

2012 HIGHLIGHTS

- FB grew monthly active users 25% from FY2011 - FY2012.
- Daily active users grew 28%.
- 57% increase in the use of mobile platform.
- Acquisition of Instagram was made in August 2012.

Value to Programmers

- FB enables payment platform with up to 30% commissions.
 - ↳ Same still as in IPO.
- Payment platform is still not available in mobile.

Strategy

- 84% of users are outside the US.
 - ↳ FOCUS on increasing penetration in emerging markets like Brazil, India, Mexico & Japan.
- R+D highly focused on mobile.
 - ↳ Instagram acquisition was part of this initiative.
- Focused on developing ways so that marketers can better target their ads such as Custom Audience + better analytics tools.

Competition

- Google, and specifically Google+ which they have integrated with some of their other products like Android phones.
- Companies that offer platforms for game developers such as Apple & Google with free to play games.
- Also compete to attract and retain capable personnel.

Technology

- As more international users join FB, they are investing in being closer to them in order to give them better service, even if they aren't being monetized yet.

Sales + Operations

- Most of the sales are done through the self service system.
- There are also mktg agencies who are experts at working with FB and buy ads for their clients.
- FB also has a small sales force that works with clients at early stages and adoption of FB ads.
 - ↳ More than 30 sales offices around the world.
- Also have a customer service team.

Government Regulations

- Regulations are in process and changing.
- Foreign regulations tend to be more restrictive than U.S. Regulations.

Risks

- Small portion of revenue being made through mobile. → Decline in PC use could be a risk.
 - ↳ FB experienced a decline in computer users during Q4 vs Q3 2012 but experienced a substantial increase in mobile.
 - ↳ Currently payments are not enabled for mobile.
 - ↳ Mobile use depends on services out of FB control (mobile operations, network carriers).
- They speculate in their competition risk the use of other social media websites including the increase use of Instagram which they have already purchased.
 - ↳ Investigate history of Instagram and/or social media in general.
- Risk of balancing relationship between Platform developers + users.
 - ↳ In order to provide better user experience FB has limited communication between developers and users which has caused unfavorable reaction from developers as this action reduces their chances of monetization.
 - ↳ FB depends on developers designing interactive applications in order to increase user engagement and time spent on the platform.
- They plan to continue making acquisition which can cause a dilution for stockholders.
- FB continues to state that they will not be paying dividends in the foreseeable future.
 - ↳ Plan to reinvest returns to grow + fund the business.
 - ↳ Also currently have a credit facility which limits them on paying dividends.

Properties

- Currently constructing a Datacenter facility in Sweden.

Legal Proceedings

- Currently involved in various legal proceeding + expect this to continue to be part of normal course of business.
- Common attitude towards legal proceedings is to defend their case which goes in accordance with their views of it being part of normal expenses vs. one-time occurrences.

Recent Sales / Unregistered Securities

- On Oct 2012, FB sold 94k additional Class A Common Stock due to an acquisition in Q3 2012.
 - ↳ They were exempt from registration since they were not part of the IPO.

Management Discussion + Financial Analysis

- Revenue increase of 31% vs cost increase of 135%.
 - ↳ Due to costs related to the vesting of options + PSU's connected to their IPO.
 - ↳ Even though FB will continue to use equity as means for payment, since options had a liquidity restriction tied to the IPO, the amount of stocks vested at once can be considered above of what will be normal in the future for the company.
- Effective tax rate is above US tax rate due to non-deductible share base compensation outside the US where they do not have tax benefit.

User Metrics

- Metrics currently do not include Instagram users.
- Increase of 25% in MAU.
 - ↳ Increase was mainly outside of the US. US increase was only 8%.
- DAUs increased 28% driven mainly by mobile usage of FB.
 - ↳ Saw decline in computer DAUs + increase in mobile.
- Increase of 57% in mobile MAUs.
 - ↳ Increase in Sept 2012 of 25% in # of MAUs who used mobile exclusively.

Factors Affecting performance

- User growth through different geographies does not necessarily imply more costs as their needs can be attended with current datacenter infrastructure as well as US staff.
- Growth in user engagement translate into better results as it give greater opportunities for displaying ads, but also increases cost as more engagement = more expenses + capex needs.
- Mobile usage: less ads are currently displayed in mobile but it is offset by price of mobile ads being more expensive.
 - ↳ Currently working on making mobile ad offers better over time.
- Increase in headcount of 44% as an investment in growing the business. Expect 2013 to continue to grow both through new hires and acquisitions.
 - ↳ Primary objective of acquisitions is to add qualified personnel.
- FB experiences Reasonability increase from Q3-Q4 and usual decline in Q1-Q2 in ad spending by companies.

Share Based Compensation

- For the Pre-2011 Compensation Plan, RSU's + options were tied to a liquidity clause that was not valid until FB's recent IPO, therefore FB had not recognized in the past any expenses related to stock compensation.
 - ↳ During IPO, they recognized high expenses where it may not be expected in the future to amount to such a high number even though they do plan to continue to offer share based compensation.
- RSU's granted after 2011 are not subject to the liquidity clause, only the time clause.
 - ↳ Are calculated at grant date and are expensed on a straight-line basis according to the time clause.
- FB has historically offered RSU's during acquisitions to certain employees.
 - ↳ As these RSU's also come with a service time clause, they are treated as are the rest of the RSU's using straight line amortization.

Income Statement

- Payment revenue comes mainly from games where Zynga is the major player.
 - ↳ As time has passed, Zynga has become less relevant in the Payment segment.
- High expenses for share based compensation.
 - ↳ Most valuable if next year trend continues, might be associated with liquidity clause.
- Increase in ad revenue due to higher ad demand as well as a price per ad increase.
 - ↳ Driven by price per ad in News Feed which is significantly higher due to its position + availability in mobile.
- Mobile ad revenue is estimated to be 11%.
 - ↳ Was not available in previous year so not comparable.
 - ↳ For 4th quarter they estimate that it was 23%.
- Zynga still remains their main client but has been losing weight in revenue as FB grows.
 - ↳ 7% in Q4 2012 vs 10% in Q4 2011.
 - ↳ 4% in FY 2012 vs 8% in FY 2011.
- 73% increase in headcount for R&D expenses as well as recognition of share based compensation.
 - ↳ Expect dollar amount for R&D to increase in 2013 since they are planning on increasing personnel but not to the extent it increased for 2012 due to share based compensation high expense triggered by IPO.
- High increase in G-A cost was also due to share based compensation expenses triggered by IPO.
 - ↳ Increase also include legal fees + settlement costs, amortization of acquired patents and other professional services.
 - ↳ Increase in employee headcount.
- FB estimates that it will have tax credit for 2012 + will include it as a discrete revenue for Q1 2013.
- Q2 results are greatly affected by stock based compensation expense which produced losses.

Cash Flow

- Most relevant income came from IPO which resulted in \$4.8 billion in net proceeds.
- \$505 million of the cash available is outside of the US.
 - ↳ This would be considered as trapped cash. Page 50 highlight.
- They add back share based compensation to cash generated by operating activities as a non-cash item.

Balance Sheet

- Other Assets include Non-Marketable Securities which FB specifies are certain investments in funds that are not publicly traded. These are recorded at cost and verified for impairment.
 - ↳ Investigate how Non-Marketable Securities could affect valuation.
- A non-marketable security is an asset that is difficult to buy or sell due to the fact that they are not traded on any major secondary market exchanges.
 - ↳ Marketable securities are easily tradable as they are traded in an open market.
- In Oct 2012 entered into a Swap Agreement in order to limit their exposure to fluctuation of interest rate on their 3-year long term loan facility.
 - ↳ Only derivative instrument + not used for trading purpose.

Notes to financial Statements

- Apart from Instagram, FB made other acquisitions in 2012 for the value of \$87 million but individually or in conjunction did not have material effect on FB financials.
- In IPO all preferred stock converted to Class B Common Stocks.
- Currently have both capital + operating lease obligations.
 - ↳ Look in page 82 for information concerning operating lease.
- Have other contractual obligations of \$749 million related to equipment and supplies for their datacenter operations + construction of datacenter. Most is due in 2013.
- Litigations connected to their IPO.
- Options Outstanding, P. 85.
 - ↳ Dividend yield is 0% because they don't pay + they don't plan to pay.
 - ↳ Page 80 for value to input in model.
- They have net operating loss benefits that carry forward.
- Revenue per geography. No country apart from US represent more than 10% of revenue.
 - ↳ P. 89 for values.