

**Facebook, Inc. (FB)**

**Second Quarter 2019 Results Conference Call – Prepared Remarks**

**July 24th, 2019**

**Deborah Crawford, VP Investor Relations**

Thank you. Good afternoon and welcome to Facebook's second quarter 2019 earnings conference call. Joining me today to discuss our results are Mark Zuckerberg, CEO; Sheryl Sandberg, COO; and Dave Wehner, CFO.

Before we get started, I would like to take this opportunity to remind you that our remarks today will include forward-looking statements. Actual results may differ materially from those contemplated by these forward-looking statements.

Factors that could cause these results to differ materially are set forth in today's press release, and in our quarterly report on form 10-Q filed with the SEC. Any forward-looking statements that we make on this call are based on assumptions as of today and we undertake no obligation to update these statements as a result of new information or future events.

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

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

**Mark Zuckerberg, CEO**

Thanks Deborah, and thank you all for joining today. This was an important quarter for us. Our community and business continue to grow, and there are now more than 2.7 billion people using Facebook, Instagram, WhatsApp or Messenger each month, and more than 2.1 billion people who use at least one of our services each day.

We continue to focus on our four priorities for this year -- making progress on the major social issues, building qualitatively new experiences, building our business, and communicating what we stand for more transparently. I'm going to focus on our first two priorities today, but first I want to talk about the recent news that we reached a settlement with the FTC over privacy concerns.

As part of this, we've agreed to pay a \$5 billion fine. But even more importantly, we're making some major changes to how we build our services and run this company. This will require investing a significant amount of our engineering resources in building tools to review our products and the ways we use data. It will also significantly increase our accountability by bringing the process for auditing our privacy controls more in line with how financial controls work at public companies with Sarbanes Oxley. We'll have to certify quarterly that we're meeting all our privacy commitments. And just as we have an audit committee of our board overseeing our financial controls, we will now also have a new privacy committee of our board that will oversee our privacy program and work with an independent privacy auditor that will report to this new committee and to the FTC. We're asking one of our most

experienced leaders in product to take on the role of Chief Privacy Officer for Product, reporting to me and managing our privacy program. We'll also be more rigorous in monitoring developers who access data through our platform. Together, we expect these changes will set a new standard for our industry.

This is a major shift for us. We build services that billions of people trust every day to communicate with the people they care about. Privacy has always been important to the services we provide, and now it's even more central to our future vision for social networking. It's critical that we get this right, and we're going to build it into all our systems. It's going to take time to do this properly, and I expect it will take us longer to ship new products, especially while we're getting this up and running. I also expect that, just as with the work we have been doing on safety and integrity, we're going to continue to identify and fix issues as we develop our systems. But our goal is to build privacy protections that are as strong as the best services we provide, and this settlement gives us clear requirements moving forward.

Now, turning to our company priorities, our top priority is making progress on the major social issues facing the internet, including privacy, and also elections, harmful content, data portability, and more. In all these areas, I've advocated that I believe the internet would benefit from governments setting clearer rules. I don't believe it's sustainable for private companies to be making so many decisions on social issues without a robust democratic process. Either the right regulations will get put into place, or we expect frustration with our industry will continue to grow.

This quarter I spent time in Europe talking with policymakers about how this could work. I met with President Macron to discuss a framework for harmful content. This is an area where I believe there could be an effective public process led by democratically elected governments in Europe, and perhaps in the U.S., a process for industry standards and self-regulation in the.

But we're not waiting for regulation to increase independent oversight. We just released our third transparency report, which shows the progress we're making on many categories of harmful content, including hate speech and graphic violence, but also the areas where we still need to do better, like bullying and harassment. I believe more companies should release transparency reports that enumerate the prevalence of harmful content on their services. This would help companies and governments design better systems for dealing with it. After next year, we're going to publish these reports quarterly so people can hold us accountable at the same cadence as these earnings calls.

We're also moving forward with our plans for an independent oversight board for decisions on content. I believe it's important that people can appeal the decisions, and that we're creating systems that are transparent and that people can trust. We've been working with experts on freedom of expression around the world, and we've gotten a lot of public input on how this could work, which we published in a report last month. We expect to form this oversight board by the end of this year.

We also continue to invest heavily in protecting elections -- including more advanced efforts to stop coordinated inauthentic behavior, new ads transparency tools, and more fact-checking partnerships. Our adversaries are continually getting more sophisticated, but recent elections in the EU and India show that our efforts are working. After the recent EU elections, the former President of the EU Parliament said that we met the commitments to fight election interference that I made in my testimony to the EU Parliament, and that thanks to our efforts the elections were much cleaner online. We'll continue building on these efforts as we approach the 2020 US elections to make sure that we stay ahead.

Next, I know there's a lot to discuss in terms of policy, but I also want to discuss our second priority -- delivering qualitatively new experiences for our community. There are a few efforts I'm particularly excited about:

The first is our privacy-focused vision for the future of social networking -- starting with secure, private and interoperable messaging. We're very focused on delivering this over the next five years, building on the foundation we have with Messenger and WhatsApp.

With Messenger, we're rewriting the app from scratch to make it the fastest and most secure major messaging platform in the world, and we're working towards making end-to-end encryption and reduced permanence the default for all conversations. With that foundation, we're starting to explore how a private social platform could become the center of your social experience, for example, by bringing together all of your ephemeral stories from your different apps into one place. We're also building things like the ability to co-watch videos together. This shows how something like video chat, which is growing quickly as a basic way we communicate, can become more of a platform for more ways we want to interact privately in the future.

With WhatsApp, which already has incredibly strong privacy and performance, we're more focused on building out all the ways you'd want to interact in this digital living room. WhatsApp Status is already the most popular ephemeral stories product in the world, and we continue to see good momentum there. With millions of small businesses using WhatsApp Business, we're also building new tools like product catalogs that entrepreneurs around the world can use for free. This matters especially for the growing number of small businesses that don't have a web presence, or that use private messaging platforms like WhatsApp as their main way of interacting with customers.

This connects to the next product area I'm very excited about, which is commerce and payments. These are huge and important spaces, and we have efforts in several major areas to deliver qualitatively better experiences than what exists today -- from Instagram Shopping to Facebook Marketplace to payments across our apps to the new Libra project that we announced with 27 other companies recently. These efforts are important both for our product experience and our business. Once people have connected to their networks on social platforms, one of the biggest questions is how can we help them use those networks that they have created to create opportunity, and one of the best ways to do that is through commerce.

Instagram Shopping will improve the experience of browsing and shopping from your favorite brands and creators, while also giving emerging creators a powerful new way to build a business and sustain their community. Facebook Marketplace gives people a way to buy and sell goods in a trusted network with real identities. Hundreds of millions of people already use Marketplace monthly. We're also building ways for people to interact with businesses through messaging, like WhatsApp Business, because people don't like having to call businesses and would rather engage asynchronously over messages if possible.

Payments is part of this I'm particularly excited about. When I look at the kinds of private interactions we can make easier, payments may be the most important for the long term. We're continuing to test payments on WhatsApp in India, and are close to launching in other countries as well. In the future, we'll enable people to use the same payments account to send money to friends and businesses on WhatsApp, shop on Instagram, or make transactions on Facebook. Being able to send money as easily as you can send a photo will open up new opportunities for businesses.

More broadly, I believe there's an opportunity to help a lot more businesses access financial tools. Last month we announced that we were working with 27 other organizations to form the Libra Association. The association will create a new currency called Libra, which will be powered by blockchain technology. The Libra Association will be independent of Facebook or any other member, but we plan to support this currency across our services. The goal is to empower billions of people around the world, who use services like WhatsApp but might be excluded from banking services, with access to a safe, stable, and well-regulated cryptocurrency. There are a lot of possibilities here, and both Facebook and the Association plan to work with regulators to help address their all of their concerns before Libra will be ready to launch. We worked with other prospective members of the association to release a white paper outlining the Libra concept in advance specifically so that we could address these important questions out in the open, and we're committed to working with policymakers to get this right.

The third product area I want to highlight where we're focused on delivering a qualitatively better experience than what exists today is in the future computing platforms of augmented and virtual reality.

This quarter, we shipped Oculus Quest, our first all-in-one headset with no wires and full freedom of movement. It has gotten great reviews and we're selling them as fast as we can make them. More importantly, we've delivered an experience that people keep using week after week, and buying more content. There's still a lot of work ahead to develop this ecosystem and deliver the future of VR and AR products that we dream of, but this is an important milestone. In a few years, we've improved the state of the art from the original Rift, which cost \$600 and needed to be tethered to a \$1000 PC, to now Quest, which costs \$400 all in, and is a superior experience in many ways. There's going to be even more innovation over the next few years, and we now have the platform we're going to build on going forward.

The reason augmented and virtual reality will deliver a qualitatively better experience than traditional computing platforms is that they deliver the feeling of presence -- that you're actually there with another person or in another place. The feeling of presence is so important to social interactions and how we're wired to interact as people. So even if it has taken longer than we expected to deliver this at scale, I continue to believe that this will be one of the most important contributions we make to the way we all use technology over the long term.

That's my update on our work on the major social issues we face and building new product experiences. We've made a lot of progress this quarter and have a lot more ahead. Our business continues to perform well, and Sheryl is going to talk more about that in a minute.

But this was also an important quarter because now we have a clearer path forward -- not just in terms of product and business, but in terms of guidance from regulators, which sets clear expectations and gives us a foundation to build on. As always, thanks for being on this journey with us, and now here's Sheryl.

## **Sheryl Sandberg, COO**

Thanks Mark, and hi everyone.

It was a strong quarter for our business. Ad revenue grew 28% year over year and we saw strong growth across all regions and on both Facebook and Instagram. Mobile ad revenue was \$15.6 billion, contributing approximately 94% of total ad revenue.

As we've been discussing, we're making significant investments in safety, security and privacy while continuing to grow our community and our business. We know we still have a lot of hard work ahead of us, but this quarter once again shows that we can do both.

We are committed to earning back trust through the actions we take. In the lead up to elections around the world, we are doing all we can to get ahead of threats and develop smarter technology. The European Parliament elections in May were an important test for us. We created an operation center in Dublin to bring our experts together and make decisions quickly. We also worked closely with third parties across the EU, including 21 fact-checking organizations. As Mark shared, these investments are starting to pay off and we remain committed to doing everything we can to stop bad actors.

We are also focused on increasing transparency. At the end of June, we made our transparency tools available globally for ads about social issues, elections or politics. These tools show who paid for an ad, how much they spent, and who saw the ad. Helping people understand who's trying to influence their vote will help us better defend against foreign interference and other abuse.

We're going to continue to make investments to protect our platform because it's the right thing to do and it's good for our business over the long-term.

At the same time, we are focused on growing our business by helping advertisers grow theirs. Consumers often adopt new technologies first and our competitive advantage is helping advertisers reach people where they are. We helped businesses make the shift to mobile and now we are helping them shift to Stories, video and eventually messaging.

We know that it's not enough to make these new formats available. We also need to make it easy for advertisers to create effective ads. We do this by launching new ad products and by improving our existing ones to deliver more value for people and advertisers.

One of our goals is to level the playing field for businesses of all sizes. We give small businesses free tools that previously only the largest companies could access. During National Small Business Week in May, we introduced Automated Ads to take the guesswork out of creating effective ads. Advertisers answer a few questions and get a customized marketing plan with up to six creative options, targeting suggestions and a recommended budget. We also launched new video editing tools to help SMBs quickly create eye-catching video with images they already have. Fernwood Fitness, a chain of women's health clubs in Australia, used these tools to build a mobile-first campaign. They targeted women interested in fitness and as a result, nearly doubled their conversions to new memberships.

We're also focused on improving our existing ad products. We often get feedback from advertisers about how we can make small adjustments to our tools to better serve them. These basis point improvements allow us to create more value for businesses over time. For example, we first rolled out

our Dynamic Ads format four years ago and since then, we have adapted the format to the needs of different verticals and surfaces. Frontier Airlines used Dynamic Ads to connect with travelers who recently looked at flights online but didn't book. This contributed to a nearly 3.5x increase in ad-related bookings and a 2.5x increase in ad-related revenue. This quarter, we launched our latest variation – Dynamic Ads in Instagram Stories – which show people ads for products they've already browsed on a retailer's website or app.

We're constantly making incremental improvements to Facebook feed ads. This quarter we improved how quickly we refresh the ads people see. In the past, these ads were pre-selected at the beginning of a feed session. Now, the ads are refreshed while people are scrolling through their feed. This means people get more relevant ads, which improves engagement and delivers a better return on investment for advertisers.

In addition to improving our ad tools, we're investing in new ways for people to discover products, engage with brands and shop on our platforms.

On discovery - more than 50% of accounts on Instagram use Explore every month to discover photos and videos related to their interests. This quarter we started rolling out Ads in Explore on Instagram. This will give businesses a chance to reach new audiences in a place where they are already spending their time and learning about new products.

On engagement - we're making it easier for people to connect with the brands and influencers they love. Last month, we launched Branded Content Ads in Instagram which allow businesses to promote Creators' posts as feed ads. Brands like Old Navy, Sephora and Jack in the Box are reaching new audiences with these ads. Soon we'll expand this option so that advertisers can do the same in Stories.

On shopping - we're building new ways for people to shop directly on our apps. We're continuing our closed beta of Checkout on Instagram and we launched a new feature this quarter that enables Creators to tag products in their posts. This gives people an easy way to shop from their favorite Creators without leaving the app. It's early days for shopping on Instagram, but we're excited about this over the long run.

I want to close by saying how grateful I am to our partners around the world. Every day, they give us valuable feedback on how to improve our products so that we can help them grow their businesses.

I also want to thank the Facebook teams who drive that growth and are making progress on the major social issues facing the internet and our company. I am grateful for our teams' tireless work and commitment.

Thanks everyone, and here's Dave.

**David Wehner, CFO**

Thanks Sheryl and good afternoon, everyone.

Let's begin with our community metrics.

Facebook daily active users reached 1.59 billion, up 8% compared to last year, led by growth in India, Indonesia and the Philippines. This represents approximately 66% of the 2.41 billion monthly active users in June. MAUs grew 180 million or 8% compared to last year.

In terms of our Family metrics, we continue to grow and estimate that on average, more than 2.1 billion people used at least one of our apps on a daily basis in June and more than 2.7 billion people were active on a monthly basis.

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

Q2 total revenue was \$16.9 billion, up 28% or 32% on a constant currency basis. Had foreign exchange rates remained constant with the second quarter of 2018, total revenue would have been approximately \$574 million higher.

Q2 total ad revenue was \$16.6 billion, up 28% or 32% on a constant currency basis.

In terms of regional ad revenue growth, North America and Asia-Pacific were strongest and both grew 30%, followed by Europe at 25%. Rest of World grew more slowly at 21% and was impacted by currency headwinds.

In Q2, the average price per ad decreased 4% and the number of ad impressions served across our services increased 33%. Similar to last quarter, impression growth was primarily driven by ads on Instagram Stories, Instagram Feed, and Facebook News Feed. The year-over-year decline in average price per ad reflects an ongoing mix shift towards Stories ads and geographies that monetize at lower rates.

Payments & Other Fees revenue was \$262 million, up 36%. This year-over-year growth was primarily driven by sales of new products, notably Oculus Quest and Rift S.

Turning now to expenses.

Total expenses were \$12.3 billion, up 66%. This includes an additional \$2 billion expense accrued in connection with our \$5 billion settlement with the Federal Trade Commission. Absent this charge, our total expense growth rate would have been 27 percentage points lower.

We ended Q2 with approximately 39,700 full-time employees, up 31%.

Operating income was \$4.6 billion representing a 27% operating margin. Absent the FTC accrual, operating margin would have been approximately 12 percentage points higher.

Our Q2 tax rate was 46% and was higher than expected due to the tax treatment of the FTC accrual and a court ruling in the IRS vs. Altera case. In that case, the Ninth Circuit reversed a prior Tax Court decision addressing the tax treatment of certain share-based compensation expenses. We changed our treatment this quarter to reflect the Ninth Circuit opinion which resulted in a one-time income tax charge of \$1.1 billion.

Net income was \$2.6 billion or \$0.91 per share. Absent the impact of the FTC accrual and the Altera ruling, our EPS would have been approximately \$1.08 higher.

Capital expenditures were \$3.8 billion, driven by investments in data centers, servers, office facilities, and network infrastructure.

We generated \$4.8 billion in free cash flow and ended the quarter with approximately \$48.6 billion in cash and investments.

In Q2, we bought back approximately \$1.1 billion of our Class A common stock.

Turning now to the revenue outlook.

We executed well in Q2 with a number of optimizations and product wins, particularly with the Facebook app, that fell in our favor and helped combat the overall trend of deceleration. However, we continue to expect that our constant currency revenue growth rates will decelerate sequentially going forward. We also expect more pronounced deceleration in the fourth quarter and into 2020, partially driven by ad targeting related headwinds and uncertainties.

Turning now to the expense outlook.

We anticipate full-year 2019 expenses to grow 53-61% compared to 2018. The \$5B in accruals we recorded in the first half of 2019 related to the FTC settlement represents approximately 16 percentage points of this anticipated expense growth. Absent the \$2B accrual we recorded in Q2, our 2019 expense outlook is essentially unchanged from last quarter.

I want to reiterate that our agreement with the FTC involves implementing a comprehensive expansion of our privacy program, including substantial management and board of directors' oversight, stringent operational requirements and reporting obligations, and a process to regularly certify our compliance with the privacy program. These efforts will require significant investments in compliance processes, personnel, and technical infrastructure. In addition, these efforts will make some of our existing product development processes more difficult, time-consuming, and costly.

We are lowering our 2019 capital expenditures outlook to \$16-18 billion, down from our prior estimate of \$17-19 billion. Our capital expenditures are driven primarily by our continued investment in data centers and servers.

We expect our tax rate for the remaining quarters of 2019 to be approximately 16%.

In summary, Q2 was another good quarter for Facebook. We're pleased with the further growth of our community and business while we continue to make significant investments in privacy, safety and security.

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