

Facebook, Inc.
Second Quarter 2019 Follow Up Call
July 24th, 2019

Operator: Good afternoon. My name is Jessa, and I will be your conference operator today. At this time, I would like to welcome everyone to Facebook's second quarter results follow-up Q&A call.

All lines have been placed on mute to prevent any background noise. To ask a question, please press star, then the number one on your telephone keypad. This call will be recorded. Thank you very much. Ms. Deborah Crawford, Facebook's Vice President of Investor Relations, you may begin.

Deborah Crawford: Thank you. Good afternoon, and welcome to the follow-up Q&A call. With me on today's call is Dave Wehner, CFO.

Before we get started, I would like to take this opportunity to remind you that our remarks today will include forward-looking statements. Actual results may differ materially from those contemplated by these forward-looking statements.

Factors that could cause these results to differ materially are set forth in today's press release and in our quarterly report on Form 10-Q filed with the SEC. Any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these statements as a result of new information or future events.

During this call, we may present both GAAP and certain non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release.

The press release and an accompanying investor presentation are available on our website at investor.fb.com. And now I would like to turn the call back over to the operator for the first question.

Operator: Thank you. We will now open the lines for a question-and-answer session. To ask a question, press star followed by the number one on your touch-tone phone.

Please pick up your handset before asking your question to ensure clarity. If you are streaming today's call, please mute your computer speakers. Your first question comes from the line of Jason Helfstein from Oppenheimer. Please go ahead.

Jason Helfstein: Thanks. I guess I just wanted to ask a question about how you're thinking about political advertising next year. Obviously, it's been controversial. But I guess there's pressure to take money for free speech purposes.

So I just – can you tell us how you're thinking about it. Obviously, there's a lot of (inaudible) to working around that (inaudible) you know, what are your thoughts? Does it go through the normal bidding system? Yeah, that's it. Thanks.

Dave Wehner: Hey, Jason. It's Dave. So as you know, we've put a lot of controls in over political advertising, such that we have to verify identity of people who are advertising for political campaigns. And so that produces friction in the process.

Political advertising is not a big, big category, though it is obviously highly seasonal and highly year dependent, so it can have some impact on revenue, in revenue growth, in region, in bigger political years, so it can have an impact. But it's still a relatively small category.

And we've put a lot of investment and controls in over it, so that's part of the work that we do on the contractor side, in terms of putting a lot of ads through review. So it's a fairly costly process, but as you said, it is part of what service we're providing. And so, we've put a lot of investment there, and the revenue there would be seasonal.

Jason Helfstein: Maybe just a quick follow-up. Just with the discussions you've had just with the regulators and FTC and around privacy, is there increased focus around, I guess, rules and content related to kind of under 18 and under 16?

And just -- I'm asking because you guys are so forward, have really been on the forefront of platform safety. There are other platforms that kind of highlight how much users they have on the younger side, yet they don't seem to have kind of -- probably not nearly as advanced as you are kind of dealing with these issues.

So this in light of a lot of what's happened recently, just any thoughts on how you've had to address, whether it's advertising or content, kind of, again, under 18 and under 16, where kind of different rules apply?

Dave Wehner: Well, in the U.S., there's COPPA, which addresses under 13. And so for the most part, other than Messenger Kids, we specifically are not servicing users who are in that regulated category.

And then in Europe, there are broader controls under GDPR as it relates to younger users, so we're complying with the regulations on the GDPR side. The FTC has more of a broad privacy mandate.

Operator: Your next question comes from the line of Youssef Squali from SunTrust. Please go ahead.

Youssef Squali: All right, thank you. Hey, Dave. A couple questions, so one is really more of a clarification. Other than the monetary fine the FTC is imposing on you, were there any changes also imposed in the way Facebook gathers and leverages users' data? Or do you see that - any changes coming down the pike at that level?

And then on your commentary about guidance, I don't want to beat a dead horse here, but I kind of went back and quickly reviewed the Q1 transcripts. And it's almost verbatim what you said versus what you said last quarter, except for the 2020 reference.

Just trying to understand, is -- were you basically trying to signal something new that you saw out of Q2 that gives you more -- makes you more cautious, or basically restating what you stated in Q1? Thanks.

Dave Wehner: Thanks, Youssef. I'll kind of go with the first thing. I mean, I would say, just as it relates to Q2 where we saw an acceleration on a constant currency basis and a reported basis, as I said, we executed well.

A lot of things fell in our favor. Good execution with the Facebook app and other product wins, and that help combat the overall trend of deceleration. It's within the context of that that I'm giving this commentary.

You know, we previously talked about ad targeting related headwinds from platform changes and certain FB product changes. And the timing of some of those has been slower than we anticipated.

However, that doesn't -- you know, we continue to expect those factors will impact the business in the medium term. And we have seen a consistent trend of decelerating revenue growth in our business and, you know, we expect that -- those factors to play into the second half of 2019 and into 2020, so it's within that context that I'm providing that.

Youssef Squali: On the first question...

Dave Wehner: And then on the monetary fine, I mean, clearly there's a lot of process changes and compliance work that we need to do on the FTC side. So, this will change how we operate the business and it will change how quickly we can get products to market.

So I think, yes, there's going to be an impact for the business based on complying with the FTC settlement. And that's going to affect both the expense that we put against it, and also the speed at which we can deploy and get out new products. And Mark commented on that.

Youssef Squali: And just one quick one, was there any deceleration or at least material deceleration within Instagram relative to what it grew in the last couple

quarters? There were some intra-quarter kind of sources -- industry sources that were kind of throwing that around.

Dave Wehner: Well, I mean, Instagram has been on a big ramp of growth. We're not specifically talking about that, but I did mention that strength in Facebook was a contributor to the quarter. And we are seeing -- and expect to see overall deceleration in the business, and I think that's consistent across both Facebook and Instagram.

Operator: Your next question comes from the line of James Lee from Mizuho Securities. Please go ahead.

James Lee: Thanks for taking my questions. Dave, a couple housekeeping questions here. Last quarter, I think Sheryl had called out a number of advertisers on IG Stories, something like 3 million.

And she also had said something about Instagram number accounts showing product at 130 million. Do you have an update for this quarter? And also, number two, I noticed that your Asian ARPU accelerated 160 basis points this quarter. I was wondering what's driving that improvement? Thanks.

Dave Wehner: So no update on Instagram Story advertisers and the number of accounts with the product. Those are the type of statistics that we just -- release not on an ongoing basis, but just episodically.

APAC ARPU accelerating - I think APAC is seeing good growth, but nothing specifically there to call out on the accelerating basis.

I would note that when you look at APAC revenue on an advertiser basis, so advertisers in APAC, we actually saw a deceleration in revenue growth rates in Q2, and we would expect that deceleration -- on an advertiser basis, not a user basis specifically -- on an advertiser basis we would expect that deceleration to continue and, certainly to be at a lower growth rate than we saw throughout 2018. You know, one of the impacts there is just the overall trade situation.

So we do think that APAC growth on an advertiser basis. We expect that to trend more in line with overall growth and not be a contributing -- and so that's going to be part of what's driving deceleration, as well.

James Lee: All right, thanks.

Operator: Your next question comes from the line of Dan Salmon from BMO Capital Markets. Please go ahead.

Dan Salmon: Hey, good afternoon. Dave, two things I wanted to ask about. First, just maybe a little bit more on the chief privacy role and just -- I think it's a gentleman named Michel Protti who's taking that role, sort of what specifically he's charged with doing, what are the goals, what we can expect him to bring to that role based on his time at the company.

And then just a second one on your expense guidance, I think your chief marketing officer was out at the advertising festival in France remarking on the Facebook's own advertising budget. I think he said doubling. I assume that that is within the 2019 guidance? Or was that maybe more of a comment heading into 2020? Just curious. Thank you.

Dave Wehner: Sure, I do -- you know, I do expect that we'll continue to invest in marketing. And so Antonio, who you're speaking about, is speaking to the investments that we're making on that front.

That's factored into the 2019 expense guidance for the remainder of the year, but we do expect to be in market on the marketing front in the latter half of the year, so that certainly is factored into the guidance that I'm giving.

And we would expect to also be investing in 2020, as well. In terms of the chief privacy role, obviously, that's an important role from an overall compliance perspective with regards to the new FTC agreement.

And Michel brings a deep background at Facebook, VP of partnership, product at Facebook, so he's got a lot of knowledge about these specific issues, as well as a depth of understanding of the Facebook organization that he brings to the table.

But he's going to be supplemented by other people within Facebook, as well as external hires to enhance the compliance program that we have to meet the new set of standards that we have with the FTC agreement.

So we think Michel is very well positioned to lead this from a compliance perspective, and we're pivoting a number of resources over to his team who have deep knowledge of the product, as well as an understanding of the agreement with the FTC.

Dan Salmon: That's very helpful. Thank you.

Operator: Your next question comes from the line of John Blackledge from Cowen. Please go ahead.

John Blackledge: Great, thanks. A couple questions. Dave, just on timing around implementation of measures to be in compliance with the FTC settlement and -- could, you know, any of the changes impact that targeting in the U.S., if at all?

And then just any color on FX impact in the third quarter? And then just lastly, did you see the pricing gap for Instagram Stories versus Feed close at all in the second quarter? Thanks.

Dave Wehner: Sure, John. In terms of whether the FTC compliance will impact ad targeting, I think where there's a potential impact is just in the overall allocation of resources and the process that we're putting place.

We have consistently -- and Sheryl's referenced this -- made basis points improvement across various different elements of the advertising product. We're going to need to be running all of the changes that we make to the advertising product through -- advertising -- through the lens of the privacy compliance program that we have in place with the FTC.

And I think, Mark referenced this as -- impacting the timing of -- delivering those new things. So I think that's the impact that we will likely see. There's going to -- certainly as we ramp up this program, we'll have a lot of focus on

compliance. And that will -- including engineering resources on it. So I think that's where you're going to see the impact on the advertising product development point.

In terms of FX impact in the second half, sort of just giving it on a -- you know, hard to predict where foreign exchange rates are going to go, and that's why we're giving the guidance on a constant currency basis.

It's -- I think on the pricing gap for Instagram Feed versus Stories, I think we're certainly making progress in terms of growing Instagram Stories demand. But we're also growing Instagram Stories supply very quickly.

Those are -- I think those are going to continue to both grow nicely, so I think we feel like we're making progress on the important front, which is getting more demand in for Stories from advertisers.

And then I think there's going to be puts and takes as to whether that's going to just -- whether that's going to play through in price or just overall revenue growth. But we're making some progress there.

But Stories is growing very quickly on the impression basis, which is always going to mitigate your growth on price when you have a fast-growing impression driver like Stories.

John Blackledge: OK, thank you.

Dave Wehner: Yes.

Operator: Your next question comes from the line of Ron Josey from JMP Securities. Please go ahead.

Ron Josey: Great, thanks for taking the question. Just two specifically on -- Dave, you talked about the optimization wins, product wins in the Facebook app this past quarter.

And I know Brian asked some questions about that on the call, but could you provide any more details around that? I thought I heard something around

groups and community, but any insights on any -- on those optimizations would be helpful.

And then just quickly on e-commerce, Mark spent time talking about Facebook's e-commerce opportunities. And I think it's more time than I've heard him spend talking about that.

I'm just curious how these ad units are progressing as we head into the holiday season and how you think about e-commerce as a driver for the holiday season. Thank you.

Dave Wehner: Sure, Ron. In terms of the optimizations wins in Q2, a few that I would call out would be dynamic ads in Instagram Stories, improvements to video ads, and then as Sheryl mentioned, one of the places that we saw outperformance was improvement in how quickly we refreshed the ads that people see as they scroll down in their feed.

So those were all contributors to both engagement and ROI for marketers, so it helped -- good optimizations that helped drive the Q2 performance.

On the e-commerce front, I think Mark is really talking about the opportunity in the long run versus -- I think we'll see growth of things like Instagram Shopping into the holiday season. But it's really off a very small base today. So the success of the holiday season is really going to be driven off of our ability to continue to grow good demand for Feed and pricing in Feed, and also growing Instagram Stories and Facebook Stories engagement and growing demand for those units.

And I think those are going to be the bigger drivers of what's going to be the second half performance and the holiday season performance. I think as we continue to make progress on Instagram Shopping and then also Marketplace, those will have a bigger impact going forward in future years than we'll necessarily read them as being big drivers in 2019.

Ron Josey: That's helpful. Thank you.

Operator: Your next question comes from the line of Andy Hargreaves from KeyBanc. Please go ahead.

Andy Hargreaves: Thank you very much. A couple more questions about the FTC, sadly. One, just wondering when the payment is due, and sorry if I missed that. And then, second, do they define specifically the data that needs to be protected?

There's just a lot of confusion, because data privacy is such a broad sort of bizarre term to me. And then if they have, can you just get a little bit more specifics about what you actually need to do versus what you've already put in place to protect privacy?

Dave Wehner: So in terms of when the payment's due, we still have to get final board approval -- court approval for the settlement. So that will determine the time to get the payment.

But anticipate it in this year. Obviously, we've already taken the accrual for that, so it's really just a question of cash flow, but we'd expect that to be this year.

In terms of what we need to do, we've talked about the significant investments that we're making in the compliance program and also the certification by individuals around the program.

So what is different that we are adding to our program is really more oversight and controls over the product development process with a lens to privacy. So it is a significant process improvement and enhancement and also reporting to and engagement with the regulators on that front.

Andy Hargreaves: OK, thanks. And then a second to ask one more. I think I heard Mark say that a lot of the upside so far versus your guy's expectations was from the core Facebook app.

Can you just, one, confirm if that was right? And then if there's any clarification you can add around that, just sort of how core Facebook is doing versus everything else, that would be awesome.

Dave Wehner: Sure. We're seeing -- in the first half, we saw good engagement across the Facebook app and we've been pleased with the engagement on that front.

And also that's been a nice contributor on the revenue performance versus expectations, as well. And I'd cite things like refreshing the ads that people see as they scroll down in their Feed on Facebook as being a contributor to outperformance on revenue.

Operator: Your next question comes from the line of Craig Huber of Huber Research Partners. Please go ahead.

Craig Huber: Yes, hi. Thanks, Dave. A year ago, in the same call you talked about getting -- thought your operating margin would get down to the mid-30s, given all the expenses you saw coming down the pike here and stuff.

I was just curious, do you still think that's reasonable? I'm assuming it includes this new privacy costs and stuff in your mind. Can you comment there first please?

Dave Wehner: Yeah, we haven't updated that outlook. Our current expense outlook, as I've said, for 2019 suggests that we'll see margins come down this year, and we've obviously outlined the drivers of both expense and investment going into 2020, these privacy investment priorities that we outlined today, and then continuing to invest in core product, innovation, safety and security, video and content, all of these will play into the margin structure in the long run. But we haven't provided a specific update on margin.

Craig Huber: And also, Dave, I wanted to ask you, when you think about your advertising load throughout Instagram and Facebook here, outside the U.S., how do you guys feel where your ad load is right now? Is it getting pretty toppy in the more developed markets, less so in the undeveloped markets? How would you categorize that?

Dave Wehner: I would say that, the broad statement that I would say, is that, in terms of Facebook and Instagram feed, we're at a place where there are not as many opportunities to grow ad load going forward.

And I think where you have opportunity is in an area like Stories, where we're seeing stronger overall engagement growth and it has a lower effective ad load today.

And so I think we'll continue to see the impression growth opportunities be skewed towards things like Instagram Stories and Facebook Stories. There are still incremental opportunities to grow Feed impressions, and we saw Feed impressions grow this past quarter on both Instagram and Facebook.

But I think you're going to see more of the opportunity from both an engagement and usage point of view and ad load point of view, be in areas like Stories. The differences between the markets are not a significant driver. It's more the overall, I think, Feed loads versus stories loads.

Operator: Your next question comes from the line of Laura Martin from Needham and Company. Please go ahead.

Laura Martin: Hi there. Can you hear me OK, Dave?

Dave Wehner: Yes.

Laura Martin: Great, OK, so a couple. Today, all of Facebook's platforms are globally scaled. And what I'm wondering is, as you think out into the future, if GDPR privacy versus the U.S. privacy is different, do you think we end up with different countries or regions having different privacy requirements? That's my first one.

Dave Wehner: Well, there's certainly going to be different regulatory regimes for different regions. And so that's going to affect how we approach compliance from a regulatory point of view.

We still plan on operating the products from a global perspective. And we are trying to build in an overall framework that can address the differing regulations.

We do think that ultimately there will be more privacy -- specific privacy regulations in markets like the U.S. and other regions. And so, we do think

the work we're doing on the compliance front for GDPR in Europe will be broadly applicable.

Laura Martin: OK. And then my second one is on the five-year frame of this investment cycle Mark was talking about. Does that actually rise over time? So year five -- is it cumulative, every year we add more expense to get to this privacy and security and compliance that the FTC has mandated?

Or are there revenue associated with some of that so the max spending year is out two or three years, and then it sort of falls off because there's revenue associated with some of this investment cycle he's talking about?

Dave Wehner: Well, I just want to clarify, when Mark is talking about privacy focused social network, he's really speaking more broadly than just specifically complying with the FTC settlement agreement.

What he's talking about is the focus on the -- what we call sort of the living room versus the town square and building more privacy-centric messaging products. So that's, WhatsApp and Messenger, it's encrypted messaging products.

It's allowing people to share more in the messaging context privately with small groups as well as individuals. So -- and it's the infrastructure that we're investing to kind of support both the growth of Messenger and WhatsApp. So, I think that's really more about the five-year timeframe.

The impact of the FTC, as I've mentioned, it's going to have a pivot of resources to focus on privacy. That's going to be more impactful in the shorter term as we get the compliance program under Michel up and running. So, I think that's going to hit us in a faster timeframe than five years, but the broader investment thesis, which actually Mark outlined on prior calls, is this pivot towards supporting a privacy centric vision on messaging based social networking on Messenger and WhatsApp.

And I think that's a broader investment theme and a set of products and services that we want to build over the next five years. So I think Mark is

setting a timeframe for that being a five-year timeframe, as opposed to talking about the FTC compliance, which has to happen more quickly.

Operator: Your next question comes from the line of Benjy Scurlock from Arete Research. Please go ahead.

Benjy Scurlock: Hi, thanks for taking my question. So the first on the economics around WhatsApp payments, is there anything you can share on what a consumer is going to pay for peer-to-peer over the long term or how businesses are charged for transactions? And what will the benefit be of using it, versus the incumbent credit card companies?

And then both you and Snap saw re-accelerating European growth on the back of GDPR annualizing. Is this a trend you think we should expect to continue into Q3 and Q4? Thanks.

Dave Wehner: So in terms of WhatsApp payments, it's just very early to say what ultimately this is going to look like. P2P, broadly, is a free product for messaging. In terms of businesses, I think it's TBD.

I think when you look at a place like India and other markets, it's really about also having payments who are serving people beyond just credit card holders. So I think it's about providing more access to financial services beyond the credit card and banked customers.

In terms of E.U., we saw a bit of acceleration coming off of the GDPR. I can't speak to Snap. I think they're in a very kind of different point of their growth. But so, we did see a modest acceleration in growth, but I'd still note that European growth is lower than North America and APAC.

Deborah Crawford: Operator, we're going to take one last question.

Operator: Thank you. Your last question comes from the line of Michael Levine from Pivotal Research Group. Please go ahead.

Michael Levine: Just following up a little bit on that question about E.U., I mean, all the data points from a macro perspective have been pretty negative.

I'm trying to figure out just the cadence last year in terms of when basically the company felt the peak impact from GDPR, combined with -- I guess were you guys internally surprised at how much GDPR ultimately impacted the business?

Dave Wehner: I guess, we saw an impact from GDPR as it phased in, in 2018. I would note that we still see European growth rates at a lower rate. There could be a number of different factors for that. It's hard to parse out what is specifically GDPR, as we don't have a control against a non-GDPR cohort in Europe.

I would say there's not anything about the European performance that was a particular surprise on how GDPR impacted us. I think it was -- we expected an impact. We saw an impact. So I think played out largely how we expected.

Deborah Crawford: Great. Thank you for joining us today. We appreciate your time, and we look forward to speaking with you again.

Dave Wehner: Thanks, everybody.

Operator: This concludes today's conference call. You may now disconnect.