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Facebook Inc
Form 10-Q
July 31, 2015
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, 2015

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: 001-35551

FACEBOOK, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

1601 Willow Road, Menlo Park, California 94025

(Address of principal executive offices and Zip Code)

(650) 543-4800

(Registrant's telephone number, including area code)

20-1665019

(I.R.S. Employer Identification Number)

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 (Exchange Act) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

Class

Number of Shares Outstanding

Class A Common Stock \$0.000006 par value

2,259,736,529 shares outstanding as of July 27, 2015

Class B Common Stock \$0.000006 par value

557,808,963 shares outstanding as of July 27, 2015

FACEBOOK, INC.
TABLE OF CONTENTS

	Page No.
<u>Note About Forward-Looking Statements</u>	<u>3</u>
<u>Limitations of Key Metrics and Other Data</u>	<u>4</u>
<u>PART I—FINANCIAL INFORMATION</u>	<u>5</u>
Item 1. <u>Financial Statements (unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Balance Sheets—June 30, 2015 and December 31, 2014</u>	<u>5</u>
<u>Condensed Consolidated Statements of Income—for the three and six months ended June 30, 2015 and 2014</u>	<u>6</u>
<u>Condensed Consolidated Statements of Comprehensive Income—for the three and six months ended June 30, 2015 and 2014</u>	<u>7</u>
<u>Condensed Consolidated Statements of Cash Flows—for the six months ended June 30, 2015 and 2014</u>	<u>8</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>10</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>35</u>
Item 4. <u>Controls and Procedures</u>	<u>36</u>
<u>PART II—OTHER INFORMATION</u>	<u>37</u>
Item 1. <u>Legal Proceedings</u>	<u>37</u>
Item 1A. <u>Risk Factors</u>	<u>38</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>56</u>
Item 6. <u>Exhibits</u>	<u>57</u>
<u>SIGNATURES</u>	<u>58</u>

NOTE ABOUT FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained in this Quarterly Report on Form 10-Q other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans, and our objectives for future operations, are forward-looking statements. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in Part II, Item 1A, "Risk Factors" in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Unless expressly indicated or the context requires otherwise, the terms "Facebook," "company," "we," "us," and "our" in this document refer to Facebook, Inc., a Delaware corporation, and, where appropriate, its wholly owned subsidiaries. The term "Facebook" may also refer to our products, regardless of the manner in which they are accessed. For references to accessing Facebook on the "web" or via a "website," such terms refer to accessing Facebook on personal computers. For references to accessing Facebook on "mobile," such term refers to accessing Facebook via a mobile application or via a mobile-optimized version of our website such as m.facebook.com, whether on a mobile phone or tablet.

LIMITATIONS OF KEY METRICS AND OTHER DATA

The numbers for our key metrics, which include our daily active users (DAUs), mobile DAUs, monthly active users (MAUs), mobile MAUs, and average revenue per user (ARPU), as well as certain other metrics such as mobile-only DAUs and mobile-only MAUs, are calculated using internal company data based on the activity of user accounts. While these numbers are based on what we believe to be reasonable estimates of our user base for the applicable period of measurement, there are inherent challenges in measuring usage of our products across large online and mobile populations around the world.

For example, there may be individuals who maintain one or more Facebook accounts in violation of our terms of service. We estimate, for example, that "duplicate" accounts (an account that a user maintains in addition to his or her principal account) may have represented less than 5% of our worldwide MAUs in 2014. We also seek to identify "false" accounts, which we divide into two categories: (1) user-misclassified accounts, where users have created personal profiles for a business, organization, or non-human entity such as a pet (such entities are permitted on Facebook using a Page rather than a personal profile under our terms of service); and (2) undesirable accounts, which represent user profiles that we determine are intended to be used for purposes that violate our terms of service, such as spamming. In 2014, for example, we estimate user-misclassified and undesirable accounts may have represented less than 2% of our worldwide MAUs. We believe the percentage of accounts that are duplicate or false is meaningfully lower in developed markets such as the United States or United Kingdom and higher in developing markets such as India and Turkey. However, these estimates are based on an internal review of a limited sample of accounts and we apply significant judgment in making this determination, such as identifying names that appear to be fake or other behavior that appears inauthentic to the reviewers. As such, our estimation of duplicate or false accounts may not accurately represent the actual number of such accounts. We are continually seeking to improve our ability to identify duplicate or false accounts and estimate the total number of such accounts, and such estimates may change due to improvements or changes in our methodology.

Our data limitations may affect our understanding of certain details of our business. For example, while user-provided data indicates a decline in usage among younger users, this age data is unreliable because a disproportionate number of our younger users register with an inaccurate age. Accordingly, our understanding of usage by age group may not be complete.

Some of our metrics have also been affected by applications on certain mobile devices that automatically contact our servers for regular updates with no user action involved, and this activity can cause our system to count the user associated with such a device as an active user on the day such contact occurs. The impact of this automatic activity on our metrics varies by geography because mobile usage varies in different regions of the world. In addition, our data regarding the geographic location of our users is estimated based on a number of factors, such as the user's IP address and self-disclosed location. These factors may not always accurately reflect the user's actual location. For example, a mobile-only user may appear to be accessing Facebook from the location of the proxy server that the user connects to rather than from the user's actual location. The methodologies used to measure user metrics may also be susceptible to algorithm or other technical errors. Our estimates for revenue by user location and revenue by user device are also affected by these factors. We regularly review our processes for calculating these metrics, and from time to time we may discover inaccuracies in our metrics or make adjustments to improve their accuracy, including adjustments that may result in the recalculation of our historical metrics. We believe that any such inaccuracies or adjustments are immaterial unless otherwise stated. In addition, our DAU and MAU estimates will differ from estimates published by third parties due to differences in methodology. For example, some third parties are not able to accurately measure mobile users or do not count mobile users for certain user groups or at all in their analyses.

The numbers of DAUs, mobile DAUs, MAUs, mobile MAUs, mobile-only DAUs, and mobile-only MAUs discussed in this Quarterly Report on Form 10-Q, as well as ARPU, do not include users of Instagram or WhatsApp unless they would otherwise qualify as such users, respectively, based on their other activities on Facebook. In addition, other user engagement metrics included herein do not include Instagram or WhatsApp unless otherwise specifically stated.

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

FACEBOOK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions, except for number of shares and par value)

(Unaudited)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$5,123	\$4,315
Marketable securities	9,002	6,884
Accounts receivable, net of allowances for doubtful accounts of \$47 and \$39 as of June 30, 2015 and December 31, 2014, respectively	1,815	1,678
Prepaid expenses and other current assets	1,011	793
Total current assets	16,951	13,670
Property and equipment, net	4,955	3,967
Intangible assets, net	3,605	3,929
Goodwill	18,025	17,981
Other assets	594	637
Total assets	\$44,130	\$40,184
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$139	\$176
Partners payable	182	202
Accrued expenses and other current liabilities	1,472	866
Deferred revenue and deposits	49	66
Current portion of capital lease obligations	39	114
Total current liabilities	1,881	1,424
Capital lease obligations, less current portion	110	119
Other liabilities	2,687	2,545
Total liabilities	4,678	4,088
Stockholders' equity:		
Common stock, \$0.000006 par value; 5,000 million Class A shares authorized, 2,256 million and 2,234 million shares issued and outstanding, including 10 million and 13 million outstanding shares subject to repurchase, as of June 30, 2015 and December 31, 2014, respectively; 4,141 million Class B shares authorized, 558 million and 563 million shares issued and outstanding, including 4 million and 6 million outstanding shares subject to repurchase, as of June 30, 2015 and December 31, 2014, respectively	—	—
Additional paid-in capital	32,479	30,225
Accumulated other comprehensive loss	(357) (228
Retained earnings	7,330	6,099
Total stockholders' equity	39,452	36,096
Total liabilities and stockholders' equity	\$44,130	\$40,184
See Accompanying Notes to Condensed Consolidated Financial Statements.		

FACEBOOK, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (In millions, except per share amounts)
 (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenue	\$4,042	\$2,910	\$7,586	\$5,412
Costs and expenses:				
Cost of revenue	668	473	1,323	936
Research and development	1,170	492	2,231	947
Marketing and sales	626	358	1,247	681
General and administrative	305	197	579	384
Total costs and expenses	2,769	1,520	5,380	2,948
Income from operations	1,273	1,390	2,206	2,464
Interest and other income/(expense), net	—	(4) (1) (4
Income before provision for income taxes	1,273	1,386	2,205	2,460
Provision for income taxes	554	595	974	1,027
Net income	\$719	\$791	\$1,231	\$1,433
Less: Net income attributable to participating securities	4	3	7	6
Net income attributable to Class A and Class B common stockholders	\$715	\$788	\$1,224	\$1,427
Earnings per share attributable to Class A and Class B common stockholders:				
Basic	\$0.26	\$0.31	\$0.44	\$0.56
Diluted	\$0.25	\$0.30	\$0.43	\$0.55
Weighted average shares used to compute earnings per share attributable to Class A and Class B common stockholders:				
Basic	2,796	2,560	2,790	2,552
Diluted	2,850	2,615	2,844	2,609
Share-based compensation expense included in costs and expenses:				
Cost of revenue	\$21	\$16	\$38	\$28
Research and development	603	219	1,169	400
Marketing and sales	82	50	154	93
General and administrative	57	29	105	67
Total share-based compensation expense	\$763	\$314	\$1,466	\$588

See Accompanying Notes to Condensed Consolidated Financial Statements.

FACEBOOK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	\$719	\$791	\$1,231	\$1,433
Other comprehensive income (loss):				
Change in foreign currency translation adjustment, net of tax	91	(20)	(132)	(21)
Change in unrealized gain/loss on available-for-sale investments, net of tax	(1)	—	3	2
Comprehensive income	\$809	\$771	\$1,102	\$1,414

See Accompanying Notes to Condensed Consolidated Financial Statements.

FACEBOOK, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In millions)
 (Unaudited)

	Six Months Ended June 30,	
	2015	2014
Cash flows from operating activities		
Net income	\$ 1,231	\$ 1,433
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	916	521
Share-based compensation	1,457	588
Deferred income taxes	(289)	(34)
Tax benefit from share-based award activity	809	875
Excess tax benefit from share-based award activity	(809)	(883)
Other	7	(23)
Changes in assets and liabilities:		
Accounts receivable	(198)	(82)
Prepaid expenses and other current assets	(90)	10
Other assets	(25)	18
Accounts payable	16	69
Partners payable	(19)	(5)
Accrued expenses and other current liabilities	241	75
Deferred revenue and deposits	(17)	15
Other liabilities	350	49
Net cash provided by operating activities	3,580	2,626
Cash flows from investing activities		
Purchases of property and equipment	(1,051)	(832)
Purchases of marketable securities	(5,560)	(4,482)
Sales of marketable securities	2,726	1,968
Maturities of marketable securities	715	1,074
Acquisitions of businesses, net of cash acquired, and purchases of intangible assets	(282)	(19)
Change in restricted cash and deposits	44	(2)
Other investing activities, net	—	(1)
Net cash used in investing activities	(3,408)	(2,294)
Cash flows from financing activities		
Taxes paid related to net share settlement	(12)	(3)
Proceeds from exercise of stock options	—	2
Principal payments on capital lease obligations	(84)	(150)
Excess tax benefit from share-based award activity	809	883
Net cash provided by financing activities	713	732
Effect of exchange rate changes on cash and cash equivalents	(77)	(3)
Net increase in cash and cash equivalents	808	1,061
Cash and cash equivalents at beginning of period	4,315	3,323
Cash and cash equivalents at end of period	\$ 5,123	\$ 4,384
See Accompanying Notes to Condensed Consolidated Financial Statements.		

FACEBOOK, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In millions)
 (Unaudited)

	Six Months Ended June 30,	
	2015	2014
Supplemental cash flow data		
Cash paid during the period for:		
Interest	\$5	\$8
Income taxes, net	\$159	\$59
Non-cash investing and financing activities:		
Net change in accounts payable and accrued expenses and other current liabilities related to property and equipment additions	\$194	\$18
Promissory note payable issued in connection with an acquisition	\$198	\$—
See Accompanying Notes to Condensed Consolidated Financial Statements.		

FACEBOOK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. As such, the information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

The condensed consolidated balance sheet as of December 31, 2014 included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP.

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

The accompanying condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2015.

There have been no changes to our significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014 that have had a material impact on our condensed consolidated financial statements and related notes.

Use of Estimates

Conformity with GAAP requires the use of estimates and judgments that affect the reported amounts in the condensed consolidated financial statements and accompanying notes. These estimates form the basis for judgments we make about the carrying values of our assets and liabilities, which are not readily apparent from other sources. We base our estimates and judgments on historical information and on various other assumptions that we believe are reasonable under the circumstances. GAAP requires us to make estimates and judgments in several areas, including, but not limited to, those related to revenue recognition, collectability of accounts receivable, contingent liabilities, fair value of financial instruments, fair value of acquired intangible assets and goodwill, useful lives of intangible assets and property and equipment, and income taxes. These estimates are based on management's knowledge about current events and expectations about actions we may undertake in the future. Actual results could differ materially from those estimates.

Recent Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which amends the existing accounting standards for revenue recognition. In July 2015, the FASB decided to delay the effective date of ASU 2014-09 by one year. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. As such, the updated standard will be effective for us in the first quarter of 2018, with the option to adopt it in the first quarter of 2017. We are still evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

Note 2. Acquisitions

In the six months ended June 30, 2015, we completed several business acquisitions for total consideration of \$469 million, the substantial majority of which is related to a business combination involving land and buildings adjacent to our headquarters in Menlo Park. Included in this amount is a \$198 million promissory note payable issued in connection with this particular acquisition. This promissory note payable is classified under accrued expenses and other current liabilities in our condensed consolidated balance sheets. These acquisitions were not material to our condensed consolidated financial statements, either individually or in the aggregate. Accordingly, pro forma historical results of operations related to these business acquisitions during the six months ended June 30, 2015 have not been presented. We have included the financial results of these business acquisitions in our condensed consolidated

financial statements from their respective dates of acquisition.

10

The following table summarizes the allocation of the total consideration transferred during the six months ended June 30, 2015, including the related useful lives, where applicable:

	(in millions)	Useful lives (in years)
Finite-lived intangible assets:		
Acquired technology	\$25	3
Other	5	3
Land acquired	379	
Other net tangible assets acquired	12	
Deferred tax assets, net	6	
Net assets acquired	\$427	
Goodwill	42	
Total fair value consideration	\$469	

Goodwill generated from all business acquisitions completed during the six months ended June 30, 2015 is primarily attributable to expected synergies from future growth and potential monetization opportunities. The amount of goodwill generated during this period that is deductible for tax purposes is not material.

Note 3. Earnings per Share

We compute earnings per share (EPS) of Class A and Class B common stock using the two-class method required for participating securities. We consider restricted stock awards to be participating securities because holders of such shares have non-forfeitable dividend rights in the event of our declaration of a dividend for common shares.

Undistributed earnings allocated to participating securities are subtracted from net income in determining net income attributable to common stockholders. Basic EPS is computed by dividing net income attributable to common stockholders by the weighted-average number of shares of our Class A and Class B common stock outstanding, adjusted for outstanding shares that are subject to repurchase.

For the calculation of diluted EPS, net income attributable to common stockholders for basic EPS is adjusted by the effect of dilutive securities, including awards under our equity compensation plans and inducement awards under a separate non-plan RSU award agreement. In addition, the computation of the diluted EPS of Class A common stock assumes the conversion of our Class B common stock to Class A common stock, while the diluted EPS of Class B common stock does not assume the conversion of those shares to Class A common stock. Diluted EPS attributable to common stockholders is computed by dividing the resulting net income attributable to common stockholders by the weighted-average number of fully diluted common shares outstanding.

Basic and dilutive securities in our basic and diluted EPS calculation for the three and six months ended June 30, 2015 do not include contingent earn-out shares. Issuance of these earn-out shares is dependent upon the completion of certain milestones. These milestones were not met as of June 30, 2015 and accordingly, these shares are excluded from the effect of basic and dilutive securities.

The restricted stock units (RSUs) excluded from the EPS calculation were not material for the three and six months ended June 30, 2015. There were 18 million and 10 million RSUs excluded from the calculation for the three and six months ended June 30, 2014, respectively, because the impact would be anti-dilutive.

Basic and diluted EPS are the same for each class of common stock because they are entitled to the same liquidation and dividend rights.

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The numerators and denominators of the basic and diluted EPS computations for our common stock are calculated as follows (in millions, except per share amounts):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2015		2014		2015		2014	
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Basic EPS:								
Numerator								
Net income	\$576	\$143	\$617	\$174	\$987	\$244	\$1,116	\$317
Less: Net income attributable to participating securities	3	1	2	1	6	1	5	1
Net income attributable to common stockholders	\$573	\$142	\$615	\$173	\$981	\$243	\$1,111	\$316
Denominator								
Weighted average shares outstanding	2,252	559	2,002	568	2,247	560	1,992	571
Less: Shares subject to repurchase	10	5	5	5	11	6	5	6
Number of shares used for basic EPS computation	2,242	554	1,997	563	2,236	554	1,987	565
Basic EPS	\$0.26	\$0.26	\$0.31	\$0.31	\$0.44	\$0.44	\$0.56	\$0.56
Diluted EPS:								
Numerator								
Net income attributable to common stockholders	\$573	\$142	\$615	\$173	\$981	\$243	\$1,111	\$316
Reallocation of net income attributable to participating securities	4	—	3	—	7	—	6	—
Reallocation of net income as a result of conversion of Class B to Class A common stock	—	—	173	—	243	—	316	—
Reallocation of net income to Class B common stock	—	3	—	7	—	7	—	14