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 second quarter 2018 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 second quarter 2018 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.

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

Mark Zuckerberg, CEO
Thanks Deborah, and thanks everyone for joining us today. We had another solid quarter. Revenue grew 42% year-over-year to $13.2 billion. And Facebook now has more than 2.2 billion monthly actives, with almost 1.5 billion using it every day.

For the first time today, we’re also releasing how many people use at least one of our apps -- Facebook, WhatsApp, Instagram, or Messenger -- and that’s 2.5 billion people each month. This number better reflects our community for a couple of reasons. First, it refers to individual people rather than active accounts, so it excludes when people have multiple active accounts on a single app. And second, it reflects that many people use more than one of our services. Dave will explain this in more detail later.
I want to start by talking about all the investments we’ve made over the last six months to improve safety, security and privacy across our services. This has been a lot of hard work, and it’s starting to pay off.

We recently launched two important ad transparency tools: one to let anyone see the ads any page is running -- even if the ads are not targeted to you -- and the other: an archive of ads with political or issue content starting in the US, ready for the midterm elections. These ads are now labeled so you can clearly see who’s paying for them. And within the archive, you can see the budget associated with each ad, how many people saw it, and search all ads with political or issue content an advertiser has run for up to seven years.

This level of transparency will mean increased accountability and responsibility for advertisers globally.

Over the next 18 months, there are important elections beyond the US in Brazil, India, and the EU. These will all be real tests for Facebook. But I’m more confident we will get this right given our results during last year’s French and German elections, the Alabama special election-- as well as this month’s presidential election in Mexico -- where our systems found and removed thousands of fake accounts, pages and groups that violated our policies. Of course security is not a problem you ever fully solve. We face sophisticated, well-funded adversaries who are constantly evolving. But during each election, we learn and improve too.

We're also making progress in the fight against misinformation. We're getting rid of the financial incentives for spammers to create fake news -- much of which is economically motivated. And we stop pages that repeatedly spread false information from buying ads. We also use AI to prevent fake accounts that generate a lot of the problematic content from ever being created in the first place.

Our investments in AI mean we can now remove more bad content quickly because we don't have to wait until after it's reported. It frees our reviewers to work on cases where human expertise is needed to understand the context or nuance of a situation. In Q1, for example, almost 90% of graphic violence content that we removed or added a warning label to was identified using AI. This shift from reactive to proactive detection is a big change -- and it will make Facebook safer for everyone.

I also want to talk about privacy. GDPR was an important moment for our industry. We did see a decline in monthly actives in Europe -- down by about 1 million people as a result. At the same time, it was encouraging to see the vast majority of people affirm that they want us to use context -- including from websites they visit -- to make their ads more relevant and improve their overall product experience.

Looking ahead, we will continue to invest heavily in security and privacy because we have a responsibility to keep people safe. But as I’ve said on past calls, we’re investing so much in security that it will significantly impact our profitability. We’re starting to see that this quarter. But in addition to this we also have a responsibility to keep building services that bring people closer together in new ways as well. In light of increased investment in security, we could choose to decrease our investment in new product areas, but we’re not going to -- because that wouldn't be the right way to serve our community and because we run this company for the long term, not for the next quarter. Dave will talk about this in a few minutes.

Now, perhaps one of the most important things we've done this year to bring people closer together is to shift News Feed to encourage connection with friends and family over passive consumption of
content. We've launched multiple changes over the last half to News Feed that encouraged more interaction and engagement between people and we plan to keep launching more like this.

Of course connecting isn't limited to News Feed. Now more than 200 million people are members of meaningful groups on Facebook -- these are communities that, upon joining, they become the most important part of your Facebook experience and a big part of your real-world social infrastructure. These are groups for new parents, for people with rare diseases, for volunteering, for military families deployed to a new base, and more. We believe there is a community for everyone on Facebook. The communities often span online and offline, and bring people together in person.

We've found that every great community has an engaged leader. But running a group can take a lot of time, so we have a roadmap to make it easier. That will enable more meaningful groups to get formed, which will help us find relevant ones to recommend to you, and eventually achieve our 5-year goal of helping 1 billion people be a part of meaningful communities. Since the 1970s, there has been a long decline in people joining physical groups around the world, and that has contributed to a broad feeling of loneliness and isolation. But if we can help 1 billion people be a part of something meaningful, that can reverse this trend.

Talking about being part of something meaningful, it's inspiring to see how people are using our fundraising tools to make a difference. Last month, a campaign to raise $1,500 for undocumented children separated from their families at the border ended up going viral and raising more than $20 million from more than half a million donors around the world. This quarter, we added the ability for pages to create and donate to fundraisers for causes they care about too.

This quarter we also reached a milestone with now more than a billion actives on Instagram. It's a moment to reflect on how this acquisition has been an amazing success. When Instagram joined us, the team had only 16 people. Since then, Kevin and the team have built Stories, Direct, and now IGTV. This has been a story of great innovation and product execution. It's also a story of how effective the integration has been. We believe Instagram has been able to use Facebook's infrastructure to grow more than twice as quickly as it would have on its own. A big congratulations to the Instagram team -- and to all the teams across our company that have contributed to this success.

I'm really excited about video too, and this quarter we launched IGTV. People are watching less TV and more video, but most video is not yet optimized for mobile. IGTV will help solve that problem. It's designed specifically for mobile and makes watching long-form, vertical video from creators easy. There's a standalone IGTV app, but you can also watch within the Instagram app. That means the entire Instagram community has been able to use it from the start.

We're also seeing Watch start to grow more quickly on Facebook too. Our teams are focused on building new experiences that help people connect and start conversations. We recently rolled out Watch Party to all groups, so you can watch and chat with friends at the same time. And we're seeing some real traction with some of the original programs -- from the talk show Red Table Talk featuring Jada Pinkett-Smith to SKAM, an interactive series that started in Norway and features a new style of storytelling where the characters have accounts on Facebook and Instagram and key parts of the story are told not just through video but through posts on their pages.

Stories continue to be a big part of the future of sharing too -- and they're growing quickly across WhatsApp, Instagram, Facebook and Messenger. While we started off just implementing the basic
stories format, we've now moved well beyond it and have built lots of new features like polls, questions, and collaborative stories in groups and events. We're also making progress developing Stories into a great format for ads. We've made the most progress here on Instagram, but this quarter we started testing Stories ads on Facebook too.

The other major trend we're seeing is the shift to more private messaging. There's a lot to build here. We've been testing payments on WhatsApp in India. It gives people a really simple way to send money to each other and contributes to greater financial inclusion. Of the people who have tested this, feedback and usage have been very strong. All signs point to a lot of people wanting to use this when the government gives us the green light. In the meantime, we've broadened our focus to building this for other countries so we can give more people this ability faster. Over the next five years, we're focused on building out the business ecosystem around messaging on WhatsApp and Messenger.

More broadly, our strategy is to use Facebook's computing infrastructure, business platforms, and security systems to serve people across all of our apps. For example, we made the decision a decade ago to build our own data centers, and we opened our first custom-built data center in 2011. Today, we have six data centers around the globe, and we're working on building eight more. We're using AI systems and our global community operations team to fight spam, harassment, hate speech, and terrorism across all our apps to keep people safe. This is incredibly useful for apps like WhatsApp and Instagram as it helps us manage the challenges of hyper-growth there more effectively.

Beyond apps -- and looking at the next 10 years -- we're making a lot of progress with VR. Our goal is to create a feeling of presence, like you're right there with people you care about even if you might be halfway around the world. Oculus Go is off to a good start, and at $199, it's going to be how a lot of people experience virtual reality for the first time.

Overall, this is a critical year for Facebook. We've made progress preventing abuse, forged ahead with new innovations, and are adapting our services to the new trends of messaging, stories, videos, and groups. As always, thank you all for being a 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**

Hi everyone.

It was a good second quarter with ad revenue growing 42% year over year. Mobile ad revenue was $11.9 billion, a 50% increase year-over-year, making up approximately 91% of total ad revenue. Our growth again was broad-based across regions, marketer segments, and verticals.

We are working to ensure that Facebook is a safe place for people and businesses. We’ve taken strong steps to address a number of issues including election integrity, fake news, and protecting people’s information. One of the most important things we can do to effect change is to increase transparency because transparency leads to greater accountability. For example, when anyone can see any ad on Facebook, advertisers have to stand behind the ads they run. Transparency also allows us to get more
input from our community and from experts around the world so that we can find and fix problems. We wish we could find everything ourselves, but we never will, so we’re building tools to make it easier for people to report issues to us.

As Mark mentioned, this quarter we took major steps to make advertising and Pages more transparent. Now anyone can see all the ads a Page is running across Facebook, Instagram, Messenger and Audience Network. You can also learn more about Pages, even if they don’t advertise. You can see when a Page was created and if they’ve changed their name.

For political and issue ads, we’re going even further. Advertisers placing ads with political content are now required to verify their identity and location. These ads will be labeled with a disclosure about who paid for them and saved in a searchable archive.

The vast majority of ads on Facebook are run by legitimate organizations — from small businesses looking for new customers, to advocacy groups raising money for their causes. But we’ve seen that bad actors can misuse our products, too, so we’re erring on the side of transparency. We’re being intentionally broad in our interpretation of political and issue ads. This includes ads for books about politicians and brand campaigns that touch on national issues. Given our commitment to transparency, we think it’s important to apply this policy to more ads rather than fewer.

These steps are just the start. We’ll keep looking for ways to improve, and we hope these tools become standard across the industry.

As we make these investments in transparency and accountability, we remain focused on our key priorities: helping businesses leverage the power of mobile, developing innovative ad products, and making our ads more relevant and effective.

First, leveraging the power of mobile.

For businesses, winning on mobile now means winning on video. Globally, people are creating and watching more video — especially on mobile devices. According to eMarketer, nearly a quarter of the world’s population will watch video on a mobile phone this year. We see this trend toward video across all of our apps — from people sharing more video with their friends on Facebook, to watching more video from creators on Instagram, to having more video calls on WhatsApp and Messenger.

Marketers are making more video of their own. We’re seeing healthy growth in video ads among all advertiser segments. M&Ms UK recently used mobile-optimized 5-second video ads on Facebook and Instagram to introduce M&Ms Mix — a bag of three kinds of M&Ms in one. Their campaign worked, driving results not just for their new product but for the brand overall. Their sales increased by over 10%, and 80% of that came from households that hadn’t bought M&Ms in the previous 26 weeks.
Second, developing new ad products.

We know that creating video can be more difficult for small businesses that have fewer resources, so we’ve launched new tools on Facebook to help anyone make videos that work well on mobile. Last quarter we released Ads Animator, a simple way to create eye-catching video ads using photos and other content that’s already on a company’s Facebook Page. We’re also testing Video Creation Kit, which gives advertisers easy-to-use video templates for different marketing objectives. By learning what performs best across our platform, we can help other businesses succeed.

We’re also making it easier to run ads on Instagram and in Stories. Ads in Stories are an immersive, engaging way for people to interact with businesses. When online retailer Overstock wanted to gain new customers and increase furniture sales, they ran video ads in Instagram Stories with a Shop Now button. They saw an 18% increase in return on ad spend and a 20% decrease in cost per acquisition. This quarter, we made it easier for more advertisers to adopt the Stories format. When an advertiser uploads video in a square or horizontal format for feed, we can automatically transform it into the fullscreen vertical format of Stories.

Third, making our ads more relevant and effective.

We’re building new products and improving existing ones to ensure advertisers can reach the right audience. For example, Automatic Placements help advertisers get better results by showing ads across our platform wherever they’ll perform best and at the lowest cost. SumUp, a German payments startup that helps small businesses accept debit and credit cards, switched from manual to automatic placements and increased sales by 34% in one week.

Advertisers of all sizes want to know if their ads are working and how to make them better, but smaller businesses don’t always have this capability. We’re changing that. Last year we introduced Test & Learn, a way for advertisers to run variations of their ads and measure the results in just a few steps. We started with tools for direct response advertisers to figure out what drives conversions. In Q2, we added a way for companies to understand the effect of their ads on brand perception. We plan to roll this out to all advertisers — big and small — so they can easily experiment with different strategies and find the ones that work best.

As always, I am grateful to our teams around the world. Their work over the past several months has helped millions of businesses grow and created new levels of transparency in advertising. I’d also like to thank our partners and the businesses of all sizes who turn to us to reach their customers and give us the feedback that helps make us better.

Thank you, and now here’s Dave.

David Wehner, CFO
Thanks Sheryl and good afternoon, everyone.
Let’s start with our community metrics.

Daily active users on Facebook reached 1.47 billion, up 11% compared to last year, led by growth in India, Indonesia, and the Philippines. This number represents approximately 66% of the 2.23 billion monthly active users in Q2. MAUs were up 228M or 11% compared to last year. It is worth noting that MAU and DAU in Europe were both down slightly quarter-over-quarter due to the GDPR rollout, consistent with the outlook we gave on the Q1 call.

As Mark mentioned, we are also introducing a family-wide audience metric. 2.5 billion people worldwide used one of our applications in June. This is our best estimate of our de-duplicated audience across Facebook, Instagram, Messenger, and WhatsApp. We believe this number better reflects the size of our community and the fact that many people are using more than one of these services.

Note that for comparison purposes, the Facebook MAU number does count multiple accounts for a single user when such accounts exist, and we estimate those represent approximately 10% of our Facebook MAUs as previously disclosed in the limitation of key metrics section in our SEC filings. The family audience metric only counts a single user in these instances.

Turning now to the financials.

All comparisons are on a year-over-year basis unless otherwise noted.

Q2 total revenue was $13.2 billion, up 42% or 38% on a constant currency basis. Foreign exchange tailwinds contributed approximately $370 million of revenue in Q2.

Q2 ad revenue was $13.0 billion, up 42% or 38% on a constant currency basis.

In terms of ad revenue by region, Europe and Asia Pacific both grew fastest at 47% each and benefitted from foreign exchange tailwinds. I’d note that European ad revenue growth decelerated more quickly than other regions and was impacted primarily by reduced currency tailwinds and, to a lesser extent, the rollout of GDPR.

Mobile ad revenue was $11.9 billion, up 50% and represents approximately 91% of ad revenue.

In Q2, the average price per ad increased 17% and the number of ad impressions served across our services increased 21%, driven primarily by ads in feed on Instagram and Facebook.

Payments & other fees revenue was $193 million, up 23%.

Turning now to expenses.
Total expenses were $7.4 billion, up 50%.

We ended Q2 with over 30,000 full-time employees, up 47% compared to last year.

Operating income was $5.9 billion, representing a 44% operating margin.

Our effective tax rate in the quarter was 13%.

Net income was $5.1 billion or $1.74 per share.

Capital expenditures were $3.5 billion, driven by investments in data centers, servers, network infrastructure, and office facilities.

In Q2, we generated $2.8 billion in free cash flow and ended the quarter with approximately $42 billion in cash and investments.

And in the second quarter, we bought back approximately $3.2 billion of our Class A common stock.

Turning now to the revenue outlook.

Our total revenue growth rate decelerated approximately 7 percentage points in Q2 compared to Q1. Our total revenue growth rates will continue to decelerate in the second half of 2018, and we expect our revenue growth rates to decline by high single digit percentages from prior quarters sequentially in both Q3 and Q4.

There are several factors contributing to that deceleration. For example, we expect currency to be a slight headwind in the second half vs. the tailwinds we have experienced over the last several quarters. We plan to grow and promote certain engaging experiences like Stories that currently have lower levels of monetization. We are also giving people who use our services more choices around data privacy which may have an impact on our revenue growth.

Turning now to expenses.

We continue to expect that full-year 2018 total expenses will grow in the range of 50-60% compared to last year. In addition to increases in core product development and infrastructure, this growth is driven by increasing investments in areas like safety & security, AR/VR, marketing, and content acquisition.

Looking beyond 2018, we anticipate that total expense growth will exceed revenue growth in 2019. Over the next several years, we would anticipate that our operating margins will trend towards the mid-30s on a percentage basis.
We expect full-year 2018 capital expenditures will be approximately $15 billion, driven by investments in data centers, servers, network infrastructure, and office facilities. We plan to continue to grow capital expenditures beyond 2018 to support global growth and our ongoing product needs.

Turning now to tax. At current stock prices, we expect that our full-year 2018 tax rate will be in mid-teens but that our Q3 tax rate will be 25-30% due to a one-time charge related to a recent court ruling in the IRS vs. Altera case. As a reminder, fluctuations in our stock price will impact our tax rate.

In summary, our community and business growth remain solid. Our financial strength has enabled us to invest heavily to improve our ability to serve our global community through our existing family of apps as well as to prepare us for the future.

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

Operator: We will now open the lines for a question-and-answer session. To ask a question, press “star” followed by the number “one” on your touch-tone phone. Please pick up your handset before asking your question to ensure clarity. If you are streaming today’s call, please mute your computer speakers. Your first question comes from the line of Brian Nowak from Morgan Stanley.

Brian Nowak: Thanks for taking my questions; I’ve got two. Just -- the first one on monetization of Facebook core versus Instagram. Can you talk a little about -- a bit about how you think about monetization levels and the key drivers currently and going forward when we think about ad load, pricing and the importance of ad improvements across the two platforms over the next, call it, year or so?

And the second one on Instagram TV, can you just talk about how you look and think about the core consumer offering, how it varies from Facebook Watch, and philosophically how you’re thinking about investing in premium content or sports context across the two products? Thanks.

David Wehner: Brian, I’ll take the first one. In terms of Facebook versus Instagram, they’re obviously both contributing to revenue growth. Instagram is growing more quickly and making an increasing contribution to growth, and we’ve been pleased with how Instagram is growing. Facebook and Instagram are really one ads ecosystem.

I think from a supply perspective, both now from a feed perspective are at similar ad loads. Instagram has more heavy usage of Stories, so that’s an area of continued
growth opportunity because the effective levels of monetization in Stories are lower.

On the demand side, we see good traction across both platforms and we're rolling out more ability for advertisers to leverage ads in Stories with more formats and the like. That's, again, an important opportunity for growth, is just continuing to build out more products on the demand side for Stories.

Mark Zuckerberg: And I can take the second part of the question about the -- what we're trying to do with IGTV and Watch at the same time.

The IGTV product approach is very focused on helping people connect with creators in a mobile-native vertical video format and helping people -- not only see content that they love from people that they want to follow -- but build a community around those creators, which is what we see people are trying to do.

And creators now uniquely have the ability to both reach a large audience and connect and engage the community through the social network on Instagram at the same time.

With Watch, a lot of what we're trying to do is make it so the video content that's on Facebook and some of the content that we're -- that we're acquiring through original programming -- that people can come together with their friends to watch that content through things like Watch Party and engage and build community that way. There's a big space here in terms of helping people have real connections and interactions around video.

These are two different takes on this. Overall, what you're going to see from us on video is not just trying to optimize for overall watch time, but to optimize for building products that help bring people together and help facilitate real interactions between people.

Operator: Your next question comes from the line of Eric Sheridan from UBS.

Eric Sheridan: Thanks for taking the question. Maybe going back to the OpEx and your comments, Dave, looking out medium- to longer-term, just want to understand if we can get a little bit more color on some of the drivers of that.
How much of it can be video in support of where you want to take the business over the medium- and long-term, versus things that maybe don't necessarily have a revenue component to them, like the security and protection of the ecosystem that the whole team's been talking about since the end of last year? Thanks so much.

David Wehner: Yes, Eric. It's going to be a combination of those factors. I would say we're going to continue to invest in core product development and infrastructure.

And so you've seen that already in terms of the ramp that we have in capital expenditures, we're continuing to build out features and functionality for the community across a wide range of different products, whether it be the ad products that Sheryl talked about or IGTV and the like.

In addition to those core developments, we're also making the significant long-term investments in the safety and security. Those investments are in the billions of dollars per year; those will have a negative impact on margins.

We think that's the right thing to do for the business in terms of ensuring the community’s safety and security and the durability to franchise so those are important investments from an ROI perspective, but they don't have obviously immediate translation into revenue dollars.

Secondly, we're continuing to make big investments in innovation, those we believe are attractive long-term investments. Things that I would point to are things like AI as well as investments in AR and VR.

Those are things that will play out -- AI in the near term, but investments in AR and VR are really about building the next generation of computing and that's got a longer-term return window.

Attractive investments, we believe, but ones that will take longer-term to pay off and thus, would have a dilutive effect in margins in the near-term. Those are the two factors that I would point to.

In addition on the CapEx side, we’re continuing to invest heavily on the capital -- on capital expenditures. First, to just get ahead of user growth and engagement, and then also to make sure that we've got the compute available to support the growth of a number of the key -- the key drivers of our business around feed ranking and ads ranking. I think those are the things that I would point to -- all factoring into the margin guidance that I gave.
Operator: Your next question comes from the line of Ross Sandler from Barclays. Your next question is from the line of Ross Sandler from Barclays.

Ross Sandler: Hi, can you hear me? Can you guys hear me?

Sheryl Sandberg: Yes.

Mark Zuckerberg: Yes.

Sheryl Sandberg: Yes.

Ross Sandler: OK. Sorry. Dave, I think you said that the quarter-on-quarter growth rates are going to be high single-digits lower than the prior year quarter-on-quarter growth rates for 3Q and 4Q? That would imply around a 20 percent year-on-year growth rate exiting fourth quarter. Just wanted to clarify, is that what you actually said and, if so, what's driving this fairly dramatic deceleration of revenue growth?

David Wehner: Yes, we grew it 42 percent in the current quarter, and we’d expect a decel in high single-digits in the next couple quarters. In terms of what is -- what is driving the deceleration, I -- it's a combination of factors, and I think I outlined those in my commentary.

First of all, there's the currency, which is going from being a tailwind to being a modest headwind, we expect. Secondly, we're going to be focusing on growing engaging new experiences like Stories and promoting those, and that's going to have a negative impact on revenue growth.

And then finally, we're giving people who use service -- the services more choice around privacy. And that's coming both in terms of impacts that could be ongoing from things like GDPR as well as other product options that we're providing that could have an impact on revenue growth.

It's a combination of all those factors that is leading to -- leading to the deceleration of revenue growth in the second half.

Operator: Your next question comes from the line of Doug Anmuth from JPMorgan.

Douglas Anmuth: Great. Thanks for taking the question. A question for Mark, I was hoping you could talk about the company's focus on the meaningful social interactions. Several months into some of those changes, do you think behavior on the platform has
shifted at all? And would you expect improvements in the experience to ultimately
drive a rebound in core Facebook engagement? Thanks.

Mark Zuckerberg: Sure. We’ve launched number of changes that are focused towards trying to
courage more interaction at the expense of some passive consumption on the
network. And we found that these have generally encouraged more interaction;
they’re positive so we’re going to keep moving in this direction.

We’re doing this for a number of reasons. One is that we just started getting a lot of
feedback from people in the community that they wanted Facebook to be more
about connecting with people, which is really the core of what’s it's always been --
less so about viral videos or news content and just passive consumption. That's one.

Another big driver is we've focused on trying to make sure that we understand the
effect of using our services on people’s well-being. Think that that's important for
all companies.

And the research there is very clear, that when people are using the Internet and --
including our services -- to interact with other people, that's associated with all the
positive elements of well-being that you’d expect -- feeling more connected, feeling
less lonely, feeling happier, and long-term measures of health.

But when you're simply using the Internet to passively consume content, that isn't
necessarily associated with positive improvements to well-being. Both because of
the feedback that we were getting and the research, we felt like this was really the
right direction to go in.

We're seeing positive signs in terms of how it’s encouraging people to interact
more. Of the usage on the platform, we do think that that is the most valuable
usage, but that’s why we’re going in that direction and everything that we've seen
so far suggests to us that we should continue moving in that direction more.

Operator: Your next question comes from the line of Heather Bellini from Goldman Sachs.

Heather Bellini: Great. Thank you and, Mark, thank you for all the detailed commentary at the
beginning.

I was just wondering if you could share with us, as you look ahead over the next 12
to 24 months and you think of assets that you have that you aren't currently
monetizing in material ways, which of those do you think about when you think
about layering on the next leg of the stool, if you will?
Which one of those would you expect us -- or would you expect -- to see start to contribute in a more meaningful way over the next couple of years? How would you kind of rank-order those assets that are not currently being monetized in a significant way at this point? Thank you.

Sheryl Sandberg: I'll take it. Obviously, we started with ads in Facebook, and that was something we have grown and they continue to grow. The ads have expanded quite nicely to Instagram. And Instagram represents a very healthy part of the growth and we expect that to continue as well.

When you think about things that are further out, I think you then start talking about our messaging apps. We are furthest ahead in Messenger, but it's still very early days. We're quite happy with the consumer engagement with 1.3 billion monthly actives on the platform. And we continue to see a lot of organic connections between businesses and consumers on the messaging platform.

We now have over 8 billion messages sent between people and businesses per month, which includes automated messages. We're being very slow and deliberate with monetization; it's still in early days. But I think we've launched some things that people are excited about and interested in, like Click-to-Messenger ads.

We also had some nice results we can share from clients. One of them recently was Lego. They launched a Messenger bot to help with gift recommendations and they created a Click-to-Messenger ad that linked to a Lego bot, which helped provide product and gift recommendations.

They reached people over 25 years in the -- old -- in the U.S., U.K., France and Germany and targeted people who are interested in Lego toys and shopping.

And they found a 3.4-times higher return on ad spend for Click-to-Messenger ads versus those that just linked to the Lego Web Site. And I share that case because it shows that we're excited about. We're excited about a new surface where businesses can interact with consumers, but also really a new functionality.

If you go further out, you would then start thinking about WhatsApp. We are very focused there on the user experience, but we're also focused, even earlier stages, on growing our business ecosystem.
The WhatsApp Business app has launched, and we now have more than 3 million people actively using it to test business solutions. That’s further out, but we think it has potential as well.

Operator: Your next question comes from the line of Mark Mahaney from RBC Capital Markets.

Mark Mahaney: Two questions please -- a near-term one and a long-term one. The near-term one is can you just comment on what you’re seeing in terms of MAU recovery growth trends in Europe? You have -- you gave us a -- what turned out to be a pretty accurate read into the June quarter; would you have a read into whether things have paced out and started to improve again post-GDPR implementation?

And then I know, Sheryl, you just talked about this, but can I just ask you just to maybe comment a little bit more on Facebook Messenger?

I've just seen the ad units there; they seem to be -- they seem like there's been a pickup recently in implementation of ads there that seemed to be highly effective and reasonably well targeted. Any learnings just from those -- the basic ad units -- that you put in there, beyond the business metrics you just reported on? Thank you.

David Wehner: Hey, Mark. It's Dave. On Europe, yes, we don't have any update on trends. We had indicated in the -- in the first quarter that we would expect to see a decline. We're not providing any guidance on MAU and DAU in Europe on this call.

Sheryl Sandberg: In terms of number two, we have an ad model where we’re able to use the targeting capabilities for Facebook. But when we put ads into a new surface, we obviously learn and evolve. One example of some of the things that we’re excited about, again, are the Click-to-Messenger ads.

That's something we can put in News Feed in Instagram and Messenger, and it both grows the ecosystem and creates a new -- a new opportunity for interaction.

We also have inbox ad where we -- inbox ads where we're enabling advertisers to extend their reach to people in Messenger, which is still really early. And we've -- also in the early days of sponsored messages, which enable businesses to reengage people once a conversation has started.

And so when we think about the format of Messenger, we think about the direct correspondence between a person -- either an existing or a potential client -- or
with a business. And we think there are many times in a lifecycle of interacting with a business where that's a very attractive opportunity.

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

John Blackledge: Great. Thanks. Mark or Sheryl, could you discuss your view about the importance of Instagram as a discovery platform for new and/or emerging brands and merchants? And then over time as these merchants and brands mature, how do you view Instagram's ability to monetize?

And then just a quick one on North American ad revenue, it was a bit lower than we expected in the second quarter; don't know if you guys have any color there? Thank you.

Sheryl Sandberg: On the first, when we think about Instagram, we think we have a great opportunity - - 25 million Instagram business profiles, two million advertisers. We're growing quite nicely across brand and DR -- and with a billion active people on the platform. I think Instagram is definitely both a direct response opportunity, but an opportunity for discovery.

Part of it's the format; the format is so visually appealing and people are telling stories with pictures. We see both anecdotally and in the data that this is a great place for people to become aware of a product in the first place. And we see a lot of small businesses really able to do things on the platform.

I'll share a recent example. We just launched a shopping experience that was just expanded in Q2 to all consumers and an additional 45 countries. DefShop is an e-commerce fashion brand in Germany.

They were an early tester for IG shopping. And what they did in that test is tagged each article of clothing. They had 56 more Web Site visitors and a 64 percent increase in sales for tagged products. And I think a lot of those were discovered and purchased right through that advertising funnel.

David Wehner: John, it's Dave. Just on the North American deceleration in ad revenue growth, kind of consistent with the trends we've seen, so nothing there notable. I would say that we're pleased that the growth that we're seeing at the scale at which we're operating.

When you -- when you look at the deceleration, the one that I called out was really Europe where you saw the currency impact as well as -- to a lesser extent -- GDPR
causing faster deceleration than in the other regions. I would say North America was within what we were seeing across the rest of the business.

Operator: Your next question comes from the line of Justin Post from Bank of America Merrill Lynch.

Justin Post: Great. Thank you. This -- the guidance for the deceleration might raise some questions just on Facebook engagement. Just wondering how you're seeing activity within just core Facebook right now? Is it growing at a healthy rate?

And then secondly, you have had a couple of months now with GDPR. Just wondering how you're thinking about how that will impact your ad targeting over the next year? Thank you.

David Wehner: Sure, Justin. I'll take that. We're continuing to see good growth in the Facebook ecosystem with 11 percent DAU growth. And obviously, we've got broader family growth as well.

In terms of -- I guess going to the GDPR question -- we've talked about -- oh sorry, are -- Sheryl, were you going to take the GDPR question?

Sheryl Sandberg: Yes, I can talk about GDPR. GDPR has not had a significant revenue impact, but we also recognize it wasn't fully rolled out this quarter. It was very encouraging for us to see that the vast majority of people affirmed that they want us to use information -- including from the Web Sites they visit -- to make their ads more relevant.

But as we look further out, we recognize that there's still risk, and we're going to watch closely. Advertisers are still adapting to the changes, so it's early to know the longer-term impact.

And things like GDPR and other privacy changes that may happen from us or may happen with regulation could make ads more relevant. One thing that we know that's not going to change is that advertisers are always looking for the highest ROI opportunity. And what's most important in winning budgets is our relative performance in the industry -- and we believe we'll continue to do very well on that.

Operator: Your next question ...

David Wehner: ... I can give a little bit more color, sorry -- I want to give a little bit more color on some of the regional trends we're seeing on Facebook DAU.
U.S. and Canada -- consistent with past quarters -- has been flat at about 185 million, and we would expect that to continue to be -- continue to bounce around. Europe, we saw the declines that we anticipated from GDPR.

And I would say there, really, those impacts were purely due to the GDPR impact, not other engagement trends. I would point to -- I would point to that; otherwise, I think feeling good about Europe.

Worldwide, we've got different puts and takes. Indonesia had a SIM card registration requirement that caused a little bit of a headwind in APAC.

And then rest of world, we saw some countries come back online, like Ethiopia came back online. Some different puts and takes, but overall, still seeing regional growth across all regions -- with the exception of the U.S and Canada being flat.

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

Mark May: Thanks. Just following up on the comments. Sheryl mentioned that there's really no meaningful impact on GDPR to the ad business, at least as of now.

But then, Dave, I think you mentioned that because you're giving people more control over their privacy and data, that this is one of the reasons why you're expecting the meaningful decel in the second half. Just trying to reconcile those two things.

Maybe the questions are -- have been too specific around the impact of GDPR and should be more broad around data and privacy. And I guess ultimately the question is what impact, if any, is these greater controls that you're giving users having on ad revenue growth and monetization? Thanks.

David Wehner: Sure, Mark. Let me take that. GDPR didn't have a significant impact in Q2, partially because of its implementation date so you're just seeing effectively one month of it in terms of -- in terms of revenue. We do think that there will be some modest impact -- and I don't want to overplay these factors -- but you've use got a couple things going on.

You've got the impact of the opt-outs. And while we're very pleased with the vast majority of people opting in to the third party data use, some did not. That'll have a small impact on revenue growth. And then we're also seeing some impact
from how advertisers are using their own data for targeting. Again, that will have a modest impact on growth.

And then in addition, we’re continuing to focus our product development around putting privacy first. And that’s going to -- that’s going to -- we believe -- have some impact on revenue growth.

It’s really a combination of how we’re approaching privacy as well as -- as well as -- as well as GDPR and the like. I think all of those factors together are one of the -- one of the factors that we’re talking about -- the other being obviously the currency -- the currency flip.

Operator: Your next question comes from the line of Rich Greenfield from BTIG.

Richard Greenfield: Hey. Thanks for taking the question. I guess one of the things as you look at -- you talked about the growth you’re seeing in users overseas or basically everywhere but the U.S. and Canada.

But when you look at ARPU, your ARPU outside -- even in Europe -- is still only a real tiny fraction of where you are in the U.S. and obviously in Asia and Rest-of-World, an infinitesimal fraction of where you are in the U.S.

How does that factor into, as you think about your long-term guidance that you just talked about, especially with margins moving towards the mid-30s, just given how early you are in those non-U.S. markets and how much headroom they have to grow as those ad markets mature -- how do you have confidence that you in that type of deceleration when you look at how much upside there is in that ARPU?

David Wehner: Yes, I guess you’ve got a couple of different factors going on there. You’ve got the opportunity, I think, for ARPU growth in those -- in those regions and that’s going to depend on the mix of countries in those regions and the GDP per capita in those countries as well as the relative size of the ad markets.

And that correlates very strongly to our opportunity and our potential ARPU and I think you’ve got upside growth potential in the long run in those markets.

As it relates to margin profile, you also just have the factor that you’re increasing growth -- the increasing mix of the business is shifting towards Asia and towards what are currently lower-ARPU markets.
And so while those are very attractive, we believe to serve -- both in the near- and in the long-run -- they're going to have a different impact on margin, because the cost to support those users relative to the revenue they bring in does have a -- does have an impact on margins in the medium-term.

Operator: Your next question comes from the line of Anthony DiClemente from Evercore.

Anthony DiClemente: Thank you. I have two; one for Sheryl and one for Mark.

Sheryl, you just -- in Dave's comments and the comments about the business impact of engagement shifting to stories versus feed products, I just -- if you could spell out for us I guess the real -- the specific reasons why Stories monetization is not as strong as feed today?

And in the context perhaps of what needs to happen in the future for Stories monetization to rebound to, let's say, parity to where feed is today and get through that negative impact?

And then for Mark, I think perhaps Heather was getting at this in her question, but the company's investing so much into owned datacenters; you talked about that I think in your prepared remarks.

Are there ways to improve the return of investment of those investments in datacenters, servers, network infrastructure? And what I'm thinking is in order to perhaps service third parties to maybe just improve those returns in the way that other tech and Internet companies have in terms of investments in infrastructure?

Thank you.

Sheryl Sandberg: On Stories, we've seen great progress with Stories as a format for people to share on our platform. We have 400 million people sharing with Instagram Stories, 450 million with WhatsApp status; Facebook is newer, but we're seeing good progress there.

The question is, will this monetize at the same rate as News Feed? And we honestly don't know; we'll have to see what happens. There are good reasons to be very optimistic about the monetization.

The opportunity -- full-screen, authentic, very engaging, different formats than Feed -- gives us an opportunity to grow. We also don't have all of our advertisers yet creating Story ads. Obviously as more and more advertisers come in and do that, the more and the better ads we'll have.
I think getting that ramp will take a while because Stories is a new format. And we definitely see that it takes a while for advertisers to adopt new formats.

I think one of the other things we feel good about over the long run -- not really in the short run -- is that since we have so many different places where you have Stories formats in Instagram and WhatsApp and Facebook, as volume increases of the opportunity, advertisers get more interested.

But we won't know for a while if it's going to monetize at the same rate. We do feel very good about a new and very engaging opportunity for ads.

Mark Zuckerberg: And I can quickly answer the second part around datacenters. I mean, the quick answer is that we're not planning on going into the cloud services; we're not planning on doing that. We have to build out all this capacity to serve our community; it's a very computationally- and resource-intensive set of services that we provide and we need to build that out.

We are very optimistic -- I'm very optimistic -- about AI overall in being able to use more computing resources to be able to crunch more data, to be able to rank News Feed and ads and search and friend suggestions and all the important things that we use our AI systems to do, in addition to the integrity and security work.

Part of the advance in AI technology now allows us to use more compute to use all the data that's in the system to provide better results, so we certainly plan on doing that.

Operator: Your next question comes from the line of Peter Stabler from Wells Fargo Securities.

Peter Stabler: Thanks. One for Sheryl and then one for Dave. Sheryl, just on the SMB side, wondering if you can give us any color by region, if possible?

And then secondly on the go-to-market strategy, to what extent is Facebook dependent upon or leveraging resellers versus small businesses discovering the ad platform on their own? How key is that reseller channel for you on the small business side?

And then for Dave, given that you've given us some kind of relatively specific guidance on the revenue growth decel through the remainder of the year, wondering if you could give us some color on what that embeds from an FX expectation at this point. Thank you very much.
Sheryl Sandberg: SMBs are very core to our business and with over 80 million SMB Pages that are using Facebook on a monthly basis, we know they're core to theirs. Our six million advertisers come from those Pages and so the fact that we have so much room to grow is exciting for us.

We don't break this out by region, but we do see very strong SMB participation across the board and around the world. Particularly as SMBs come online, the more -- as SMBs come online, the more -- so you can imagine that some of it goes with Internet penetration and Internet use.

In terms of resellers, we think it's a big opportunity. We don't break that out either but obviously some of our ads are sold directly and bought directly through our online interfaces. We also have third parties that sell our ads and we welcome that as well.

David Wehner: Peter, it's Dave. Just on the FX, we're just looking at current rates and just rolling those forward, not predicting what the rates will be, but rather looking at current rates, and thus, what the impact would be if rates stay the same on the second half.

Operator: Your next question comes from the lime of Brent Thill from Jefferies.

Brent Thill: Thanks. Dave, I want to go back to the magnitude of the deceleration. I think many investors are having a hard time reconciling that type of deceleration, considering how good the advertiser feedback is on your platform. And I realize you've outlined FX and Stories and the other factors.

But is there something that you're hearing now from advertisers that are -- is giving you more confidence that they're seeing something different about what we're all hearing right now? It just seems like the magnitude is beyond anything we've seen, especially across the number of tech things we all cover.

David Wehner: Yes, Brent, I'll take that, and if Sheryl wants to add color, she should step in as well. The -- this is a move we consistently have seen over the last eight quarters -- constant currency deceleration.

There's a continuation of this trend. I don't think there's anything beyond that and the factors that I outlined. I would note, we've been benefiting from continued growth across Instagram. Instagram ad load in feed is at the same level as Facebook, so about the -- that's certainly been helpful in our -- in our recent quarters.
I think when you look at the factors going forward, I would -- I would say, we've got the currency impact, we’ve got some of the impacts around privacy and the like, but we continue to get good advertiser feedback on ROI.

We continue to believe we're delivering great ROI for advertisers. I don't -- I don't think there's anything from the advertiser perspective that's necessarily playing out differently than expectations. Sheryl can add any color there.

Sheryl Sandberg: Yes, I'd add there. I mean, even at decreasing growth rates, we are still growing and predicting growth at very healthy rates, and that's based on returning for advertisers.

We're very focused on helping advertisers meet their ultimate goals, looking at their ROI, looking at the return they get on ringing the cash register, whether that cash register rings online or offline. And we hear from them and we continue to see in our results that we continue to deliver strong results.

We have a lot of opportunity ahead of us. We're going to continue to invest in that opportunity. And what we're hearing from advertisers all over the world is that they want to continue to grow and invest with us as well.

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

Operator: The last question comes from the line of Colin Sebastian from Robert W. Baird.

Colin Sebastian: Great. Thanks. Just a couple of follow-ups for me. First off, Dave, maybe I missed this, but what timeframe are you referring to in terms of getting down to the mid-30s operating margin?

And does that outlook assume any meaningful contribution from any of the new areas of innovation that you highlighted on the call? Just trying to figure out how much of that might be conservatism.

And then on the near-term trends and the midterm elections in the U.S., given the amount of scrutiny that will exist in your platform, how should we think about your level of preparation -- on one hand -- to manage content and then on the other hand, is this part of the potential impact on monetization of revenue growth in the back half of the year that you're taking into consideration? Thanks.
David Wehner: Sure, Colin. Let me take a crack at that. In terms of -- in terms of the guidance, I had given guidance. This is several years, so more than two, but less than many. It's over a timeframe more than -- more than -- more than two years is our expectation.

And then in terms of does that have any meaningful contribution from areas of innovation, we talked about some of the areas that we are investing in.

Obviously on the safety and security side, that -- those were costs that are layering in and that we think are the right thing to do for the business, but don't necessarily have a revenue impact. Certainly takes those into account.

It also takes into account the ongoing investments we're making in the longer-term innovation work, which I don't think will necessarily have any meaningful revenue relative to the size of the business in this timeframe.

We're also investing in things like video, Watch and the like, which have the potential to contribute on the -- on the revenue side, but still relatively small when in perspective of the overall business.

Mark Zuckerberg: All right. And I can take the question on the midterm elections. Yes, the short answer is, we're much more confident that we're going to get this right for the elections in 2018, which include the U.S. midterms, but also elections in Brazil and upcoming elections in early 2019 in India and the E.U.

And the reason why we're confident that we can get this right is because there have been several elections since the 2016 ones that have had much better results including the French presidential election, the German election, the Alabama special election and the Mexican election about a month ago.

And in each of these, I mean, going back to 2016, we were -- we have a very big security team that was focused on security around even the 2016 election and we found hacking and phishing attacks that the Russian government was trying to do, and we notified the right people about those. But 2016 was really the first time that we saw this kind of coordinated information operation.

And since then, we've built a playbook out that has included building AI tools to identify thousands of fake accounts and Groups and Pages that violate the policies. It's included growing the security and content review teams to 20,000 people to be able to handle the volume of work that we need to do.
And it includes a lot of the transparency work around advertising in general, but also the political and issue ads archive and verifying all advertisers that are trying to run political and issue ads.

There are a number of other things that we're doing too, including creating an external program for independent academics to study how the impact of social media and how foreign governments do try to interfere in elections, and that will have a longer-term impact as well.

But the short answer we've been very focused on this. Twenty-eighteen is a big year and because of the successful results that we've seen in a number of elections recently, we feel like our roadmap and our level of preparation is much higher now than it has been and we feel relatively confident going into these elections.

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