

Facebook, Inc. (FB)
Fourth Quarter and Full Year 2018 Results Conference Call
January 30th, 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 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 fourth 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 thank you all for joining us today. Our community continues to grow and our business delivered good results this quarter. There are now 2.7 billion people using Facebook, Instagram, WhatsApp or Messenger each month, and more than 2 billion people who use at least one of our services every day.

On our last call, I talked about our overall strategy as we face some important opportunities and challenges. Today I want to give you an update and talk about our priorities for 2019.

For the past couple of years, most of our focus and energy has gone into addressing some of the biggest social issues around the future of the internet -- including election integrity, content governance, safety and security, data privacy, and digital well-being. These are all complex issues, but we've made real progress. In many of these areas we believe we've built the most advanced systems in the world -- in many cases more advanced than any other company or government. And in other areas we have clear roadmaps ahead. Still, there's a lot more to do, and I expect it will take strong execution through 2019 and beyond before we get all our systems to the levels we need.

But we've fundamentally changed how we run this company. We've changed how we build services to focus more on preventing harm. We've invested billions of dollars in security, which has affected our profitability. We've taken steps that reduced engagement in WhatsApp to stop misinformation, and reduced viral videos in Facebook by more than 50 million hours a day to improve well-being.

We've made significant progress, and we're going to continue this work. But we're also going to allocate more of our energy to building new and inspiring ways to help people connect and build community.

Going into 2019, we're focused on four priorities:

First, continue making progress on the major social issues facing the internet and our company.

Second, build new experiences that meaningfully improve people's lives today and set the stage for even bigger improvements in the future.

Third, keep building our business by supporting the millions of businesses -- mostly small businesses -- that rely on our services to grow and create jobs.

And fourth, communicate more transparently about what we're doing and the role our services play in the world.

I want to take a minute to talk about each of these.

First, continue making progress on the major social issues.

The most important work here is to keep executing our roadmap to build systems that can proactively identify harmful content so we can act on it sooner. We just finished a year of very heavy investment to get these systems to a better place, and we've seen the results of that in recent elections, including the US midterms, and in our transparency reports where we report what percent of violating content we identify proactively. We ended 2018 with more than 30,000 people working on safety and security -- up from 10,000 people a couple of years ago.

This work will never be finished, but I now believe we've built some of the most advanced systems in the world for dealing with these issues. However, this raises a broader set of values questions about how to use these systems.

One question is about who decides what speech is acceptable and what isn't. Right now we have a deliberative process of consulting with experts around the world. But I've increasingly come to believe that we shouldn't be making so many of these decisions about content ourselves. In November, I wrote a note on A Blueprint for a System of Content Governance and Enforcement, which includes giving people the ability to appeal our internal content decisions to an independent body. We're currently working with experts to design this system, and we plan to start piloting it this half.

Another important issue is the future of privacy and encryption. People really value the privacy that encrypted messaging brings, and we've built the most secure global messaging service in the world. As people increasingly share more privately, we're working on making more of our products end-to-end encrypted by default, and making more of our products ephemeral so your information doesn't stick around forever. I'll discuss this more over the coming quarters.

Our second priority for 2019 is that as we make progress on these social issues, we also need to deliver new experiences that meaningfully improve people's lives. I'm not talking about the many day-to-day iterative improvements we make so that ranking gets a bit better or things get somewhat faster, but major improvements to people's lives that whole communities recognize and say "wow, we're all doing something new on Facebook or WhatsApp that we weren't doing before". The last experience like this was Stories which continues to grow very quickly – for example, Instagram just passed 500M daily actives on Stories. But the reality is we've put most of our energy into security over the past 18 months so that building new experiences wasn't the priority over that period.

This year I think we're going to deliver several of these experiences:

Messaging is the area that's growing the most quickly, and this year people are going to feel these apps becoming the center of their social experience in more ways. We'll roll out payments on WhatsApp in some more countries. Private sharing in groups and stories will become more central to the experience. We're going to onboard millions of more businesses that people can interact with.

In Facebook, the way people experience groups and communities will continue to deepen. We're going to get to a point soon where people feel like Facebook is about communities as much as it's about your friends and family -- where almost everyone is in a group that is meaningful to them and that community is a central part of their experience.

On Facebook, I also expect this to be the year where Watch becomes more mainstream. There are now 400 million people who use it every month, and people spend on average over 20 minutes on Watch daily. This means we're finding ways for video to grow outside of News Feed so it doesn't displace the social interactions that people primarily come to our services for.

In Instagram, one of the areas I'm most excited about this year is commerce and shopping. There's a lot of natural activity happening here, and this year I expect us to deliver some qualitatively new experiences around that.

Longer term, I remain very focused on building technology that brings people together in new ways, including through AR and VR. I'm looking forward to Oculus Quest shipping this spring -- the feedback there so far has been very positive. And I've also been positively surprised that Portal has done better than I expected it to. I love using it with my own family, but we'd never shipped Facebook-branded hardware before, and a lot of people said this would be a difficult time to start, so I'm pleased that so many people are enjoying this experience of being able to feel closer to the people they care about, even when they're physically far apart.

Our third priority is to continue strong execution on our business.

In the past couple of years, a lot of our business challenges have been self-imposed. The reality is that we had a number of substantive issues that we needed to address, and the investments we made in safety, security, privacy, and well-being both increased our costs and in some cases reduced our revenues. But as I said at the time, I believe these investments are the right thing to do and will make our community and our business stronger over the long term.

And what we've seen is that the fundamentals of the business remain strong. More than 90 million small businesses now use our products -- the vast majority of them for free -- and of those we surveyed, half tell us that they've been able to grow their businesses and hire more people since joining Facebook. This means they're using our services to create millions of jobs. This is one of the most important contributions that we feel we can make to the world. To put this in perspective, the US economy added about 2.6 million jobs last year.

Our last priority is to get out there more and make the case for the role our services play in the world.

Right now there's a lot of negativity about the impact of technology -- some of it is fair and some of it is misplaced. And we and the tech industry overall should be scrutinized heavily because we play a role in many people's lives. My approach here is to listen to the critique first, work on addressing our issues, figure out what we believe are the most important principles to uphold, and then go and engage in the debate.

I feel like we've come out of 2018 not only having made real progress on important issues, but having a clearer sense of what we believe are the right ways to move forward. We're still going to make mistakes along the way, but we now have a clearer sense of the path ahead. We're ready to work with people to understand our role and move towards good outcomes -- whether that's regulation on content or data, cooperation on shared threats, working openly to make sure AI best serves people, or just standing up for the kind of open and connected world that we all want to see.

The internet is a massive force for change, and we're at the center of a lot of the debate that brings. But our core value to people and society remains the same: we offer a service, free to everyone, that helps you stay connected with the people you care about, express what you're thinking and feeling, get help when you need it most, support the causes and ideas you believe in, start and grow businesses no matter where you are. That makes a lot of good possible, and we're committed to building technology that people can use to create positive change.

As always, thank you for being along on this journey with us, 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 good end to the year. Q4 mobile ad revenue was \$15.5 billion, increasing 36% year over year and contributing approximately 93% of our total ad revenue. Full year mobile ad revenue grew 45% compared to 2017.

2018 was a challenging and important year for us. As Mark said, we made significant investments in safety and security and strengthened our defenses against election interference. We gave people tools to better control their information and set a new standard for transparency in ads. We have focused on making progress in these important areas while continuing to grow our community and our business. This quarter proves we can do both.

We know we still have a lot of hard work ahead of us. We need to continue to do better at anticipating the risks that come from connecting so many people. And we need to earn back people's trust – not with words alone, but with actions.

Part of building trust is helping people better understand our business model. Protecting people's privacy and showing them relevant ads are not at odds. We don't sell your data and we don't tell advertisers who you are. What we do is allow advertisers to reach people interested in their products. The result is that people see more relevant ads, and small businesses can reach people in ways that only big companies previously could. This business model keeps Facebook free so people all around the world can use it — and levels the playing field for businesses of all sizes while protecting people's privacy.

I am excited to announce today that we have more than 7 million active advertisers across our services. From local shops to global brands, companies all over the world are growing and hiring because they can reach their customers on our platform.

The opportunities we create for businesses drive our growth, which continues to be broad-based across regions, marketer segments, and verticals. During the holidays, companies used our ads to help people

discover deals and find gifts. We saw particular strength among advertisers that optimized for measurable objectives, like conversions or sales. For example, Bryan Anthony's, an online jewelry store based in Austin, Texas, used our campaign budget optimization to bring in new customers and sales on Black Friday. The campaign was so successful, that they tripled their holiday purchases and hired additional people to help pack and ship orders during the busy season.

We're also helping advertisers keep up with shifts in how people use technology. People are creating more Stories and sending more messages, which means these are emerging areas of opportunity for marketers.

Today we're also announcing that 2 million advertisers are using Stories to reach customers across our family of apps. We're making it easier for advertisers to adapt their campaigns for Stories. In Q4, we expanded Automatic Placements, which converts feed ads into a format that works for Stories and delivers ads wherever they'll get the best results. Framebridge, a start-up that provides custom picture framing, recently used Automatic Placements to run ads across Instagram Stories, Facebook and Instagram feed. They ran short videos to show that their frames make great holiday gifts – and Instagram Stories generated over 25% of their new customer sales.

As people increasingly use messaging apps, we're helping small businesses make that shift too. In Q4, we launched ads in Messenger Stories, which means advertisers can now easily buy Stories ads across Facebook, Instagram and Messenger.

Beyond Stories and messaging, we have an opportunity to connect people and businesses on new surfaces like Marketplace. We're seeing good early results with Marketplace ads. In Q4, we worked on making ads more relevant to the products that people are looking for. For example, if someone is browsing furniture in Marketplace, we'll try to show them an ad for furniture or a related item. We plan to keep working on this to provide a better experience for people and more value to advertisers over time.

As we build new ad products, we remain focused on improving the overall quality of our ads. Across all of our platforms and formats, we're investing in AI to make ads more relevant and effective. In Q4, we developed new AI ranking models to help people see ads they're more likely to be interested in. We're also using AI to identify and more quickly review ads that might violate our policies, which was particularly important during the US midterm elections. Looking ahead, we see more opportunities to use AI to keep people safe on Facebook and help businesses grow.

I want to close by saying thank you to the businesses around the world who are using our tools to create jobs and growth. Last month, I went to Facebook's Community Boost in my home town of Miami – which was the 50th stop on our tour across the US in 2018 offering digital skills training to small businesses and job seekers. I met entrepreneurs like Alex Kassab, who started Morelia Gourmet Paletas with friends just two years ago. He says that 60% of new customers learn about their ice cream from Facebook and Instagram, and because of this growth, they've expanded to 12 locations and hired more

than 35 people. Last week, I was in Europe and met with SMEs from across the continent who shared similar stories of growing their companies, hiring people, and investing in their communities. These stories motivate us to keep improving so more people can succeed on our platform.

I also want to thank our global team for their commitment to tackling our issues and making our products better every single day. As we come out of a challenging year and continue to face challenges ahead, I believe we're in a position to build on the progress we've made and better serve our community in 2019. I am grateful to all of you for your continued hard work and dedication.

Now here's Dave.

David Wehner, CFO

Thanks Sheryl and good afternoon, everyone.

Q4 was a strong quarter, wrapping up a good year for our business. Full-year 2018 revenue grew 37% to \$56 billion and we generated over \$15 billion of free cash flow.

Let's begin with our community metrics

Daily active users on Facebook reached 1.52 billion, up 9% compared to 2017, led by growth in India, Indonesia, and the Philippines. This number represents approximately 66% of the 2.32 billion monthly active users in Q4. MAUs grew 191 million or 9% compared to last year.

Turning to our overall family metrics. Around 2.7 billion people worldwide used one of our applications in December and on average over 2 billion people were active daily. This is our best estimate of our de-duplicated audience across Facebook, Instagram, Messenger, and WhatsApp. We believe these numbers better reflect the size of our community and the fact that many people are using more than one of our services. For the time being, we will continue to disclose both sets of numbers, but over time we expect family metrics will play the primary role in how we talk about our company, and we will eventually phase out Facebook-only community metrics.

Turning now to the financials.

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

Q4 total revenue was \$16.9 billion, up 30% or 33% on a constant currency basis. Had foreign exchange rates remained constant with Q4'17, total revenue would have been approximately \$348 million higher.

Q4 total ad revenue was \$16.6 billion, up 30% or 33% on a constant currency basis.

In terms of regional ad revenue growth, Asia-Pacific was strongest at 34%, followed by North America at 31% and Europe at 28%. Rest of World ad revenue grew 24% and was impacted by ongoing currency weakness and macroeconomic challenges.

In Q4, the average price per ad decreased 2% and the number of ad impressions served on our services increased 34%. Impression growth was primarily driven by ads on Instagram – including both Feed & Stories – as well as Facebook mobile News Feed. The year-over-year decline in average price per ad reflects an ongoing mix shift towards product surfaces and geographies that monetize at lower rates.

Payments & Other Fees revenue was \$274 million, up 42%. Sales of Oculus Go and the launch of Portal contributed to the revenue growth in the quarter.

Turning now to expenses.

Total expenses were \$9.1 billion, up over \$1 billion sequentially and up 62% compared to last year. In addition to continued investment in infrastructure, safety & security, and innovation, expenses were also driven by seasonal factors – including marketing efforts, notably the promotion of Portal and Oculus Go.

We ended the year with over 35,500 full-time employees, a 42% increase.

Operating income was \$7.8 billion, representing a 46% operating margin.

Our Q4 tax rate was 14%. Net income was \$6.9 billion, or \$2.38 per share.

Full-year capital expenditures for 2018 were \$13.9 billion, driven by investments in data centers, servers, network infrastructure, and office buildings.

We generated \$3.3 billion in free cash flow in Q4 and ended the year with approximately \$41 billion in cash and investments.

In Q4, we bought back approximately \$3.5 billion of our Class A common stock and completed our prior repurchase authorization. In December, our board of directors authorized the repurchase of an additional \$9 billion of stock.

Turning now to the revenue outlook.

In Q1, we expect our total revenue growth rate to decelerate by a mid-single digit percentage on a constant currency basis compared to the Q4 rate. We also expect that our revenue growth rates will continue to decelerate sequentially throughout 2019 on a constant currency basis.

Turning now to the expense outlook.

On a full-year basis, we continue to expect 2019 total expenses will grow approximately 40-50% compared to 2018.

Our 2019 capital expenditures outlook is unchanged at \$18-\$20 billion, driven primarily by our continued large investment in building data centers.

Lastly, we expect that our 2019 tax rate will be a few percentage points higher than our 2018 rate.

In conclusion, we are confident in our ability to continue to invest effectively in the key priorities that Mark outlined in his opening remarks: making progress on the major social issues facing the Internet, building new experiences that meaningfully improve people's lives and growing our business by supporting the many businesses that rely on our services.

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