

**Facebook, Inc. (FB)**  
**Fourth Quarter and Full Year 2016 Results Conference Call**  
**February 1<sup>st</sup>, 2017**

**Operator**

Good afternoon. My name is Mike and I will be your conference operator today. At this time I would like to welcome everyone to the Facebook fourth Quarter and Full Year 2016 Earnings Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. If you would like to ask a question during that time, please press star then the number 1 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, VP Investor Relations**

Thank you. Good afternoon and welcome to Facebook's fourth quarter and full year 2016 earnings conference call. Joining me today to discuss 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. 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 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](http://investor.fb.com).

And now, I'd like to turn the call over to Mark...

**Mark Zuckerberg, CEO**

Thanks, Deborah. And thanks everyone for joining today.

This was another good quarter and a good end to 2016. Our community continues to grow, and now with nearly 1.9 billion people using Facebook every month and more than 1.2 billion using it every day. We've seen continued growth and engagement on our platform, and our ads business is doing well, too. Total revenue grew by 51% year-over-year to \$8.8 billion, and advertising revenue was up 53% to \$8.6 billion.

Facebook stands for connecting people and creating a global community, and in 2016 more people than ever made their voices heard. We saw billions of conversations about everything from important

elections to the Olympics to breaking news stories around the world. And more people are taking advantage of new tools to connect and share on our family of apps -- especially with video.

2016 was also a year that reinforced the importance of connecting the world.

Today is the five-year anniversary of the day we filed to go public. In our letter to potential shareholders, I wrote that "There is a huge need and a huge opportunity to get everyone in the world connected, to give everyone a voice and to help transform society for the future." I believe that now more than ever. And as the largest global community, I see our responsibility as very important, and we will continue to focus on doing everything we can to bring the world closer together.

I want to give you an update on our progress over our 3, 5 and 10-year time horizons with a particular focus on what we're going to be doing over the next three years.

I've said before that I see video as a mega trend on the same order as mobile. That's why we're going to keep putting video first across our family of apps and making it easier for people to capture and share video in new ways.

To make it easier to find and watch videos, we've added a tab at the bottom of the Facebook app with top videos and recommendations. We've already rolled the tab out to everyone in the U.S., and we're planning to bring it to more countries soon.

We're also improving live video as more people use it. New Year's Eve was our biggest live moment ever, with more people going live than at any other time since we launched the product. We're experimenting with live 360 video, audio-only live for people with slower connections, and live face masks and more camera effects and we'll have more updates soon.

Finally, we're looking for ways to grow the ecosystem of video content on Facebook. We want people to think of Facebook as a place for interesting and relevant video content from professional creators as well as their friends. Last year we started to invest in more original video content to help seed the ecosystem, and we're planning to do more in 2017.

We're also focused on building a more informed community.

We see Facebook as a community, and ourselves, our role, as supporting that community. We don't write the news that you read, but we want to be a place where people can access information and have meaningful conversations, and this is a responsibility that we take very seriously.

In the past we've taken steps to reduce spam and clickbait, and now we're approaching misinformation and hoaxes the same way. In Q4, we started working with third-party fact-checkers in the U.S. to flag disputed stories and make them less likely to appear in News Feed. We've made it easier to report and identify misinformation. And we're working to build stronger ties between Facebook and the news industry.

Our primary goal here is to do the right thing for our community. If we can help people stay informed and make Facebook a better place to understand what's going on in the world, then we think that's going to make our community stronger and a more positive force for good in the world.

So that's the 3-year update. Over the next five years, we're going to keep building ecosystems around our apps that a lot of people are already using.

Growth and engagement on Instagram have been strong. We announced in December that Instagram now has over 600 million monthly actives and recently passed 400 million daily actives. Instagram Stories reached 150 million daily actives just five months after the launch, and we've added new features like Boomerang and Live into Stories and I'm excited to see that continue to grow.

Our messaging services are making good progress as well. In Q4, Messenger launched a new camera, group video chat for up to 50 people, and games. 400 million people now use voice and video chat on Messenger every month.

WhatsApp is growing quickly, too. We recently reached 1.2 billion monthly actives and more than 50 billion messages are sent through WhatsApp every day. In the last quarter we also added the ability to make video calls in the app.

Over the next 10 years, we're going to continue to invest in these platforms and technologies that will give more people a voice and make sharing even more immersive.

Through our efforts with Internet.org, we have now connected more than 50 million people to the internet. And in November, our connectivity lab set a world record by transmitting 20 GBPS over 13 kilometers using the same amount of power it takes to light a single lightbulb. Ultimately, this technology is going to make it into the solar-powered planes that we're building to beam internet to parts of the world that aren't connected.

On artificial intelligence, we developed a new technique called "style transfer" that uses AI to study a painting and then can take your photos or videos and draw them in that style in real time on your phone. And if you post on Facebook looking for a place to eat or suggestions for where to go, we can now use AI to understand the text of your post and understand what you're asking and surface recommendations from the comments.

We're still early in our 10-year plan for virtual reality, but we've made some good progress. In December, we shipped our Touch controllers, and the community response has been very positive. Samsung announced that they've now shipped more than 5 million Gear VRs. And we're bringing more social experiences to VR with apps like Oculus Rooms for Gear VR. We're going to keep making big investments in VR content, and I'm excited about what's coming in 2017 -- from new games to more immersive educational experiences.

As I said on our call last quarter, we're going to continue to invest and hire aggressively -- to help improve our products, but also to build the infrastructure that will help us grow in the future. A few weeks ago I visited our newest data center in Fort Worth, Texas. It's going to be the biggest data center we've built, powered by 100% renewable energy, and it's a great example of the investments that we're making to help us serve our community even better.

So we've made some good progress, but we have a lot more to do to help bring the world together. I want to thank our community, our teams, our partners, and all of you for being a part of this journey with us.

Now, here's Sheryl.

**Sheryl Sandberg, COO**

Thanks Mark and hi everyone.

We had a strong fourth quarter capping off a great 2016.

Q4 ad revenue grew 53%. Mobile ad revenue reached \$7.2 billion, up 61% year-over-year, and was approximately 84% of total ad revenue. Our growth this quarter was broad-based across all regions, marketer segments, and verticals.

We're really excited to announce today that 65 million businesses are using our free Facebook Pages product and 5 million are using Instagram Business profiles. More and more of these businesses are becoming advertisers with over 4 million advertising on Facebook and over 500,000 on Instagram. As a result, our revenue base is becoming more diverse. In Q4, our top 100 advertisers represented less than a quarter of our ad revenue, which is a decline from Q4 last year.

We continue to focus on our three priorities – capitalizing on the shift to mobile, growing the number of marketers using our ad products, and making our ads more relevant and effective.

First - capitalizing on the shift to mobile.

In Q4, we saw consumers use mobile for more of their holiday shopping. ComScore found that mobile drove over a billion dollars in total Cyber Monday sales for the first time ever.

Marketers are increasingly seeing mobile as an opportunity it is. In 2016, we saw more marketers prioritizing mobile and especially mobile video.

People consume video differently on mobile so the best marketers are optimizing their creative. For example, Hershey's used Facebook Live and Video ads for the launch of their Cookie Layer Crunch. They optimized their Video Ads to grab attention in the first few seconds and used captions for people viewing without sound. Nielsen Brand Effect measured an 11pt lift in brand awareness, and a 20pt lift in ad recall.

We are helping more businesses connect with more people on mobile, both on Facebook and off. Last month, we announced that advertisers can reach over one billion people a month on the Audience Network.

Our second priority is growing the number of marketers using our ad products.

It's clear that businesses of all sizes are using our platforms to reach customers.

Two weeks ago, I visited Holzconnection, a family-run furniture maker in Berlin. When competition increased several years ago, the owner worried he might have to close stores. His son joined the family business and convinced his father to market on Facebook. Holzconnection didn't change anything about their traditional craft, just the way they reached customers. Since then, they've opened 5 new locations both domestically and internationally. We want to help more small businesses grow, so we've invited companies including Holzconnection to participate in Small Business Councils around the world.

We continue to invest in making our free and paid products easier to use – expanding our online tutorials and offering creative tools to businesses of all sizes. For example, the owners of Distinctive Gardens – a gardening center in Illinois – watched one of our online tutorials and then used a mobile phone to shoot a holiday-themed video. They sold out their holiday inventory.

Our third priority is making our ads more relevant and effective.

Our goal is to drive value for our clients. As we grow the diversity of businesses on our platform, we've invested in building ad products that meet a broad set of objectives – from building brands to moving products off shelves online and in-stores. To make our ad products as relevant and effective as possible, we're increasingly tailoring them by vertical.

In 2016 we invested in Dynamic Ads, which allow advertisers to automatically promote products from their entire catalog. We expanded Dynamic Ads across Facebook, Instagram, and the Audience Network and tailored them for verticals like travel and retail. Dynamic Ads for Travel enable businesses to show ads based on dates and destinations people are interested in, while Dynamic Ads for Retail show people the products available at nearby locations in real-time. Last month we introduced Dynamic Ads for Broad Audiences to help businesses reach new customers based on their interests on Facebook and online behavior. We'll continue to work on building effective ad products and proving the value they drive.

We know that measurement is important to building advertiser trust. Last year, we discovered several metrics issues. While no billable metrics were affected, we took action to fix the errors and reviewed all of our metrics. We also expanded our partnerships with third parties given the important role they play in verification. We'll continue to invest in measurement, including third party partnerships, in the upcoming year.

We believe our strong 2016 is because of the value we drove for businesses on our platforms. We're inspired by the entrepreneurs we work with, like the owners of Holzconnection and Distinctive Gardens, and we're grateful for the opportunity to help them reach customers, grow their businesses, and hire more people.

With only a small fraction of the businesses on Facebook and Instagram advertising, we know we have a lot of opportunity and hard work ahead. In 2017, we'll stay focused on helping businesses of all sizes reach customers around the world and grow.

Thanks, and now here's Dave.

**David Wehner, CFO**

Thanks Sheryl and good afternoon everyone.

2016 was another year of strong, profitable growth, and we continued to invest in building our business for the long-term. Full-year 2016 revenue was \$27.6 billion and grew 54% or 56% on a constant currency basis, and we generated over \$10 billion in GAAP net income.

Let's start with our community metrics.

In December, 1.23 billion people used Facebook on an average day, up 189 million or 18% compared to last year. 1.86 billion people used Facebook during the month of December, up 269 million or 17% compared to last year.

In addition to our ongoing Internet.org and Android product efforts, we benefitted from an increase in third party promotional free data plans in Asia and the Rest of World.

Mobile continues to drive our growth, with 1.15 billion people accessing Facebook on mobile on an average day in December, up 212 million or 23% compared to last year.

Given that the vast majority of monthly and daily usage now occurs on mobile devices, my comments will focus on total MAU and DAU beginning next quarter, and we do not plan to include mobile and mobile-only usage breakdowns in our supplemental investor materials after this quarter.

Turning now to the financials.

My prepared remarks will focus on our GAAP results unless otherwise noted. As I have noted before, we focus on GAAP results because stock-based compensation plays an important role in how employees are compensated in our business and industry more broadly, and we view it as a real expense.

Q4 total revenue was \$8.8 billion, up 51%. Q4 ad revenue was \$8.6 billion, up 53% or 54% on a constant currency basis.

Mobile ad revenue was \$7.2 billion, up 61%, and represented approximately 84% of total ad revenue. Desktop ad revenue grew 22%, despite a decline in desktop usage, helped by our efforts to limit the impact of ad blockers on advertisements served on personal computers.

The same supply and demand factors we have discussed in the past continue to drive our mobile ads revenue.

On the demand side, we continued to improve our targeting, measurement, and ad formats to drive strong results for marketers. As Sheryl mentioned, these efforts are working for an increasingly broad set of advertisers.

On the supply side, growth in users, time spent, and ad load also contributed to our strong results.

In Q4, the average price per ad increased 3% and the total number of ad impressions served increased 49%, driven primarily by mobile feed ads on Facebook and Instagram.

Payments & Other Fees revenue was \$180 million, down 12%.

Q4 total expenses were \$4.2 billion, up 29%.

We ended the year with approximately 17,000 employees, up 34% compared to last year and an increase from the 31% growth rate last quarter.

Q4 operating income was \$4.6 billion, representing a 52% margin. Our tax rate was 21%.

Note that our tax rate reflects our early adoption of a new accounting standard -- ASU 2016-9. Under this standard, the tax benefit related to the difference between the vesting price and the grant price of RSUs is now reflected in our income tax provision, whereas previously it was reflected as an adjustment to equity. This is purely an accounting convention change and does not change the cash taxes we pay.

Excluding the impact of this new standard, our Q4 GAAP tax rate would have been approximately 26% and in-line with the guidance we provided on the Q3 call.

Net income was \$3.6 billion or \$1.21 per share.

Full-year 2016 capital expenditures were approximately \$4.5 billion, up 78%, as we continue to invest to support the rapid growth of the business around the world. Over the course of 2016, we expanded four of our existing data centers and began construction of four new data centers.

In 2016, we generated over \$11.6 billion in free cash flow and ended the year with \$29.4 billion in cash and investments.

Also note that the new accounting standard changed how we present operating cash flow and the free cash flow calculation. In the past, we treated the excess tax benefit as a financing cash flow item and thus was not included in either cash flow metric.

Adoption of this standard also resulted in a retrospective adjustment to certain 2016 quarterly financial line items. For more detail on these adjustments, please refer to the supplemental earnings slides available on our investor website.

Turning now to the outlook.

First, on revenue, the outlook is unchanged. Consistent with my comments on the Q3 call, we continue to expect that our ad revenue growth rate will come down meaningfully in 2017. The factors driving this expectation remain the same.

We also expect that our full-year 2017 Payments & Other Fees revenue will decline compared to full-year 2016.

Second, on expenses. Consistent with what I said last quarter, we expect that 2017 will be an aggressive investment year.

We saw hiring growth accelerate in Q4 and we plan to accelerate hiring further in 2017 from that 34% growth rate. In addition to headcount, we expect to increase investments in R&D, content, sales and marketing and other areas as we execute on our near, medium and long-term priorities.

We expect that full-year 2017 total GAAP expenses will grow 40%-50% compared to the full-year 2016.

We anticipate that full-year 2017 share-based compensation expenses will be in the range of \$3.9-\$4.1 billion, approximately \$1.3 billion of which is related to acquisitions, most notably WhatsApp. We also expect full-year 2017 amortization expenses to be approximately \$700-\$800 million.

Accordingly, on a non-GAAP basis, we would expect total expenses to grow approximately 47-57% compared to the full year 2016. We anticipate our expense growth rates will increase over the course of the year.

We expect our full-year 2017 capital expenditures will be in the range of \$7-\$7.5 billion as we fund the expansion of data center capacity and office facilities to support the continued rapid growth of our business.

Turning now to tax. At current stock prices, we expect that our full-year 2017 GAAP and non-GAAP tax rates will be one to two percentage points lower than our respective 2016 tax rates. Let me note two additional factors with the new standard. First, our tax rate will vary based on the stock price. And secondly, we anticipate the tax rate will start lower in Q1 and then trend up throughout the year.

Before wrapping up, as a reminder, in the fourth quarter our board of directors authorized a \$6 billion stock repurchase program beginning in 2017 with no fixed expiration date.

Our main priority is to invest aggressively to grow the business while maintaining a strong cash position. At this time, the company's strong balance sheet and financial performance puts us in a position to

make opportunistic repurchases of our common stock from time to time to help offset the dilution incurred through equity issuance.

To conclude, 2016 was a strong year for Facebook in terms of community growth, engagement, product innovation and the growth of our advertising business. We believe we have significant opportunities ahead of us as we invest in our mission to make the world more open and connected.

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