Facebook, Inc. (FB)
Second Quarter 2020 Results – Prepared Remarks
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Deborah Crawford, VP, Investor Relations

Thank you. Good afternoon and welcome to Facebook's second quarter 2020 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. I hope you're all doing okay and staying healthy.

This was a strong quarter for us, especially compared to what we expected at the start. There are now more than 3.1 billion people using our services every month to stay connected, and more than 180 million businesses who use our tools to connect with customers. We also had more than 9 million active advertisers across our services as many shifted their business online.

As I said yesterday: the tech industry is an American success story. The products we build have changed the world for the better and improved people's lives. Our industry is one of the ways that America shares its values with the world, and one of our greatest economic and cultural exports of our country. Facebook is part of this story. We started with an idea -- to give people the power to share and connect -- and we've built services that billions of people find useful. I'm proud that we've given a platform for people to make their voices heard, and given small businesses access to tools that only the largest players used to have.

Since Covid emerged, people have used our services to stay in touch with friends and family who they can't be with in person, and to keep their businesses running online even when physical stores are closed. In many ways, amidst this very difficult period for people around the world, our services are more important now than ever before.

It's worth reflecting on this for a moment, because there's such a fundamental difference between how the vast majority of people actually experience our services, and the impression you'd get if you just read much of the commentary about Facebook.

Imagine going through this pandemic two decades ago when the internet was nascent. Facebook didn't even exist. Sheltering in place is incredibly disruptive now, but until recently it would have meant almost no connection with your friends and the broader economy. Most of the small businesses whose storefronts had to close would have gone under, and there wouldn't have been another infrastructure like the internet that they could move quickly to in order to stay afloat.

People sharing their day to day experiences with friends, communicating in groups with people who share interests, watching entertaining content, and buying and selling things – this is how the vast majority of people use our services.

Yet some seem to wrongly assume that most of the content on our services is about politics, news, misinformation, or hate. Let me be clear: it's not. These make up a small part of the content on our services, although they are all things that people generally tell us they'd like to see even less of. We do not profit from misinformation or hate, and we do not want this content on our platforms. People come to our services to connect with people they care about. That is why people are using our services at record levels now, and enabling more of those meaningful social interactions is how we succeed.
And we have a plan to further reduce the amount of harmful content. Our AI systems already proactively identify about 90% of hate speech we remove before anyone reports it -- no other internet service does anything remotely as sophisticated as this -- and we are committed to continuing to improve. We're having an independent audit done of our Community Standards Enforcement Report, which is our transparency report on how effectively we're removing harmful content. We're also opening ourselves up to an audit from the Media Rating Council to look at our content monetization policies and brand safety controls, and we're going to work with the Global Alliance for Responsible Media to provide greater transparency into our measurement of hate speech numbers.

Some also seem to wrongly assume that our business is dependent on a few large advertisers. While we value every single one of the businesses that use our platforms, the biggest part of our business is serving small businesses. Our advertising is one of the most effective tools that small businesses have to find customers, to grow their businesses, and to create jobs.

That's why I am often troubled by the calls to go after internet advertising, especially during a time of such economic turmoil like we face today with Covid. It's true that making it more difficult to target ads would affect the revenue of companies like Facebook. But the much bigger cost of such a move would be to reduce the effectiveness of the ads and opportunities for small businesses to grow. This would reduce opportunities for small businesses so much that it would probably be felt at a macro-economic level. Is that really what policymakers want in the middle of a pandemic and recession? The right path, I believe, is regulation that keeps people's data safe while allowing the benefits of this kind of personalized and relevant advertising.

Looking forward, I expect the rest of this year to continue to be unpredictable.

From a health perspective, with Covid growing quickly in the US, there is currently no end in sight for when our teams here will be able to return to our offices. It is incredibly disappointing because it seems like the US could have avoided this current surge in cases if our government had handled this better. For

Facebook's part, we are continuing to show our Covid Information Center to share authoritative health information. To date, we have directed more than 2 billion people to see it in order to see important health messages, including interviews with Dr. Fauci, and recently, information about why wearing a mask is so important.

During this time, we have found that most Facebook employees can work productively remotely. Even before Covid, we had a long term goal of enabling more remote work since the ability to feel present even when you're remote is a core aspect of our own product work on video presence, Workplace, and virtual and augmented reality. We're using this moment to accelerate these plans -- and I expect that up to 50% of our employees will be remote long-term, within the next 5-10 years. This will enable us to attract and retain broader pools of talent regardless of where they live.

Economically, with the initial Cares Act stimulus ending here in the US, it is unclear what the economic outlook will be during this next period. I continue to believe that getting the virus under control is the most important step we can take towards economic recovery. For our part, we are accelerating our work to help small businesses sell online through our services. We launched Facebook Shops to let businesses set up a storefront and sell across our apps, and that is scaling quickly. We're going to have more to share there soon. WhatsApp Business now has 50 million people using it and is growing quickly. We've also created grant programs to help small businesses during this period -- including a $100 million program to support small businesses globally, and another $100 million program specifically to support Black-owned businesses, Black creators and non-profits that serve the Black community here in the US.

Politically, Covid has added a heightened level of uncertainty to this year's elections. Because of the virus, many people may not want to go to the polls in person, so voting by mail will be more important than ever. Since many people haven't voted by mail before, it's critical that we get official voting information in front of people and help people register to vote. We have built a Voting Information Center and our goal is to help 4 million Americans register to vote in this election. This will be the largest voting information drive in American history, and double the number of people that we helped register in 2016 and 2018. We've already started attaching links to official voting information to any post from political candidates discussing voting. Our goal is to help people register to vote regardless of what these candidates or posts are saying.

We're also continuing to focus on stopping election interference, including removing voter suppression. We have already broadened our policies here and have adopted new policies to partner with local election officials to remove false information about voting in the period leading up to the elections. We are currently considering additional steps we might take.

With all this going on, I've been impressed by how much progress our teams have been able to make on our proactive product priorities around building a private messaging platform, enabling small businesses and commerce, and building the future computing platforms around virtual and augmented reality. We announced Messenger Rooms in April, and people around the world can now join a Room from any one of our apps – or even if you don't have an account with us at all. We expanded Messenger Kids this quarter to 143 new countries and territories, helping a lot of parents as they look for ways to safely preserve their children's friendships remotely. And our AR and VR and hardware products keep getting better -- we saw an increase in Portal sales across the product line this quarter and Quest, which we launched last May, already has more usage than any other device in our ecosystem.

As I told Congress yesterday: I'm proud of the services we build and how they improve people's lives. I'm thankful to everyone at Facebook who is doing this important work, and to all of our partners and everyone else on this journey with us.

And now, I'll hand it over to Sheryl.

Sheryl Sandberg, COO

Thanks Mark, and hi everyone.

I want to start by building on what Mark said about hate speech. Facebook stands firmly against hate. Being a platform where everyone can make their voice heard is core to our mission, but that does not mean it's acceptable for people to spread hate. It's not. We don't benefit from it and we never have. Our users don't want to see it and our advertisers don't want to be associated with it.

For years, we've spent billions of dollars on teams and technology to find and remove hateful content – and to protect the integrity of our platform generally – and we've become a pioneer in using artificial intelligence to remove hateful content at scale. We've made real progress and, in many ways, we've led our industry in being more transparent and more proactive in enforcement. A recent study from the European Commission shows that these investments are paying off – and that Facebook acts faster and removes a greater percentage of the hate speech on our services than other major internet platforms.

We've made real progress – but this work is never finished. Earlier this month, we met with the organizers of the ads boycott and other civil rights leaders to listen to their concerns, and we published our civil rights audit. We were the first social media company to undertake an audit of this kind – an independent two-year review of the civil rights impact of our products and practices. It's clear we have a lot more to do, and we are working every day to meet this challenge – not because of pressure from advertisers but because it is the right thing to do.

We are also working every day to support people and businesses through this difficult period. The pandemic is not just a public health crisis, but an economic crisis that has hit businesses around the world hard. I want to talk about what we are seeing in our own business – and how we are supporting small businesses as they transition online in order to weather this storm.

After seeing flat year-over-year revenue growth in the first few weeks of April, we saw a considerable recovery in May and June. Our total ad revenue for Q2 was $18.3 billion, which is a 10% year-over-year increase. This demonstrates not only our resilience as a company, but a wider trend that has been underway for some time – people are spending more and more time online, so businesses need to be online too. This was true long before the pandemic, but it is especially true now that people can't always get together in person. In the United States before the crisis, 1 in 3 companies still did not have a website. Now more and more businesses realize they have to be online.

This month, in partnership with the World Bank and OECD, we published our first Global State of Small Business Report, based on a survey of more than 30,000 small business leaders across more than 50 countries. The data paints a sobering picture of the struggle businesses are facing, but it also points to the scale of the digital transformation we are witnessing. In the majority of countries, at least one-third of SMBs reported earning a minimum of 25% of their sales from digital channels in the previous 30 days.

Over the years we've invested in free and paid tools to help businesses in this increasingly digital-first economy. Anyone can setup a digital storefront on Facebook or Instagram for free in just minutes. That is why now more than 180 million businesses use our tools every month.

Along with our free tools, personalized advertising is a lifeline for businesses – especially small businesses who can't afford broad campaigns aimed at mass audiences. For just a few dollars, now more than 9 million advertisers use our platforms to reach audiences interested in their products – and we enable this in a way that protects people's privacy and produces measurable results. In today's economy when businesses are struggling and customers aren't physically walking into their stores or restaurants, this is more important than ever.

Due to social distancing restrictions, Italian coffee shop owner Nicola Taranto had to get creative and reimagine what a virtual coffee experience could look like. With the help of Facebook, Instagram and WhatsApp, he promoted online sales and free home delivery to people interested in coffee within 10 to 12 miles of his store and he saw a 20x return on ad spend.

It's not just small businesses that have used personalized ads to help them pivot. At the onset of the pandemic, Kirkland's, a home furnishing retailer in the US, shifted its focus online and used Facebook ads targeted at adults within 10-15 miles of their stores to drive sales with curbside pickup. This is the type of customer acquisition that is only possible with personalized ads – and as a result, they saw a 24x return on ad spend and 3x increase in these sales, directly attributable to Facebook.

As Mark discussed, regulatory and platform challenges threaten this lifeline for businesses – but we remain committed to doing everything we can to help them adapt so they can survive and thrive in the online economy. We recently launched the "Businesses Nearby" tool to help people find businesses in their neighborhoods – and we continue to develop Shops to make selling online quick and easy.

We know making tools available is not enough. We also need to ensure business owners have the digital skills to use these tools effectively. In March, we launched our Business Resource Hub to share free training and resources, and since then, over 20 million people have visited. We then launched our "Summer of Support" program in June to share even more advice for businesses – whether or not they use our services. Since launch, more than 15 million people have tuned in to hear practical tips for rebuilding and strengthening their business.

In addition to tools and training, businesses have told us they need direct financial help. In mid-March we announced a $100 million grant program to help small businesses around the world. Since we opened applications for the program, we have seen a huge amount of interest from Black-owned businesses – so we know they are facing enormous challenges. Black businesses have faced systemic barriers for generations, and they have also been hit hardest by the economic impact of the pandemic. Last month we announced an additional $100 million investment in Black-owned small businesses, Black creators, and nonprofits that serve the Black community in the US. Our grant program is on top of a goal we set previously to spend at least $1 billion with diverse suppliers next year and every year thereafter. As part of this, we'll spend at least $100 million annually with Black-owned suppliers, from facilities to construction to marketing agencies and more.

The COVID-19 crisis is lasting longer than everyone hoped and expected. We are acutely aware of the responsibility we have to keep people connected during this turbulent time, and to help businesses weather the storm and transition to the digital economy.

I want to close by saying how grateful I am to our partners around the world who continue to give us valuable feedback and hold us accountable – and to our incredible teams who are deeply committed to making progress on the issues that matter most and launching new products that continue to make a real difference in people's lives.

Now, here's Dave.

Dave Wehner, CFO

Thanks Sheryl and good afternoon everyone.

We continue to operate in an uncertain and challenging environment around the world. At the same time, we are seeing accelerated participation in the digital economy, and Facebook is helping alleviate the economic challenges associated with COVID-19. We are pleased to support people and businesses through these very trying times.

Turning now to our results.

Our Q2 growth and engagement metrics reflected increased engagement due to the impact of the pandemic. However, as expected, we are seeing signs of normalization as shelter-in-place measures have eased around the world. I will provide more detail in the outlook.

In June, we estimate that approximately 2.5 billion people used at least one of our services on a daily basis, and that approximately 3.1 billion people used at least one of our services on a monthly basis. Note that these Q2 Family metrics reflect new data from a recent user survey and certain methodology improvements. Further details are included in the earnings slides on our IR website.

Facebook itself continued to grow with daily active users reaching 1.79 billion, up 12% compared to last year. DAUs represented approximately 66% of the 2.70 billion monthly active users in June. MAUs grew by 287 million or 12% compared to last year.

Turning now to the financials.

Q2 total revenue was $18.7 billion, up 11% or 12% on a constant currency basis. Had foreign exchange rates remained constant with Q2 of last year, total revenue would have been $297 million higher. Q2 ad revenue was $18.3 billion, up 10% or 12% on a constant currency basis.

As Sheryl mentioned, ad revenue growth in the quarter was stronger in May and June relative to April. In terms of verticals, we saw particular strength from both new and existing online commerce and services advertisers who primarily leverage our direct response ad formats.

Facebook has been a lifeline of economic activity during a time when offline activity has been curtailed. Our growth was primarily driven by small and medium sized businesses around the world who leveraged our advertising platforms to connect with customers. As a result, we continue to see increased diversification among our advertiser base. In Q2, our top 100 advertisers represented 16% of our ad revenue, which is a lower percentage than a year ago.

On a user regional basis, ad revenue growth was strongest in US & Canada, Asia-Pacific, and Europe which grew 14%, 11%, and 9%, respectively. Rest of World declined 6% and was impacted by challenging macroeconomic conditions as well as foreign currency headwinds.

Turning now to our price and volume metrics. In Q2, the total number of ad impressions served across our services increased 40% and the average price per ad decreased 21%. Similar to last quarter, the growth in impressions was primarily driven by Facebook Mobile News Feed, due to product changes and increased engagement compared to last year. The decline in average price per ad was largely attributable to the economic impact of the pandemic, although we saw year-over-year pricing trends improve in the latter half of the quarter.

Other revenue was $366 million, up 40%, driven primarily by sales of Oculus and Portal products.

Turning now to expenses.

Q2 total expenses were $12.7 billion, up 4% on a reported basis. Excluding the $2 billion expense that we recorded in Q2 of last year related to our settlement with the FTC, total expenses were up 24% year-over-year, an 11 percentage point deceleration compared to Q1. The biggest factor in the deceleration of expense growth from the first quarter was a decline in people-related costs like travel, events and amenities as our employees worked almost entirely from home. By line item, the trends were as follows:

- Cost of revenue increased 16%, driven primarily by depreciation related to our data center spend.
- R&D grew 35%, driven primarily by investments in core products as well as our innovation efforts, notably in AR/VR.
- Marketing and sales grew 18%, driven primarily by consumer and growth marketing.
- Finally, excluding the FTC expense from Q2 of 2019, G&A expenses grew 30%, driven primarily by higher legal expenses.

As Mark mentioned, we continued to invest throughout the economic downturn in order to build products and services for the future. We had our strongest hiring quarter ever in Q2, adding over 4,200 net new hires, primarily in technical functions. We ended the quarter with over 52,500 full-time employees, up 32% year-over-year. We are pleased with our ability to recruit, onboard, and retain talent in this environment.

Operating income was $6 billion, representing a 32% operating margin. Our tax rate was 16%. Net income was $5.2 billion or $1.80 per share.

Capital expenditures were $3.4 billion driven by investments in data centers, servers, office buildings, and network infrastructure. Note that this is a decline of 11% compared to last year, primarily due to a pause in data center construction for roughly half of the quarter due to the shelter-in-place measures. We have since resumed our data center construction efforts with proper safety precautions in place.

In Q2, we announced a new data center in Illinois which will be supported by 100% renewable energy. We remain committed to minimizing our environmental impact and earlier this month, we published our inaugural Sustainability Report, which is available on Facebook's Sustainability website.

Free cash flow was $514 million and, as a reminder, this is net of the $5 billion FTC settlement that was paid in Q2 but as previously noted was expensed in 2019.

We purchased $1.4 billion of our Class A common stock and ended the quarter with $58.2 billion in cash and investments. In July, we closed our investment in Jio Platforms Limited and paid approximately $5.8 billion in cash.

Turning now to the outlook.

As I mentioned earlier, we are seeing signs of normalization in user growth and engagement as shelter-in-place measures have eased around the world, particularly in developed markets where Facebook's penetration is higher. Looking forward, as shelter-in-place restrictions continue to ease, we expect the number of Facebook DAUs and MAUs to be flat or slightly down in most regions in Q3 compared to Q2.

In the first three weeks of July, our year-over-year ad revenue growth rate was approximately in-line with our Q2 ad revenue growth rate of 10%. We expect our full quarter Q3 year-over-year ad revenue growth rate to be roughly similar to this July performance. There are several factors contributing to this:

- First, continued macroeconomic uncertainty including the pace of recovery and the prospects for additional economic stimulus;
- Second, the expectation that some of the recent surge in community engagement will normalize as regions reopen;
- Third, the impact from certain advertisers pausing spend on our platforms related to the current boycott which is reflected in our July trends; and
- Lastly, headwinds related to ad targeting and measurement, including the impact of regulation, such as the California Consumer Privacy Act, as well as headwinds from expected changes to mobile operating platforms, which we anticipate will be increasingly significant as the year progresses.

Turning now to expenses. We expect total expenses in 2020 to be in the range of $52-55 billion, narrowed slightly from our prior range of $52-56 billion.

We expect capital expenditures to be approximately $16 billion, at the high end of our previous $14-16 billion range[1], as we have resumed data center construction efforts earlier than expected. However, a great deal of uncertainty remains in our outlook, and our full-year capital expenditures will depend on how the pandemic impacts our ability to construct data centers and refresh equipment.

Turning now to tax. We expect our full-year 2020 tax rate to be in the mid-teens, although we may see fluctuations in our quarterly rate depending on our financial results.

We are proud of the role that Facebook has played in keeping people connected during the COVID crisis and the role that we have played in helping businesses reach consumers online during these challenging times.

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

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[1] On the call, Mr. Wehner mistakenly referred to the prior 2020 capital expenditures guidance range as $15-16 billion. The prior range was $14-16 billion and is noted as corrected in this document.