

**Facebook, Inc. (FB)**  
**Fourth Quarter and Full Year 2017 Results Conference Call**  
**January 31<sup>st</sup>, 2018**

**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 2017 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 2017 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 us today.

2017 was a strong year for Facebook in many ways. Our community continues to grow with more than 2.1 billion people now using Facebook every month and 1.4 billion people using it daily. Our business grew 47% year-over-year to \$40 billion.

I'm proud of the progress that our team has made and the ways Facebook is helping people around the world: giving people a voice who didn't have one before, strengthening relationships by helping family and friends stay connected wherever they are, and enabling more than 70 million small businesses to grow and create jobs.

But 2017 was also a hard year. The world feels anxious and divided—and that played out on Facebook. We've seen abuse on our platform, including interference from nation states, the spread of news that is false, sensational and polarizing, and debate about the utility of social media. We have a responsibility to fully understand how our services are used, and to do everything we can to amplify the good and prevent the harm. This is my personal challenge for 2018.

One of the most important things we can do is make sure our services aren't just fun to use, but also good for people's well-being and for society overall.

So far this year we've already announced a couple of important updates:

The first is prioritizing meaningful social interactions over passive consumption of content. Research shows that strengthening our relationships improves our well-being. When we use social media to connect with people, that correlates with long term measures of well-being that you'd expect, like happiness and health. But passively watching videos or reading articles may not have those same effects.

You can think about it this way. When you see a photo from a friend in News Feed, that's not just content that makes you smile or laugh, it's an opportunity to connect with that friend, to reach out to them and to remind them that you care about each other. That connection is deeply important to us as people. But when you see a video or a news article—even if it's informative or entertaining—unless you start a conversation around it, you're not building a relationship.

We've also gotten feedback from our community that these moments that lead us to connect are the unique experience that people want and expect from Facebook. But in the last couple of years, the ecosystem of public content like video, news, and posts from businesses has grown massively—to the point where it's starting to crowd out the personal connection people value most.

News and video will always be an important part of Facebook. But when people are spending so much time passively consuming public content that it starts taking away from the time people are connecting with each other, that's not good. So let me be clear: helping people connect is more important than maximizing the time they spend on Facebook.

As a result of this update, you will now see more content from friends, family and groups that lead you to interact with people, and less public content that leads to more overall time spent.

Now, as I made clear announcing these changes, I expect the time people spend on Facebook and some measures of engagement will go down as a result. But I also expect the amount we actually interact with each other to go up over time.

We're already starting to see this play out. On our last earnings call, I said that video done well can bring people together, but too often today, watching video is just a passive experience. To shift that balance, I said that we were going to focus on videos that encourage meaningful social interactions. And in Q4, we updated our video recommendations and made other quality changes to reflect these values.

We estimate these updates decreased time spent on Facebook by roughly 5% in the fourth quarter. To put that another way: we made changes that reduced time spent on Facebook by an estimated 50

million hours every day to make sure that people's time is well spent. That's how serious we are about this.

Now, we don't normally share time metrics because they're not the best way of understanding engagement. But this shows how committed we are to making sure the time you spend on Facebook is valuable.

Through this process, we have also gotten a sense for how some updates impact other metrics as well. For example, changes we made to improve quality in the fourth quarter contributed to a decline in people using Facebook daily in some countries.

By focusing on meaningful interactions, I expect the time we all spend on Facebook will be more valuable. And I always believe that if we do the right thing and deliver deeper value, our community and our business will be stronger over the long term.

In this case, it intuitively makes sense. If people interact more, that should lead to a stronger community. And we already know that time in News Feed interacting with people is more valuable than time passively consuming video or news. When you care about something, you're willing to see ads to experience it. But if you just come across a viral video, then you're more likely to skip over it if you see an ad.

So I want to be clear: the most important driver of our business has never been time spent by itself. It's the quality of the conversations and connections. And that's why I believe this focus on meaningful social interactions is the right one.

The second update we announced is about making sure the information you see on Facebook comes from broadly trusted and high-quality sources, in order to counter misinformation and polarization.

The idea is this update will show more news from sources that are broadly trusted across the community and not only by those who read them directly. For example, take the Wall Street Journal or the New York Times. Even if you don't read them or if you don't agree with everything they write, most people have confidence that they're high quality journalism. On the flip side, there are blogs that have intense followings but are not widely trusted beyond their core audience. We will show those publications somewhat less.

Preventing false news, hate speech, and other abuse is another important area of focus for us. In order to protect the security and integrity of our platform, we're investing in both people and technology. We now have around 14,000 people working across community ops, online ops, and our security efforts. That's almost double where we were a year ago. We've also built new technology to detect suicidal posts that has helped first responders reach more than 100 people who needed help quickly, and we've built AI systems to flag suspicious behavior around elections in real time and remove terrorist content. Thanks to our AI systems, 99% of the ISIS and Al-Qaeda-related terror content we take down is now removed before anyone even flags it to us—and in some cases, before anyone sees it.

We've also made progress demoting false news in News Feed, which typically reduces an article's traffic by 80% and destroys the economic incentives that most spammers and troll farms have to generate these false articles in the first place.

Finally, we've started rolling out a major ads transparency effort. We support Congress passing legislation to make all advertising more transparent, but we're not going to wait for them to act. We've already begun launching a way for anyone to view the ads a page is running on Facebook, Instagram, and Messenger—even if they aren't the intended audience. We're testing in Canada first with the goal of rolling it out in the US this summer ahead of the midterm elections.

As I said last quarter, I expect these investments—on top of other investments we're making—will significantly impact our profitability. But just like the changes we're making that will impact time spent, these investments will help us build a stronger community over the long term.

Now, building a stronger community also means delivering on our product roadmap for the next 3, 5 and 10 years.

Over the next three years, we know video will continue to grow, so our job is to build video experiences that help people connect with family, friends, and groups. That's why I'm excited about Watch as a place to connect with people who have similar interests, and it's why we launched products like Watch Party where friends can watch a show together.

Another important shift that we're seeing across the industry is the growth of Stories. We expect Stories are on track to overtake posts in feeds as the most common way that people share across all social apps. That's because Stories is a better format for sharing multiple quick video clips throughout your day. The growth of Stories will have an impact on how we build products and think about our business, including WhatsApp and Instagram, which are the #1 and #2 most-used Stories products in the world.

Beyond video, we have a long roadmap working to help people connect in meaningful ways.

Today, more people are using groups than ever. These include smaller groups of friends and family, and also larger communities where people connect around shared interests. We're focused on helping more people find the right communities for them and giving group admins and leaders the new tools they need to run these groups and help them grow.

The goal of Marketplace is to connect people through commerce. More than 700 million people each month now come to Facebook to buy and sell things. We launched Marketplace in 30 countries last year, including 11 countries in the last quarter alone.

Over the next five years, we remain focused on building ecosystems around our services that lots of people already use.

In Messenger and WhatsApp, we're working to give businesses more ways to communicate with their customers. We launched a plug-in for Messenger so people can chat live with companies on their websites, and now more than 2 billion messages are sent between businesses and customers every month.

WhatsApp recently crossed 1.5 billion monthly actives, with people now sending more than 60 billion messages every day. A growing number of these messages are between people and companies, which is why we launched WhatsApp Business—a new app designed specifically for small and medium businesses to connect with people they want to reach.

Over the next 10 years, we're working on the foundational technologies needed to bring the world closer together.

Our goal with AI is to understand the meaning of all the content on Facebook to help us build better services. In addition to making it easier to get people the help they need and remove harmful content, this will also help us show more content that encourages connection and conversation.

On the VR side, we're excited to get Oculus Go into people's hands this year. Time Magazine named it one of the top inventions of 2017, and I can't wait for more people to use it.

So 2017 was a good year in many ways, but it was also challenging. That's why our focus this year will be making sure our services are not just fun, but also good for us—and I'm confident that we will we'll rise to the challenge. Thanks to all of you for being part of this journey, and I'm looking forward to making more progress together.

And now, here's Sheryl to talk about our business.

**Sheryl Sandberg, COO**

Thanks Mark and hi everyone.

We had a strong fourth quarter and a great end to the year. Q4 ad revenue grew 48% year-over-year. Mobile ad revenue was \$11.4 billion, up 57% from last year, and contributed approximately 89% of total ad revenue in Q4. Full year 2017 mobile ad revenue grew 56% compared to 2016 – and was broad-based across regions, marketer segments and verticals.

We continue to make progress on our three priorities: helping businesses leverage the power of mobile, developing new ad products and making our ads more relevant and effective.

Facebook and Instagram are where people and businesses connect and are especially meaningful platforms for small businesses. Globally, 70 million businesses use Facebook. We surveyed small businesses in 18 countries, and 57% of them are employing more people due to growth in demand since joining Facebook. Last week, I met Adam of Kings Barbers Club who started with 2 employees in Birmingham, England and now has 15 salons and 70 employees. I also met Domingo from Pescaria, a restaurant in Southern Italy that uses Facebook and Instagram to connect with customers. 80% of their diners – and 70% of their revenue – comes from Facebook. They opened their second restaurant, and now employ more than 60 people. Like Adam and Domingo, small business owners are some of the most dedicated entrepreneurs. They are the heart of every economy and create the majority of new jobs throughout the world.

As Mark said, we are taking strong action to maximize the good we do in communities. As part of this, we are investing heavily in small businesses and in helping people gain digital skills. In November we launched our Community Boost program, which provides digital training for people in need of work and helps local businesses and nonprofits get the most out of the internet. During my trip last week, I announced we're expanding the program to the EU. This year we'll visit more than 30 cities in the U.S. and Europe to work side-by-side with SMBs, startups and NGOs. Over 2 million people and businesses have already used our online and offline training – and by 2020, we'll have trained 1 million people and businesses across Europe alone.

As people and businesses shift to mobile, Instagram continues to grow quickly. There are more than 2 million active advertisers on Instagram and we announced in November that more than 25 million businesses have profiles on Instagram – up from 15 million in July. Instagram is a business’s mobile visual shop, and we’re seeing more people seek out businesses there. About two-thirds of the visits to Instagram business profiles are from people who don’t follow them yet – and this is helping bring in new customers.

Our second priority is developing innovative ad products.

Each year mobile advertising reaches new milestones during the holiday shopping season. A year ago, we saw mobile conversions – actions taken on a mobile website after viewing an ad on Facebook – surpass desktop conversions for the first time. In 2017, mobile conversions continued to accelerate. Data from 17 markets shows mobile accounted for 69% of online conversions on Black Friday and 64% on Cyber Monday. It also drove 80% of conversions on Singles’ Day, a popular day for online shopping in China and increasingly other countries. Big shopping days like these are the kind of global events that Facebook and Instagram are uniquely positioned to support.

During these events and throughout the year, businesses are using our innovative ad products like Dynamic Ads to connect and reconnect with shoppers. For example, Holiday Inn Express recently used Dynamic Ads for Travel with our Collection format to advertise to people who searched for hotels on their website but hadn’t yet booked. They ran ads with a video that showed a personalized selection of hotels for the city and dates people had looked up. This resulted in 3X higher return on ad spend than their previous campaigns. In Q4 we also launched Dynamic Ads for Auto, which allows dealers and manufacturers to show the right cars to the right audiences.

As we expand and improve our ad products, advertisers are increasingly developing mobile-first ads rather than simply taking their TV creative and putting them online. Mobile-first video was 50% of our video ad revenue this quarter, compared to 41% last quarter. We’re seeing these short-form videos work well in Instagram Stories, where people can watch a full-screen vertical video and swipe up to quickly learn about a product or brand. 60% of these ads are viewed with sound on.

Recently, Open Table used Instagram Stories to advertise their reservation service to US adults who are frequent diners or are interested in dining. They combined food and restaurant footage with a “Book Now” button. The ads reached 1.5 million people and achieved 33% lower cost per reservation than their other campaigns. We are making it easier for any advertiser to try Stories ads as part of their other campaigns on our platform.

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

Targeting makes advertising better – more relevant to people and more effective for businesses. This is especially important for small businesses as they have limited budgets and need to make every dollar count. Facebook gives small businesses the same powerful tools that were previously only available to large advertisers – so they can reach the right people at the right time. For example, we’re continuing to invest in Value Optimization, which helps advertisers show their ads to people who are likely to spend more with them. We’ve been gradually rolling this out to advertisers using Web conversion, Dynamic Ads, and Mobile App Install ads. The early results are promising – over 2,500 businesses have tried Value Optimization since June and many are putting more of their budgets toward it.

We take our responsibility to prevent abuse of our ad systems very seriously, and we are investing heavily in both people and technology to protect the integrity of our platform. In addition to rolling out the ads transparency tool in Canada that Mark mentioned, we've disabled the option that lets advertisers exclude people in specific multicultural affinity segments until we can develop better safeguards against discrimination.

We're also focused on improving ad quality and delivering a better experience for people who interact with marketers on our platform. This holiday we took additional steps to penalize e-commerce advertisers who created misleading or negative ads.

In 2018, we'll continue to focus on our same three priorities – and do more to ensure the quality, transparency, and authenticity of ads on our platform.

As part of our effort to be more transparent, last quarter we published our Advertising Principles which have long guided our approach across all of our platforms. These principles are our commitment to the people who use our services. They are:

- We build for people first
- We don't sell your data
- You can control the ads you see
- Advertising should be transparent
- Advertising should be safe and civil; it should not divide or discriminate
- Advertising should empower businesses big and small
- And we're always improving our advertising

As Mark said, 2017 was a challenging and important year for Facebook – a year where we committed to increasing our investment in the safety and security of our community. It was also a strong year for our business, where our investments in helping our clients grow paid off. We will continue to make all of these investments in 2018 and in the coming years.

I'm thankful to our partners around the world and to our employees who work so hard to make us better every day.

Thanks, and now here's Dave.

**David Wehner, CFO**

Thanks Sheryl, and good afternoon everyone.

Q4 was a strong quarter for Facebook and a great end to the year. Full-year 2017 total revenue grew 47% to over \$40 billion and we generated over \$17 billion of free cash flow.

Let's begin with our community metrics.

Overall our global community is strong and growing. Daily active users on Facebook in Q4 reached 1.40 billion, up 14% compared to last year, led by growth in markets like India, Indonesia and Brazil.

This number represents approximately 66% of our 2.13 billion monthly active users in Q4. MAUs were up 269M or 14% compared to last year.

As Mark mentioned, certain product quality changes impacted our DAU growth. In the US & Canada, these changes contributed to a DAU decline of 700,000 compared to Q3. We don't see this as an ongoing trend, but we do anticipate that DAU in this region may fluctuate given the relatively high penetration level.

We continue to see healthy growth across the Facebook family of apps including Instagram, WhatsApp and Messenger.

Turning now to the financials. All comparisons are on a year-over-year basis unless otherwise noted.

Q4 total revenue was \$13 billion up 47% or 44% on a constant currency basis. Foreign exchange tailwinds contributed \$329M of revenue in Q4.

Q4 total ad revenue was \$12.8 billion, up 48% or 44% on a constant currency basis.

Mobile ad revenue was \$11.4 billion, up 57%.

In Q4, the average price per ad increased 43% and the number of ad impressions served increased 4%, driven primarily by feed ads on Facebook and Instagram.

Payments & other fees revenue was \$193 million, up 7%.

Total expenses in Q4 were \$5.6 billion, up 32%. Headcount remains a primary driver of total expenses. In Q4, we added approximately 1,900 people and ended the year with over 25,000 employees, up 47% compared to last year.

In 2017, we made significant investments in R&D and security. On the R&D side, we added more people in 2017 than we did in 2016 and 2015 combined.

On the security side, as Mark mentioned, we have accelerated our efforts and at the end of the year had around 14,000 employees and contractors working across community operations, online operations, and integrity efforts. We also continued to invest aggressively in key areas such as content and our long-term innovation efforts.

Q4 stock based compensation expenses were \$814 million which was down from the \$831 million in Q4 of last year due to a decline in deal-related stock based compensation expenses. As a reminder we acquired Oculus and WhatsApp in 2014 and we expect the deal-related SBC expenses to be substantially recognized by the end of 2018.

Q4 operating income was \$7.4 billion, representing a 57% operating margin.

Our effective tax rate was 43%. In Q4, we recorded approximately \$2.3 billion in one-time charges as a result of the 2017 Tax Cuts and Jobs Act. This was largely driven by the mandatory transition tax based on the accumulated earnings from our foreign subsidiaries.

Net income was \$4.3 billion or \$1.44 per share. Again, the one-time charges related to the tax on accumulated earnings reduced EPS by approximately \$0.77.

Full-year 2017 capital expenditures were approximately \$6.7 billion, driven by investments in servers, data centers, office facilities and network infrastructure.

In 2017, we generated over \$17 billion in free cash flow and ended the year with nearly \$42 billion in cash and investments.

In 2017, we bought back approximately \$2 billion of our Class A common stock and had approximately \$4 billion remaining on our current authorization as of December 31st. We remain committed to repurchases of our stock to help manage dilution.

Turning now to the revenue outlook.

We believe we have good opportunities to grow the business across both Facebook and Instagram in 2018. We continue to improve the effectiveness of our ads which helps drive ROI for advertisers and demand for our ad products. On the supply side, we expect we will be able to continue to grow ad impressions at a modest pace.

In 2018 we expect constant currency ad revenue growth rates to decelerate consistent with the trends we have seen over the past year. I would also note that in the first half of 2018 we will likely benefit from favorable exchange rate tailwinds due to the recent depreciation of the dollar.

Moving on to expenses.

We continue to expect full-year 2018 total expenses will grow approximately 45 to 60% compared to full-year 2017.

Turning now to Cap Ex. We expect that our full-year 2018 capital expenditures will be in the range of \$14 to \$15 billion, driven by increased investment in data centers, servers, office facilities and network infrastructure.

We currently anticipate that our full-year 2018 tax rate will be in the mid-teens.

In summary, 2017 was another good year for Facebook. We continued to grow our global community and deliver great results for our advertisers.

Importantly, we accelerated our investments to make our products better and the community stronger as we push forward on our mission of giving people the power to build community and bring the world closer together.

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