

Facebook Q2 2015 Earnings Call
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Deborah Crawford

Thank you. Good afternoon and welcome to Facebook's second quarter earnings conference call. Joining me today to talk about our results are Mark Zuckerberg, CEO, Sheryl Sandberg, COO and 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, and actual factors 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 will present both GAAP and 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'd like to turn the call over to Mark.

Mark Zuckerberg

Thanks Deborah, and thanks everyone for joining today.

This was a good quarter for us. We've continued to make good progress in the growth of our community, with 1.49 billion people now using Facebook each month and more than 1.3 billion people using Facebook on mobile.

We've also continued to make gains in engagement. More than 968 million people worldwide now use Facebook daily and 65 percent of our monthly actives are also daily actives. Several products in the Facebook app are reaching global scale too, now with more than 450 million people now using Events each month and more than 850 million using Groups. And when it comes to time spent, across Facebook, Messenger and Instagram, people are now spending more than 46 minutes per day on average. And that doesn't include WhatsApp.

Our business performance has grown with our community. This quarter our total revenue was more than 4 billion dollars for the first time, and advertising revenue grew by 43 percent year over year.

These results reflect the ongoing investments and improvements we've made in the quality, performance and usefulness of our services, and continuing to make progress here remains our biggest priority.

Now with that in mind, I'd like to talk about how we're working on this across our current products, our next generation of apps and our long term innovation efforts.

Over the next few years our main focus is on helping our existing communities and businesses reach their full potential.

An important part of our strategy is continuing to deliver great experiences across all our products. This means improving the speed and reliability of our apps and building new infrastructure to support our global scale, like our new data center in Texas. Over the last six months we've improved the performance of our core app, reducing crashes on iOS by more than 30 percent and some Android phones by more than 40 percent. On Messenger, people can now send messages up to 20 percent faster and it's twice as fast when starting the app. These are just a few examples of how our engineering focus is delivering better experiences for everyone.

Another part of delivering great experiences is helping people connect with the content they want. This quarter we've continued to focus on improving people's experience in News Feed by making it easier to find more relevant and engaging content from friends and the entire community.

Connecting people with more great video content is an important part of this. Video continues to be some of the richest and most engaging content for people and publishers, and since the start of the year Pages are also sharing more than 40 percent more videos. This quarter we updated our News Feed ranking to help people see more of the videos they care about, and also began testing new options for video monetization to help our partners build their businesses. We're excited about the potential for continued work here.

The focus we've had on video also supports our efforts to connect people around important public moments and events. From the 59 million people who generated more than 300 million

interactions around the Copa América, to the 26 million people who changed their profile photos for Pride, or the more than 150 million people who were notified that their friends were safe after the Nepal earthquake, Facebook has clearly become the home for global conversations about things people care about.

And when it comes to serving businesses on our platform, this quarter we continued to focus on delivering more useful tools and resources to help them achieve their goals. Helping marketers to tell more visually engaging stories through video and carousel ads is an important focus, as well as supporting small businesses. There are now more than 40 million small businesses and medium sized businesses using Pages on Facebook, so we have a big opportunity to create value for communities all over the world. Sheryl will talk more about this in a moment.

Next, let's talk about how we're building our next generation of services, which we also expect to become important parts of our business over the next few years.

With Instagram, the continued growth in the size and engagement of the community shows how this is becoming one of the best places to get a real time snapshot of the world. For moments from the US presidential campaign trail to NASA's first photos from Pluto, people are using Instagram in a lot of interesting ways. This quarter we made some big improvements to the app including upgrading our search tool and introducing trending content, which we expect will provide even more engaging experiences.

On Messenger, this quarter we rolled out a number of new features including mobile video calling, a new way to share locations, and the option to sign up for Messenger without using a Facebook account. We also continue to make good progress with building out the Messenger Platform. We expect these improvements to continue making Messenger a more useful and engaging experience for people. More than 700 million people now use Messenger, and we've reached more than 1 billion downloads on Android. These milestones are a good sign that we're on the right path.

With WhatsApp, we're pleased with our continued growth, and the team is continuing to roll out new features to serve the community. We've continued to improve the web experience for WhatsApp, as well as launching VoIP calling to more people on more devices.

And with search, we are continuing to build a better search experience for our community. We recently crossed 1.5 billion searches per day, and we've now indexed more than 2 trillion posts.

This is a huge set of unique experiences and perspectives, and by allowing people to unlock this knowledge we have a huge opportunity to create value for the world in the coming years.

Finally, let's talk about our other efforts that we expect to deliver impact over the longer term.

With Internet.org, we have a lot of momentum with our goal of connecting everyone in the world to the internet. A year ago we launched the Internet.org app for the first time in Zambia and since then we've made free basic internet services available to more than a billion people in 17 countries. Our results show that Internet.org is working. After launching free basic services, mobile operators are seeing people adopt mobile data 50% faster than before, and more than half the new people coming online through Internet.org choose to pay for data and access more internet services within their first 30 days.

We recently made changes to the Internet.org program for both developers and operators that will give more people access to even more free services. With the Internet.org Platform, now it's easy for any developer to create services that integrate with Internet.org, and just this week we announced a portal for operators that makes it easy for them to quickly launch free basic services in new countries.

We're also making progress on our efforts to connect people living in some of the most remote communities on Earth. Our Connectivity Lab is working on new technologies for connecting communities that include drones, satellites and laser communications systems, and we'll be sharing more of our progress here very soon.

And with Oculus, we've announced that the Rift will ship to consumers in the first quarter of 2016. The team also recently introduced details about the full hardware and software experience that people can expect, including our new Touch controllers. Oculus is going to be the best VR experience in the world when it launches, and I'm really excited for us to begin delivering on the promise of virtual reality.

So that's how we've focused our efforts over the last quarter. We're preparing for the future, but we're also working to deliver better experiences and value to our community today.

And as usual, I want to thank our whole community, including our employees, our shareholders and our partners. Thanks to you, our community is getting stronger and stronger every day, and we're making progress on our mission to make the world more open and connected.

So thank you - and now here's Sheryl.

Sheryl Sandberg

Thanks Mark and hi everyone.

We had another strong quarter and a great first half of the year. Ad revenue grew 43% year-over-year – 55% on a constant currency basis. Mobile ad revenue grew 74% year-over-year, making it over three quarters of total ad revenue.

Our growth was broad-based across all marketer segments and industry verticals. Similar to Q1, we're pleased with adoption of our ad products across all regions and we saw strong revenue growth in North America and Asia Pacific in particular.

We're staying focused on our three main priorities – capitalizing on the shift to mobile, growing the number of Facebook marketers, and making our ads more relevant and effective.

First – capitalizing on the shift to mobile.

People are spending more time on their mobile devices and on Facebook apps. We continue to get more than 1 out of every 5 minutes on smartphones in the US, and mobile usage is driving our growth globally as well.

We believe we have the best performing mobile ad product in the market, and video is making it even better. With so many consumer videos being watched on Facebook, video ads are a natural part of the News Feed experience. For marketers, video has always been a compelling format – now Facebook enables mass reach and cross device targeting and measurement abilities far superior to what other platforms offer.

Mobile video was a major theme at the Cannes Lion festival last month where some of the biggest winners – like Under Armour's "I will what I want" with Droga5 and Procter and Gamble's "Like a Girl" with Leo Burnett – used mobile video on Facebook as part of their campaigns.

Our second priority is growing the number of marketers using our ad products. In Q2 we announced that 40 million small and medium businesses have active Facebook pages, and this number continues to grow. Earlier this month I hosted SMB roundtables in Berlin and London. I got to hear first-hand how advertising on Facebook is helping SMBs sell their products, grow their businesses, hire new employees, and even expand to other cities and countries. One of

the business owners I met was Kelly Wright, a single mom who started selling dresses from her home. She began by shooting videos of her dresses on her mobile phone and promoting them on Facebook for just a few pounds. Using Facebook as her only marketing channel, Kelly grew her business - Krystellie Fashion - to over 3M pounds annually – and she now has 10 employees.

We're increasing our engagement with the global SMB community and have now held more than 80 local "Boost your Business" events around the world, meeting thousands of businesses, and getting their feedback on how we can make our products work better for them.

We're also building out our leadership teams around the world. In recent weeks we've added senior talent to our international teams, including a new head of Latin America and new regional leadership in several countries in EMEA. We also opened an office in Johannesburg – our first in Africa.

Our third priority is making our ads more relevant and effective. Better, more engaging and relevant ads are good for people AND marketers – and we're working hard to improve them. We continue to innovate at a rapid pace by introducing new ad formats and new tools for marketers.

This quarter we expanded Carousel Ads, which show multiple images in one ad unit. We introduced Dynamic Product Ads, which allow marketers to upload their product catalogue and show the right product to the right person and at the right time. We also introduced a new ad format called Lead Ads, a simpler way for people to connect with companies they're interested in hearing from.

We continue to focus on providing world-class products and tools for direct response advertisers. Booking.com, a Priceline Group company, is using Facebook link ads featuring "Book Now" buttons to drive reservations. In Q2, Facebook ads drove a meaningful increase in room reservations for Booking.com, helping them meet their ROI goals for the campaign. They're now expanding their use of Facebook ads across multiple markets.

We continue to make progress with ads on Instagram. In Q2 we launched Instagram ads in Brazil, Germany and Japan. We also introduced additional capabilities for marketers, including Carousel Ads on Instagram, which brands are using in creative ways — for example, to showcase a spring fashion collection, gradually reveal a full panorama, or show different views of a location.

Over the coming months Instagram ads will be available to more advertisers with new formats, better targeting, and the ability to buy online as well as through 3rd party partners. As we ramp Instagram ads, we remain focused on quality and relevance to ensure the best experience for people and the highest performance for marketers.

Measurement is a key priority as we work to expand our share of global marketing budgets. Since we introduced Conversion Lift, which measures the direct impact that Facebook ads have on sales, we've seen adoption from marketers across verticals. When Acura launched the TLX – the largest launch in their history – they used Facebook video to show the TLX in scenarios that quickly captured people's attention, like imitating a roller coaster. They then used our retargeting technology to show more detailed ads only to the people who watched the videos. Using Conversion Lift, they proved that Facebook ads directly drove vehicle sales.

To help marketers target and measure campaigns both on and off Facebook, we're continuing to build out our ad tech platform with Atlas, Live Rail and the Audience Network.

Entertainment company Live Nation knew that people browsed for concert tickets on mobile devices but were never able to measure whether they converted into sales. Using Atlas, Live Nation was able to link their mobile ads to 66% more ticket purchases for one of their largest artists. This shows the promise of Atlas to measure cross device conversion.

We're pleased with the progress we're making on our three main priorities and we plan to stay focused.

Now here's Dave.

Dave Wehner

Thanks Sheryl and good afternoon everyone.

Q2 was another strong quarter for Facebook. We generated \$4.0 billion in revenue and \$1.3 billion in free cash flow.

Strong community growth and engagement underpinned our financial performance. In June, approximately 968 million people used Facebook on an average day, an increase of 17% compared to last year. This daily number represents 65% of the 1.49 billion people who used Facebook during the month of June.

That MAU number grew by 173 million year-over-year. By this measure, the second quarter was our strongest in terms of community growth since 2013.

Mobile remains the key driver of our growth. In June, approximately 1.31 billion people accessed Facebook on mobile devices, up 23% from last year.

We also saw strong growth in our next generation of services with Instagram, Messenger and WhatsApp now exceeding 300M, 700M and 800M MAU respectively.

Now turning to the financials...

All of our comparisons are on a year-over-year basis unless otherwise noted. Additionally our non-GAAP measures exclude stock-based compensation and the amortization of intangibles.

Total revenue was \$4.0 billion, up 39%, or 50% on a constant currency basis.

Ad revenue was \$3.8 billion, up 43% or 55% on a constant currency basis. The strengthening of the US dollar has continued to have an unfavorable impact on our revenue. Had foreign exchange rates remained constant with Q2 2014 levels, our total revenue this quarter would have been approximately \$330 million higher.

Regionally, we saw strong North American ad revenue growth of 55% in the quarter, and APAC growth also remained strong at 48%. Europe and the Rest of World ad revenue grew more slowly at 30% and 22%, respectively, as currency had a significant negative impact on each of these region's year-over-year growth rates.

Mobile is the engine of our revenue growth. Mobile ad revenue in Q2 was \$2.9 billion, up 74% from last year and represents 76% of our advertising revenue. Revenue from ads served on personal computers was down approximately 8%.

In Q2, the average price per ad increased 220%, while total ad impressions declined 55%. Similar to last quarter, these price/volume trends were primarily driven by the redesign of our right hand column ads, which rolled out in the third quarter of last year. To a lesser degree, the shift of usage towards mobile, where we don't have right hand column ads, also contributed to the reported price/volume trends.

Total Payments & Other Fees revenue was \$215 million, down 8% compared to last year. The decline was driven by a 19% year-over-year reduction in Payments revenue related to games

played on personal computers offset primarily by the addition of Other revenue related to acquisitions closed in the second half of 2014.

Turning now to expenses...

Our Q2 total GAAP expenses were \$2.8 billion, up 82%, and non-GAAP expenses were \$1.8 billion, up 57%. Similar to last quarter, stock-based compensation and amortization expenses related to the WhatsApp acquisition contributed significantly to the year-over-year growth in GAAP expenses. Non-GAAP expense growth was primarily driven by increases in headcount-related costs, cost of revenue and marketing expenses.

We ended the quarter with 10,955 employees, up 52% compared to last year. With 873 additional employees, Q2 was one of our strongest quarters in terms of hiring. And the majority of the new employees were added in R&D.

Our Q2 GAAP operating income was \$1.3 billion, representing a 31% operating margin. Non-GAAP operating income was \$2.2 billion, representing a 55% margin.

Our Q2 GAAP and non-GAAP tax rates were 44% and 36%, respectively.

Q2 GAAP net income was \$719 million or \$0.25 per share, and non-GAAP net income was \$1.4 billion or \$0.50 per share.

In Q2, capital expenditures were \$549 million and we generated \$1.3 billion of free cash flow. We ended the year, sorry, ended the quarter with \$14.1 billion in cash and investments.

Turning now to the outlook...

Let's start with revenue.

Since the first quarter of 2014, we have seen year-over-year advertising revenue growth rates decline each subsequent quarter. We expect this trend to continue in Q3 and Q4 as we continue to grow off a much larger base and face currency headwinds due to the strong dollar.

In addition, we expect our total Payments & Other Fees revenues to decline on a year-over-year basis for the remainder of the year. The decline in the second half of the year should be closer to the 19% year-over-year decline we experienced in the Payments business alone as we will be

lapping periods in which we added Other Fees revenue from acquisitions closed in the second half of 2014.

Turning to expense guidance...

Based on our second quarter results, we are narrowing the expense guidance range for 2015. We now expect the year-over-year growth rate for total 2015 GAAP expenses to be between 55-60%, narrowed from the prior range of 55-65%. And we expect the year-over-year growth rate for total 2015 non-GAAP expenses to be between 50-55% narrowed from the prior range of 50-60%.

We anticipate our 2015 capital expenditures will be in the neighborhood of \$2.5-\$3.0 billion down slightly from the prior range of \$2.7-\$3.2B.

We continue to expect stock based compensation in 2015 to be in the range of \$3-\$3.3 billion, approximately half of which is related to our prior acquisitions, most notably WhatsApp.

We expect amortization expenses in 2015 to be approximately \$700-\$800 million.

And lastly, we anticipate our Q3 and full-year 2015 GAAP and Non-GAAP tax rates to be consistent with the rates in the second quarter.

We have had a great first half of the year with solid revenue performance underpinned by healthy community growth across all of our services and regions. We have many exciting opportunities ahead, and we are investing in the talent and resources to capitalize on them as we seek to build long-term shareholder value.

With that, operator, let's open up the call for questions.

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 touchtone 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 Anthony DiClemente with Nomura Securities. Your line is open.

Anthony DiClemente: Thanks a lot. I have one for Mark and one for Dave. Mark, Facebook's had so much success in terms of the engagement the growth of the engagement just wondering if there's a framework that you used to think about how much of that success is due to the core value proposition of Facebook itself continuing to resonate with people at its most basic level as opposed to the product innovation that you detailed in your prepared remarks or use cases, which are more of a driver in your mind? And then second one for Dave, CapEx being down as a percentage of revenue in the 2Q you lowered the guidance, it doesn't feel like you guys are in the midst of ramping investment in the infrastructure. I wonder as you look at the assets, you have so much growth you have a shift of bandwidth intensive content and applications. Do you feel like you guys have been more efficient in terms of your CapEx spent or at some point should we anticipate a reacceleration to CapEx? Thanks.

Mark Zuckerberg: I can talk to the first part. So at some level I do think that the core mission and promise of helping to connect people with their friends and family is very fundamental. Everyone has friends and family and wants to stay connected, and uses a variety of tools and ways to do that in the world today which are often very inefficient and the Internet offers new opportunities to make that a lot better. When you look at the specific products that ... and the work that we're doing there is this process that we've followed that we basically will look at an area of our products that people are using. So, for example, going back a few years, newsfeed, right -- It's always been since we rolled it out a very central part of the product. But we're looking at the stuff with increasing rigor now where we organize the Company into these product groups. And each product group leader will not just look at the product as one thing but what are the key three or four or five use cases which often can really be their own product lines on their own, and we go through and build those out to be world-class.

And I think a lot of the success that we've seen has been because of some of the work that we've done a few years back at this point in products like newsfeed - and that team has executed really well - but when I look forward I'm very excited about doing the same thing for messaging, and groups and

video. There's many different use cases. You don't want to just look at these as one thing. There are a bunch of different use cases and we want to be the best at each of them and if you have good people leading those teams, then I think you can deliver that over time. So I think yes is the answer to your question. The mission is fundamentally deeply important to people but that has to be coupled with good thorough execution of each of the available opportunities.

Dave Wehner: Yes. Anthony, it's Dave. So on CapEx we're absolutely investing in the infrastructure and 2015 is an investment year so we are ramping CapEx versus 2014. The guidance is \$2.5 to \$3 billion and that's up from \$1.8 billion last year. We've got a lot of infrastructure investments that we're making across data centers, servers, network, we are clearly investing for the growth of both Facebook at its core, and then also the additional services that we're bringing on. So we're proud about the efficiencies that we've had. The infrastructure team has done an outstanding job in driving good efficiencies through things like the open compute project. Which allows us to leverage an open source strategy to lower our costs on server and other expensive hardware. So it's been a great strategy for us, but given the growth we have in the business, given the opportunity we have before us we are very much in investment mode in terms of the infrastructure.

Operator: Your next question comes from Douglas Anmuth with JPMorgan. Your line is open.

Douglas Anmuth: Mark, you talked about Oculus rift shipping in 1Q 16. Can you talk more about what you're most excited about in terms of a primary applications when it into the mainstream and then Dave can you help us to help us understand the cost structure more here as that product ramps? And then Sheryl if you could help us understand how broadly Instagram will open up to advertisers by year-end? Thank you.

Mark Zuckerberg: I can talk about Oculus. So the reason why Facebook is excited in this space is I can give you two reasons for this. One is there's this continued progression of people getting richer and richer ways to share what's on their mind. So if you go back 10 years, most of how people communicated and

shared was text. We're going through a period where now it's mostly visual and photos. We were entering into a period where that's going to increasingly be primarily video. And we're seeing huge growth there. But that's not the end of the line. There's always a richer way now that people want to share and consume thoughts and ideas and I think that immersive 3-D content is the obvious next thing after video. So if you look at what the initial use cases are going to be around that, I think it's a lot of the stuff that you hear people talking about. Video I think will be huge. So just taking that to be 3-D and immersive, gaming will be huge, those are both areas that Facebook has been involved with. Once you start to get more of a critical mass I think you can start to get social applications which is what we as a Company are more interested in over the long term. And think have a huge amount of potential. In addition to the video and gaming stuff which I just think is going to be awesome in the next few years as well.

Dave Wehner: Doug, it's Dave. Just on the question of how Oculus would affect the cost structure, it's premature for us to be giving guidance on the cost structure in 2016. But I think one of the things to recognize here is that we're still early with Oculus. We haven't announced any specific plans as it relates to shipment volumes for the consumer for Rift. But VR is still early in the development stage so it would be early to be talking about large volume shipments. Obviously we're investing on the research and develop inside on Oculus in 2015 and that's factored into our expense guidance for this year.

Sheryl Sandberg: We're opening up more advertisers. I talked about some of our global overlaps in the past quarter. We're also opening up more abilities which means more formats like direct response, more ways to buy like self-serve. That said it's important to understand this, while we think there's a lot of interest and great opportunity, we're going to be really thoughtful and strategic about how we ramp revenue. Instagram remains small relative to Facebook and it's going to really take time to have significant impact on our growth.

Operator: Your next question is from Heather Bellini of Goldman Sachs. Your line is open.

Heather Bellini: I wanted to ask a little bit more about as you started to speak with more advertisers, on the Instagram opportunity, how are you and they thinking about the differences in how they'll engage with their customers across both platforms? And I guess what I'm getting at is do you see Instagram targeting a different type of advertiser or do you expect people to leverage both platforms and almost think of them as kind of separate areas to budget for?

Sheryl Sandberg: I think one of the things that's interesting about Instagram is while the ads are really visually appealing and that brings to mind certain verticals like fashion or autos, things where the visual really matters, what we're seeing is that lots of different verticals can use the platform really well. So a recent example, HTC working with their agency Swift, did Instagram videos to raise awareness of their mobile device warranty program. So they targeted 18 to 34-year-olds.

They did five short videos with these funny moments of about where you're about to break your phone and they got a six-point lift in awareness of what is a warranty program I think that's not something you would think of typically as Instagram. In terms of Instagram and Facebook we believe that marketers are looking to connect with people in a really deep way, connect with the right people and our targeting we think is really strong compared to other any other platform at the right time. And that really means mobile. And we see such engagement on both Facebook and Instagram along with the different targeting and ad formats. We believe we'll be able to have and are already starting to have relationships with markers which grew across both platforms. Our focus with our marketing that forms is their business results. I talked about in my remarks how we're looking for conversions, we're trying to help them measure if you do a car ad for us how many vehicles were driven off the lot? We see what products you use within Facebook or Instagram or Facebook and Instagram as less important as the best product for the right marketer at the right time to drive their business results. And we like having more abilities, more products, more apps to work with so that we can drive this business results.

Operator: Your next question comes from the line of Brian Nowak with Morgan Stanley. Your line is open.

Brian Nowak: In early June you rolled out some new CPC measurement methods about how the changes and the clicks and CPCs are measured. I'd be curious about early findings you see an ad engagement growth, average price per ad, and then the advertiser feedback or changing budgeting since you've ruled out these CPC measurement changes. And then the second one on the North American advertising results were really strong I think you have accelerating growth. Sheryl, could you call out any specific ad products that are driving this faster North American growth? Thanks.

Sheryl Sandberg: On the first, we're always trying to improve our ad products so marketers can buy what they want and pay as they want to pay. We recently announced that we're updating the definition of CPC so that includes only websites and apps. But you can also buy on a cost per engagement basis and that includes comments and shares. It's too early to see any direct impact but I think it's part of the innovation that you'll see from us as we continued rollout different ways that marketers can use our tools different ways they can pay different results they can target. When you look at our overall growth our growth is very broad-based. We're broad-based in all of our segments of marketers so brand and direct response SMB's and developers. Definitely a part of the story here is video. Our video demand is very deep. People love the format of video. It's a long been used to reach people in a compelling way and we can do targeting a way that's really unique.

So I'll share another example. When Wendy's working with their agency VML, launched their Jalapeno Fresco Spicy Chicken product and they were trying to reach millennials in spicy food lovers. So working with us they did five video ads and on our platform they could not just to the video format but they could target millennials and people who like spicy food which is very specific targeting. They got an eight-point lift in ad recall a four point lift in purchase attempts among their millennial targeted and so what that shows is our growth is being driven by the ability of us to do this broad-based consumer media advertising but do it in a more targeted way.

Dave Wehner: I think Brian you were also commenting on North America. Obviously it's probably everybody realizes this but the big disparity between the U.S.-

Canada growth rates versus the other regions like Europe and the rest of the world are the currency headwinds which had a very significant impact to the year-over-year advertising growth rates in those regions.

Operator: Your next question comes from the line of John Blackledge with Cowen and Company. Your line is open.

John Blackledge: Couple questions on video. Mark, I think you mentioned potentially some new options for video monetization. Maybe could you discuss some of the new options that we may see implemented? More broadly, how does video content evolve on Facebook from what we see today? Thank you.

Dave Wehner: On the options on video monetization it's going to be still our focus is going to be on continuing to grow autoplay and continuing to leverage the video units in newsfeed. That's going to be the primary driver of video growth for us. So that's really the main focus. We've got other areas that we're experimenting with like suggested videos which are going to be very much like those ads in a feed of suggested videos. Which are also an opportunity for us but essentially the focus is going to be on monetizing through feed ads for video.

Mark Zuckerberg: I think you got it.

Operator: Your next question comes from the line of Justin Post with Merrill Lynch. Your line is open.

Justin Post : I think on the call you said time spent was 46 minutes per day. Any comparable metric from past quarters? And then how would you, if you can't give us that, how would you gauge overall engagement of Facebook just for the core site? Maybe some help about what you're seeing there and what products are really having an impact? Thank you.

Dave Wehner: I think in terms of engagement the product that is having the biggest impact is newsfeed continuing to do very well. So newsfeed at the core is proving to be just a great experience for users. It's getting better, we continue to invest in that. As people spend more time with newsfeed we get better about understanding what they like and getting the content that they care about in

front of them. So we're investing on that front. We're also doing more with public content. That's having an impact so we're seeing across the board good improvements to newsfeed videos, another big contributor there as well. So that's what we're seeing in terms of driving engagement. Engagement across the different regions as we think about it from a DAU to MAU perspective was at record levels in the quarter so we're pleased with that. And we continue to see time spent grow across the platform. So on all those measures we really like what we're seeing and we like the investments that we're making to make that newsfeed experience even better.

Operator: Your next question comes from the line of Ross Sandler with Deutsche Bank. Your line is open.

Ross Sandler: I just had two questions one for Mark and then one clarification for Dave. Mark, question on the messaging app. So the vibe at F8 from the first keynote at the end of the day, Brian Acton and David Marcus were basically presenting different strategies in terms of their long-term philosophy around monetization of those two platforms. So if you look at three to five years, do you see the opportunity with Messenger and WhatsApp as being similar, or can you talk about the strategy there? And is the engagement for the messaging apps similar, higher, lower than the average for the core Facebook app in terms of daily visits? And then Dave, you mentioned that you expect ad revenue to decelerate. I'm guessing that's a function of some of the FX headwinds. Can you talk about that on a currency neutral basis? Relative to the 55 percent in the second quarter? Thanks.

Dave Wehner: I can take the second part first. So in terms of also you had asked about the growth rate in the back half of the year. So I'd kind of reiterate what I said in my comments, the business continues to perform very well driven off the strength of our mobile newsfeed ads business. And really consistent with the trend we've seen in the last several quarters we would expect that year over year ads growth rate to decline modestly in Q3 and Q4. It's really because we're delivering growth against a much larger scale newsfeed business in the prior-year period and also of course headwinds are an impact as well as you mentioned.

Mark Zuckerberg: And I can talk to the messaging strategy questions. So the playbook that we're going to run with Messenger and WhatsApp is kind of similar to how we thought about building a business in Facebook and newsfeed. Where if you go back to 2006 and 2007 there were a lot of people who were encouraging us to just put Banner ads and inorganic content into the experience and what we decided was that over the long term, the ads and monetization would perform better if there was an organic interaction between people using the product and businesses. So instead of focusing on ads first, what we did was we built pages and we made that free so that way as many businesses as possible could get into the network. And we built insights to make it so that businesses knew how they were driving business when they used pages for free and could post them to newsfeed and then on top of that whole ecosystem, we then had the opportunity to build what has turned into a newsfeed business that we're really proud of, that we think is driving a lot of value and good content for people using the platform and helping a lot of businesses find customers and sell their products and grow overall.

Messaging I think is going to be pretty similar. We're right now some people in WhatsApp use the service in order to message businesses, Messenger is I think more people to people today, where we're working on a lot of different things that make it so that people can get value from interacting with businesses. We launched some of them at F8. We have a number of other things that we're working on across Messenger and WhatsApp. But the long-term bet is that by enabling people to have good organic interactions with businesses, that will end up being a massive multiplier on the value of the monetization down the road when we work on that and really focus on that in a bigger way. So we asked for some patience on this to do this correctly. And the game plan will be more similar to what we did in Facebook with newsfeed.

Dave Wehner: And Ross, you also asked about I think the impact of Messenger on our user statistics and the daily users. The vast, vast majority virtually all of Messenger users are using newsfeed as well. So Messenger only usage is not having a material impact on our overall usage stats.

Operator: Your next question comes from the line of Mark May with Citi. Your line is open.

Mark May: I had one on search. I think you mentioned \$1.5 billion daily searches. Just kind of curious, what portion of those are commercial if you will, not so much lookups for friends and family but more commercial oriented? And can you give us an update of where you are in the process of building out an even more robust search experience on Facebook and across the other family of apps? And then on Instagram, just a question on how we should be thinking about the ramp as well as the long-term opportunity. I guess the question would be in your tests, have you noticed any meaningful difference in Instagram users willingness to see or interact with ads in the newsfeed as compared with an average Facebook user recognizing that probably Instagram's audience is more geared towards some of the developing markets than the U.S. relative to the Facebook? Thanks.

Dave Wehner: Sure. On the search experience and Mark can add anything if he'd like but on the search experience from a monetization perspective the vast majority of the searches are for people or posts and there can be there's a potential for there to be commercially relevant content in people's posts, people searches which is the largest part of searching is not something that we think is really a monetizing category. But there's certainly great content that people are finding using post-search but it's really the focus is really to try and allow people to discover content that's been shared on Facebook that's relevant to them. And that's going to be the focus in the near term. And as people consume more content on Facebook there's opportunities to show them ads in feeds. So there's an opportunity there but it's really around engaging with content that you want to find on Facebook.

Sheryl Sandberg: On Instagram we haven't noticed any difference in willingness to engage with ads between the platforms for Instagram and Facebook. But we've brand really slowly and we're very, very cautious and again we're going to continue to focus on the user experience, focus on the community growth and monetization will follow.

Operator: Your next question is from Ben Schachter of Macquarie. Your line is open.

Ben Schachter: A couple questions. One, given your success with standalone apps should we expect to see more apps in the future and could one of those focus specifically on video? And then on Oculus, monetization for that, should we expect an app store like model where you'll be sharing revenue with the content partners? Thanks.

Mark Zuckerberg: We work on a lot of different things. I don't think we rule out the things that you just mentioned, but we don't have anything specific to talk about today on either of them I think.

Dave Wehner: Obviously a big part of our investment strategy is investing in this next generation of apps and focus their is on growing the communities around Messenger, WhatsApp, and of course Instagram. That's all going really well and that's a big focus of our investments.

Operator: Your next question is from Mark Mahaney of RBC Capital Markets. Your line is open.

Mark Mahaney: Two questions. David, the sales and marketing expenses this quarter were almost flattish sequentially. You don't normally see that in your business. Was there anything any particular reason behind that and why you didn't have that area grow? I assume it will continue to grow going forward. And Mark, you made a comment about I think you were referring to Instagram becoming one of the best places to get a realtime snapshot of the world and kind of reminds me or makes me think about some other leading platforms on the Internet and I wonder how does that happen with Instagram? Is that something that you're already seeing users use Instagram to make that happen or is that something that you have to tweak the user interface and change the product a little bit in order to take have people think about it that way? How does it become that realtime snapshot of the world? Thanks.

Dave Wehner: So on the sales and marketing expenses, Mark, I think you're going to see that be lumpy. That's just due to product marketing. And that's just not going to necessarily be a study a steady quarter-to-quarter trend so you're going to see that be lumpy but yes, we are investing more in general in sales and marketing over time so you'd expect to see that grow in line with the

expense guidance that we're giving so it's definitely an area that we'll be investing in on an ongoing basis and I wouldn't read too much into the quarterly trends there.

Mark Zuckerberg: Yes. In terms of Instagram, I just think, Kevin and the team are doing amazing work. The clarity of focus and clarity of the vision that Kevin and Mike have has been exceptional. And this is something that they've always focused on. They've cared deeply about it since the first conversations I've had with Kevin. And I think it takes real composure as a leader to scale something from too many X where it was just a few years ago and build up the organization and be able to continue pushing the products forward every day to be able to do that. And I think it's rare that you get someone who's as talented as the folks who are leading this and they're just doing an amazing job.

Operator: Your next question is from the line of Paul Vogel with Barclays. Your line is open.

Paul Vogel: Similar follow-up question for Mark. Your DAU to MAU number has been exceptionally strong and moving up. I'm going to guess a lot of that is mobile related so I guess that would be question number one. Is it a lot mobile? And the second question would be again around this realtime issue, are you seeing more realtime usage of Facebook? Are you developing more products specifically around realtime usage of Facebook as a platform?

Thank you.

Mark Zuckerberg: I think a lot of it is that we're getting better and better at ranking and showing people the content they want. So part of it is that there's of course a bigger opportunity when people have their phones with them all the time but I think that there are plenty of other worlds that we could be living and where we wouldn't have necessarily executed on that opportunity. And the execution is hard. And just having something that's appealing universally to people wanting to stay connected with their friends that's an important piece of it, but the team has just done really good work in terms of ranking the content and making the experience faster and building out better ways to get

feedback from our community on what kinds of content they want to see in newsfeed. And helping people have the tools that they need to share the social content and news and video content that they want. So that way it exists in the corpus of content that can be shown. I just think the team is doing really good work on all of these and I'm really proud of them.

Dave Wehner: Paul, there's no doubt that mobile has the beneficial effect on our engagement. In the U.S., two out of three smartphone users check their phone as soon as they wake up in the morning. It's just having that experience readily available in your pocket is tremendous and we just see that being helpful across the business as it relates to mobile engagement.

Operator: Your next question is from Brian Wieser of Pivotal Research. Your line is open.

Brian Wieser: You mentioned 40 million small businesses have active pages. I'm wondering if you can update us on how many individual small businesses or businesses in total are buying ads right now and separately I was curious about current thoughts on how ad tech businesses will evolve if you see an integrated marketplace evolving over if you see discrete demand and supply side businesses evolving?

Sheryl Sandberg: On the first, we announced that we have over 2 million advertisers who are buying ads on Facebook. And the process for that is often that small businesses become organic users. So those 40 million small business pages that are using it once a month. And then we're able to move them onto being advertisers. And the best way we've done that is by simplified and price. 82 percent of the people we start advertising with a start with our really simple ad products. Do you want to pay a few dollars or a few pounds or a few euro to sponsor this post? Is a really easy on-ramp for a small business.

In terms of the overall ad tech world I think a lot is happening and there's a lot that's going to evolve in the whole ecosystem. Our focus is on bringing people-based marketing and the effectiveness and relevance of Facebook ads off of Facebook. So we can give marketers and publishers the tools to

reach people across all of their devices and importantly for our business is connect the dots between online marketing and business outcomes and you heard on this call me give a few examples of where we're already able to connect what happens in terms of ads with real sales of real products. For us this is an important investment and it's a very strategic. We are going to put the time in to make this work rather than look for any short run specific return.

Operator: Your next question is from Peter Stabler of Wells Fargo Securities. Your line is open.

Peter Stabler: Drafting off that, Sheryl, wondering if you could update us on Atlas? We understand Atlas in and of itself is not likely to be a major revenue driver, but we do see it as a strategically an important piece of your toolsets wondering if you could comment on agency adoption. Is it going according to plan? Are you happy with it? Secondly on SMB, wondering the 80 events that you've held around the world, in terms of learning coming out of those, you talked a little bit about how folks get introduced as users and that makes sense. Is the toolset simple enough today for SMB's to grasp? Or are there significant additions that you need to make to the toolset to accelerate the growth of SMB advertisers? Thanks very much.

Sheryl Sandberg: On the first, Atlas is really important because it's solving and measurement problem which is at the current systems for serving and measuring ads are really flawed. They basically assume that you are one person on one device and we know that's not true. They're only about 65 percent accurate and demographic targeting they don't work on mobile because they are cookie-based they don't work on multiple devices they don't go off-line to online and they overemphasize the last click and reach. And so our focus with Atlas is helping people really understand the results they get with ads. And you heard my Live Nation example earlier where we are able to connect Facebook ads and our platform directly to ticket sales. We never could have done that without Atlas measurement.

In terms of the migration process this is an enterprise sale. We have to work client by client, then they have to choose us then they have to migrate their

systems. And so it's going to take time. What really matters is that when we get the migration and we are seeing it, we are able to show them the value because it makes their buying much more effective because they understand real results in a new way. In tune with SMB's I would say two things. One, our products aren't simple enough yet because they can never be simple enough for SMBs. But two our products are probably the simplest ones out there. And so I think we're leaving at I think we have a lot more to do. If you look him in the United States which is a very advanced markets I think it's something like 35 percent of SMB's don't have a Web presence of any kind.

But the great majority of those to have a Facebook page and that's because setting up a Web presence for an SMB is complicated and expensive you can't just start a webpage. But it is easier and free to start a Facebook page and so you see broad adoption. We also make a lot of things that they couldn't do in other platforms available on us. So over 1 million SMB's have posted a video on Facebook. Which is pretty amazing because I doubt 1 million SMBs has ever run a video or TV had. That's because you can shoot it on your mobile device, you can upload it, you can do that for free or you can pay us for the ad. And so I think our tools are the simplest. But I think we still need to do better because what we hear from SMBs is simple, fast inexpensive, showing them real return - and we're going to continue to focus on all of those things.

Operator: Your next question is from Eric Sheridan with UBS. Your line is open.

Eric Sheridan: I wonder if I could give an update on the e-commerce initiatives including the partnership with Shoppify and how we should be thinking longer-term about e-commerce becoming a bigger and bigger part of the platform, Sheryl you called out Priceline.com and the booking relationship during your prepared remarks. Curious how for that might go longer-term. Thanks.

Sheryl Sandberg: E-commerce is one of our top categories of advertisers and we are already driving a lot of product sales through Facebook but importantly our e-commerce initiatives are really about connecting consumers with marketers so they can buy from companies. They are not buying through us. We are testing a buy button in the new shop Section on pages but again that buy

button is letting people buy directly from their advertisers, not from us. It's pretty early days. We're excited by what we see in the e-commerce vertical and we're going to continue to invest in growing that vertical as part of our ads business.

Deborah Crawford: Operator, we have time for one more question, please.

Operator: The last question is from Brian Pitz of Jefferies. Your line is open.

Brian Pitz : Question's on audience network. Any updates here including a sense of the level of adoption you're seeing from developers? Also any synergies with the mobile app install product? And finally any comments on ad price comparisons to traditional newsfeed ads?

Sheryl Sandberg: We're seeing investment, we're investing in the audience network, and we think it's important because it makes the ads more relevant as part of our overall ad tech push to bring the effectiveness and relevance of our ads also. We're growing the number of advertisers and publishers and we're continuing to see growth and we'll continue to invest. When you think about mobile app install ads, those are an important but relatively small part of our revenue.

The important thing to understand here is that they're not only used by developers they're used by all four marketer segments. So for example HBO used our video retargeting mobile app install ads on Facebook to drive downloads at HBO Now and Facebook is now the number one channel driving subscribers. And I think when people think about our mobile app install ads they often think this only applies to developers and small companies. And really it's them as well but it's also companies like HBO which are using those ads to drive adoption and downloads.

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

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for joining us. You may now disconnect your lines.

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