

FACEBOOK, INC.

Operator: My name is Jessa, and I will be your conference operator today. At this time, I would like to welcome everyone to Facebook's third quarter 2018 follow-up Q&A call.

All lines have been placed on mute to prevent any background noise. To ask a question, please press "star" then the number "one" on your telephone keypad. Today's call will last 30 minutes. It will be recorded and a transcript will be posted on Facebook's Web Site at investor.fb.com. Thank you very much.

Ms. Deborah Crawford, Facebook's Vice President of Investor Relations, you may begin.

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

Before we get started, I would like to take this opportunity to remind you that our remarks today will include forward-looking statements. Actual results may differ materially from those contemplated by these forward-looking statements. Factors that could cause these results to differ materially are set forth in today's press release and in our quarterly report on Form 10-Q filed with the SEC. Any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these statements as a result of new information or future events.

During this call, we may present both GAAP and certain non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. The press release and an accompanying investor presentation are available on our website at investor.fb.com.

And now I would like to turn the call back over to the operator for the first question.

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

John Blackledge: Excuse me, great, thank you. Two questions. On the Watch tab, I think Mark mentioned users are up 3X in the U.S. recently. Curious if those users are spending more time overall on core Facebook or if it's cannibalizing their time spent in the feed. And then I have one follow-up question.

Dave Wehner: Hey, John. I don't have data on that. I know the intent of the Watch experience is that it is additive to the overall Facebook experience. That's certainly the goal. But I don't have the data on that.

John Blackledge: OK, thank you. And then on Stories ads, just wondering, you guys have mentioned, I think multiple times, the pricing of lower than Feed. Is that because of lower conversion rates? Or is it something with supply-and-demand? And then just wondering if you can kind of frame the length of time it make take to get Stories ads, whatever it is, conversions, supply-and-demand, to the level of Feed ads?

Dave Wehner: Yes, I mean, it's an auction product, so it is absolutely a result of supply versus demand. I think the -- that is absolutely what's driving it. But, the question is, why is, demand not there yet to meet supply? And it's a variety of reasons.

One is, on Feed, which is a mature advertising product, you've got a lot more formats, you've got the ability to drive more types of direct response ads, for instance. You've got an embedded advertising base. We don't have all of the different advertising objectives launched for Stories at this point. And so that's -- that's certainly a driver.

There's also just different characteristics of Stories that I think could impact it both positively and negatively. It's a full-frame experience, so that could be a positive. But also users scroll much faster through Stories, so you're getting -- you're potentially going to get less engagement on those ads. But you also

might see more of them because of the fast scroll speed. There's going to be just different characteristics of how the format plays out.

In terms of how we might be able to improve pricing and get towards more of a convergence on pricing with Feed, that's going to be very similar to how we've worked with introducing all of our new advertising formats, whether it was when we first went from right-hand column to Newsfeed ads and when we went from Facebook Feed ads to Instagram Feed ads, it's about getting advertisers adopting the new format so it's a lot around what we call placement optimization, where we get advertisers to opt in to using new formats, what we call automatic placement, where it's automatically opting into that and going to those new formats. We'll be working on doing that to bring more demand to the table.

I do think there is going to be certainly something that we're expecting that we were going to get, Stories ads to over time improve pricing and converge on Feed ads, but that's something that's going to take not quarters, but years. And at the same time, it's a dynamic market in both places, so it's going to depend on how much supply is growing in Feed and how much demand is growing in Feed and how much supply is growing in Stories and how much demand is growing in Stories.

It's going to be a very dynamic set of data going into this. But we do think over time, as we get more objectives launched, as we bring more advertisers in, we will have a convergence, but it's not something that's going to happen overnight by any means.

John Blackledge: OK, thanks so much. Thank you for the questions.

Dave Wehner: Thanks, John.

Operator: Your next question comes from the line of Michael Nathanson from MoffettNathanson. Please go ahead.

Michael Nathanson: Thanks, Dave. I have two for you. One, going back to that answer you gave John about engagement, I wonder, have you guys done any studies on maybe the monetization or the reaction consumers have to Stories-based

advertising versus Feed-based advertising? You mentioned the scroll speed, but I wonder, have you bolted down to just it's less engagement per hour? Is there anything you've learned by just observing consumer engagement with different types of ads in Stories versus Feed?

Dave Wehner: Yes, I mean, I don't have any direct surveys to share with you, results of that. I mean, the GMS team, the global marketing services organization, they very well may have done those.

What I can tell you is that we certainly have a number of representative advertisers who are having very good luck in terms of driving their business objectives through Stories, so we're seeing good initial traction with advertisers in Stories both on Instagram, and to a lesser extent, because it's less developed than Facebook.

I think we're certainly seeing early adopters of the Stories format seeing good results. In terms of kind of how consumers engage with it in different ways, like I said, there's different characteristics. I think you're certainly getting the ability to kind of have a full engaged vertical experience with Stories versus Feed ads. That's positive.

The scroll speed, you're going to get more opportunities to show those engaging ads. But at least currently, there's less direct response type of objectives available on Stories, so that's going to affect kind of how consumers engage.

Michael Nathanson: OK. And can I ask a quick one on Portal? It's hard to miss the Portal marketing this quarter. What's the use case for Portal? And is this kind of the first in a wave of devices that you see an opportunity for? That's just what I wanted to ask you.

Dave Wehner: Well, we already have devices out there with, obviously, the Oculus family of products.

Michael Nathanson: Right.

Dave Wehner: It's not sort of our first foray into hardware. The idea of Portal is really to bring a -- a video calling device to the home that will make it easier for people to stay in touch with their closest friends and family, very consistent with the Facebook mission of bringing the world closer together.

It's -- our first sort of non -- I guess non-VR product for the home, and it's very much centered on a use case that we think is core to Facebook, which is connecting with family and friends. That's really -- I don't think it's anything more complicated than that.

Michael Nathanson: OK. Thanks, Dave.

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

Youssef Squali: Thank you very much. Hi, Dave, Deborah. Two questions from me, please. If I look at the average revenue per user across geos, it looks like Europe has flattened out sequentially. I'm trying to understand how much of that may be due to GDPR now that you had it for a full quarter. Just trying to understand whether that may be the canary in the coalmine in terms of maybe the impact of less data on monetization.

And second, on a question that -- or an answer you already gave on the main call, Dave, about the 40 percent to 50 percent growth in GAAP expenses in 2019, if I remember correctly, I think on the last earnings call or the follow-up call, you talked about how we should get to mid-30s in more than two years, but less than many. It looks like if you use 40 percent to 50 percent for next year, we may already be getting there. What just changed in the thinking to get us from more than two years, less than many, to next year?

Dave Wehner: OK, Youssef. Let me start with the ARPU question. I mean, the E.U. ARPU -- I mean, there's a couple different factors that are going to play into that. Currency is going to play into it, so you've got a currency headwind in Europe versus a currency tailwind. So as the euro, when you look at it on a year-over-year basis and a sequential basis, that's going to play into the ARPU, as well, because the ARPU is reported in dollars.

The second thing you've got going on there is, Europe is a mix of different countries at their own different ARPUs. If you look at the top countries in Europe, you're going to have countries like Turkey at the top, and a lot of times people are thinking about Europe as being very analogous to the U.S. and Canada. But it's actually a mix of countries that are similar to the U.S. and Canada and different, in terms of just the overall size of the ad market per person.

I think you're getting more of a diverse economic mix in Europe, and so that kind of affects the ARPU.

On the expense guidance for next year, I did mention that we expect -- on the call -- I did mention we expect 2019 to be a big investment year. And in terms of how we expect our margin structure to evolve over time, we would expect to have the biggest change in our margin structure happen in 2019 and for it to moderate from there.

In terms of kind of the consistency of the long-term kind of margin guidance and how we're guiding expenses next year, I'd just say we expect the largest change in our margin structure to happen in 2019. It's hard to be too prescriptive about 2020 and beyond, but we do think that, with the 2019 investment year, that will be the biggest change in margin structure.

Youssef Squali: OK. And starting in 2020, the assumption there is going back to Mark's comment that revenue growth should echo or cost -- growth in costs should echo costs and growth in revenue?

Dave Wehner: I would just say let Mark's comment stand.

Youssef Squali: OK. All right. Thanks a lot.

Operator: Your next question comes from the line of Aaron Kessler from Raymond James. Please go ahead.

Aaron Kessler: Yes, hi, guys. Thanks. A couple questions, just first on Facebook revenues. I mean, talking to agencies, it sounds like Facebook core revenues are starting to mature, at least in kind of U.S. and Europe's more mature markets. I mean,

how confident kind of in the core revenue side do you think you can continue to drive up meaningful dollars in the more mature markets, outside of Instagram?

And then second, just G&A was up decently in Q3. Was there any one-time items there? And outside of COGS, like D&A, kind of data centers, is the main costs we should think about kind of being licensing or video costs? Or kind of what else is driving that? Thank you.

Dave Wehner: Yes, I think when you look at the overall opportunity for growing the core business, I think broadly we think about Facebook and Instagram both together as a -- as really kind of the core sort of Feed business and then Stories augmenting on top of that.

We think there are good opportunities to continue to grow the Feed business in 2019, continued impression growth, as well as pricing growth. I think if you are talking about Facebook specifically, just looking at the DAU data, you can see that in the developed markets, Facebook is stable, and if you look at the developing markets, that's where you've got the most growth opportunity for Facebook. Instagram I think more growth opportunities in the developed markets.

But there's also just continuing to drive advertiser demand for all of our Feed products that play into that. And then Stories layering in as an additional growth opportunity on top.

In terms of G&A, in Q3, I would say we -- there's always kind of puts and takes that come into play. There are some legal expenses both kind of -- both, I think, I would characterize as expenses that will be kind of baking into the cost structure over time as we ramp, various efforts, as well as some episodic spend. But in general, I would say we've got -- we did see legal being a driver in G&A in Q3.

On COGS, outside of depreciation, you've got cost of good for our hardware units, so that's sort of coming into play in -- more significantly in Q2, because we launched the Oculus Go in Q2. If you look at the comparable on COGS for Q2 versus Q3, you're getting some Oculus Go, more Oculus Go hitting in

Q2 versus Q3, and then content acquisition, is a growing line item in COGS, as well.

Aaron Kessler: Great, thank you.

Dave Wehner: Yes.

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

Rich Greenfield: Hi. Thanks for taking the questions. I got two. The first just -- you moved two of your senior execs from Messaging and Instagram over to blockchain. You know -- curious like, what's the thinking? What exactly are you building on the blockchain side? Does it tie to what Sheryl is talking about in terms of trying to build out more direct commerce platforms or shopping platforms, tying marketing to actual transactions? Like, what -- just kind of give us some color on kind of where that investment's going and what markets and the team are building.

And then, two, just to follow up on a couple of specific numbers, you mentioned -- I think Mark mentioned that Watch was up three times in the last couple of months. Is there any way to quantify, like -- I think Watch is still primarily only in a couple of markets, or not -- certainly not fully worldwide. Like, how many people are actually touching Watch in a week, in a month? Is there any way to just think about how many people are actually using this product now?

And then the last point -- just also kind of data-wise -- I think you mentioned 800 million people using Marketplace. There's a perception in the U.S., at least among investors, that nobody uses Marketplace. The number is a huge number. Is most of that happening outside of the U.S.? Like just -- I think there's just a perception when people look at that Marketplace tab, they don't understand what it is, yet it seems to be getting a tremendous amount of overall usage.

Dave Wehner: Yes, Rich. On -- starting with your questions on blockchain, I don't think we have anything that we're announcing at this point on blockchain. It's really a

research effort around how do we look at these technologies and look at their broad applicability for Facebook, ranging from the potential in payments to other areas. But at this point, no specific product initiatives to announce.

In terms of Watch, we have launched that worldwide. And so that is -- that is a global launch at this point. And I would characterize it as early, but seeing good growth. And, we don't have a lot of statistics that we're announcing on it.

We did have a question earlier on the call about whether it was accretive to overall time spent, which it is, though it does cannibalize some time spent in Feed. So we're looking at that. Watch, we think, is a good opportunity, but obviously early and good growth indicators.

In terms of the Marketplace launch, we are seeing good adoption around the globe on Marketplace, and also in the U.S. It is -- I think it is a product that is seeing broad applicability across the globe. And it depends on the geography as to how extensively it's used.

Rich Greenfield: And the Facebook Watch comment, is the growth that you're seeing of 3X driven by the worldwide expansion? Or is it actually growing even in (inaudible)...

Dave Wehner: That was -- that was a comment on growth in the U.S. from Mark's --...

Rich Greenfield: That was just U.S.? It has nothing to do with the global expansion of total time on the -- or total users on the ...

Dave Wehner: No, that's -- in addition, we've rolled it out globally, yes.

Rich Greenfield: Thank you very much.

Operator: Your next question comes from the line of Jason Helfstein from Oppenheimer. Please go ahead.

Jason Helfstein: Thanks. I'll just ask one. Clearly you're saying that you believe in the Stories format, you've tested it with certain advertisers (inaudible) kind of future bet on how consumers will engage. If we separate the marketing budget that

could potentially go to a Watch or (call it like TV-ish, video thing or dollars) versus what's kind of the basically Feed dollars today, that you're trying to get into Stories, as well, how do we think about, total budget available over time? Clearly, there's more advertisers you want to get in, but I guess what -- is there a way you think about, total budget available? Can Stories be cannibalistic to Feed over time? How are you thinking about a multi-year budget available for a kind of Feed plus Stories, separating from Watch? Thanks.

Dave Wehner: Yes, I mean, I think we look at the global advertising market availability. And, how do we -- ultimately, we're trying to deliver business outcomes for businesses and the way that we can do that is by delivering messages that convert to business outcomes effectively for those marketers. And the more inventory that we have available, the more outcomes that we can potentially deliver and the more effective we are at being able to convert those -- convert those impressions into those end outcomes, the better we'll be.

We're working on all of those fronts, both delivering I think experiences that engage consumers and also provide the opportunity for impressions. And we think that Stories is clearly going to be additive to that, because it's generating more content on our services, both Facebook and Instagram, and then generating accretive engagement and more inventory opportunities as a result of that. That means that we'll be able to have more impression availability and just a greater share of the market from that perspective.

Ultimately, I don't think it's a discrete budget that you're necessarily playing against with Stories. I think you're likely just competing in the overall market. We're going to have automatic placement and placement optimization across Facebook, Instagram, Stories on Facebook and Stories on Instagram, and it's going to be a question of where the different outcomes are more effectively delivered at what price that will drive kind of where the ad goes.

There undoubtedly will be some amount of shift of budgets depending on where we're able to effectively deliver outcomes for advertisers, but ultimately if we can grow more impressions through Stories and incremental impressions and engagement that's going to lead to a larger share of the advertising market for Facebook as a company.

Jason Helfstein: Would you put Messenger ads in there, as well, in that bucket?

Dave Wehner: Sure. I think any place that we're -- have the opportunity to drive impression growth and convert for outcomes that businesses care about is an opportunity for us. There's probably incremental opportunities in messaging for, things like paid messaging and notifications, as well. Slightly different use case that's not -- probably a different place in terms of the advertising funnel.

Jason Helfstein: Thank you.

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

Andy Hargreaves: Thanks. Another question just on the COGS. I'm just wondering if you can give us any commentary on either the growth rate you're expecting for D&A or like the average life of CapEx, so we can sort of work into that? And is the security spend that you guys are talking about, is a meaningful amount of that going into the COGS number?

Dave Wehner: Well, we're not guiding on specific line items of cost. Clearly, you're going to have -- clearly, you're going to have CapEx dollars over time flow through in depreciation into COGS, and that's going to depend on -- the depreciation lifetime is going to depend on whether it's data center, server, or network spend. The data center spend tends to be a longer life cycle, because you're building buildings that have, 20-, 30-year lives versus servers that could have 3-year lifetimes. It's going to depend on the mix of that.

In terms of security spend, we are defining safety and security investments pretty broadly. It's not purely cybersecurity investments. It's about putting in place community operations teams that review content that's flagged by users. It's about business integrity teams that review advertising content from advertisers. Those expenses fall in different places, so community operations team falls in marketing and sales. A lot of the business integrity work falls into the cost of goods. It's going to depend on the specific activities that are being performed as to where it's getting categorized.

Andy Hargreaves: OK.

Dave Wehner: And also, we're investing quite a bit on the R&D side, in terms of things like, applied machine learning, to be able to better proactively identify content, so that we're not relying on user reports, and, we're getting good at things like, identifying proactively terrorist content. I think we're able to proactively find, 99 percent of that without intervention from users.

We're actually flagging that with our own applied machine learning systems. That is a lot of -- that work is falling into R&D, as well. I'd say it's not one category of expense that is being subsumed within security.

Andy Hargreaves: OK. And then just two clarifications. Is the rev outlook for Q4 constant currency or reported? And the buyback, is that, the board and management being opportunistic, or are you just trying to sort of maintain the share count and offset dilution at this point?

Dave Wehner: Sure. On the outlook for Q4, it's a reported number, so I don't know that we anticipate currency having a huge impact in terms of the change from the deceleration from Q3 to Q4.

As far as the buyback is concerned, there's really two components there. There's a -- we're working to offset dilution, but we're also doing opportunistic share repurchases. So Q3 did reflect more than just dilution offset. We did also have opportunistic repurchases in Q3.

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

Ron Josey: Great, thanks for taking the question. I have two, one on investments and one on Stories. And so I'll start with investments first. And, Dave, you narrowed the range in 2018 towards the lower end, wondering why? And then as we think about 2019, I think you talked about, most -- a lot of 2019 is due -- increase in 2019 is due to just basically the headcount out of this year. Though can you just -- any insight on how you think about the pace of hiring going forward would be helpful.

And then on Stories, I think going back to the Q4'17 call, Mark talked about Stories as set to become the most common form of sharing across Instagram and Facebook, with ad demand following. And just wondering if you're seeing that on Instagram today, most common form of, of sharing -- and then I have a quick follow-up when -- and then basically the other follow-up, as Mark said today, it's a bigger opportunity than Feed. So just any additional color there would be helpful. Thank you.

Dave Wehner: Sure. In terms of narrowing the range towards the lower end, I mean, it's not really anything more complicated than we have better visibility as to where we expect spend to come out in 2018. We're narrowing the range to reflect that.

As we think about 2019, yes, we're kind of entering the year with, the additional incremental headcount that we've hired in 2019, so that's going to kind of layer into the expense base that is, part of the growth in 2019. We would expect the headcount growth rate to moderate going forward on a percentage basis in 2019.

And then your question about Stories, in terms of Instagram, I don't think we've specifically said -- I mean, we have -- most recent, I believe, Stories DAU number on Instagram was from the second quarter of 400 million DAU engaging with Stories, so it's clearly, a very significant part of Instagram engagement and is extremely popular format with Instagram. But I don't think we've quantified it relative to Feed.

In terms of the opportunity, I think what Mark's really speaking to there is that -- having this way to share moments that are ephemeral creates a very -- a much lower barrier for people to share on our services. And that -- and over time, that we believe is going to be a place where people are going to share more and more content, because it won't be kind of legacy content that's persistent in Feed forever.

So we think ultimately there's going to be more opportunity for sharing on Stories. But that'll take time to get there and for user behavior. Clearly not

there today on Facebook, but over time we do think there's more opportunities for more sharing. And that's what Mark's speaking to.

In terms of the business opportunity, the business opportunity clearly in the near term is on Feed with Stories kind of layering in on top of that as an additional growth opportunity, but still growth opportunities from a business perspective on Feed.

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

Operator: Your last question comes from the line of Mark Mahaney from RBC Capital Markets. Please go ahead.

Mark Mahaney: OK, I'll throw in a couple of quick ones. And I think some of these answers will be short. Any comments on the digital service tax in the U.K.? That's one.

Secondly, how much is this question on the impact of Stories on overall engagement? Would you be able to say whether Stories on -- just on Instagram itself -- has Stories boosted overall engagement anywhere you could quantify that?

And then third -- I don't think you'll quantify it, but I'll try it again anyway. On the Stories versus Feed monetization gap on Instagram -- and, I know it's going to take a while, but, like, could you just give a sense, is it like a dramatic app now? Is it half? And however you measure it, like how actually do you measure that gap? How wide is it? Is there anything you could -- I know it's going to -- you've already said it's going to take a while to close, but can you just give us a sense of the magnitude of the gap? That's it. Thanks.

Dave Wehner: Yes, Mark, taking those in sequence, on the digital sales tax, there's -- that proposal does not come into effect until April 2020. We're clearly learning more about that and we'll continue to watch that in the next few weeks and months. So no specific comments on that, but obviously it's something that we'll be watching as we get more information on it.

In terms of the impact of Stories on overall engagement, I think all we've said is that Stories does have -- is accretive to overall engagement on Instagram, but haven't been more specific than that. So I'd stick with that commentary.

And then on the Stories versus Feed monetization gap, we look at it on a cost per -- effectively on a CPM basis. And we don't have a specific quantification that we're sharing with people at this time. It's obviously going to be impacted by all of the different supply-and-demand dynamics related to both Feed and Stories. It's a fairly dynamic picture.

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

Dave Wehner: Thanks, all.

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

END