

Facebook, Inc. (FB)
Fourth Quarter 2019 Results Conference Call – Prepared Remarks
January 29th, 2020

Deborah Crawford, VP, Investor Relations

Thank you. Good afternoon and welcome to Facebook's fourth quarter and full year 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.

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

Mark Zuckerberg, CEO

Thanks everyone for joining us today.

This was a good quarter for our community and our business, and a strong end to the year. There are now around 2.9 billion people using Facebook, Instagram, WhatsApp or Messenger each month, and around 2.3 billion people using at least one of our services daily. There are now more than 140 million small businesses that use our services to grow -- the vast majority of which use our services for free.

Last year I shared our four company priorities, and they're still our priorities in 2020: making progress on the major social issues, building qualitatively new product experiences, continuing to grow our business, and getting out there and communicating more transparently.

Today I'm going to focus mostly on the new product experiences we're building, but before I get to that, this is going to be another critical year for making progress on social issues.

We're very focused on election integrity -- and this is an area where I'm proud of the progress we've made preventing foreign interference. We were behind in 2016, but after working to protect elections in countries across the world from the EU to India to Mexico to the US midterms for the past few years, we think our systems are now more advanced than any other company and we're often alerting law enforcement and intelligence about threats we identify.

There will still be debate about what kinds of political speech should be allowed, especially as the 2020 elections heat up, but by any objective measure our efforts on election integrity have made a lot of progress.

This is also going to be a big year for our greater focus on privacy as well. As part of our FTC settlement, we committed to building privacy controls and auditing that will set a new standard for our industry – going beyond anything required by law today. We currently have more than 1,000 engineers working on privacy-related projects and helping to build out this program. Related to this, just yesterday we announced we're rolling out a Privacy Checkup tool to nearly 2 billion people reminding them of the controls they have and making sure they're set the way they want them. We also introduced a new tool that notifies you anytime your account signs into a new service. So it's going to take time, but over the next decade I want us to build a reputation for privacy that's as strong as our reputation around building good, stable services.

When it comes to these important social issues, I don't think private companies should be making so many important decisions by themselves. I don't think each service should individually decide what content or advertising is allowed during elections, or what content is harmful overall. There should be a more democratic process for determining these rules and regulations. For these issues, it's not enough to make principled decisions – the decisions also need to be seen as legitimate and reflecting what the community wants. That's why I've called for clearer regulation for our industry. And until we get clearer rules or establish other mechanisms of governance, I expect we and our whole industry will continue to face a very high level of scrutiny.

During this, our job is to keep doing what we think is right on the social issues, and to stay focused on continuing to deliver product improvements and better experiences for our community.

The product areas I'm most focused on for the next chapter of our company are building out the private social platform and more intimate communities, enabling more commerce and payments, and delivering the next computing platform.

When I look at the internet today, we all have this ability to connect with people, content and opportunities coming from all around the world in ways that were unimaginable just a generation ago. I grew up in a town of 10,000 people and making a long-distance call anywhere outside the area was very expensive. Today we all have access to billions of people. That's made it easier to find people who are into the same things you are. But as our networks and communities have gotten so large, we increasingly crave a sense of intimacy and privacy. Delivering this experience is our focus.

Across our services, the greatest growth in how people are communicating continues to come from private messaging, small groups, and disappearing stories where your data doesn't stick

around forever. There's a lot more to do here. While the Facebook and Instagram apps have developed with lots of different ways to interact with the people you care about, our private communication apps are still pretty much just about texting. So we've spent the last year building infrastructure to turn our private messaging apps -- WhatsApp and Messenger -- into richer private social platforms where you can hang out and be present with friends, find groups with your interests, and engage with businesses more naturally. Some of these are bigger projects, like full end-to-end encryption, interoperability across the apps or rewriting our apps for performance -they are going to take a long time to see through. But we should start seeing more new experiences later this year. And this will all be built on a very strong privacy foundation.

Commerce and payments is another area that will be important for the private social platform but also across all of our apps, including Facebook and Instagram. Our goal here is to make sure every individual small business entrepreneur out there has the same opportunity and access to the same type of sophisticated tools that historically only the big companies have had access to. That's what we stand for -- putting power in individuals' hands.

One example we've been working on is WhatsApp Payments. You'll be able to send money as quickly and easily as sending a photo. We got approval to test this with a million people in India back in 2018, and when so many of the people kept using it week after week, we knew it was going to be big when we get to launch. I'm really excited about this and I expect this to start rolling this out in a number of countries and for us to make a lot of progress here in the next six months.

Beyond WhatsApp Payments, we're working on several other efforts to help facilitate more commerce, from Facebook Marketplace to Instagram Shopping to our work on Facebook Pay or our work on Libra. This is such a big space and it's important for empowering people so we're taking a number of different approaches -- ranging from people buying and selling to each other directly, to businesses setting up storefronts to people engaging with businesses directly through messaging, and a number of things on payments, ranging from using existing national systems like India's UPI to creating new global systems.

Having small businesses succeed is not only key to creating broad economic growth where everyone can support themselves; it's also important to maintaining healthy communities since small businesses are often where people come together. We see on our services all the time how the small businesses that use our tools are often at the heart of their local communities. So this is a top priority for us on both fronts -- the social mission and the business.

We've also been focused on delivering the next computing platform with augmented and virtual reality. The defining characteristic of AR and VR is that they deliver this sense of presence -- like you're right there with another person or in another place. This is the holy grail of social experiences and will let us build things we've only dreamed of for the last 15 years --

like letting people interact as if they're in person together no matter where they are, or letting people live wherever they want and hologram into work so they can access opportunities anywhere and don't have to move to a city or another country to find a job.

While full augmented reality is still a number of years away, we hit a real milestone for virtual reality with Quest. Sales are stronger than we expected and people are buying and engaging with more content than we'd expected too. On Christmas day, people bought almost \$5 million worth of content in the Oculus Store. That's an outlier day, but still this is real volume by any measure and it shows the progress this ecosystem is making. The experience also just keeps getting better. Last quarter we shipped hand-tracking, which almost no one thought was going to be possible with Quest hardware. And we shipped Oculus Link so you can run all your Rift content from your PC on Quest.

On the AR side, while we're working on the long term hardware and operating system, it's worth noting that our Spark AR platform is the most widely used AR platform in the world with hundreds of millions of people interacting with effects every month. Artists are using this to create new face filters and other tools that are going viral across Instagram and Facebook. We're well positioned here overall and we're going to keep developing this platform.

Those are some of the bigger product initiatives I'm excited about. Aside from these, we're also focused on communicating, more clearly, what we stand for. One critique of our approach for much of the last decade was that because we wanted to be liked, we didn't always communicate our views as clearly because we worried about offending people. This led to positive but shallow sentiment towards us and towards the company.

My goal for this next decade isn't to be liked, but to be understood. In order to be trusted, people need to know what you stand for. So we're going to focus more on communicating our principles -- whether that's standing up for giving people a voice against those who would censor people who don't agree with them, standing up for letting people build their own communities against those who say that new types of communities forming on social media is dividing us, standing up for encryption against those who say privacy mostly helps bad people, standing up for giving small businesses more opportunity and sophisticated tools against those who say targeted advertising is a problem, or standing up for serving every person in the world against those who say you have to pay a premium in order to really be served. These positions aren't always going to be popular, but I think it's important for us to take these debates head on. I know that there are a lot of people who agree with these principles, and there are whole a lot more who are open to them and want to see these arguments get made. So expect more of that this year.

This is going to be another important year. It's going to be an intense year with the elections. Some of our long-term technology bets are going to start coming to fruition. We have strong business momentum. And we have to get out there and show what we stand for.

As always, I am grateful to all of you for your support and for being on this journey with us. And now I'm going to hand it over to Sheryl to talk about our business.

Sheryl Sandberg, COO

Thanks Mark, and hi everyone.

We had a good quarter across the board and a strong end to the year. Q4 ad revenue was \$20.7 billion, increasing 25% year over year. Full year ad revenue grew 27% compared to 2018.

We're focused on creating value over the long-term – for our community, and for the 140 million businesses around the world who use our platforms to connect with customers and grow. The majority use our free tools, but there are also more than 8 million businesses who advertise with us. This is because we help businesses create a mobile presence, increase sales, build the right relationships with customers and hire people. We will continue to focus on helping businesses use our free and paid tools to reach the people who matter the most.

Throughout the holiday season, people used our apps to take advantage of the best deals and shop for the perfect gifts. We saw particular strength with e-commerce and online retailers who optimized for measurable objectives, like website visits or sales. Pura Vida – a jewelry company based in San Diego – ran ads on Facebook and Instagram for a 50% off sale. In 9 days, they sold more than 300,000 bracelets, supporting more than 800 artisans around the world.

People often adopt new technologies before businesses, and we try to make it as easy as possible for businesses to catch-up. Stories is a great example. We recently announced 4 million advertisers are using Stories – up from 2M this time last year. Bombas, a sock and apparel company, used Instagram Stories to show people wearing their socks while ice skating and gift wrapping. As a result, they saw a 60% increase in purchases from people under 35.

In addition to helping businesses shift to new formats, we're also making it easier for people to shop directly on our apps. We launched Checkout on Instagram with a small closed beta in Q1 2019. We've slowly been building the experience – and now, hundreds of businesses in the US are experimenting with Checkout. We're taking the time to get this right and growing slowly so people and advertisers can benefit over the long-term.

We give small and growing businesses, like Pura Vida and Bombas, the same tools that previously only the biggest firms could access. Large companies can buy national TV spots and large billboards, but most small businesses can't. That's why small businesses benefit most from targeted ads. We help them reach a more focused audience with the right message, and we do it while protecting people's privacy. This really matters, because as Mark said, when businesses of all sizes succeed, they hire people and invest in their communities. Last week, we released a report with Copenhagen Economics. According to 7,000 companies surveyed across 15 EU countries, our apps helped businesses contribute about 200 billion Euros to the European economy just last year. Economists say this translates to more than 3 million new jobs last year alone.

I announced these findings in London last week, where I had the chance to meet with Naomi Roberts. Naomi started Flare Audio with her husband to improve the sound quality in everything from ear plugs

to loudspeakers. More than 75% of their sales come from Facebook and Instagram. This has enabled them to export to more than 180 countries and grow their business from 2 employees to 22.

Stories like Naomi's are why we remain committed to helping small businesses reach customers and grow. But we know it's not enough – we also have to keep people safe and give them control over their experience on our apps. And we are.

This month we announced a number of improvements to our industry-leading ads transparency tools – including a new feature that gives people the option to see fewer political ads. We also updated our Ads Library to make it more transparent and easier to navigate. These updates help people understand who is trying to reach them, and we believe this transparency is critical to empowering people and keeping them safe.

We also want everyone to be in control of their privacy on Facebook. As Mark said, we are rolling out our updated Privacy Checkup tool to nearly 2 billion people around the world. With a few taps, people can control who sees what they share and how to keep their account secure.

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 we can help them turn great ideas into revenue, jobs, and economic empowerment.

I also want to thank our teams around the world for working to solve tough challenges while still building great products that businesses use to grow, compete and hire. Thanks to your continued dedication, we are better prepared to serve the billions of people who count on us.

Now, here's Dave.

David Wehner, CFO

Thanks Sheryl and good afternoon everyone. Q4 was a strong quarter and ended a good year for our business. Full-year 2019 revenue grew 27% to \$71 billion and we generated over \$18 billion in net income.

Let's begin with our community metrics.

In terms of family metrics, we estimate that approximately 2.3 billion people used at least one of our services on a daily basis in December, and that approximately 2.9 billion people were active on a monthly basis. As a reminder, the Family metrics are our best estimate of the deduplicated audience across Facebook, Instagram, Messenger, and WhatsApp. We believe these numbers better reflect the size of our community and the fact that many people use more than one of our services. Beginning this quarter, we are including Family metrics and related information in our SEC filings and the slide presentation on our investor website.

Turning now to Facebook. We were pleased with the growth of the Facebook community in all regions this quarter. Daily active users reached 1.7 billion, up 9% compared to last year led by growth in India, Indonesia, and the Philippines. DAUs represented approximately 66% of the 2.5 billion monthly active users in December. MAUs grew 178 million or 8% compared to last year. We plan to continue to disclose Facebook-only community metrics through late 2020.

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

Q4 total revenue was \$21.1 billion, up 25% or 26% on a constant currency basis. Had foreign exchange rates remained constant with Q4 of last year, total revenue would have been approximately \$295 million higher.

Q4 total ad revenue was \$20.7 billion, up 25% or 26% on a constant currency basis.

On a regional basis, ad revenue growth rates were strongest in Asia-Pacific and Rest of World which grew 33% and 28%, respectively. Europe and US & Canada grew more slowly at 24% and 22%, respectively.

In Q4, the total number of ad impressions served across our services increased 31% and the average price per ad decreased 5%. Similar to last quarter, impression growth was driven primarily by Facebook News Feed, Instagram Stories, and Instagram Feed. Facebook News Feed impression growth benefitted largely from community growth and engagement trends on the Facebook app. The year-over-year decline in average price per ad was primarily driven by the ongoing mix shift towards ads on Stories and in geographies which monetize at lower rates.

Other revenue was \$346 million, up 26%. Year-over-year growth was driven by sales of Oculus Quest.

Turning now to expenses.

Total expenses were \$12.2 billion in Q4, up 34%.

Cost of revenue increased 25% and the growth was driven primarily by depreciation related to our infrastructure spend.

R&D grew 36% and was driven primarily by increased investments in core product as well as our innovation efforts, particularly in AR/VR.

Marketing and Sales grew 23% and was driven primarily by consumer and growth marketing.

Finally, G&A grew 87%, largely driven by higher legal fees & settlements. This includes charges related to a \$550M settlement in principle we reached this month in connection with the Illinois Biometric Information Privacy Act litigation.

We had over 9,300 net new hires in 2019, primarily in technical functions. We ended the year with approximately 45,000 full-time employees, up 26% compared to last year.

Operating income was \$8.9 billion, representing a 42% operating margin. Our tax rate was 20%. Net income was \$7.3 billion or \$2.56 per share.

Full-year capital expenditures were \$15.7 billion, up 12%, driven by investments in data centers, servers, office buildings, and network infrastructure. In 2019, we opened data centers in Nebraska, New Mexico, and Denmark. These new data centers are supported by 100% renewable energy.

We are committed to doing our part to help tackle the challenge of climate change. That's why we're working to minimize our energy, emissions and water impact. Across the entire company, we are on track to meet our 2020 goal of supporting our global operations with 100% renewable energy and lowering our operational carbon emissions by 75% from 2017 levels.

We ended the year with \$54.9 billion of cash and investments. I would note that, though we booked the expense in 2019, we have not paid the \$5 billion FTC fine announced earlier this year as the agreement is still pending court approval.

In the quarter, we repurchased \$1.3 billion of our Class A common stock and had \$4.9 billion remaining of our prior authorization as of December 31st. Today, we announced a \$10 billion increase in our stock repurchase program authorization.

Turning now to the revenue outlook.

We expect our year-over-year total reported revenue growth rate in Q1 to decelerate by a low-to-mid single digit percentage point as compared to our Q4 growth rate. Factors driving this deceleration include the maturity of our business, as well as the increasing impact from global privacy regulation and other ad targeting related headwinds. While we have experienced some modest impact from these headwinds to date, the majority of the impact lies in front of us.

Turning now to expenses. We anticipate our 2020 total expenses will be in the range of \$54-\$59 billion, unchanged from our prior outlook.

Our 2020 capital expenditures outlook is also unchanged at \$17-\$19 billion, driven by investments in data centers, servers, office facilities and our network infrastructure.

Lastly, we expect our 2020 effective tax rate to be in the high teens.

In summary, Q4 was a strong finish for 2019. We are pleased with the growth of our community and business as we continue to focus on our mission.

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