (a)(i) the last day of the fiscal year following the fifth anniversary of the closing of our initial public offering; (ii) the last day of the fiscal year in which we have total annual gross revenue of at least $1.235 billion; or (iii) the last day of the fiscal year in which we are deemed to be a "large accelerated filer" as defined in Rule 12b-2 under the Exchange Act, which would occur if the market value of our common stock held by non-affiliates exceeded $700.0 million as of the last business day of the second fiscal quarter of such year and (b) the date on which we have issued more than $1.0 billion in non-convertible debt securities during the prior three-year period.

We are also a "smaller reporting company" as defined in the Exchange Act. We may continue to be a smaller reporting company even after we are no longer an emerging growth company. We may take advantage of certain of the scaled disclosures available to smaller reporting companies and will be able to take advantage of these scaled disclosures for so long as our voting and non-voting common stock held by non-affiliates is less than $250.0 million measured on the last business day of our second fiscal quarter, or our annual revenue is less than $100.0 million during the most recently completed fiscal year and our voting and non-voting common stock held by non-affiliates is less than $700.0 million measured on the last business day of our second fiscal quarter.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a "smaller reporting company" as defined by Item 10 of Regulation S-K, the Company is not required to provide the information required by this item.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Rule 13a-15 € under the Exchange Act) that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of June 30, 2023. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual and interim financial statements will not be prevented or detected in a timely manner. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of such date due to a material weakness in the internal control over financial reporting involving failure to properly design and implement controls related to the accounting for income taxes and equity, failure to design and implement sufficient disclosure controls related to certain items in the statement of cash flows, and failure to properly classify certain operating expenses and game server costs as cost of revenues in the consolidated financial statements and deferred taxes in the consolidated footnotes. We intend to enhance our financial reporting close control procedures and hire additional personnel with a depth of knowledge and experience to join our accounting and finance organization in order to remediate this material weakness. During the process for preparing the unaudited condensed consolidated financial statements for the six months ended June 30, 2023, we identified a previously undisclosed related party transaction involving an affiliate of Mr. Hai Shi, our Founder, Chairman, and Chief Strategy Officer. The previously undisclosed related party transaction was a commercial real property lease that was executed by Snail Games USA Inc., our principal operating subsidiary, but was utilized and paid for by an affiliated entity controlled by Mr. Shi. We evaluated the impact of including the previously unreported right of use asset and lease liability related to this lease on our historical consolidated financial statements and concluded it did not have a material impact on our previously filed financial statements. Accordingly, we corrected the reporting in the unaudited condensed consolidated financial statements for the six months ended June 30, 2023. However, the lack of effective control over the identification of related party transactions gives rise to a material weakness in our internal control over financial reporting. We plan to remediate this internal control weakness by inquiring of all executive management and board of directors of any contracts entered into on behalf of the Company, or its subsidiaries, on a quarterly basis. Further, the Company intends to review any unusual and recurring significant payments for related contracts. See Part II Item 1A "Risk Factors — General Risk Factors — We identified material weaknesses in our internal control over financial reporting and we may identify additional material weaknesses in the future that may cause us to fail to meet our reporting obligations or result in material misstatements of our financial statements. If we do not effectively remediate the material weaknesses or if we otherwise fail to maintain effective internal control over financial reporting, we may not be able to accurately and timely report our financial results."

In light of the material weakness, we performed additional analyses and reconciliations to determine that our unaudited condensed consolidated financial statements are prepared in accordance with U.S. GAAP. Accordingly, the Chief Executive Officer and Chief Financial Officer concluded that the unaudited condensed consolidated financial statements included in this Quarterly Report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the three months ended June 30, 2023, which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II OTHER INFORMATION

Item 1. Legal Proceedings

See Item 1 of Part I, “Unaudited Condensed Consolidated Financial Statements — Note 18 *Commitments and Contingencies — Litigation.”*

Item 1A. Risk Factors.

A description of the risks and uncertainties associated with our business is set forth below. You should carefully consider the risks and uncertainties described below, as well as the other information in this Quarterly Report, including our unaudited condensed consolidated financial statements and the related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” The occurrence of any of the events or developments described below, or of additional risks and uncertainties not presently known to us or that we currently deem immaterial, could materially and adversely affect our business, results of operations, financial condition and growth prospects. In such an event, the market price of our common stock could decline, and you could lose all or part of your investment.

Risk Factors Summary

Our business is subject to numerous risks and uncertainties, including those highlighted in this section titled Item 1A. “Risk Factors,” that represent challenges that we face in connection with the successful implementation of our strategy and growth of our business. The occurrence of one or more of the events or circumstances described in this section titled Item 1A. “Risk Factors,” alone or in combination with other events or circumstances, may have an adverse effect on our business, cash flows, financial condition and results of operations. Such risks include, but are not limited to, the following:

- Due to our recent net loss, negative cash flow from operations, and significant revolving and term debt coming due in less than 12 months, there is substantial doubt about our ability to continue as a going concern.

- We are dependent on the future success of our *ARK* franchise, and we must continue to publish “hit” titles or sequels to such “hit” titles in order to compete successfully in our industry.

- If we do not consistently deliver popular, high-quality content in a timely manner, if we are not successful in meaningfully expanding our existing franchise, or if consumers prefer products from our competitors, our business may be negatively impacted.

- We rely on license agreements to publish certain games, including games in our *ARK* franchise. Failure to renew our existing content licenses on favorable terms or at all or to obtain additional licenses would impair our ability to introduce new games, improvements or enhancements or to continue to offer our current games, which would materially harm our business, results of operations, financial condition and prospects.

- We depend on our key management and product development personnel.

- Our management team has limited experience managing a public company.

- Our business is subject to the risks of earthquakes, fire, floods, public health crises and other natural catastrophes and to interruption by man-made problems such as power disruptions, computer viruses, data security breaches or other incidents or terrorism.

- Our industry is subject to rapid technological change, and if we do not adapt to, and appropriately allocate our resources among, emerging technologies and business models, our business may be negatively impacted.

- We rely on third-party platforms, such as Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, the Apple App Store, the Google Play Store, My Nintendo Store and the Amazon Appstore, to distribute our games and collect revenues generated on such platforms and rely on third-party payment service providers to collect revenues generated on our own platforms.

- We depend on servers and networks to operate our games with online features. If we were to lose functionality in any of these areas for any reason, our business may be negatively impacted.

- We may be unable to effectively manage the continued growth and the scope and complexity of our business, including our expansion into new business models that are untested and into adjacent business opportunities with large, established competitors.

- The interactive entertainment software industry is highly competitive.

- We are subject to product development risks, which could result in delays and additional costs, and often times we must adapt to changes in software technologies.

- Our business is subject to our ability to develop commercially successful products for the current video game platforms, which may not generate immediate or near-term revenues, and as a result, our business and operating results may be more volatile and difficult to predict during console transitions than during other times.

- Our results of operations or reputation may be harmed as a result of objectionable consumer- or other third party-created content, or if our distributors, retailers, development, and licensing partners, or other third parties with whom we are affiliated, act in ways that put our brand at risk.

- The Company has debt obligations with short term durations that are coming due within one year.

- The products or services we release may contain defects, bugs or errors.

- External game developers may not meet product development schedules or otherwise fulfill their contractual obligations.

- Any cybersecurity-related attack, significant data breach, or disruption of the information technology systems or networks on which we rely could negatively impact our business.

- Our operating results may fluctuate from quarter to quarter, which makes our future results difficult to predict.

- If we are unable to protect the intellectual property relating to our material software, the commercial value of our products will be adversely affected, and our competitive position could be harmed.

- We are a “controlled company” under the corporate governance rules of Nasdaq and, as a result, qualify for and rely on exemptions from certain corporate governance requirements. Since we elected to rely on the exemptions available to a “controlled company,” you do not have the same protections afforded to stockholders of companies that are subject to such corporate governance requirements.

- Mr. Shi, our Founder, Chief Strategy Officer and Chairman, controls us, and his ownership of our common stock prevents you and other stockholders from influencing significant decisions.

- We cannot guarantee that our Share Repurchase Program will be fully implemented, nor that it will enhance stockholder value, and share repurchases could affect the price of our Class A common stock.

- The realization of the Company’s deferred tax assets is contingent upon the Company’s upcoming new game releases to generate sufficient taxable income through the end of the year.

Risks Related to Our Business and Industry

Due to our recent net loss, negative cash flow from operations, and significant revolving and term debt coming due in less than 12 months, there is substantial doubt about our ability to continue as a going concern.

For the six months ended June 30, 2023, we incurred a net loss of $7.1 million and had a negative cash flow from operations of $8.9 million. Our 2021 Revolving Loan and 2022 Short Term Note of $6.0 million and $2.9 million are due in December 2023 and January 2024, respectively. We intend to renegotiate with the lender to extend the maturity date of the 2021 Revolving Loan. However, there is no guarantee that we will be able to renegotiate the terms of the 2021 Revolving Loan with the lender at terms acceptable to us or at all. Additionally, we plan to repay the outstanding amounts under the 2022 Short Term Note pursuant to the terms of the 2022 Short Term Note agreement and to secure an additional debt arrangement.

We may need to raise additional capital. The need for additional capital depends on many factors, including, among other things, whether we can successfully renegotiate the terms of our debt arrangements, the rate at which our business grows, demands for working capital, revenue generated from existing DLCs and game titles and launches of new DLCs and new game titles, and any acquisitions that we may pursue. From time to time, we could be required, or may otherwise attempt, to seek additional sources of capital, including, but not limited to, equity and/or debt financings. We cannot provide assurance that we will be able to successfully access any such equity or debt financings, that the required equity or debt financings would be available on terms acceptable to us, if at all, or that any such financings would not be dilutive to our stockholders.

Our recent net loss, level of cash used in operations, debt obligations coming due in less than 12 months, potential need for additional capital, and the uncertainties surrounding our ability to raise additional capital and renegotiate our debt arrangements raise substantial doubt about our ability to continue as a going concern. For us to continue operations beyond the next 12 months and be able to discharge our liabilities and commitments in the normal course of business, we must re-establish profitable operations, renegotiate the terms of our debt arrangements or raise additional capital when needed. Our current goal is to improve our financial condition and ultimately improve our financial results by increasing revenues through increased sales of existing DLCs and game titles, launches of new DLCs and game titles and reduced expenses. However, if we are unable to do so on a timely basis, we will be required to seek additional sources of capital, including, but not limited to, equity and/or debt financings. There is no guarantee that we will be able to obtain additional capital on terms acceptable to us, if at all. If we are unable to renegotiate the terms of our debt arrangements, raise additional capital or re-establish profitable operations, we will be unable to continue to fund our operations, develop new gaming content, realize value from our assets or discharge our liabilities in the normal course of business. If we are unable to continue as a going concern, we could be required to liquidate our assets, and potentially realize significantly less than the values at which our assets are carried on our unaudited condensed consolidated financial statements, and our stockholders could lose all or part of their investment in our common stock.

Our unaudited condensed consolidated financial statements for the six months ended June 30, 2023 were prepared on a going concern basis in accordance with GAAP. The going concern basis assumes that we will continue in operation for the next 12 months and will be able to realize our assets and discharge our liabilities and commitments in the normal course of business. Thus, our unaudited condensed consolidated financial statements included in this Quarterly Report do not include any adjustments that might be necessary if we are unable to continue as a going concern.

We are dependent on the future success of our ARK franchise, and we must continue to publish "hit" titles or sequels to such "hit" titles in order to compete successfully in our industry.

ARK is a "hit" product and has historically accounted for a substantial portion of our revenue. The *ARK* franchise contributed 87.1% of our net revenue for the six months ended June 30, 2023, and our five best-selling franchises (including *ARK*), which may change year over year, in the aggregate accounted for 92.4% of our net revenue for the six months ended June 30, 2023. If we fail to continue to develop and sell new commercially successful "hit" titles or sequels to such "hit" titles or experience any delays in product releases or disruptions following the commercial release of our "hit" titles or their sequels, our revenue and profits may decrease substantially, and we may incur losses. In addition, competition in our industry is intense and a relatively small number of hit titles account for a large portion of total revenue in our industry. Hit products offered by our competitors may take a larger share of consumer spending than we anticipate, which could cause revenue generated from our products to fall below our expectations. If our competitors develop more successful products or services at lower price points or based on payment models perceived as offering better value, or if we do not continue to develop consistently high-quality and well-received products and services, our revenue and profitability may decline.

If we do not consistently deliver popular, high-quality content in a timely manner, if we are not successful in meaningfully expanding our existing franchise, or if consumers prefer products from our competitors, our business may be negatively impacted.

Consumer preferences for games are usually cyclical and difficult to predict. Even the most successful games can lose consumer audiences over time, and remaining popular is increasingly dependent on the games being refreshed with new content or other enhancements. In order to remain competitive and maximize the chances that consumers select our products as opposed to the various entertainment options available to them and with which we compete, we must continuously develop new products or new content for, or other enhancements to, our existing products. These products or enhancements may not be well-received by consumers, even if well-reviewed and of high quality. Our competitors include very large corporations with significantly greater financial, marketing and product development resources than we have and many smaller competitors, particularly on the mobile platform. Our larger competitors may be able to leverage their greater financial, technical, personnel and other resources to provide larger budgets for development and marketing and make higher offers to licensors and developers for commercially desirable properties, as well as adopt more aggressive pricing policies to develop more commercially successful video game products than we do. Further, competitors may develop content that imitates or competes with our best-selling games, potentially reducing our sales or our ability to charge the same prices we have historically charged for our products. These competing products may take a larger share of consumer spending than anticipated, which could cause product sales to fall below expectations. If we do not continue to develop consistently high-quality and well-received games or enhancements to those games, if our marketing fails to resonate with our consumers, if we are not successful in meaningfully expanding our franchises further on the mobile platform or if consumers lose interest in a genre of games we produce, our revenues and profit margins could decline. In addition, our own best-selling products could compete with our other games, reducing sales for those other games. Further, a failure by us to develop a high-quality product, or our development of a product that is otherwise not well-received, could potentially result in additional expenditures to respond to consumer demands, harm our reputation, and increase the likelihood that our future products will not be well-received. The increased importance of DLC to our business amplifies these risks, as DLC for poorly-received games typically generates lower-than-expected sales. The increased demand for consistent enhancements to our products also requires a greater allocation of financial resources to those products.

Additionally, consumer expectations regarding the quality, performance and integrity of our products and services are high. Consumers may be critical of our brands, games, services and/or business practices for a wide variety of reasons, and such negative reactions may not be foreseeable or within our control to manage effectively. For example, if our games or services, such as our proprietary online gaming service, do not function as consumers expect, whether because they fail to function as advertised or otherwise, our sales may suffer. The risk that this may occur is particularly pronounced with respect to our games with online features because they involve ongoing consumer expectations, which we may not be able to consistently satisfy. Our games with online features are also frequently updated, increasing the risk that a game may contain significant errors, or “bugs.” If any of these issues occur, consumers may stop playing the game and may be less likely to return to the game as often in the future, which may negatively impact our business.

Further, delays in product releases or disruptions following the commercial release of one or more new products could negatively impact our business and reputation and could cause our results of operations to be materially different from expectations. If we fail to release our products in a timely manner, or if we are unable to continue to extend the life of existing games by adding features and functionality that will encourage continued engagement with the game, our business may be negatively impacted.

Additionally, the amount of lead time and cost involved in the development of high-quality products is increasing, and the longer the lead time involved in developing a product and the greater the allocation of financial resources to such product, the more critical it is that we accurately predict consumer demand for such product. If our future products do not achieve expected consumer acceptance or generate sufficient revenues upon introduction, we may not be able to recover the substantial up-front development and marketing costs associated with those products.

We rely on license agreements to publish certain games, including games in our* **ARK** *franchise. Failure to renew our existing content licenses on favorable terms or at all or to obtain additional licenses would impair our ability to introduce new games, improvements or enhancements or to continue to offer our current games, which would materially harm our business, results of operations, financial condition and prospects.

We license certain intellectual property rights from third parties, including related parties, and in the future, we may enter into additional agreements that provide us with licenses to valuable intellectual property rights or technology. In particular, we license intellectual property rights related to our *ARK* franchise from SDE, the parent company of Studio Wildcard, which is also an entity that is owned and controlled by the spouse of our Founder, Chief Strategy Officer and Chairman, Mr. Shi. We entered into an original exclusive software license agreement with SDE in November 2015, for the rights to *ARK: Survival Evolved*, and subsequently entered into the amended and restated ARK1 License Agreement. In December 2022, we amended the ARK1 License Agreement. The terms of our license agreements with SDE may differ from those terms which would be negotiated with independent parties. In addition, we may have disputes with SDE that may impact our business, results of operations, financial condition and/or prospects. The *ARK* franchise contributed 87.1% of our net revenue for the six months ended June 30, 2023. Even if our games that are dependent on third-party license agreements remain popular, any of our licensors could decide not to renew our existing license agreements or not to license additional intellectual property rights to us and instead license to our competitors or develop and publish its own games or other applications, competing with us in the marketplace. Moreover, many of our licensors develop games for other platforms and may have significant experience and development resources available to them should they decide to compete with us rather than license to us. For additional information concerning our license arrangements, including licensing agreements with affiliated third parties, see Item 1 of Part I, “Business — Intellectual Property,” included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2022.

Failure to maintain or renew our existing material licenses or to obtain additional licenses could impair our ability to introduce new games and new content or to continue to offer our current games, which could materially harm our business, results of operations and financial condition. If we breach our obligations under existing or future licenses, we may be required to pay damages and our licensors may have the right to terminate the license or change an exclusive license to a non-exclusive license. Termination of our license agreements by a material licensor, such as SDE, would cause us to lose valuable rights, such as the rights to our *ARK* franchise, and would inhibit our ability to commercialize future games, which would harm our business, results of operations and financial condition. In addition, certain intellectual property rights may be licensed to us on a non-exclusive basis. The owners of nonexclusively licensed intellectual property rights would be free to license such rights to third parties, including our competitors, on terms that may be superior to those offered to us, which could place us at a competitive disadvantage. Moreover, our licensors may own or control intellectual property rights that have not been licensed to us and, as a result, we may be subject to claims, regardless of their merit, that we are infringing or otherwise violating the licensor's rights. In addition, the agreements under which we license intellectual property rights or technology from third parties and related parties are generally complex, and certain provisions in such agreements may be susceptible to multiple interpretations. The resolution of any contract interpretation disagreement that may arise could narrow what we believe to be the scope of our rights to the relevant intellectual property or technology or increase what we believe to be our financial or other obligations under the relevant agreement. Any of the foregoing could harm our competitive position, business, financial condition, results of operations and prospects.

We depend on our key management and product development personnel.

Our continued success will depend to a significant extent on our senior management team and maintaining positive relationships with our games' developers, including Studio Wildcard, and the product development personnel responsible for content creation and development of our *ARK* franchise. We are also highly dependent on the expertise, skill and knowledge of Mr. Shi, our Founder, Chief Strategy Officer and Chairman, Mr. Jim Tsai, our Chief Executive Officer, and Mr. Peter Kang, our Chief Operating Officer.

The loss of the services of our executive officers, including Messrs. Shi, Tsai or Kang or certain key product development personnel, including those employed by studio partners, such as Studio Wildcard, could significantly harm our business. In addition, if one or more key employees were to join a competitor or form a competing company, we may lose additional personnel, experience material interruptions in product development, delays in bringing products to market and difficulties in our relationships with licensors, suppliers and customers, which would significantly harm our business. Failure to continue to attract and retain qualified management and creative personnel could adversely affect our business and prospects.

Our management team has limited experience managing a public company.

Most members of our management team have limited experience managing a publicly traded company, interacting with public company investors and regulators and complying with the increasingly complex laws pertaining to public companies. Our management team may not successfully or efficiently manage our transition to being a public company subject to significant regulatory oversight and reporting obligations under the federal securities laws and the continuous scrutiny of securities analysts and investors. These new obligations and constituents will require significant attention from our senior management and could divert their attention away from the day-to-day management of our business, which could adversely impact our business, operating results and financial condition.

Our business is subject to the risks of earthquakes, fire, floods, public health crises and other natural catastrophes and to interruption by man-made problems such as power disruptions, computer viruses, data security breaches or other incidents, war or terrorism.

Our corporate headquarters is located in Culver City, California. Additionally, we rely on third-party infrastructure, enterprise applications and internal technology systems for our development, marketing, operational support and sales activities. The West Coast of the United States, where our corporate headquarters are located, contains active earthquake zones and has been subject to numerous devastating wildfires and associated electrical blackouts. In the event of a catastrophic event, including a natural disaster such as an earthquake, hurricane, fire, flood, tsunami or tornado, or other catastrophic event such as power loss, telecommunications failure, software or hardware malfunction, cyber-attack, war, terrorist attack or incident of mass violence in the Los Angeles area or elsewhere where our operations are located or where certain other systems and applications that we rely on are hosted, we may be unable to continue our operations and may endure significant system interruptions, reputational harm, delays in our application development, lengthy interruptions in our platform, breaches of data security and loss of critical data, all of which could have an adverse effect on our future operating results. In addition, natural disasters, cyber-attacks, escalation of geopolitical tensions, including as a result of escalations in the ongoing conflict between Russia and Ukraine, acts of terrorism, public health crises, such as pandemics and epidemics, or other catastrophic events could cause disruptions in our or our customers' businesses, national economies or the world economy as a whole.

Our industry is subject to rapid technological change, and if we do not adapt to, and appropriately allocate our resources among, emerging technologies and business models, our business may be negatively impacted.

Technology changes rapidly in the interactive entertainment industry. We must continually anticipate and adapt to emerging technologies, such as cloud-based game streaming, and business models, such as free-to-play and subscription-based access to a portfolio of interactive content, to stay competitive. Forecasting the financial impact of these rapidly changing technologies and business models is inherently uncertain and volatile. Supporting a new technology or business model may require partnering with a new platform, business, or technology partner, which may be on terms that are less favorable to us than those for more traditional technologies or business models. If we invest in the development of interactive entertainment products for distribution channels that incorporate a new technology or business model that does not achieve significant commercial success, whether because of competition or otherwise, we may not recover the often substantial up-front costs of developing and marketing those products, or recover the opportunity cost of diverting management and financial resources away from other products or opportunities. Further, our competitors may adapt to an emerging technology or business model more quickly or effectively than we do, creating products that are technologically superior to ours, more appealing to consumers, or both.

If, on the other hand, we elect not to pursue the development of products incorporating a new technology, or otherwise elect not to pursue new business models that achieve significant commercial success, it may have adverse consequences. It may take significant time and expenditures to shift product development resources to that technology or business model, and it may be more difficult to compete against existing products incorporating that technology or using that business model.

We rely on third-party platforms, such as Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, the Apple App Store, the Google Play Store, My Nintendo Store and the Amazon Appstore, to distribute our games and collect revenues generated on such platforms and rely on third-party payment service providers to collect revenues generated on our own platforms.

Our games are primarily purchased, accessed and operated through Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, and in the case of our mobile games, the Apple App Store, the Google Play Store and the Amazon Appstore. Substantially all of the games, DLC and in-game virtual items that we sell are purchased using the payment processing systems of these platforms and, for the six months ended June 30, 2023, 87.3% of our revenues were generated through Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, the Apple App Store, the Google Play Store, My Nintendo Store and the Amazon Appstore. Consequently, our expansion and prospects depend on our continued relationships with these providers, and any other emerging platform providers that are widely adopted by our target players. In addition, having such a large portion of our total net revenues concentrated in a few counterparties reduces our negotiating leverage. We are subject to the standard terms and conditions that these platform providers have for game developers, which govern the content, promotion, distribution, operation of games and other applications on their platforms, as well as the terms of the payment processing services provided by the platforms, and which the platform providers can change unilaterally on short notice or without notice. As such, our business would be harmed if:

- the platform providers discontinue or limit our access to their platforms;
- governments or private parties, such as internet providers, impose bandwidth restrictions, increase charges or restrict or prohibit access to those platforms;
- the platforms increase the fees they charge us;
- the platforms modify their algorithms, communication channels available to developers, respective terms of service or other policies;
- the platforms decline in popularity;
- the platforms adopt changes or updates to their technology that impede integration with other software systems or otherwise require us to modify our technology or update our games in order to ensure players can continue to access our games and content with ease;
- the platforms elect or are required to change how they label free-to-play games or take payment for in-game purchases;
- the platforms block or limit access to the genres of games that we provide in any jurisdiction;
- the platform experiences a bankruptcy or other form of insolvency event; or
- we are unable to comply with the platform providers’ terms of service.

Moreover, if our platform providers do not perform their obligations in accordance with our platform agreements or otherwise meet our business requirements, we could be adversely impacted. For example, in the past, some of these platform providers have experienced outages for short periods of time, unexpectedly changed their terms or conditions, or experienced issues with their features that permit our players to purchase games or in-game virtual items. In addition, if we do not adhere to the terms and conditions of our platform providers, the platform providers may take actions to limit the operations of, suspend or remove our games from the platform, and/or we may be exposed to liability or litigation. For example, in August 2020, Epic Games, Inc. ("Epic Games"), attempted to bypass Apple and Google's payment systems for in-game purchases with an update that allowed users to make purchases directly through Epic Games in its game, Fortnite. Apple and Google promptly removed Fortnite from their respective app stores, and Apple filed a lawsuit seeking injunctive relief to block the use of Epic Games' payment system and sought monetary damages to recover funds made while the updated version of Fortnite was active.

If any such events described above occur on a short-term or long-term basis, or if these third-party platforms and online payment service providers otherwise experience issues that impact the ability of players to download or access our games, access social features, or make in-game purchases, it would have a material adverse effect on our brands and reputation, as well as our business, financial condition and results of operations.

We depend on servers and networks to operate our games with online features. If we were to lose functionality in any of these areas for any reason, our business may be negatively impacted.

Our business relies on the continuous operation of servers, the vast majority of which are owned and operated by third parties. Although we strive to maintain more than sufficient server capacity, and provide for active redundancy in the event of limited hardware failure, any broad-based catastrophic server malfunction, a significant service-disrupting attack or intrusion by hackers that circumvents security measures, a failure of disaster recovery service or the failure of a company on which we are relying for server capacity to provide that capacity for whatever reason would likely degrade or interrupt the functionality of our games with online features, and could prevent the operation of such games altogether, any of which could result in the loss of sales for, or in, such games. The risk is particularly pronounced with respect to our multiplayer game services, which rely on systems hosted in a hybrid of data centers across the world as well as cloud providers. Further, insufficient server capacity, in particular during times of peak player activity corresponding with the release of new games or DLC, could affect our ability to provide game services, which could negatively impact our business. Conversely, if we overestimate the amount of server capacity required by our business, we may incur additional operating costs.

We also rely on platforms and networks operated by third parties, such as Xbox Live and Game Pass, PlayStation Network, Steam, My Nintendo Store and Epic Games Store for the sale and digital delivery of downloadable console and PC game content, the functionality of our games with online features. Similarly, we rely on those platforms and networks, as well as the continued operation of the Apple App Store, the Google Play Store and the Amazon Appstore for our free-to-play games. An extended interruption to any of these services could adversely affect our ability to sell and distribute our digital products and operate our games with online features, which could result in a loss of revenue and otherwise negatively impact our business.

We may be unable to effectively manage the continued growth and the scope and complexity of our business, including our expansion into new business models that are untested and into adjacent business opportunities with large, established competitors.

In recent years, we have experienced significant growth in the scope and complexity of our business. From time to time we seek to establish and implement new business models, including eSports offerings, our *NOIZ* influencer platform and animation ventures. Forecasting the success of any new business model is inherently uncertain and depends on a number of factors both within and outside of our control. Our actual revenue and profit for these businesses may be significantly greater or less than our forecasts. In addition, these new business models could fail, resulting in the loss of our investment in the development and infrastructure needed to support these new business models, as well as the opportunity cost of diverting management and financial resources away from more successful and established businesses. While we anticipate growth in these areas of our business, consumer demand is difficult to predict as a result of a number of factors, including satisfaction with our products and services, our ability to provide engaging products and services, reliability of our infrastructure and the infrastructure of our partners, pricing, the actual or perceived security of our and our partners' information technology systems and reductions in consumer spending levels.

We do not know to what extent these and any future expansions into new business models will be successful. Further, even if successful, our aspirations for growth in our core businesses and these adjacent businesses could create significant challenges for our management, operational, and financial resources. If not managed effectively, this growth could result in the over-extension of our operating infrastructure, and our management systems, information technology systems, and internal controls and procedures may not be adequate to support this growth. Failure by these new businesses or failure to adequately manage our growth in any of these ways may damage our brand or otherwise negatively impact our core business. Further, the success of these new businesses is largely contingent on the success of our underlying franchises and as such, a decline in the popularity of a franchise may impact the success of the new businesses adjacent to that franchise.

The interactive entertainment software industry is highly competitive.

We compete for the sale of interactive entertainment software with Sony and Microsoft, each of which is a large developer and marketer of software for its own platforms. We also compete with game publishers, such as Activision Blizzard, Inc., Electronic Arts Inc., Take-Two Interactive, Ubisoft, Epic Games, Tencent, Zynga, Netmarble, Sony, Microsoft and Nintendo primarily for game development on consoles, PCs and mobile devices. Across the sandbox survival game genre, we primarily compete with Embracer Group, Saber Group, Enand Global 7, FunCom, Axolot Games and Facepunch Studios. As our business is dependent upon our ability to develop hit titles, which require increasing budgets for development and marketing, the availability of significant financial resources has become a major competitive factor in developing and marketing software games. Some of our competitors have greater financial, technical, personnel and other resources than we do and are able to finance larger budgets for development and marketing and make higher offers to licensors and developers for commercially desirable properties. Our titles also compete with other forms of entertainment, such as social media and casual games, in addition to film, television and audio and video products featuring similar themes, online computer programs and other entertainment, which may be less expensive or provide other advantages to consumers.

A number of software publishers who compete with us have developed and commercialized or are currently developing online games. As technological advances significantly increase the availability of online games and as consumer acceptance of online gaming grows substantially, it could result in a decline in our platform-based software sales and negatively affect sales of such products.

Additionally, we compete with other forms of entertainment and leisure activities. While we monitor general market conditions, significant shifts in consumer demand that could materially alter public preferences for different forms of entertainment and leisure activities are difficult to predict. Failure to adequately identify and adapt to these competitive pressures could have a negative impact on our business.

We are subject to product development risks, which could result in delays and additional costs, and often times we must adapt to changes in software technologies.

We depend on our internal development studios and related-party developers to develop new interactive entertainment software within anticipated release schedules and cost projections. Our development costs can be substantial. If we or our related-party developers experience unanticipated development delays, financial difficulties or additional costs, for example, as a result of the COVID-19 pandemic or increasing costs due to inflation, we may not be able to release titles according to our schedule and at budgeted costs. There can be no assurance that our products will be sufficiently successful so that we can recoup these costs or make a profit on these products.

Additionally, in order to stay competitive, our internal development studios must anticipate and adapt to rapid technological changes affecting software development, such as cloud-based game streaming. Any inability to respond to technological advances and implement new technologies could render our products obsolete or less marketable. Further, the failure to pursue the development of new technology, platforms, or business models that obtain meaningful commercial success in a timely manner may negatively affect our business, resulting in increased production or development costs and more strenuous competition.

Our business is subject to our ability to develop commercially successful products for the current video game platforms, which may not generate immediate or near-term revenues, and as a result, our business and operating results may be more volatile and difficult to predict during console transitions than during other times.

We derive most of our revenue from publishing video games on third-party platform providers, such as Xbox Live and Game Pass, PlayStation Network, Steam, Epic Games Store, the Apple App Store, the Google Play Store, My Nintendo Store and the Amazon Appstore, which, in the aggregate, comprised 87.3% of our net revenue by product platform for the six months ended June 30, 2023. The success of our business is subject to the continued popularity of these platforms and our ability to develop commercially successful products for these platforms.

Historically, when next generation consoles are announced or introduced into the market, consumers have typically reduced their purchases of products for prior-generation consoles in anticipation of purchasing a next-generation console and products for that console. During these periods, sales of the products we publish may decline until new platforms achieve wide consumer acceptance. Console transitions may have a comparable impact on sales of DLC, amplifying the impact on our revenues. This decline may not be offset by increased sales of products for the next-generation consoles. In addition, as console hardware moves through its life cycle, hardware manufacturers typically enact price reductions, and decreasing prices may put downward pressure on software prices. During console transitions, we may simultaneously incur costs both in continuing to develop and market new titles for prior-generation video game platforms, which may not sell at premium prices, and also in developing products for next-generation platforms, which may not generate immediate or near-term revenues. As a result, our business and operating results may be more volatile and difficult to predict during console transitions than during other times.

Our results of operations or reputation may be harmed as a result of objectionable consumer- or other third party-created content, or if our distributors, retailers, development and licensing partners, or other third parties with whom we are affiliated, act in ways that put our brand at risk.

Certain of our games support collaborative online features that allow consumers to communicate with one another and post narrative comments, in real time, that are visible to other consumers. Additionally, certain of our games allow consumers to create and share "user-generated content" that is visible to other consumers. From time to time, objectionable and offensive consumer content may be distributed within our games and on our broadcasts through these features or to gaming websites or other sites or forums with online chat features or that otherwise allow consumers to post comments. We may be subject to lawsuits, governmental regulation or restrictions, and consumer backlash (including decreased sales and harmed reputation), as a result of consumers posting offensive content.

In many cases, our business partners and other third party affiliates are given access to sensitive and proprietary information or control over our intellectual property to provide services and support to our team. These third parties may misappropriate or misuse our information or intellectual property and engage in unauthorized use of it. Further, the failure of these third parties to provide adequate services and technologies or to adequately maintain or update their services and technologies could result in a disruption to our business operations or an adverse effect on our reputation and may negatively impact our business. At the same time, if the media, consumers or employees raise any concerns about our actions vis-à-vis third parties, including consumers who play our games, this could also harm our business, results of operations or our reputation.

The products or services we release may contain defects, bugs or errors.

Our products and services contain or rely upon extremely complex software programs and are difficult to develop and distribute. We have quality controls in place to detect defects, bugs or other errors in our products and services before they are released. Nonetheless, these quality controls are subject to human error, overriding and resource or technical constraints. In addition, the effectiveness of our quality controls and preventative measures may be negatively affected by the distribution of our workforce resulting from, among other things, the COVID-19 pandemic. As such, these quality controls and preventative measures may not be effective in detecting all defects, bugs or errors in our products and services before they have been released into the marketplace. In such an event, the technological reliability and stability of our products and services could be below our standards and the standards of our players, and our reputation, brand and sales could be adversely affected. In addition, we could be required to, or may find it necessary to, offer a refund for the product or service, suspend the availability or sale of the product or service or expend significant resources to cure the defect, bug or error each of which could significantly harm our business and operating results.

External game developers may not meet product development schedules or otherwise fulfill their contractual obligations.

We are heavily reliant upon contracts with external game developers to develop our games or distribute our games. While we maintain contractual protections, we have less control over the product development schedules of games developed by external developers. We depend on their ability to meet product development schedules which could be negatively affected by, among other things, the distributed workforce model resulting from the COVID-19 pandemic or the loss of key development personnel. In addition, disputes occasionally arise with external developers, including with respect to game content, launch timing, achievement of certain milestones, the game development timeline, marketing campaigns, contractual terms and interpretation of such terms. If we have disputes with external developers or they cannot meet product development schedules, acquire certain approvals or are otherwise unable or unwilling to fulfill their contractual obligations to us, we may delay or cancel previously announced games, alter our launch schedule or experience increased costs and expenses, which could result in a delay or significant shortfall in anticipated revenue, harm our profitability and reputation and cause our financial results to be materially affected.

Any cybersecurity-related attack, significant data breach or disruption of the information technology systems or networks on which we rely could negatively impact our business.

In the course of our day-to-day business, we and third parties operating on our behalf and from which we license certain intellectual property create, store, and/or use commercially sensitive information, such as the source code and game assets for our interactive entertainment software products and sensitive and confidential information with respect to our customers, consumers, and employees. Our ability to effectively manage our business and coordinate the manufacturing, sourcing, distribution and sale of our interactive entertainment software products depends significantly on the reliability and capacity of these systems. We are critically dependent on the integrity, security and consistent operations of these systems. A malicious cybersecurity-related attack, intrusion or disruption by hackers (including through spyware, ransomware, viruses, phishing, denial of service and similar attacks) or other breach of the systems on which such source code and assets, account information (including personal information) and other sensitive data is stored could lead to piracy of our software, fraudulent activity, disclosure or misappropriation of, or access to, our customers', consumers' or employees' personal information, or our own business data. Such incidents could also lead to product code-base and game distribution platform exploitation, should undetected viruses, spyware, or other malware be inserted into our products, services, or networks, or systems used by our consumers. We have implemented cybersecurity programs and the tools, technologies, processes, and procedures intended to secure our data and systems, and prevent and detect unauthorized access to, or loss of, our data, or the data of our customers, consumers or employees. However, because these cyberattacks may remain undetected for prolonged periods of time and the techniques used by criminal hackers and other third parties to breach systems are constantly evolving, change frequently and we may be unable to anticipate these techniques or implement adequate preventative measures. A data intrusion into a server for a game with online features or for our proprietary online gaming service could also disrupt the operation of such game or platform. If we are subject to cybersecurity breaches, or a security-related incident that materially disrupts the availability of our products and services, we may have a loss in sales or subscriptions or be forced to pay damages or incur other costs, including from the implementation of additional cyber and physical security measures, or suffer reputational damage. If there were a public perception that our data protection measures are inadequate, whether or not the case, it could result in reputational damage and potential harm to our business relationships or the public perception of our business model. In addition, such cybersecurity breaches may subject us to legal claims or proceedings, like individual claims and regulatory investigations and actions, including fines, especially if there is loss, disclosure, or misappropriation of, or access to, our customers' personal information or other sensitive information, or there is otherwise an intrusion into our customers' privacy.

If we do not successfully invest in, establish and maintain awareness of our brand and games or if we incur excessive expenses promoting and maintaining our brand or our games, our business, financial condition, results of operations or reputation could be harmed.

We believe that establishing and maintaining our brand is critical to maintaining and creating favorable relationships with players, platform providers, advertisers and content licensors, as well as competing for key talent. Increasing awareness of our brand and recognition of our games is particularly important in connection with our strategic focus on in-licensing games successfully cross-promoting such games. In addition, globalizing and extending our brand and recognition of our games requires significant investment and extensive management time to execute successfully. 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 revenues could be limited, our costs could increase and our business, financial condition, results of operations or reputation could suffer.

In addition, if a game contains objectionable content or the messaging functionality of our games is abused, we could experience damage to our reputation and brand. Despite reasonable precautions, some consumers may be offended by certain game content, including user-generated content, the third-party advertisements displayed in our mobile games, or by treatment of other users. If consumers believe that a game we published or third-party advertisement displayed in a game contains objectionable content, it could harm our brand and consumers could refuse to play it and could pressure the platform providers to remove the game from their platforms. For example, we rely on third-party advertising partners to display advertisements within our mobile games, and may experience in the future instances where offensive or objectionable content has been displayed in our games through our advertising partners. While this may violate the terms of our agreements with these advertising partners, our reputation and player experience may suffer. Furthermore, steps that we may take in response to such instances, such as temporarily or permanently shutting off access of such advertising partner to our network, may negatively impact our revenue in such period.

Our operating results may fluctuate from quarter to quarter, which makes our future results difficult to predict.

Our quarterly operating results have fluctuated in the past and may fluctuate in the future. Additionally, we have a limited operating history with the current scale of our business, which makes it difficult to forecast our future results and subjects us to a number of uncertainties, including our ability to plan for and anticipate future growth. As a result, you should not rely upon our past quarterly operating results as indicators of future performance. We have encountered, and will continue to encounter, risks and uncertainties frequently experienced by growing companies in rapidly evolving markets, such as the risks and uncertainties described herein. Our operating results in any given quarter can be influenced by numerous factors, many of which are unpredictable or are outside of our control, including:

- our ability to maintain and grow our player base;
- our ability to retain and increase revenue from existing customers;
- our ability to introduce new features and functionalities and enhance existing features and functionalities;
- our ability to respond to competitive developments, including pricing changes and the introduction of new products and features by our competitors, or the emergence of new competitors;
- seasonal purchasing patterns of our consumers;
- impact of downtime or defects in our game and reputational harm;
- changes to financial accounting standards and the interpretation of those standards that may affect the way we recognize and report our financial results, including changes in accounting rules governing recognition of revenue;
- general economic and political conditions and government regulations in the countries where we currently operate or plan to expand;
- decisions by us to incur additional expenses, such as increases in sales and marketing or research and development; and
- potential costs to attract, onboard, retain and motivate qualified personnel.

The impact of one or more of the foregoing and other factors may cause our operating results to vary significantly. As such, we believe that quarter-to-quarter comparisons of our operating results may not be meaningful and should not be relied upon as an indication of future performance. The variability and unpredictability of our operating results could result in our failure to meet our expectations or those of analysts that cover us or investors with respect to revenue or other operating results for a particular period. If we fail to meet or exceed such expectations, then the trading price of our Class A common stock could fall substantially, and we could face costly lawsuits, including securities class action suits.

We have experienced rapid growth and expect to invest in our growth for the foreseeable future. If we fail to manage our growth effectively, then our business, operating results and financial condition would be adversely affected.

We have experienced rapid growth in recent periods, and we expect to continue to invest broadly across our organization to support our growth. Although we have experienced rapid growth historically, we may not sustain our current growth rates, nor can we assure you that our investments to support our growth will be successful. The growth and expansion of our business will require us to invest significant financial and operational resources and the continuous dedication of our management team.

Failure to manage growth effectively could result in difficulty or delays in attracting new players, declines in quality or player satisfaction and demand for our games, increases in costs, difficulties in introducing new products and features or enhancing our offerings, loss of customers or consumers, difficulties in attracting or retaining talent or other operational difficulties, any of which could adversely affect our business, operating results and financial condition. Effectively managing our growth may also be more difficult to accomplish the longer that our employees, our customers and the overall economy is impacted by rising interest rates, inflation and the ongoing conflict in Ukraine.

Risks Related to Intellectual Property

If we are unable to protect the intellectual property relating to our material software, the commercial value of our products will be adversely affected, and our competitive position could be harmed.

We are highly reliant upon in-licensed intellectual property and developing proprietary software, where we have obtained the rights to publish and distribute software developed by third parties and related parties. We and our licensors attempt to protect our software and production techniques under patent, copyright, trademark and trade secret laws as well as through contractual restrictions on disclosure, copying and distribution. Nonetheless, our software is susceptible to piracy and unauthorized copying, and third parties may potentially exploit, misappropriate or otherwise violate our intellectual property and proprietary information, causing significant reputational damage. Unauthorized third parties, for example, may be able to copy or to reverse engineer our software to obtain and use programming or production techniques that we regard as proprietary. Well-organized piracy operations have also proliferated in recent years, resulting in the ability to download pirated copies of our software over the Internet. Although we attempt to incorporate protective measures into our software, piracy of our products could negatively affect our future profitability. In addition, “cheating” programs or other unauthorized software tools and modifications that enable consumers to cheat in games harm the experience of players who play fairly and could negatively impact the volume of microtransactions or purchases of DLC. Also, vulnerabilities in the design of our applications and of the platforms upon which they run could be discovered after their release. This may lead to lost revenues from paying consumers or increased cost of developing technological measures to respond to these vulnerabilities, either of which could negatively affect our business.

If we infringe, misappropriate, or otherwise violate or are alleged to infringe, misappropriate or otherwise violate the intellectual property rights of third parties, our business could be adversely affected.

As our industry grows, we may be subject to an increasing amount of litigation that is common in the software industry based on allegations of infringement or other alleged violations of patent, copyright, or trademarks. In addition, we believe that interactive entertainment software will increasingly become the subject of claims that such software infringes on the intellectual property rights of others with both the growth of online functionality and advances in technology, game content and software graphics as games become more realistic. From time to time, we may receive notices from third parties or be named in lawsuits by third parties alleging infringement of their proprietary rights. Although we believe that our software and technologies and the software and technologies of third-party developers and publishers with whom we have contractual relations do not and will not infringe or violate proprietary rights of others, it is possible that infringement of proprietary rights of others may occur. Any claims of infringement, with or without merit, could be time-consuming, costly and difficult to defend. Moreover, intellectual property litigation or claims could require us to discontinue the distribution of products, obtain a license or redesign our products, which could result in additional substantial costs and material delays.

If we are unable to protect the confidentiality of our trade secrets, our business and competitive position would be harmed.

We rely on trade secrets and proprietary knowledge to protect our unpatented know-how, expertise, technology and other proprietary information and to maintain our competitive position. We enter into nondisclosure and confidentiality agreements with our employees and independent contractors regarding our trade secrets and proprietary information in order to limit access to, and disclosure and use of, our trade secrets and proprietary information. Nevertheless, we cannot guarantee that we have entered into such agreements with each party that may have or has had access to our trade secrets or proprietary information. Furthermore, trade secrets are difficult to protect. We cannot assure you that the obligation to maintain the confidentiality of our trade secrets and proprietary information will be honored. Any of these parties may breach the agreements and disclose our proprietary information, including our trade secrets, and we may not be able to obtain adequate remedies for such breaches. Enforcing a claim that a party illegally disclosed or misappropriated a trade secret is difficult, expensive, and time-consuming, and the outcome is unpredictable. In addition, some courts inside and outside the United States are less willing or unwilling to protect trade secrets. Monitoring unauthorized disclosure is difficult, and we do not know whether the steps we have taken to prevent such disclosure are, or will be, adequate. If we were to enforce a claim that a third party had illegally obtained and was using our trade secrets, it would be expensive and time-consuming, and the outcome would be unpredictable. If any of our trade secrets were to be lawfully obtained or independently developed by a competitor or other third party, we would have no right to prevent them, or those to whom they communicate it, from using that technology or information to compete with us. If any of our material trade secrets were to be disclosed to or independently developed by a competitor, our competitive position would be harmed. In general, any loss of trade secret protection or other unpatented proprietary rights could harm our business, financial condition, results of operations, and prospects.

We may be subject to claims that our employees, consultants or advisors have wrongfully used or disclosed alleged trade secrets of their current or former employers or claims asserting ownership of what we regard as our own intellectual property.

Many of our employees, consultants and advisors are currently or were previously employed at other companies in our field, including our competitors or potential competitors. Many of them executed proprietary rights, non-disclosure and/or non-competition agreements in connection with such previous employment or engagement. Although we try to ensure that our employees, consultants, and advisors do not use the intellectual property rights, proprietary information know-how or trade secrets of others in their work for us, we may be subject to claims that we or they have, inadvertently or otherwise, used, infringed, misappropriated or otherwise violated intellectual property rights, or disclosed the alleged trade secrets or other proprietary information, of any such individual's current or former employer. Litigation may be necessary to defend against these claims. Any litigation or the threat of litigation may adversely affect our ability to hire employees or engage consultants and contractors. A loss of key personnel or their work product could hamper or prevent us from developing and commercializing products and product candidates, which could harm our business. If we fail in defending any such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel. Even if we are successful in defending against such claims, litigation could result in substantial costs and be a distraction to management.

In addition, while it is our policy to require our employees, consultants and contractors who may be involved in the conception or development of intellectual property to execute agreements assigning such intellectual property to us, we may be unsuccessful in executing such an agreement with each party who, in fact, conceives, develops and/or reduces to practice intellectual property that we regard as our own. The assignment of intellectual property rights may not be self-executing, or the assignment agreements may be breached, and we may be forced to bring claims against third parties, or defend claims that they may bring against us, to determine the ownership of what we regard as our intellectual property. Any of the foregoing could harm our competitive position, business, financial condition, results of operations and prospects.

Accordingly, if we fail in prosecuting or defending any such claims, we may be required to pay monetary damages, and we may also lose valuable intellectual property rights or personnel, which could harm our competitive position and prospects. Such intellectual property rights could be awarded to a third-party, and we could be required to obtain a license from such third-party to commercialize our technology or products, which license may not be available on commercially reasonable terms, or at all, or such license may be non-exclusive. Even if we are successful in prosecuting or defending against such claims, litigation could result in substantial costs and be a distraction to our management and employees.

We may become involved in lawsuits to protect or enforce our intellectual property, which could be expensive, time-consuming and unsuccessful.

Third parties, including our competitors, could be infringing, misappropriating or otherwise violating our owned and licensed trademarks, trade secrets or other intellectual property rights. Monitoring unauthorized use of our intellectual property is difficult, time-consuming and costly. The steps we have taken to protect our proprietary rights may not be adequate to enforce our rights against infringement, misappropriation or other violation of our intellectual property. We may not be able to detect unauthorized use of, or take appropriate steps to enforce, our intellectual property rights. Any inability to meaningfully enforce our intellectual property rights could harm our ability to compete and reduce demand for our games.

In the future, we may make claims of infringement or misappropriation against third parties, or make claims that third-party intellectual property rights are invalid or unenforceable. These claims could:

- cause us to incur greater costs and expenses in the protection of our intellectual property;
- potentially negatively impact our intellectual property rights, for example, by causing one or more of our intellectual property rights to be ruled or rendered unenforceable or invalid; or
- divert our technical personnel's or management's attention and our resources. In any lawsuit we bring to enforce our intellectual property rights, a court may refuse to stop the other party from using the technology at issue on grounds that our intellectual property rights do not cover the technology in question, are not valid, or otherwise not enforceable against such other party. Further, in such proceedings, the defendant could counterclaim that our intellectual property is invalid or unenforceable and the court may agree, in which case we could lose valuable intellectual property rights. The outcome in any such lawsuit is unpredictable.

Litigation or other legal proceedings relating to intellectual property claims, even if resolved in our favor, may cause us to incur significant expenses and could distract our technical and management personnel from their normal responsibilities. In addition, there could be public announcements of the results of hearings, motions, or other interim proceedings or developments, and if securities analysts or investors perceive these results to be negative, it could have a substantial adverse effect on the price of our Class A common stock or cause reputational harm. We may not have sufficient financial or other resources to conduct such litigation or proceedings adequately. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their greater financial resources and more mature and developed intellectual property portfolios. Uncertainties resulting from the initiation and continuation of intellectual property proceedings could harm our ability to compete in the marketplace. In addition, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information or trade secrets could be compromised by disclosure during this type of litigation. Any of the foregoing could harm our competitive position, business, financial condition, results of operations and prospects. For more information, see Item 1 of Part II, “Legal Proceedings.”

We or our licensors may not be able to enforce our intellectual property rights throughout the world.

We or our licensors may be required to protect our proprietary technology and content in an increasing number of jurisdictions, a process that is expensive and may not be successful, or which we or our licensors may not pursue in every location due to costs, complexities or other reasons. Filing, prosecuting, maintaining, defending, and enforcing our owned or in-licensed intellectual property rights in all jurisdictions throughout the world would be prohibitively expensive, and our intellectual property rights in some jurisdictions outside the United States may be less extensive than those in the United States. Competitors may use our technologies in jurisdictions where we have not obtained intellectual property protection to develop their own games and, further, may export otherwise infringing, misappropriating, or otherwise violating games to territories where we have intellectual property protection, but enforcement is not as strong as that in the United States. These games may compete with our games, and our intellectual property rights may not be effective or sufficient to prevent such competition. In addition, the laws of some foreign jurisdictions do not protect proprietary rights to the same extent as the laws of the United States, and many companies have encountered significant challenges in establishing and enforcing their proprietary rights outside of the United States. These challenges can be caused by the absence or inconsistency of the application of rules and methods for the establishment and enforcement of intellectual property rights outside of the United States. In addition, the legal systems of some jurisdictions, particularly developing countries, do not favor the enforcement of intellectual property protection. This could make it difficult for us to stop the infringement, misappropriation or other violation of our intellectual property rights. Accordingly, we or our licensors may choose not to seek protection in certain jurisdictions, and we will not have the benefit of protection in such jurisdictions. Proceedings to enforce our intellectual property rights in foreign jurisdictions could result in substantial costs and divert our efforts and attention from other aspects of our business. Accordingly, our or our licensors’ efforts to protect our intellectual property rights in such jurisdictions may be inadequate. In addition, changes in the law and legal decisions by courts in the United States and foreign jurisdictions may affect our ability to obtain adequate protection for our games and other technologies and the enforcement of intellectual property rights. Any of the foregoing could harm our competitive position, business, financial condition, results of operations and prospects.

If our trademarks and trade names are not adequately protected, we may not be able to build name recognition in our markets of interest and our competitive position may be harmed.

The registered or unregistered trademarks or trade names that we own or license may be challenged, infringed, circumvented, declared generic, lapsed or determined to be infringing on or dilutive of other trademarks. We may not be able to protect our rights in these trademarks and trade names, which we need in order to build name recognition. In addition, third parties have filed, and may in the future file, for registration of trademarks similar or identical to our owned or licensed trademarks, thereby impeding our ability to build brand identity and possibly leading to market confusion. If such third parties succeed in registering or developing common law rights in such trademarks, and if we are not successful in challenging such third-party rights, we may not be able to use these trademarks to develop brand recognition of our games. In addition, there could be potential trade name or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of our registered or unregistered owned or licensed trademarks or trade names. If we are unable to establish or protect our trademarks and trade names, or if we are unable to build name recognition based on our owned or licensed trademarks and trade names, we may not be able to compete effectively, which could harm our competitive position, business, financial condition, results of operations and prospects.

We use open source software in connection with certain of our games and services, which may pose particular risks to our proprietary software, products, and services in a manner that could have a negative impact on our business.

We use open source software in connection with some of the games and services we offer and may continue to use open source software in the future. Some open source software licenses require users who distribute open source software as part of their software to publicly disclose all or part of the source code to such software or make available any derivative works of the open source code on unfavorable terms or at no cost. The terms of various open source licenses have not been interpreted by courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our use of the open source software. Were it determined that our use was not in compliance with a particular license, we may be required to release our proprietary source code, pay damages for breach of contract, re-engineer our games or products, discontinue distribution in the event re-engineering cannot be accomplished on a timely basis, or take other remedial action that may divert resources away from our game development efforts, any of which could negatively impact our business.

Risks Related to Legal or Regulatory Compliance

Changing data privacy and security laws and regulations in the jurisdictions in which we or our consumers do business could increase the cost of our operations and subject us to possible sanctions, civil lawsuits (including class action or similar representative lawsuits) and other penalties; such laws and regulations are continually evolving. Our platform and service providers' actual or perceived failure to comply with these laws and regulations could harm our business financial condition and results of operations.

We collect, process, store, use and share data in our operations. While our business receives limited, if any, personal information of our end users from our platform providers, we may elect to collect such information in the future. Our business and the business of our platform providers are therefore subject to a number of federal, state, local and foreign laws, regulations, regulatory codes and guidelines governing data privacy, data protection and security, including with respect to the collection, storage, use, processing, transmission, sharing and protection of personal information. Such laws, regulations, regulatory codes and guidelines may be inconsistent across jurisdictions or conflict with other rules.

The legislative and regulatory landscapes for data privacy and security continue to evolve in jurisdictions worldwide, with an increasing focus on privacy and data protection issues with the potential to affect our business. In the United States, such privacy and data security laws and regulations include federal laws and regulations like the federal Controlling the Assault of Non-Solicited Pornography and Marketing Act, the Telephone Consumer Protection Act, the Do-Not-Call Implementation Act, and rules and regulations promulgated under the authority of the Federal Trade Commission and state laws like the California Consumer Privacy Act ("CCPA") and the varying data breach notification laws that have been enacted in all 50 U.S. states and the District of Columbia. The CCPA, which became effective on January 1, 2020 and became enforceable by the California Attorney General on July 1, 2020, along with related regulations that came into force on August 14, 2020, provides additional individual privacy rights for California residents and places increased data privacy and security obligations on entities handling certain personal information of California residents and households. Among other things, the CCPA expands rights related to such individual's personal information, including the right to access and require deletion of their personal information, opt out of certain personal information sharing, and receive detailed information about how their personal information is collected, used, and shared by covered business. Many of the CCPA's requirements as applied to personal information obtained in a business to business context, as well as personal information of a business's personnel and related individuals, were subject to a moratorium that expired on January 1, 2023. The CCPA provides for civil penalties for violations, as well as a private right of action and statutory damages for security breaches that may increase security breach litigation. The effects of the CCPA are significant and have required, and could continue to require, us to modify our data collection or processing practices and policies and to incur substantial costs and expenses in an effort to comply. Some observers have noted that the CCPA could mark the beginning of a trend toward more stringent state privacy legislation in the U.S., which could increase our potential liability and adversely affect our business. Further, in November 2020, California voters passed the California Privacy Rights Act ("CPRA"). The CPRA, which came into effect in most material respects on January 1, 2023 with a one-year look back period, significantly amended and expanded existing CCPA requirements, including, among other things, by introducing additional obligations such as data minimization and storage limitations on the sharing of personal information for cross on text behavioral advertising and on the use of "sensitive" personal information, granting additional rights to consumers, such as correction of personal information and additional opt-out rights, and creating a new entity, the California Privacy Protection Agency, to implement and enforce the law and impose administrative fines. There currently are a number of additional proposals related to data privacy or security pending before federal, state, and foreign legislative and regulatory bodies, including in a number of U.S. states considering comprehensive consumer protection laws. States such as Virginia, Colorado, Utah and Connecticut have passed comprehensive data privacy laws that have become effective, or will become effective in the near future. Such legislation may add complexity, variation in requirements, restrictions and potential legal risk, require additional investment in resources to compliance programs, and could impact strategies and availability of previously useful data and could result in increased compliance costs and/or changes in business practices and policies.

Many of the other jurisdictions where we or our customers do business, including the EU, also have restrictive laws and regulations dealing with the processing of personal information. In addition to regulating the processing of personal information within the relevant jurisdictions, these legal requirements often also apply to the processing of personal information outside these jurisdictions, where there is some specified link to the relevant jurisdiction. For example, the European Union's Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (the "General Data Protection Regulation" or "GDPR") became effective in May 2018, imposes strict requirements on controllers and processors of personal data in the European Economic Area ("EEA"), including, for example, higher standards for obtaining consent from individuals to process their personal data, more robust disclosures to individuals and a strengthened individual data rights regime, greater control for data subjects (including the "right to be forgotten" and data portability) and shortened timelines for data breach notifications. The GDPR created new compliance obligations applicable to our business and our platform and service providers, which could require us to self-determine how to interpret and implement these obligations, change our business practices and expose us to lawsuits (including class action or similar representative lawsuits) by consumers or consumer organizations for alleged breach of data protection laws. Failure to comply with the requirements of GDPR may result in significant fines of up to €20,000,000 or up to 4% of the total worldwide annual turnover of the preceding financial year, whichever is higher, and other administrative penalties. The United Kingdom operates a separate but similar regime to the European Union with which we will have to comply and that allows for fines of up to the greater of £17.5 million or 4% of the total worldwide annual turn over of the preceding financial year. Further, beginning January 1, 2021, we have been required to comply with the GDPR and also the United Kingdom GDPR ("UK GDPR"), which, together with the amended United Kingdom Data Protection Act 2018, retains the GDPR in United Kingdom national law. The relationship between the United Kingdom and the European Union in relation to certain aspects of data protection law remains unclear, and it is unclear how the United Kingdom's data protection laws and regulations will develop in the medium to longer term, and how data transfers to and from the United Kingdom will be regulated in the long term. For example, while the EU Commission has adopted an adequacy decision in favor of the United Kingdom, enabling data transfers from European Union member states to the United Kingdom without additional safeguards, the decision will automatically expire in June 2025 unless the EU Commission re-assesses and renews/extends it. These changes may lead to additional costs and increase our overall risk exposure.

Recent legal developments also have created compliance uncertainty regarding the transfer of personal information from the U.K. and EEA to certain locations outside of the U.K. and EEA where we or our clients operate or conduct business. In July 2020, the Court of Justice of the European Union ("CJEU") ruled the EU-US Privacy Shield Framework, one of the primary safeguards that allowed U.S. companies to import personal data from the EU to the U.S., was invalid. The CJEU's decision also raised questions about whether the most commonly used mechanism for cross-border transfers of personal data out of the EEA, namely, the European Commission's Standard Contractual Clauses, can lawfully be used for personal data transfers from the EU to the U.S. or other third countries the European Commission has determined do not provide adequate data protections under their laws. On June 4, 2021, the European Commission published new Standard Contractual Clauses (which became effective on June 27, 2021), which impose on companies additional obligations relating to data transfers, including in the transfer, to implement additional security measures and update internal privacy practices. If we elect to rely on the new Standard Contractual Clauses for applicable data transfers, we may be required to incur significant time and resources to update our contractual arrangements and to comply with new obligations. If we are unable to implement a valid mechanism for personal data transfers from the EEA, we could face increased exposure to regulatory actions, substantial fines and injunctions against processing personal data from the EEA. As discussed above, these same considerations must currently be taken into account with regard to the UK GDPR as well. Additionally, other countries outside of the EU have enacted or are considering enacting similar cross order data transfer restrictions and laws requiring local data residency, which could increase the cost and complexity of delivering our services and operating our business. The type of challenges we face in the EU and U.K. will likely also arise in other jurisdictions that adopt regulatory frameworks of equivalent complexity. Accordingly, any actual or perceived failure to comply with these laws and regulations could harm our business, financial condition and results of operations.

Our business and products are subject to potential legislation and other governmental restrictions. The adoption of such proposed legislation and restrictions could limit the retail market for our products.

Several proposals have been made for federal legislation to regulate our industry. Such proposals seek to prohibit the sale of products containing certain content included in some of our games. If any such proposals are enacted into law, it may limit the potential market for some of our games in the United States, and adversely affect our business, financial condition and operating results. Other countries have adopted laws regulating content both in packaged games and those transmitted over the Internet that are stricter than current U.S. law. While no such laws are currently in place in the United States, the adoption into law of such legislation in jurisdictions in which we do significant business could severely limit the retail market for some of our games.

On August 30, 2021, China's National Press and Publication Administration announced a new regulation that required online gaming companies limit their services provided to minors to one hour per day on Fridays, Saturdays, Sundays and public holidays. We continue to assess the impact this new regulation may have on our results of operations however, at this time, the impact of this new regulation remains uncertain.

Changes in government regulations relating to the Internet could have a negative impact on our business.

We rely on our consumers' access to significant levels of Internet bandwidth for the sale and digital delivery of our content and the functionality of our games with online features. Changes in laws or regulations that adversely affect the growth, popularity, or use of the Internet, including laws affecting "net neutrality" or measures enacted in certain jurisdictions as a result of the COVID-19 pandemic, could decrease the demand for our products and services or increase our cost of doing business.

Although certain jurisdictions have implemented laws and regulations intended to prevent Internet service providers from discriminating against particular types of legal traffic on their networks, other jurisdictions may lack such laws and regulations or repeal existing laws or regulations. For example, on December 14, 2017, the Federal Communications Commission voted to repeal net neutrality regulations in the United States, and, following that decision, several states enacted net neutrality regulations. Given the uncertainty around these rules, including changing interpretations, amendments or repeal, coupled with the potentially significant political and economic power of local Internet service providers and the relatively significant level of Internet bandwidth access our products and services require, we could experience discriminatory or anti-competitive practices that could impede our growth, cause us to incur additional expenses, or otherwise negatively affect our business.

We may be involved in legal proceedings that have a negative impact on our business.

From time to time, we have been, and in the future may be, involved in claims, suits, investigations, audits and proceedings arising in the ordinary course of our business, including with respect to labor and employment, intellectual property, competition and antitrust, regulatory, tax, privacy and/or commercial matters. In addition, negative consumer sentiment about our business practices may result in inquiries or investigations from regulatory agencies and consumer groups, as well as litigation.

Claims, suits, investigations, audits and proceedings are inherently difficult to predict, and their results are subject to significant uncertainties, many of which are outside of our control. Regardless of the outcome, such legal proceedings can have a negative impact on us due to reputational harm, legal costs, diversion of management resources and other factors. It is also possible that a resolution of one or more such proceedings could result in substantial settlements, judgments, fines or penalties, injunctions, criminal sanctions, consent decrees or orders preventing us from offering certain features, functionalities, products or services, requiring us to change our development process or other business practices.

There is also inherent uncertainty in determining reserves for these matters. Significant judgment is required in the analysis of these matters, including assessing the probability of potential outcomes and determining whether a potential exposure can be reasonably estimated. In making these determinations, we, in consultation with outside counsel, examine the relevant facts and circumstances on a quarterly basis assuming, as applicable, a combination of settlement and litigated outcomes and strategies. Further, it may take time to develop factors on which reasonable judgments and estimates can be based.

We regard our software as proprietary and rely on a variety of methods, including a combination of copyright, patent, trademark and trade secret laws, and employee and third-party non-disclosure and invention assignment agreements, to protect our proprietary rights. We own or license various copyrights, patents, trademarks and trade secrets. The process of registering and protecting these rights in various jurisdictions is expensive and time-consuming. Further, we are aware that some unauthorized copying and piracy occurs, and if a significantly greater amount of unauthorized copying or piracy of our software products were to occur, it could negatively impact our business. We also cannot be certain that existing intellectual property laws will provide adequate protection for our products in connection with emerging technologies or that we will be able to effectively protect our intellectual property through litigation and other means.

Financial and Economic Risks

If general economic conditions decline, demand for our games could decline. In addition, our business is vulnerable to changing economic conditions and to other factors that adversely affect the gaming industry, which could negatively impact our business.

In-game purchases involve discretionary spending on the part of consumers. Consumers are generally more willing to make discretionary purchases, including purchases of games and services like ours, during periods in which favorable economic conditions prevail. As a result, our games may be sensitive to general economic conditions and economic cycles. A reduction or shift in domestic or international consumer spending could result in an increase in our marketing and promotional expenses, in an effort to offset that reduction, and could negatively impact our business. Discretionary spending on entertainment activities could further decline for reasons beyond our control, such as natural disasters, acts of war, pandemics, terrorism, transportation disruptions or the results of adverse weather conditions. Additionally, disposable income available for discretionary spending may be reduced by unemployment, higher housing, energy, interest or other costs, or where the actual or perceived wealth of customers has decreased because of circumstances such as lower residential real estate values, increased foreclosure rates, inflation, increased tax rates or other economic disruptions. Any prolonged or significant decrease in consumer spending on entertainment activities could result in reduced play levels and decreased spending on our games, and could adversely impact our results of operations, cash flows and financial condition.

Changes in tax laws or tax rulings, or the examination of our tax positions, could materially affect our financial condition and results of operations.

Tax laws are dynamic and subject to change as new laws are passed and new interpretations of the law are issued or applied. Our existing corporate structure and intercompany arrangements have been implemented in a manner we believe is in compliance with current prevailing tax laws. However, the tax benefits that we intend to eventually take advantage of could be undermined due to changing tax laws, both in the United States and in other applicable jurisdictions. In addition, the taxing authorities in the United States and other jurisdictions where we do business regularly examine income and other tax returns and we expect that they may examine our income and other tax returns. The ultimate outcome of these examinations cannot be predicted with certainty.

Tax law or tax rate changes could affect our effective tax rate and future profitability.

Our effective tax rate was 21% for the six month period ended June 30, 2023 and 20% for the six month period ended June 30, 2022. In general, changes in applicable U.S. federal and state and foreign tax laws and regulations, or their interpretation and application, including the possibility of retroactive effect, could affect our tax expense. In addition, taxing authorities in many jurisdictions in which we operate may propose changes to their tax laws and regulations. These potential changes could have a material impact on our effective tax rate, long-term tax planning and financial results.

The realization of the Company's deferred tax assets is contingent upon the Company's upcoming new game releases to generate sufficient taxable income through the end of the year.

The Company assesses the need for valuation allowances against deferred tax assets based on estimates and judgements about future taxable income. In the event the Company's game releases are delayed, are ill received, or do not meet the Company's estimates, the deferred tax assets may not be realizable. As such, the Company may need to record a valuation allowance to reflect the likelihood that the deferred tax assets will not be realized, which could have a material impact on our financial position. See Note 16 - *Income Taxes* to our unaudited condensed consolidated financial statements included in this Quarterly Report.

Our reported financial results could be significantly impacted 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 national accounting standards bodies and the methods, estimates and judgments that we use in applying our accounting policies. Policies affecting revenue recognition have affected, and could further significantly affect, the way we report revenues related to our products and services. We recognize a majority of the revenues from video games that include an online service on a deferred basis over an estimated service period for such games. In addition, we defer the cost of revenues of those products. Further, as we increase our DLC and add new features to our online services, our estimate of the service period may change, and we could be required to recognize revenues, and defer related costs, over a shorter or longer period of time. 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 revenues and income taxes, could have a significant impact on our reported net revenues, net income and earnings per share under generally accepted accounting principles in the United States in any given period.

The Company has debt obligations with short term durations that are coming due within one year.

We have significant debt obligations coming due within one year. Our current revolving loan has a balance of $6.0 million as of June 30, 2023, and is due for repayment on December 31, 2023. Our short-term note has a balance of $2.9 million as of June 30, 2023, and has even monthly debt service payments until the loan is fully repaid in January 2024. The Company intends to extend the revolving loan and faces the risk that we will be unable to extend. If we are unable to extend the loan, the Company may have significantly reduced unrestricted and restricted cash which could adversely impact our results of operations and ability to invest in the development and acquisition of IP. See Note 15 - *Revolving Loan, Short Term Note and Long-Term Debt* to our unaudited condensed consolidated financial statements included in this Quarterly Report.

Risks Related to Our Corporate Structure

We are a "controlled company" under the corporate governance rules of Nasdaq and, as a result, qualify for and rely on exemptions from certain corporate governance requirements. Since we elected to rely on the exemptions available to a "controlled company," you do not have the same protections afforded to stockholders of companies that are subject to such corporate governance requirements.

Our controlling stockholder, Founder, Chief Strategy Officer and Chairman, Mr. Shi, controls a majority of our outstanding common stock. As a result, we are a "controlled company" within the meaning of the corporate governance standards of the Nasdaq rules. Under these rules, a listed company of which more than 50% of the voting power is held by an individual, group or another company is a "controlled company" and may elect not to comply with certain corporate governance requirements, including:

- requirement that a majority of its board of directors consist of independent directors;
- the requirement that its director nominations be made, or recommended to the full board of directors, by its independent directors or by a nominations committee that is comprised entirely of independent directors and that it adopts a written charter or board resolution addressing the nominations process; and
- the requirement that it has a compensation committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities.

We elected to rely on these exemptions. As a result, our board of directors does not have a majority of independent directors, our compensation committee does not consist entirely of independent directors and our directors are not nominated or selected by independent directors. Accordingly, you do not have the same protections afforded to stockholders of companies that are subject to all of the corporate governance requirements of the Nasdaq rules.

Mr. Shi, our Founder, Chief Strategy Officer and Chairman, controls us, and his ownership of our common stock prevents you and other stockholders from influencing significant decisions.

Mr. Shi controls shares representing a majority of our combined voting power. As long as Mr. Shi continues to control shares representing a majority of our voting power, he will generally be able to determine the outcome of all corporate actions requiring stockholder approval, including the election and removal of directors (unless supermajority approval of such matter is required by applicable law and our amended and restated certificate of incorporation). In the ordinary course of his business activities, Mr. Shi may engage in activities where his interests may not be the same as, or may conflict with, the interests of our other stockholders. Even if Mr. Shi were to control less than a majority of our voting power, he may be able to influence the outcome of corporate actions so long as he controls a significant portion of our voting power.

Our stockholders are not able to affect the outcome of any stockholder vote while Mr. Shi controls the majority of our voting power (or, in the case of removal of directors, two-thirds of our voting power). Due to his ownership and rights under our amended and restated certificate of incorporation and our amended and restated bylaws, Mr. Shi controls, subject to applicable law, the composition of our board of directors, which in turn controls all matters affecting us, including, among other things:

- any determination with respect to our business direction and policies, including the appointment and removal of officers and, in the event of a vacancy on our board of directors, additional or replacement directors;
- any determinations with respect to mergers, business combinations or dispositions of assets;
- determination of our management policies;
- determination of the composition of the committees on our board of directors;
- our financing policy;
- our compensation and benefit programs and other human resources policy decisions;
- changes to any other agreements that may adversely affect us;
- the payment of dividends on our common stock; and
- determinations with respect to our tax returns.

In addition, the concentration of Mr. Shi's ownership could also discourage others from making tender offers, which could prevent holders from receiving a premium for their common stock. Because Mr. Shi's interests may differ from ours or from those of our other stockholders, actions that he takes with respect to us, as our controlling stockholder, may not be favorable to us or to you or our other stockholders.

Mr. Shi, our Founder, Chief Strategy Officer and Chairman, is a Chinese national. For so long as a Chinese individual continues to exercise majority voting control over us, changes in U.S. and Chinese laws in the future may make it more difficult for us to operate as a publicly traded company in the United States.

Future developments in U.S. and Chinese laws may restrict our ability or willingness to operate as a publicly traded company in the United States for so long as Mr. Shi, who is a Chinese national, or other Chinese investors, continue to beneficially own a significant percentage of our outstanding shares of common stock. The relations between the United States and China are constantly changing. During his administration, President Donald J. Trump issued a memorandum directing the President's Working Group on Financial Markets to convene to discuss the risks faced by U.S. investors in Chinese companies and issued several executive orders restricting the operations of Chinese companies, such as the company that owns TikTok, in the United States. Additionally, the federal government has recently proposed legislation intended to protect American investments in Chinese companies. President Joseph R. Biden has not put forth specific policy proposals regarding China and it is unclear at this time which of President Trump's policies, if any, President Biden will continue to implement. In addition, various equity-based research organizations have published reports on Chinese companies after examining their corporate governance practices, related party transactions, sales practices and financial statements, and these reports have led to special investigations and listing suspensions on U.S. national exchanges. While we are not a Chinese company, any similar scrutiny of us, regardless of its merit, could have an adverse effect upon our business, including our results of operations, financial condition, cash flows and prospects. Additionally, should we be the subject of or indirectly covered by new legislation or executive orders addressed at protecting American investments in Chinese or Chinese-owned companies, our revenues and profitability would be materially reduced, and our business and results of operations would be seriously harmed.

The Committee on Foreign Investment in the United States may modify, delay or prevent our future acquisition or investment activities.

For so long as Mr. Shi retains a material ownership interest in us, we will be deemed a "foreign person" under the regulations relating to the Committee on Foreign Investment in the United States ("CFIUS"). As such, acquisitions of or investments in U.S. businesses or foreign businesses with U.S. subsidiaries that we may wish to pursue may be subject to CFIUS review, the scope of which was expanded by the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") to include certain non-passive, non-controlling investments (including certain investments in entities that hold or process personal information about U.S. nationals), certain acquisitions of real estate even with no underlying U.S. business, transactions designed or intended to evade or circumvent CFIUS jurisdiction and any transaction resulting in a "change in the rights" of a foreign person in a U.S. business if that change could result in either control of the business or a covered non-controlling investment. FIRRMA also subjects certain categories of investments to mandatory filings. If a particular proposed acquisition or investment in a U.S. business falls within CFIUS's jurisdiction, we may determine that we are required to make a mandatory filing or that we will submit to CFIUS review on a voluntary basis, or to proceed with the transaction without submitting to CFIUS and risk CFIUS intervention, before or after closing the transaction. CFIUS may decide to block or delay an acquisition or investment by us, impose conditions with respect to such acquisition or investment or order us to divest all or a portion of a U.S. business that we acquired without first obtaining CFIUS approval, which may limit the attractiveness of or prevent us from pursuing certain acquisitions or investments that we believe would otherwise be beneficial to us and our stockholders. Our inability to complete acquisitions and integrate those businesses successfully could limit our growth or disrupt our plans and operations. In addition, among other things, FIRRMA authorizes CFIUS to prescribe regulations defining "foreign person" differently in different contexts, which could result in less favorable treatment for investments and acquisitions by companies from countries of "special concern." If CFIUS were to promulgate regulations imposing additional burdens on acquisition and investment activities involving China or Chinese investor-controlled entities, our ability to consummate transactions falling within CFIUS's jurisdiction that might otherwise be beneficial to us and our stockholders would be hindered.

Hua Yuan International Limited, a minority stockholder, is indirectly controlled by China-Singapore Suzhou Industrial Park Ventures Co., Ltd., a Chinese state-owned entity, which could subject us to risks involving U.S. -China relations and related risks.

Hua Yuan International Limited, which beneficially owns 8.7% of our common stock and controls 1.1% of our voting power as of June 30, 2023, is indirectly controlled by China-Singapore Suzhou Industrial Park Ventures Co., Ltd., a Chinese state-owned entity. Recent political and economic tensions between the United States and China have negatively impacted certain public companies with stockholders that are Chinese state-owned entities. For example, in May 2021, three telecommunications companies with controlling stockholders that are Chinese state-owned entities — China Mobile Limited, China Unicom and China Telecom Corp., Ltd. — announced they would be delisted by the New York Stock Exchange pursuant to U.S. investment restrictions enacted in 2020. In addition, the Holding Foreign Companies Accountable Act, enacted in December 2020, requires SEC registrants to disclose whether an issuer is owned or controlled by a governmental entity in a foreign jurisdiction that does not allow inspection by the Public Group Accounting Oversight Board, principally including issuers based in China.

Although Hua Yuan International Limited does not own a controlling interest in us, its investment may subject us to risks related to having an indirect principal stockholder that is a Chinese state-owned entity as well as risks arising from political and economic tensions between the United States and China generally.

General Risk Factors

We are subject to risks related to corporate and social responsibility and reputation.

Many factors influence our reputation including the perception held by our customers, business partners and other key stakeholders. Our business faces increasing scrutiny related to environmental, social and governance activities. We risk damage to our reputation if we fail to act responsibly in a number of areas, such as diversity and inclusion, environmental stewardship, supply chain management, climate change, workplace conduct, human rights and philanthropy. Any harm to our reputation could impact employee engagement and retention and the willingness of customers and our partners to do business with us, which could have a material adverse effect on our business, results of operations and cash flows.

We cannot predict the impact our dual class structure may have on the market price of our Class A common stock.

We cannot predict whether our dual class structure will result in a lower or more volatile market price of our Class A common stock or in adverse publicity or other adverse consequences. For example, certain index providers have restrictions on including companies with multiple-class share structures in certain of their indexes. In July 2017, FTSE Russell and Standard & Poor's announced that they would cease to allow most newly public companies utilizing dual or multi-class capital structures to be included in their indices. Affected indices include the Russell 2000 and the S&P 500, S&P MidCap 400, and S&P SmallCap 600, which together make up the S&P Composite 1500. Under these policies, our dual class capital structure would make us ineligible for inclusion in certain indices, and as a result, mutual funds, exchange-traded funds, and other investment vehicles that attempt to passively track those indices will not be investing in our stock. Because of our dual class structure, we will likely be excluded from certain of these indexes and we cannot assure you that other stock indexes will not take similar actions. Given the sustained flow of investment funds into passive strategies that seek to track certain indexes, exclusion from stock indexes would likely preclude investment by many of these funds and could make our Class A common stock less attractive to other investors. As a result, the market price of our Class A common stock could be adversely affected.

Securities analysts may not publish favorable research or reports about our business or may publish no information at all, which could cause our stock price or trading volume to decline.

Our stock price and trading volume may be heavily influenced by the way analysts and investors interpret our financial information and other disclosures. If securities or industry analysts do not publish research or reports about our business, delay publishing reports about our business, or publish negative reports about our business, regardless of accuracy, our Class A common stock price and trading volume could decline.

The trading market for our Class A common stock is influenced to some extent by the research and reports that industry or financial analysts publish about us and our business. We do not control these analysts. As a newly public company, we may be slow to attract research coverage and the analysts who publish information about our Class A common stock may have relatively little experience with us or our industry, which could affect their ability to accurately forecast our results and could make it more likely that we fail to meet their estimates. If any of the analysts who cover us provide inaccurate or unfavorable research or issue an adverse opinion regarding our stock price, our stock price could decline. If one or more of these analysts cease coverage of us or fail to publish reports covering us regularly, we could lose visibility in the market, which in turn could cause our stock price or trading volume to decline.

Even if our Class A common stock is actively covered by analysts, we do not have any control over the analysts or the measures that analysts or investors may rely upon to forecast our future results. Over-reliance by analysts or investors on any particular metric to forecast our future results may lead to forecasts that differ significantly from our own.

If our estimates or judgments relating to our critical accounting policies are based on assumptions that change or prove to be incorrect, our results of operations could fall below our publicly announced guidance or the expectations of securities analysts and investors, resulting in a decline in the market price of our Class A common stock.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenues and expenses that are not readily apparent from other sources. If our assumptions change or if actual circumstances differ from our assumptions, our results of operations may be adversely affected and could fall below our publicly announced guidance or the expectations of securities analysts and investors, resulting in a decline in the market price of our Class A common stock.

A significant portion of our total outstanding shares are restricted from immediate resale but may be sold into the market in the future. This could cause the market price of our Class A common stock to decline, even if our business is doing well.

Sales of a substantial number of shares of our Class A common stock in the public market could occur at any time. These sales, or the perception in the market that the holders of a large number of shares intend to sell their shares, could result in a decrease in the market price of our Class A common stock. As of June 30, 2023, we had 36,649,725 shares of common stock outstanding. This includes 35,000,000 shares that are currently restricted as a result of securities laws but will be able to be sold as described in the section entitled "Shares Eligible for Future Sale" of our Prospectus as filed by us with the SEC on November 10, 2022 pursuant to Rule 424(b)(4) under the Securities Act, relating to our registration statement on Form S-1, as amended. We have also registered, and we intend to continue to register, all shares of common stock that we may issue under our equity compensation plans. Once we register these shares, they can be freely sold in the public market, subject to volume limitations applicable to affiliates.

We cannot guarantee that our share repurchase program will be fully implemented or it will enhance stockholder value, and share repurchases could affect the price of our Class A common stock.

In November 2022, our board of directors authorized a share repurchase program of up to $5 million of our outstanding Class A common stock (the "Share Repurchase Program"), which does not have a fixed expiration date. Share repurchases under the program may be made from time to time through open market transactions, block trades, privately negotiated transactions or otherwise and are subject to market and business conditions, levels of available liquidity, cash requirements for other purposes, regulatory, and other relevant factors, at the discretion of management and in accordance with applicable federal securities laws and other applicable legal requirements and Nasdaq listing rules. The timing, pricing, and size of share repurchases will depend on a number of factors, including, but not limited to, price, corporate and regulatory requirements, and general market and economic conditions. As of June 30, 2023, approximately $1.3 million of the Share Repurchase Program remains available for future repurchases. The Share Repurchase Program does not obligate us to repurchase any dollar amount or number of shares, and the program may be suspended or discontinued at any time, which may result in a decrease in the price of our Class A common stock.

Repurchases under our Share Repurchase Program will decrease the number of outstanding shares of our Class A common stock and therefore could affect the price of our Class A common stock and increase its volatility. The existence of our Share Repurchase Program could also cause the price of our Class A common stock to be higher than it would be in the absence of such a program and could reduce the market liquidity for our Class A common stock. Additionally, repurchases under our Share Repurchase Program will diminish our cash reserves, which could impact our ability to further develop our business and service our indebtedness. There can be no assurance that any share repurchases will enhance stockholder value because the market price of our Class A common stock may decline below the levels at which we repurchased such shares. Any failure to repurchase shares after we have announced our intention to do so may negatively impact our reputation and investor confidence in us and may negatively impact our Class A common stock price. Although our Share Repurchase Program is intended to enhance long-term stockholder value, short-term price fluctuations could reduce the program's effectiveness.

Provisions in our amended and restated certificate of incorporation and bylaws and under Delaware law could make an acquisition of us more difficult and may prevent attempts by our stockholders to replace or remove our current management.

Provisions in our amended and restated certificate of incorporation and our amended and restated bylaws may discourage, delay or prevent a merger, acquisition or other change in control of us that stockholders may consider favorable, including transactions in which stockholders might otherwise receive a premium for their shares. These provisions could also limit the price that investors might be willing to pay in the future for shares of our Class A common stock, thereby depressing the market price of our Class A common stock. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors. Because our board of directors is responsible for appointing the members of our management team, these provisions could in turn affect any attempt by our stockholders to replace current members of our management team.

Because we do not anticipate paying any cash dividends on our capital stock in the foreseeable future, capital appreciation, if any, will be your sole source of gain.

We currently intend to retain all of our future earnings, if any, to finance the growth and development of our business. Any determination to pay dividends in the future will be at the discretion of our board of directors and may be restricted by our credit facilities or any future debt or preferred securities or future debt agreements we may enter into. As a result, capital appreciation, if any, of our Class A common stock will be your sole source of gain for the foreseeable future. See “Dividend Policy” of our Prospectus as filed by us with the SEC on November 10, 2022 pursuant to Rule 424(b)(4) under the Securities Act, relating to our registration statement on Form S-1, as amended.

If we default on our credit obligations, our operations may be interrupted, and our business could be seriously harmed.

We have a credit facility that we may draw on to finance our operations and other corporate purposes. If we default on these credit obligations, our lenders may accelerate the debt and/or foreclose on property securing the debt.

If any of these events occur, our operations may be interrupted and our ability to fund our operations or obligations, as well as our business, could be seriously harmed. In addition, our credit facility contains operating covenants, including maintenance of certain financial ratios. Our ability to comply with these covenants may be affected by events beyond our control, and breaches of these covenants have in the past, and could in the future, result in a default under the credit facility and any future financial agreements into which we may enter. If not waived, defaults could cause our outstanding indebtedness under our credit facility and any future financing agreements that we may enter into to become immediately due and payable. For more information on our credit facility, see Item 2 of Part I, “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources.”

If we fail to maintain effective internal control over financial reporting, as well as required disclosure controls and procedures, our ability to produce timely and accurate consolidated financial statements or comply with applicable regulations could be impaired.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. We are continuing to develop and refine our disclosure controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file with the SEC is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that information required to be disclosed in reports under the Exchange Act is accumulated and communicated to our principal executive and financial officers. We are also continuing to develop and refine our internal control over financial reporting. Some members of our management team have limited or no experience managing a publicly traded company, interacting with public company investors, and complying with the increasingly complex laws pertaining to public companies, and we have limited accounting and financial reporting personnel and other resources with which to address our internal controls and related procedures. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, we have expended, and anticipate that we will continue to expend, significant resources, including accounting-related costs and significant management oversight.

Our current controls and any new controls that we develop may become inadequate because of changes in conditions in our business. In addition, changes in accounting principles or interpretations could also challenge our internal controls and require that we establish new business processes, systems and controls to accommodate such changes. We have limited experience with implementing the systems and controls that are necessary to operate as a public company, as well as adopting changes in accounting principles or interpretations mandated by the relevant regulatory bodies. Additionally, if these new systems, controls or standards and the associated process changes do not give rise to the benefits that we expect or do not operate as intended, it could adversely affect our financial reporting systems and processes, our ability to produce timely and accurate financial reports or the effectiveness of our internal control over financial reporting. Moreover, our business may be harmed if we experience problems with any new systems and controls that result in delays in their implementation or increased costs to correct any post-implementation issues that may arise.

Further, any failure to implement and maintain effective internal control over financial reporting could also adversely affect the results of periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting that we will eventually be required to include in our periodic reports that will be filed with the SEC. Ineffective disclosure controls and procedures or internal control over financial reporting could also cause investors to lose confidence in the accuracy and completeness of our reported financial and other information, which would likely have a negative effect on the trading price of our Class A common stock. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on the Nasdaq. As a public company, we are required to provide an annual management report on the effectiveness of our internal control over financial reporting commencing with our second Annual Report on Form 10-K.

Our independent registered public accounting firm is not required to formally attest to the effectiveness of our internal control over financial reporting until the later of (1) our second Annual Report on Form 10-K or (2) the Annual Report on Form 10-K for the first year we no longer qualify as an emerging growth company. At such time, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our internal control over financial reporting is documented, designed or operating. Any failure to maintain effective disclosure controls and internal control over financial reporting could harm our business and could cause a decline in the trading price of our Class A common stock. In addition, we could become subject to investigations by the stock exchange on which our securities are listed, the SEC or other regulatory authorities, which could require additional financial and management resources. These events could have a material and adverse effect on our business, results of operations, financial condition and prospects.

We identified material weaknesses in our internal control over financial reporting and we may identify additional material weaknesses in the future that may cause us to fail to meet our reporting obligations or result in material misstatements of our financial statements. If we do not effectively remediate the material weaknesses or if we otherwise fail to maintain effective internal control over financial reporting, we may not be able to accurately and timely report our financial results.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. Our management is likewise required, on a quarterly basis, to evaluate the effectiveness of our internal controls and to disclose any changes and material weaknesses identified through such evaluation in those internal controls. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

Our management identified a material weakness in our internal control over financial reporting involving lack of sufficient financial reporting close controls, including certain disclosure controls, and a material weakness in our internal control over financial reporting involving lack of effective control over the identification of related party transactions as of June 30, 2023. See Item 4, “Controls and Procedures,” in this Quarterly Report for information regarding the identified material weaknesses and our actions to date to remediate the material weaknesses. As a result of the material weaknesses, our management has concluded that our internal control over financial reporting were not effective as of June 30, 2023.

We are taking steps to remediate the material weakness, which include enhancing control procedures, hiring personnel with the depth of knowledge and experience to join our accounting and finance organization and inquiring of all executive management and board of directors of any contracts entered into on behalf of the Company, or its subsidiaries, on a quarterly basis. Further, the Company intends to review any unusual and recurring significant payments for related contracts. However, our efforts to remediate the material weaknesses may not be effective in preventing a future material weakness or significant deficiency in our internal control over financial reporting. If we do not effectively remediate the material weaknesses or if we otherwise fail to maintain effective internal control over financial reporting, we may not be able to accurately and timely report our financial results, which could cause our reported financial results to be materially misstated, result in the loss of investor confidence and cause the market price of our Class A common stock to decline.

We can give no assurance that the measures we have taken or plans to take in the future will remediate the material weaknesses identified or that any additional material weaknesses or restatements of financial results will not arise in the future due to a failure to implement and maintain adequate internal control over financial reporting or circumvention of these controls.

Our amended and restated certificate of incorporation provides that the Court of Chancery of the State of Delaware (or, if the Court of Chancery does not have jurisdiction, another State court in Delaware or the U.S. District Court for the District of Delaware) is the sole and exclusive forum for substantially all disputes between us and our stockholders, which could limit our stockholders' abilities to obtain a favorable judicial forum for disputes with us or our directors, officers or employees.

Our amended and restated certificate of incorporation specifies that, unless we consent in writing to the selection of an alternative forum, to the fullest extent permitted by law, the Court of Chancery of the State of Delaware is the sole and exclusive forum for most legal actions involving actions brought against us by stockholders; provided that, the exclusive forum provision will not apply to suits brought to enforce any liability or duty created by the Exchange Act or any other claim for which the U.S. federal courts have exclusive jurisdiction; and provided further that, if and only if the Court of Chancery of the State of Delaware dismisses any such action for lack of subject matter jurisdiction, such action may be brought in another state or federal court sitting in the State of Delaware. Our amended and restated certificate of incorporation also provides that the federal district courts of the United States of America is the exclusive forum for the resolution of any complaint asserting a cause of action against us or any of our directors, officers, employees or agents and arising under the Securities Act of 1933, as amended, or the Securities Act. We believe these provisions may benefit us by providing increased consistency in the application of Delaware law and federal securities laws by chancellors and judges, as applicable, particularly experienced in resolving corporate disputes, efficient administration of cases on a more expedited schedule relative to other forums and protection against the burdens of multi-forum litigation. However, these provisions may have the effect of discouraging lawsuits against our directors and officers. The enforceability of similar choice of forum provisions in other companies' certificates of incorporation has been challenged in legal proceedings, and it is possible that, in connection with any applicable action brought against us, a court could find the choice of forum provisions contained in our amended and restated certificate of incorporation to be inapplicable or unenforceable in such action.

We are an "emerging growth company," and the reduced disclosure requirements applicable to emerging growth companies may make our Class A common stock less attractive to investors.

We are an "emerging growth company," as defined in the JOBS Act. We could continue to be considered an emerging growth company for up to five years, although we would lose that status sooner if our annual gross revenues exceed $1.235 billion, if we issue more than $1.0 billion in nonconvertible debt in a three-year period or if the fair value of our Class A common stock held by non-affiliates exceeds $700.0 million (and we have been a public company for at least 12 months and have filed at least one Annual Report on Form 10-K). For the fiscal year ended December 31, 2022, our total net revenue was $74.4 million.

For as long as we continue to be an emerging growth company, we may take advantage of exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies, including reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. It is unclear whether investors will find our Class A common stock less attractive because we may rely on these exemptions. If some investors find our Class A common stock less attractive as a result, there may be a less active trading market for our Class A common stock and the trading price of our Class A common stock may be more volatile.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchases

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs
	In thousands, except per share amounts			
Period				
January 2023	153	$ 1.68	153	$ 1,333
February 2023	—	—	—	—
March 2023	—	—	—	—
April 2023	—	—	—	—
May 2023	—	—	—	—
June 2023	—	—	—	—
Total	153		153	

On November 10, 2022, our board of directors authorized a Share Repurchase Program under which we may repurchase up to $5 million in outstanding shares of our Class A common stock, subject to ongoing compliance with Nasdaq listing rules. The program does not have a fixed expiration date. The share repurchases may be made from time to time through open market transactions, block trades, privately negotiated transactions or otherwise and are subject to market and business conditions, levels of available liquidity, cash requirements for other purposes, regulatory, and other relevant factors. All share repurchases settled in the six month period ended June 30, 2023 were open market transactions. As of June 30, 2023, 1,350,275 shares of Class A common stock were repurchased pursuant to the Share Repurchase Program for an aggregate purchase price of approximately $3.7 million. The average price paid per share was $2.72 and approximately $1.3 million aggregate amount of shares of Class A common stock remain available for repurchase under the Share Repurchase Program. For more information regarding the Share Repurchase Program refer to Note 2 — *Summary of Significant Accounting Policies* to our unaudited condensed consolidated financial statements included in this Quarterly Report.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information.

During the quarter ended June 30, 2023, no director or officer of the Company adopted or terminated any "Rule 10b5-1 trading arrangement" or "non-Rule 10b5-1 trading arrangement," as each term is defined in Item 408(a) of Regulation S-K.

Item 6. Exhibits

Exhibit Index

		Incorporation by Reference				
Exhibit Number	**Description**	**Form**	**File No.**	**Exhibit**	**Filing Date**	**Filed Herewith**
31.1	Certification of Chief Executive Officer of Snail, Inc. pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1*	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.2*	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	Inline XBRL Instance Document					
101.SCH	Inline XBRL Taxonomy Extension Schema Document					
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document					
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document					
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document					
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document					
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)					

* These certifications are being furnished solely to accompany this Quarterly Report on Form 10-Q pursuant to 18 U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of Snail, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

† Indicates management contract or compensatory plan.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in Culver City, California, on August 14, 2023.

	Snail, Inc
Date: August 14, 2023	By: */s/ Jim S. Tsai* **Jim S. Tsai** **Chief Executive Officer**
Date: August 14, 2023	By: */s/ Heidy Chow* **Heidy Chow** **Chief Financial Officer**

Exhibit 31.1

OFFICER'S CERTIFICATE
PURSUANT TO SECTION 302

I, Jim S. Tsai, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Snail, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) [Paragraph intentionally omitted in accordance with SEC Release Nos. 34-47986 and 34-54942];

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2023

/s/ Jim S. Tsai
Jim S. Tsai
Chief Executive Officer

Exhibit 31.2

OFFICER'S CERTIFICATE
PURSUANT TO SECTION 302

I, Heidy Chow, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Snail, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal controls over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) [Paragraph intentionally omitted in accordance with SEC Release Nos. 34-47986 and 34-54942];

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 14, 2023

/s/ Heidy Chow

Heidy Chow
Principal Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES OXLEY ACT OF 2002
CERTIFICATION

In connection with the Quarterly Report of Snail, Inc. (the “Company”) on Form 10-Q for the period ended June 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Jim S. Tsai, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Jim S. Tsai
Jim S. Tsai
Chief Executive Officer
(Principal Executive Officer)

August 14, 2023

Exhibit 32.2

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES OXLEY ACT OF 2002
CERTIFICATION**

In connection with the Quarterly Report of Snail, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2023, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Heidy Chow, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Heidy Chow

Heidy Chow
Chief Financial Officer
(Principal Financial Officer)

August 14, 2023