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Facebook Inc
Form 10-Q
April 25, 2019
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 March 31, 2019

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) 20-1665019 (I.R.S. Employer Identification Number)

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)

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 every Interactive Data File required to be submitted 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 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.

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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	2,402,542,856 shares outstanding as of April 22, 2019
Class B Common Stock \$0.000006 par value	451,945,880 shares outstanding as of April 22, 2019

FACEBOOK, INC.
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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), monthly active users (MAUs), and average revenue per user (ARPU), 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. In addition, we are continually seeking to improve our estimates of our user base, and such estimates may change due to improvements or changes in our methodology.

We regularly evaluate these metrics to estimate the number of "duplicate" and "false" accounts among our MAUs. A duplicate account is one that a user maintains in addition to his or her principal account. We divide "false" accounts 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. The estimates of duplicate and false accounts are based on an internal review of a limited sample of accounts, and we apply significant judgment in making this determination. For example, to identify duplicate accounts we use data signals such as similar IP addresses or user names, and to identify false accounts we look for names that appear to be fake or other behavior that appears inauthentic to the reviewers. Our estimates may change as our methodologies evolve, including through the application of new data signals or technologies, which may allow us to identify previously undetected duplicate or false accounts and may improve our ability to evaluate a broader population of our users. Duplicate and false accounts are very difficult to measure at our scale, and it is possible that the actual number of duplicate and false accounts may vary significantly from our estimates.

In the fourth quarter of 2018, we estimated that duplicate accounts may have represented approximately 11% of our worldwide MAUs. We believe the percentage of duplicate accounts is meaningfully higher in developing markets such as the Philippines and Vietnam, as compared to more developed markets. In the fourth quarter of 2018, we estimated that false accounts may have represented approximately 5% of our worldwide MAUs. Our estimation of false accounts can vary as a result of episodic spikes in the creation of such accounts, which we have seen originate more frequently in specific countries such as Indonesia and Vietnam. From time to time, we may make product changes or take other actions to reduce the number of duplicate or false accounts among our users, which may also reduce our DAU and MAU estimates in a particular period.

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.

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 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. We intend to disclose our estimates of the number of duplicate and false accounts among our MAUs on an annual basis. In addition, our DAU and MAU estimates will differ from estimates published by third parties due to differences in methodology.

The numbers of DAUs and MAUs discussed in this Quarterly Report on Form 10-Q, as well as ARPU, do not include Instagram, WhatsApp, or Oculus users 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, WhatsApp, or Oculus 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)

	March 31, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	\$11,076	\$ 10,019
Marketable securities	34,167	31,095
Accounts receivable, net of allowances of \$216 and \$229 as of March 31, 2019 and December 31, 2018, respectively	6,475	7,587
Prepaid expenses and other current assets	1,582	1,779
Total current assets	53,300	50,480
Property and equipment, net	27,345	24,683
Operating lease right-of-use assets, net	6,747	—
Intangible assets, net	1,150	1,294
Goodwill	18,333	18,301
Other assets	2,602	2,576
Total assets	\$109,477	\$ 97,334
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$604	\$ 820
Partners payable	537	541
Operating lease liabilities, current	645	—
Accrued expenses and other current liabilities	7,980	5,509
Deferred revenue and deposits	142	147
Total current liabilities	9,908	7,017
Operating lease liabilities, non-current	6,565	—
Other liabilities	6,488	6,190
Total liabilities	22,961	13,207
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.000006 par value; 5,000 million Class A shares authorized, 2,404 million and 2,385 million shares issued and outstanding, as of March 31, 2019 and December 31, 2018, respectively; 4,141 million Class B shares authorized, 452 million and 469 million shares issued and outstanding, as of March 31, 2019 and December 31, 2018, respectively.	—	—
Additional paid-in capital	43,533	42,906
Accumulated other comprehensive loss	(781) (760)
Retained earnings	43,764	41,981
Total stockholders' equity	86,516	84,127
Total liabilities and stockholders' equity	\$109,477	\$ 97,334
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 March 31,	
	2019	2018
Revenue	\$ 15,077	\$ 11,966
Costs and expenses:		
Cost of revenue	2,816	1,927
Research and development	2,860	2,238
Marketing and sales	2,020	1,595
General and administrative	4,064	757
Total costs and expenses	11,760	6,517
Income from operations	3,317	5,449
Interest and other income, net	165	161
Income before provision for income taxes	3,482	5,610
Provision for income taxes	1,053	622
Net income	\$ 2,429	\$ 4,988
Less: Net income attributable to participating securities	—	1
Net income attributable to Class A and Class B common stockholders	\$ 2,429	\$ 4,987
Earnings per share attributable to Class A and Class B common stockholders:		
Basic	\$ 0.85	\$ 1.72
Diluted	\$ 0.85	\$ 1.69
Weighted average shares used to compute earnings per share attributable to Class A and Class B common stockholders:		
Basic	2,856	2,906
Diluted	2,869	2,945
Share-based compensation expense included in costs and expenses:		
Cost of revenue	\$ 87	\$ 56
Research and development	723	718
Marketing and sales	113	109
General and administrative	87	72
Total share-based compensation expense	\$ 1,010	\$ 955
See Accompanying Notes to Condensed Consolidated Financial Statements.		

FACEBOOK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)

(Unaudited)

	Three Months Ended March 31,	
	2019	2018
Net income	\$2,429	\$4,988
Other comprehensive income (loss):		
Change in foreign currency translation adjustment, net of tax	(175)	94
Change in unrealized gain/loss on available-for-sale investments and other, net of tax	154	(161)
Comprehensive income	\$2,408	\$4,921
See Accompanying Notes to Condensed Consolidated Financial Statements.		

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FACEBOOK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In millions)

(Unaudited)

	Three Months Ended March 31, 2019					Three Months Ended March 31, 2018				
	Class A and Class B Common Shares	Additional Paid-In Stock Par Capital Value	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity	Class A and Class B Common Shares	Additional Paid-In Stock Par Capital Value	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
Balances at beginning of period	2,854	\$ -42,906	\$(760)	\$41,981	\$84,127	2,906	\$ -40,584	\$(227)	\$33,990	\$74,347
Impact of the adoption of new accounting pronouncement	—	—	—	—	—	—	—	—	141	141
Issuance of common stock	8	—4	—	—	4	12	—3	—	—	3
Shares withheld related to net share settlement	(3)	—(387)	—	(125)	(512)	(5)	—(408)	—	(424)	(832)
Share-based compensation, related to employee share-based awards	—	—1,010	—	—	1,010	—	—955	—	—	955
Share repurchases	(3)	—	—	(521)	(521)	(11)	—	—	(1,915)	(1,915)
Other comprehensive loss	—	—	(21)	—	(21)	—	—	(67)	—	(67)
Net income	—	—	—	2,429	2,429	—	—	—	4,988	4,988
Balances at end of period	2,856	\$ -43,533	\$(781)	\$43,764	\$86,516	2,902	\$ -41,134	\$(294)	\$36,780	\$77,620

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2019	2018
Cash flows from operating activities		
Net income	\$2,429	\$4,988
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,355	949
Share-based compensation	1,010	955
Deferred income taxes	183	(47)
Other	6	8
Changes in assets and liabilities:		
Accounts receivable	1,070	788
Prepaid expenses and other current assets	84	(365)
Other assets	41	22
Operating lease right-of-use assets, net	(1,190)	—
Accounts payable	(96)	1
Partners payable	(1)	2
Accrued expenses and other current liabilities	3,154	707
Deferred revenue and deposits	(4)	(5)
Operating lease liabilities, non-current	1,083	—
Other liabilities	184	(143)
Net cash provided by operating activities	9,308	7,860
Cash flows from investing activities		
Purchases of property and equipment, net	(3,837)	(2,812)
Purchases of marketable securities	(6,603)	(4,022)
Sales of marketable securities	1,512	4,330
Maturities of marketable securities	2,210	1,267
Other investing activities, net	(50)	(50)
Net cash used in investing activities	(6,768)	(1,287)
Cash flows from financing activities		
Taxes paid related to net share settlement of equity awards	(512)	(832)
Repurchases of Class A common stock	(613)	(1,774)
Principal payments on finance leases	(125)	—
Net change in overdraft in cash pooling entities	(177)	—
Other financing activities, net	4	3
Net cash used in financing activities	(1,423)	(2,603)
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	(44)	36
Net increase in cash, cash equivalents, and restricted cash	1,073	4,006
Cash, cash equivalents, and restricted cash at beginning of the period	10,124	8,204
Cash, cash equivalents, and restricted cash at end of the period	\$11,197	\$12,210
Reconciliation of cash, cash equivalents, and restricted cash to the condensed consolidated balance sheets		
Cash and cash equivalents	\$11,076	\$12,082
Restricted cash, included in prepaid expenses and other current assets	10	14
Restricted cash, included in other assets	111	114

Total cash, cash equivalents, and restricted cash	\$11,197	\$12,210
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See Accompanying Notes to Condensed Consolidated Financial Statements.

FACEBOOK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Three Months Ended March 31,	
	2019	2018
Supplemental cash flow data		
Cash paid during the period for:		
Interest	\$2	\$—
Income taxes, net	\$682	\$736
Non-cash investing activities:		
Net change in prepaids and liabilities related to property and equipment	\$(314)	\$429
Accrued property and equipment	\$1,617	\$1,291
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 year ended December 31, 2018.

The condensed consolidated balance sheet as of December 31, 2018 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 that are necessary to present fairly the results for the interim periods presented. Interim results are not necessarily indicative of the results for the full year ending December 31, 2019.

Use of Estimates

Conformity with GAAP requires the use of estimates and judgments that affect the reported amounts in the 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 income taxes, loss contingencies, fair value of acquired intangible assets and goodwill, collectability of accounts receivable, fair value of financial instruments, leases, useful lives of intangible assets and property and equipment, and revenue recognition. 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.

Recently Adopted Accounting Pronouncements

On January 1, 2019, we adopted Accounting Standards Update No. 2016-02, Leases (Topic 842) (ASU 2016-02), as amended, which supersedes the lease accounting guidance under Topic 840, and generally requires lessees to recognize operating and financing lease liabilities and corresponding right-of-use (ROU) assets on the balance sheet and to provide enhanced disclosures surrounding the amount, timing and uncertainty of cash flows arising from leasing arrangements. We adopted the new guidance using the modified retrospective transition approach by applying the new standard to all leases existing at the date of initial application and not restating comparative periods. The most significant impact was the recognition of ROU assets and lease liabilities for operating leases, while our accounting for finance leases remained substantially unchanged. For information regarding the impact of Topic 842 adoption, see Significant Accounting Policies - Leases and Note 7— Leases.

Significant Accounting Policies - Leases

On January 1, 2019, we adopted Topic 842 using the modified retrospective transition approach by applying the new standard to all leases existing at the date of initial application. Results and disclosure requirements for reporting periods beginning after January 1, 2019 are presented under Topic 842, while prior period amounts have not been adjusted and continue to be reported in accordance with our historical accounting under Topic 840.

We elected the package of practical expedients permitted under the transition guidance, which allowed us to carryforward our historical lease classification, our assessment on whether a contract was or contains a lease, and our

initial direct costs for any leases that existed prior to January 1, 2019. We also elected to combine our lease and non-lease components and to keep leases with an initial term of 12 months or less off the balance sheet and recognize the associated lease payments in the consolidated statements of income on a straight-line basis over the lease term. Additionally, for certain equipment leases, we apply a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Upon adoption, we recognized total ROU assets of \$6.63 billion, with corresponding liabilities of \$6.35 billion on the condensed consolidated balance sheets. This included \$761 million of pre-existing finance lease ROU assets previously reported in the network equipment within property and equipment, net. The ROU assets include adjustments for prepayments and accrued lease payments. The adoption did not impact our beginning retained earnings, or our prior year condensed consolidated statements of income and statements of cash flows.

Under Topic 842, we determine if an arrangement is a lease at inception. ROU assets and liabilities are recognized at commencement date based on the present value of remaining lease payments over the lease term. For this purpose, we consider only payments that are fixed and determinable at the time of commencement. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Our incremental borrowing rate is a hypothetical rate based on our understanding of what our credit rating would be. The ROU asset also includes any lease payments made prior to commencement and is recorded net of any lease incentives received. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise such options.

Operating leases are included in operating lease right-of-use assets, operating lease liabilities, current and operating lease liabilities, non-current on our condensed consolidated balance sheets. Finance leases are included in property and equipment, net, accrued expenses and other current liabilities, and other liabilities on our condensed consolidated balance sheets.

Note 2. Revenue

Revenue disaggregated by revenue source for the three months ended March 31, 2019 and 2018, consists of the following (in millions):

	Three Months Ended March 31,	
	2019	2018
Advertising	\$14,912	\$11,795
Payments and other fees	165	171
Total revenue	\$15,077	\$11,966

Revenue disaggregated by geography, based on the billing address of our customer, consists of the following (in millions):

	Three Months Ended March 31,	
	2019	2018
Revenue:		
US & Canada ⁽¹⁾	\$6,777	\$5,442
Europe ⁽²⁾	3,624	3,027
Asia-Pacific	3,337	2,475
Rest of World ⁽²⁾	1,339	1,022
Total revenue	\$15,077	\$11,966

(1) United States revenue was \$6.36 billion and \$5.09 billion for the three months ended March 31, 2019 and 2018, respectively.

(2) Europe includes Russia and Turkey, and Rest of World includes Africa, Latin America, and the Middle East.

Deferred revenue and deposits consists of the following (in millions):

	March 31, December 31,	
	2019	2018
Deferred revenue	\$ 111	\$ 117
Deposits	31	30
Total deferred revenue and deposits	\$ 142	\$ 147

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. In 2018, the calculation of diluted EPS also included the effect of inducement awards under separate non-plan restricted stock unit (RSU) award agreements.

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.

RSUs with anti-dilutive effect were excluded from the EPS calculation and they were not material for the three months ended March 31, 2019 and 2018, respectively.

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			
	March 31,			
	2019		2018	
	Class	Class	Class	Class
	A	B	A	B
Basic EPS:				
Numerator				
Net income	\$2,038	\$391	\$4,123	\$865
Less: Net income attributable to participating securities	—	—	1	—
Net income attributable to common stockholders	\$			