Facebook Inc
Form 10-Q
October 24, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2012
or
o 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	20-1665019
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1601 Willow Road, Menlo Park, California 94025
(Address of principal executive offices and Zip Code)
(650) 308-7300
(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 x 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 x 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 x (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 x

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	1,099,471,393 shares outstanding as of October 22, 2012
Class B Common Stock $0.000006 par value	1,066,955,915 shares outstanding as of October 22, 2012

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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-lookin 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.

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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)

	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$2,478	$1,512
Marketable securities	7,974	2,396
Accounts receivable, net of allowances for doubtful accounts of $18 and $17 as of September 30, 2012 and December 31, 2011, respectively	635	547
Income tax refundable	567	—
Prepaid expenses and other current assets	631	149
Total current assets	12,285	4,604
Property and equipment, net	2,289	1,475
Goodwill and intangible assets, net	1,423	162
Other assets	41	90
Total assets	$16,038	$6,331
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$59	$63
Platform partners payable	155	171
Accrued expenses and other current liabilities	409	296
Deferred revenue and deposits	85	90
Current portion of capital lease obligations	372	279
Total current liabilities	1,080	899
Capital lease obligations, less current portion	530	398
Other liabilities	254	135
Total liabilities	1,864	1,432
Stockholders' equity:		
Convertible preferred stock, $0.000006 par value, issuable in series; no shares and 569 million shares authorized as of September 30, 2012 and December 31, 2011, respectively, no shares and 543 million shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively	—	615
Common stock, $0.000006 par value; 5,000 million and 4,141 million Class A shares authorized as of September 30, 2012 and December 31, 2011, respectively, 949 million and 117 million shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively, including 2 million and 1 million outstanding shares subject to repurchase as of September 30, 2012 and December 31, 2011, respectively; 4,141 million Class B shares authorized, 1,217 million and 1,213 million shares issued and outstanding as of September 30, 2012 and December 31, 2011, respectively, including 12 million and 2 million outstanding shares subject to repurchase as of September 30, 2012 and December 31, 2011, respectively	—	—
Additional paid-in capital	12,585	2,684
Accumulated other comprehensive loss	(6)	(6)

Retained earnings	1,595	1,606
Total stockholders’ equity	14,174	4,899
Total liabilities and stockholders’ equity	$16,038	$6,331

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue	$1,262	$954	$3,504	$2,580
Costs and expenses:				
Cost of revenue	322	236	967	613
Research and development	244	108	1,102	264
Marketing and sales	168	114	703	272
General and administrative	151	82	717	222
Total costs and expenses	885	540	3,489	1,371
Income from operations	377	414	15	1,209
Interest and other income (expense), net:				
Interest expense	(11)	(10)	(35)	(26)
Other income (expense), net	6	(25)	9	(7)
Income (loss) before provision for income taxes	372	379	(11)	1,176
Provision for income taxes	431	152	—	478
Net (loss) income	$(59)	$227	$(11)	$698
Less: Net income attributable to participating securities	—	77	—	235
Net (loss) income attributable to Class A and Class B common stockholders	$(59)	$150	$(11)	$463
(Loss) earnings per share attributable to Class A and Class B common stockholders:				
Basic	$(0.02)	$0.11	$(0.01)	$0.36
Diluted	$(0.02)	$0.10	$(0.01)	$0.32
Weighted average shares used to compute (loss) earnings per share attributable to Class A and Class B common stockholders:				
Basic	2,420	1,316	1,884	1,283
Diluted	2,420	1,520	1,884	1,507
Share-based compensation expense included in costs and expenses:				
Cost of revenue	$8	$3	$79	$6
Research and development	114	33	719	72
Marketing and sales	28	13	279	24
General and administrative	29	21	311	39
Total share-based compensation expense	$179	$70	$1,388	$141

See Accompanying Notes to Condensed Consolidated Financial Statements.

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FACEBOOK, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(In millions)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net (loss) income	$(59)	$227	$(11)	$698
Other comprehensive income (loss):				
Foreign currency translation adjustment	21	(2)	(1)	(1)
Change in unrealized gain on available-for-sale investments, net of tax	2	—	1	—
Comprehensive (loss) income	$(36)	$225	$(11)	$697

See Accompanying Notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities		
Net (loss) income	$(11)	$698
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	425	220
Loss on write-off of equipment	8	6
Share-based compensation	1,388	141
Deferred income taxes	(434)	(29)
Tax benefit from share-based award activity	854	405
Excess tax benefit from share-based award activity	(854)	(405)
Changes in assets and liabilities:		
Accounts receivable	(90)	(72)
Income tax refundable	(567)	—
Prepaid expenses and other current assets	24	(113)
Other assets	—	(25)
Accounts payable	20	36
Platform partners payable	(16)	91
Accrued expenses and other current liabilities	162	(9)
Deferred revenue and deposits	(5)	44
Other liabilities	27	51
Net cash provided by operating activities	931	1,039
Cash flows from investing activities		
Purchases of property and equipment	(1,037)	(421)
Purchases of marketable securities	(8,590)	(2,742)
Sales of marketable securities	571	95
Maturities of marketable securities	2,413	90
Investments in non-marketable equity securities	(3)	(2)
Acquisitions of businesses, net of cash acquired, and purchases of intangible and other assets	(911)	(5)
Change in restricted cash and deposits	(2)	5
Net cash used in investing activities	(7,559)	(2,980)
Cash flows from financing activities		
Net proceeds from issuance of common stock	6,760	998
Proceeds from exercise of stock options	9	27
Repayment of long term debt	—	(250)
Proceeds from sale and lease-back transactions	205	15
Principal payments on capital lease obligations	(231)	(128)
Excess tax benefit from share-based award activity	854	405
Net cash provided by financing activities	7,597	1,067
Effect of exchange rate changes on cash and cash equivalents	(3)	(5)
Net increase (decrease) in cash and cash equivalents	966	(879)
Cash and cash equivalents at beginning of period	1,512	1,785

Cash and cash equivalents at end of period	$2,478	$906
Supplemental cash flow data		
Cash paid during the period for:		
Interest	$30	$19
Income taxes	$184	$179
Non-cash investing and financing activities:		
Net change in accounts payable and accrued expenses and other current liabilities related to property and equipment additions	$(80)	$62
Property and equipment acquired under capital leases	$251	$393
Fair value of shares issued related to acquisitions of businesses and other assets	$275	$46

See Accompanying Notes to Condensed Consolidated Financial Statements.

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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 (SEC) 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 prospectus filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933, as amended, on May 18, 2012 (Prospectus).

The condensed consolidated balance sheet as of December 31, 2011, 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 unaudited 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, 2012.

We have reclassified certain prior period expense amounts from marketing and sales to general and administrative within our condensed consolidated statements of operations to conform to our current period presentation. These reclassifications did not affect revenue, total costs and expenses, income from operations, or net (loss) income.

There have been no changes to our significant accounting policies described in the Prospectus that have had a material impact on our condensed consolidated financial statements and related notes.

Initial Public Offering and Share-based Compensation

In May 2012, we completed our initial public offering (IPO) in which we issued and sold 180 million shares of Class A common stock at a public offering price of $38.00 per share. We received net proceeds of $6.8 billion after deducting underwriting discounts and commissions of $75 million and other offering expenses of approximately $7 million. Upon the closing of the IPO, all shares of our then-outstanding convertible preferred stock automatically converted into an aggregate of 545 million shares of Class B common stock and an aggregate of 336 million shares of Class B common stock converted into Class A common stock.

Restricted stock units (RSUs) granted prior to January 1, 2011 (Pre-2011 RSUs) vest upon the satisfaction of both a service condition and a liquidity condition. The service condition for the majority of these awards is satisfied over four years. The liquidity condition is satisfied upon the occurrence of a qualifying event, defined as a change of control transaction or six months following the completion of our IPO, which occurred in May 2012. The vesting condition that will be satisfied six months following our IPO does not affect the expense attribution period for the RSUs for which the service condition has been met as of the date of our IPO. This six-month period is not a substantive service condition and, accordingly, beginning on the effectiveness of our IPO in May 2012, we recognized a cumulative share-based compensation expense for the portion of the RSUs that had met the service condition. In the three and nine months ended September 30, 2012, we recognized $28 million and $1,014 million, respectively, of share-based compensation expense related to our Pre-2011 RSUs. As of September 30, 2012, we had approximately $164 million of additional future period share-based compensation expense related to our Pre-2011 RSUs to be recognized over a weighted-average period of approximately two years.

RSUs granted on or after January 1, 2011 (Post-2011 RSUs) are not subject to a liquidity condition in order to vest, and compensation expense related to these grants is based on the grant date fair value of the RSUs and is recognized on a straight-line basis over the applicable service period. The majority of Post-2011 RSUs are earned over a service period of four to five years. In the three and nine months ended September 30, 2012, we recognized $138 million and $348 million, respectively, and in the three and nine months ended September 30, 2011, we recognized $59 million and $117 million, respectively, of share-based compensation expense related to the Post-2011 RSUs. As of September 30, 2012 we anticipate $1,871 million of future period expense related to such RSUs will be recognized over a weighted-average period of approximately three years.

As of September 30, 2012, there was $2,302 million of unrecognized share-based compensation expense, of which $2,035 million relates to RSUs, and $267 million relates to restricted shares and stock options. This unrecognized compensation expense is expected to be recognized over a weighted-average period of approximately three years.

Under settlement procedures applicable to the Pre-2011 RSUs, we are permitted to deliver the underlying shares within 30 days before or after the date on which the liquidity condition is satisfied. We previously disclosed in our Current Report on Form 8-K filed with the SEC on September 4, 2012 that we will vest and settle outstanding Pre-2011 RSUs for which the service condition has been satisfied and that are held by employees who were employed by us through October 15, 2012 on October 25, 2012 and such shares will be eligible for sale in the public markets as of market open on October 29, 2012. We will vest and settle outstanding Pre-2011 RSUs held by our non-employee directors and former employees on November 14, 2012.

On the settlement dates, we plan to withhold and remit income taxes for RSU holders at applicable minimum statutory rates based on the closing price of our common stock on the trading day immediately preceding the applicable settlement date. We currently expect that the average of these withholding tax rates will be approximately 45%. If the price of our common stock on the trading day immediately preceding the applicable settlement date were equal to $21.66, the closing price of our Class A common stock on September 30, 2012, we estimate that this tax obligation would be approximately $2.6 billion in the aggregate. The amount of this obligation could be higher or lower, depending on the closing price of our shares on the trading day immediately preceding the applicable settlement date. To settle these RSUs, assuming an approximate 45% tax withholding rate, we estimate that we will net settle by delivering approximately 121 million shares of Class B common stock and withholding approximately 99 million shares of Class B common stock on October 25, 2012 and by delivering approximately 31 million shares of Class B common stock and withholding approximately 20 million shares of Class B common stock on November 14, 2012.

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 share-based awards, 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.

Note 2. Acquisitions

In August 2012, we completed our acquisition of Instagram, Inc. (Instagram), a privately-held company which has built a mobile phone-based photo-sharing service that is expected to enhance our photos product offerings and to enable users to increase their levels of mobile engagement and photo sharing. We have accounted for this transaction as a business acquisition for a total purchase price of $521 million, consisting of the issuance of approximately 12 million vested shares of our Class B common stock to non-employee stockholders of Instagram and $300 million in cash. The value of the equity component of the purchase price was determined for accounting purposes based on the fair value of our common stock on the closing date. We also issued approximately 11 million unvested shares of our Class B common stock to employee stockholders of Instagram on the closing date, with an aggregate fair value of $194 million, which will be recognized as they vest over a three-year service period as share-based compensation expense.

During the nine months ended September 30, 2012, we also completed other business acquisitions for total consideration of $87 million. These acquisitions were not material to our condensed consolidated financial statements individually or in the aggregate. Pro forma results of operations related to our acquisition of Instagram or of other companies during the nine months ended September 30, 2012 have not been presented because they are not material to our condensed consolidated statements of operations, either individually or in the aggregate.

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The fair value of assets acquired and liabilities assumed for all acquisitions completed during the nine months ended September 30, 2012 was based upon a preliminary valuation and our estimates and assumptions are subject to change within the measurement period. The primary areas of the purchase price that are not yet finalized are related to income taxes and residual goodwill. Measurement period adjustments that we determine to be material will be applied retrospectively to the period of acquisition in our condensed consolidated financial statements and, depending on the nature of the adjustments, other periods subsequent to the period of acquisition could also be affected.
The following table summarizes the allocation of estimated fair values of the assets acquired and liabilities assumed, including those items that are still preliminary allocations, and related useful lives, where applicable:

	Instagram, Inc.		Other	
	(in millions)	Useful lives (in years)	(in millions)	Useful lives (in years)
Amortizable intangible assets:				
Acquired technology	$74	5	$19	3 - 5
Tradename and other	63	2 - 7	8	2 - 3
Net liabilities assumed	(1)		(4)	
Deferred tax liabilities	(50)		(9)	
Net assets acquired	$86		$14	
Goodwill	$435		$73	
Total fair value considerations	$521		$87	

Goodwill generated from all business acquisitions completed during the nine months ended September 30, 2012 is primarily attributable to expected synergies from future growth and potential monetization opportunities and is not deductible for tax purposes.
During the nine months ended September 30, 2012, we also acquired $633 million of patents and other intellectual property rights. We completed the largest of these intangible asset purchases in June 2012 under an agreement with Microsoft Corporation pursuant to which we were assigned Microsoft's rights to acquire approximately 615 U.S. patents and patent applications and certain of their foreign counterparts, consisting of approximately 170 foreign patents and patent applications, that were subject to an agreement between AOL Inc. and Microsoft entered into on April 5, 2012. We paid $550 million in cash in exchange for these patents and patent applications. As part of this transaction, we established a deferred tax liability of $49 million to reflect the difference between the future tax basis and book basis in the acquired patents and patent applications, which also increased the capitalized patent cost by this amount. As part of this transaction, we obtained a license to the other AOL patents and patent applications being purchased by Microsoft and granted Microsoft a license to the AOL patents and patent applications that we acquired. The acquisitions of these patents, patent applications and other intellectual property rights were accounted for as asset acquisitions. Patents acquired during the nine months ended September 30, 2012 have estimated useful lives ranging from three to 17 years from the dates of acquisition.

Note 3. (Loss) Earnings per Share

We compute (loss) earnings per share (EPS) of Class A and Class B common stock using the two-class method required for participating securities. Prior to the date of the IPO, we considered all series of our convertible preferred stock to be participating securities due to their non-cumulative dividend rights. Immediately after the completion of our IPO in May 2012, all outstanding shares of convertible preferred stock converted to Class B common stock. Additionally, 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 these participating securities are subtracted from net income in determining net income attributable to common stockholders. Net losses are not allocated to these participating securities. Basic EPS is computed by dividing net (loss) 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 addition, the computation of the diluted EPS of Class A common stock assumes the conversion from Class B common stock, while the diluted EPS of Class B common stock does not assume the conversion of those shares. Diluted EPS attributable to common stockholders is computed by dividing the

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resulting net income attributable to common stockholders by the weighted-average number of fully diluted common shares outstanding.

Dilutive securities in our diluted EPS calculation for the three and nine months ended September 30, 2011 do not include Pre-2011 RSUs. Vesting of these RSUs is dependent upon the satisfaction of both a service condition and a liquidity condition. The liquidity condition is satisfied upon the occurrence of a qualifying event, defined as a change of control transaction or six months following the completion of our IPO. Our IPO did not occur until May 2012. Therefore, prior to this date the holders of these RSUs had no rights in our undistributed earnings and accordingly, they are excluded from the effect of basic and dilutive securities. However, subsequent to the completion of our IPO in May 2012, these RSUs are included in our basic and diluted EPS calculation. Post-2011 RSUs are not subject to a liquidity condition in order to vest, and are thus included in the calculation of diluted EPS. For the three and nine months ended September 30, 2012 in which we reported a net loss, we did not allocate any loss to participating securities in the basic and diluted EPS computation. Additionally, we did not include employee stock options, unvested RSUs, and shares subject to repurchase in our calculation of diluted EPS, as the impact of these awards is 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 September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Basic EPS:								
Numerator								
Net (loss) income	$(19)	$(40)	$19	$208	$(3)	$(8)	$58	$640
Less: Net income attributable to participating securities	—	—	7	70	—	—	20	215
Net (loss) income attributable to common stockholders	$(19)	$(40)	$12	$138	$(3)	$(8)	$38	$425
Denominator								
Weighted average shares outstanding	794	1,632	113	1,208	431	1,457	107	1,181
Less: Shares subject to repurchase	1	5	1	4	1	3	—	5
Number of shares used for basic EPS computation	793	1,627	112	1,204	430	1,454	107	1,176
Basic EPS	$(0.02)	$(0.02)	$0.11	$0.11	$(0.01)	$(0.01)	$0.36	$0.36
Diluted EPS:								
Numerator								
Net (loss) income attributable to common stockholders	$(19)	$(40)	$12	$138	$(3)	$(8)	$38	$425
Reallocation of net income attributable to participating securities	—	—	6	—	—	—	22	—
Reallocation of net (loss) income as a result of conversion of Class B to Class A common stock	(40)	—	138	—	(8)	—	425	—
Reallocation of net income to Class B common stock	—	—	—	8	—	—	—	26
Net (loss) income attributable to common stockholders for diluted EPS	$(59)	$(40)	$156	$146	$(11)	$(8)	$485	$451
Denominator								
Number of shares used for basic EPS computation	793	1,627	112	1,204	430	1,454	107	1,176
Conversion of Class B to Class A common stock	1,627	—	1,204	—	1,454	—	1,176	—
Weighted average effect of dilutive securities:								
Employee stock options	—	—	188	188	—	—	212	212
RSUs	—	—	10	10	—	—	5	5
Shares subject to repurchase	—	—	4	4	—	—	4	4
Warrants	—	—	2	2	—	—	3	3
Number of shares used for diluted EPS computation	2,420	1,627	1,520	1,408	1,884	1,454	1,507	1,400
Diluted EPS	$(0.02)	$(0.02)	$0.10	$0.10	$(0.01)	$(0.01)	$0.32	$0.32

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Note 4. Property and Equipment

Property and equipment consisted of the following (in millions):

	September 30, 2012	December 31, 2011
Network equipment	$1,628	$1,016
Land	35	34
Buildings	454	355
Leasehold improvements	163	120
Computer software, office equipment and other	88	73
Construction in progress	655	327
Total	3,023	1,925
Accumulated depreciation and amortization	(734)	(450)
Property and equipment, net	$2,289	$1,475

Construction in progress includes costs primarily related to the construction of data centers and equipment located in our new data centers in Oregon, North Carolina and Sweden.

Note 5. Goodwill and Other Intangible Assets

Goodwill and other intangible assets, and related useful lives, where applicable, consisted of the following (in millions, except indicated otherwise):

	Useful lives from date of acquisitions (in years)	September 30, 2012	December 31, 2011
Amortizable intangible assets:			
Acquired patents	3 - 18	$684	$51
Acquired technology	2 - 10	131	38
Tradename and other	2 - 7	94	23
Accumulated amortization		(76)	(32)
Net acquired intangible assets		833	80
Goodwill		590	82
Goodwill and intangible assets		$1,423	$162

Amortization expense of intangible assets for the three and nine months ended September 30, 2012 was $31 million and $44 million, respectively, and for the three and nine months ended September 30, 2011 was $5 million and $15 million, respectively.

Estimated amortization expense for the unamortized acquired intangible assets as of September 30, 2012 for the next five years and thereafter is as follows (in millions):

The remainder of 2012	$34
2013	126
2014	120
2015	112
2016	101
2017	85
Thereafter	255
	$833

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Note 6. Fair Value Measurements

Assets measured at fair value on a recurring basis are summarized below (in millions):

Description	September 30, 2012	Fair Value Measurement at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	$730	$730	$—	$—
U.S. government securities	234	234	—	—
U.S. government agency securities	208	208	—	—
Marketable securities:				
U.S. government securities	5,644	5,644	—	—
U.S. government agency securities	2,330	2,330	—	—
Total cash equivalents and marketable securities	$9,146	$9,146	$—	$—

Description	December 31, 2011	Fair Value Measurement at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	$892	$892	$—	$—
U.S. government securities	60	60	—	—
U.S. government agency securities	50	50	—	—
Marketable securities:				
U.S. government securities	1,415	1,415	—	—
U.S. government agency securities	981	981	—	—
Total cash equivalents and marketable securities	$3,398	$3,398	$—	$—

Gross unrealized gains or losses for cash equivalents and marketable securities as of September 30, 2012 and December 31, 2011 were not material.

The following table classifies our marketable securities by contractual maturities as of September 30, 2012 (in millions):

	Fair Value
Due in one year	$5,658
Due in one to two years	2,316
	$7,974

Note 7. Commitments and Contingencies

Leases

We have entered into various capital lease arrangements to obtain property and equipment for our operations. Additionally, on occasion we have purchased property and equipment for which we have subsequently obtained capital financing under sale-leaseback transactions. These agreements are typically for three years except for building leases which are for 15 years, with interest rates ranging from 1% to 13%. The leases are secured by the underlying leased buildings and equipment. We have also entered into various non-cancelable operating lease agreements for certain of our offices, equipment, land and data centers with original lease periods expiring between 2012 and 2027. We are committed to pay a portion of the related actual operating expenses

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under certain of these lease agreements. Certain of these arrangements have free rent periods and/or escalating rent payment provisions, and we recognize rent expense under such arrangements on a straight-line basis.
Operating lease expense totaled $50 million and $151 million for the three and nine months ended September 30, 2012, and $52 million and $171 million for the three and nine months ended September 30, 2011.

Contingencies
Legal Matters

On March 12, 2012, Yahoo filed a lawsuit against us in the U.S. District Court for the Northern District of California, claiming that we infringe ten of Yahoo's patents that Yahoo claimed relate to "advertising," "social networking," "privacy," "customization," and "messaging," and on April 27, 2012 Yahoo added two patents to the lawsuit that Yahoo claims relate to "advertising." Yahoo sought unspecified damages, a damage multiplier for alleged willful infringement, and an injunction. On April 3, 2012, we filed our answer with respect to this complaint and asserted counterclaims that Yahoo's products infringe ten of our patents. On July 6, 2012, the parties entered into a settlement agreement resolving all claims made in the litigation. On July 9, 2012, the parties filed a stipulated dismissal of the litigation with the U.S. District Court for the Northern District of California and this litigation was dismissed on July 10, 2012. We have no payment obligations under this settlement agreement.

Beginning on May 22, 2012, multiple putative class actions, derivative actions, and individual actions were filed in state and federal courts in the United States and in other jurisdictions against us, our directors, and/or certain of our officers alleging violation of securities laws or breach of fiduciary duties in connection with our IPO and seeking unspecified damages. We believe these lawsuits are without merit, and we intend to continue to vigorously defend them. On October 4, 2012, on our motion, the vast majority of the cases in the United States, along with multiple cases filed against The NASDAQ OMX Group, Inc. and The Nasdaq Stock Market LLC (collectively referred to herein as NASDAQ) alleging technical and other trading-related errors by NASDAQ in connection with our IPO, were ordered centralized for coordinated or consolidated pre-trial proceedings in the United States District Court for the Southern District of New York. In addition, the events surrounding our IPO have become the subject of various government inquiries, and we are cooperating with those inquiries.
We are also party to various legal proceedings and claims which arise in the ordinary course of business.
In the opinion of management, there was not at least a reasonable possibility we may have incurred a material loss, or a material loss in excess of a recorded accrual, with respect to loss contingencies relating to the matters set forth above. However, the outcome of litigation is inherently uncertain. Therefore, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against us in the same reporting period for amounts in excess of management's expectations, our condensed consolidated financial statements of a particular reporting period could be materially adversely affected.
Credit Facilities
In February 2012, we entered into an agreement for an unsecured five-year revolving credit facility that allows us to borrow up to $5,000 million for general corporate purposes, with interest payable on the borrowed amounts set at London Interbank Offered Rate (LIBOR) plus 1.0%. Under the terms of the agreement, we are obligated to pay a commitment fee of 0.10% per annum on the daily undrawn balance. No amounts were drawn down under this credit facility as of September 30, 2012.
Concurrent with our entering into the revolving credit facility, we also entered into a bridge credit facility agreement that allows us to borrow up to $3,000 million to fund tax withholding and remittance obligations related to the settlement of RSUs in connection with our IPO, with interest payable on the borrowed amounts set at LIBOR plus 1.0% and an additional 0.25% payable on drawn balances outstanding from and after the 180th day of borrowing. Any amounts outstanding under this facility will be due one year after the date we draw on the facility but no later than June 30, 2014. Under the terms of the agreement, we are obligated to pay a commitment fee of 0.10% per annum on the daily undrawn balance from and after the 90th day following the date we entered into the bridge facility. In October 2012, we amended and restated our existing bridge credit facility (the Amended and Restated Term Loan) and

converted it into a three-year unsecured term loan facility that allows us to borrow up to $1,500 million. See Note 11 Subsequent Event for information on the Amended and Restated Term Loan.
No amounts were drawn down under the bridge credit facility agreement as of September 30, 2012.

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Note 8. Stockholders' Equity

Share-based Compensation Plans

We maintain three share-based employee compensation plans: the 2012 Equity Incentive Plan, the 2005 Stock Plan and the 2005 Officers' Stock Plan (Stock Plans). In January 2012, our board of directors approved our 2012 Equity Incentive Plan (2012 Plan), and in April 2012 our stockholders adopted the 2012 Plan, effective on May 17, 2012, which serves as the successor to our 2005 Stock Plan and provides for the issuance of incentive and nonstatutory stock options, restricted stock awards, stock appreciation rights, RSUs, performance shares and stock bonuses to qualified employees, directors and consultants. No new awards will be issued under the 2005 Stock Plan as of the effective date of the 2012 Plan. Outstanding awards under the 2005 Stock Plan continue to be subject to the terms and conditions of the 2005 Stock Plan. Shares available for grant under the 2005 Stock Plan, which were reserved but not issued or subject to outstanding awards under the 2005 Stock Plan as of the effective date, were added to the reserves of the 2012 Plan.

We have initially reserved 25,000,000 shares of our Class A common stock for issuance under our 2012 Plan. The number of shares reserved for issuance under our 2012 Plan will increase automatically on the first day of January of each of 2013 through 2022 by a number of shares of Class A common stock equal to (i) the lesser of 2.5% of the total outstanding shares our common stock as of the immediately preceding December 31st or (ii) a number of shares determined by the board of directors. The maximum term for stock options granted under the 2012 Plan may not exceed ten years from the date of grant. Our 2012 Plan will terminate ten years from the date of approval unless it is terminated earlier by our compensation committee.

The 2005 Officers' Stock Plan provides for the issuance of up to 120,000,000 shares of incentive and nonstatutory stock options to certain of our employees or officers. The 2005 Officers' Stock Plan will terminate ten years after its adoption unless terminated earlier by our compensation committee. Stock options become vested and exercisable at such times and under such conditions as determined by our compensation committee on the date of grant. In November 2005, we issued a nonstatutory stock option to our CEO to purchase 120,000,000 shares of our Class B common stock under the 2005 Officers' Stock Plan. As of September 30, 2012, the option had been partially exercised in respect of 60,000,000 shares with the remainder remaining outstanding and fully vested, and no options were available for future issuance under the 2005 Officers' Stock Plan.

The following table summarizes the stock option and RSU award activity under the Stock Plans during the nine months ended September 30, 2012:

		Shares Subject to Options Outstanding				Outstanding RSUs	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value[(1)]	Outstanding RSUs	Weighted Average Grant Date Fair Value
	(in thousands)	(in thousands)		(in years)	(in millions)	(in thousands)	
Balance as of December 31, 2011	52,318	258,539	$0.47	4.38	$7,360	378,772	$6.83
RSUs granted	(33,865)	—				33,865	34.69
Stock options exercised	—	(84,568)	0.11			—	
Stock options forfeited/cancelled	584	(584)	0.62			—	
RSUs forfeited and cancelled	9,089	—				(9,089)	19.32
2012 Equity Incentive Plan shares authorized	25,000						
Balance as of September 30, 2012	53,126	173,387	$0.65	3.83	$3,643	403,548	$8.89

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying stock option awards and the assessed fair value of our common stock as of December 31, 2011 and the closing price of our common stock on September 30, 2012.

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Note 9. Income Taxes

Our tax provision for interim periods is determined using an estimate of our annual effective tax rate, adjusted for discrete items arising in that quarter. In each quarter we update our estimate of the annual effective tax rate, and if our estimated annual tax rate changes, we make a cumulative adjustment in that quarter. Our quarterly tax provision, and our quarterly estimate of our annual effective tax rate, are subject to significant volatility due to several factors, including our ability to accurately predict our income (loss) before provision for income taxes in multiple jurisdictions, including the portions of our share-based compensation that will not generate tax benefits, and the effects of acquisitions and the integration of those acquisitions. In addition, our effective tax rate can be more or less volatile based on the amount of income (loss) before provision for income taxes. For example, the impact of non-deductible share based compensation expenses on our effective tax rate is significantly greater when our income (loss) before provision for income taxes is lower.

Our effective tax rate has exceeded the U.S. statutory rate primarily because of the impact of non-deductible share-based compensation and losses arising outside the United States in jurisdictions where we do not receive a tax benefit. These losses were primarily due to the initial start-up costs incurred by our foreign subsidiaries to operate in certain foreign markets, including the costs incurred by those subsidiaries to license, develop, and use our intellectual property. Our effective tax rate in the future will depend on the portion of our profits earned within and outside the United States, which will also be affected by our methodologies for valuing our intellectual property and intercompany transactions.

Our effective tax rate in the three months ended September 30, 2012 exceeded our effective tax rate in the three months ended September 30, 2011 because the impact of non-deductible share-based compensation and the losses arising outside the United States in jurisdictions where we do not receive a tax benefit are proportionately larger relative to income (loss) before provision for income taxes in 2012 than in 2011. Our effective tax rate in the three months ended September 30, 2012 was also higher due to the expiration of the federal tax credit for research and development activities.

Our effective tax rate in the nine months ended September 30, 2012 was zero. This occurred because the discrete tax items that arose during the nine months ended September 30, 2012 offset the tax benefit as determined based on an estimate of our annual effective tax rate as applied to our loss before provision for income taxes for the nine months ended September 30, 2012. Our effective tax rate in the nine months ended September 30, 2012 was lower than our effective tax rate in the nine months ended September 30, 2011 due to this effect.

Our income tax refundable was $567 million as of September 30, 2012, which reflects the expected refund of estimated income tax payments made in 2012 and the expected refund from income tax loss carrybacks to 2010 and 2011. Our net deferred tax assets were $399 million as of September 30, 2012, which is an increase of $339 million from December 31, 2011. This increase is primarily due to the recognition of tax benefits related to share-based compensation, offset by deferred tax liabilities established as part of our purchase accounting related to our acquisitions in the nine months ended September 30, 2012.

We are subject to taxation in the United States and various other state and foreign jurisdictions. The material jurisdictions in which we are subject to potential examination include the United States and Ireland. We are under examination by the Internal Revenue Service (IRS) for our 2008 and 2009 tax years. We believe that adequate amounts have been reserved for a