

Facebook, Inc. (FB)
Second Quarter 2021 Results – Prepared Remarks
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Deborah Crawford, VP, Investor Relations

Thank you. Good afternoon and welcome to Facebook's second quarter 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

Hi everyone. Thanks for joining us today. This was a good quarter for our products and business. There are now more than 3.5 billion people who actively use one or more of our services, and I'm excited about our product roadmaps ahead.

I want to start today by discussing some of the themes we're seeing in our major efforts around creators, commerce, and the next computing platform. Each of these areas is important and is going to unlock a lot of value on its own. But they're also building blocks for the future of the internet and the future vision for our company, and I'll discuss that as well.

Creators and Video

First, let's talk about creators. We want our platforms to be the best place for millions of creators to earn a living. If we can do this, then our services will also have the best content across many different types of media -- from text and photos to audio, gaming, and video.

Video in particular is becoming the primary way that people use our products and express themselves. I know this is a theme we've been talking about for a few years now, but we've been executing on this for a while and video has steadily become more important in our products. Video now accounts for almost half of all time spent on Facebook. Reels is already the largest contributor to engagement growth on Instagram.

Across all forms of video, short form video like Reels is growing especially quickly. We're very focused on making it easy for anyone to create video, and then for those videos to be viewed across all of our different services, starting with Facebook and Instagram first. People like to watch videos recommended by our personalized algorithms, so this gives creators a good way to reach new people who don't follow them yet. This is also a good complement to our social feeds and it's an area where our progress in AI is going to make the experience a lot better in the coming months and years.

On-demand video, like in Facebook Watch, is also growing quickly and is now growing faster than other types of video or content in News Feed. We're building a number of new video monetization tools for creators so they can get compensated for making great content. For example, last year people sent more than \$50 million of Stars to game stream creators going live on Facebook alone, and now we're expanding Stars so fans can send them to any creator during on-demand video as well.

I also want to call out live video for a moment. This is a smaller percent of overall video on our services, but it's some of the most unique content and it gives creators a way to build community and engage with their followers. We're also focused on developing monetization tools like Live Breaks for mid-roll ads and Live Shopping so creators can make a living and engage their communities more deeply in commerce with their content.

Overall, there's a lot more to do here, and as it becomes the majority of engagement across our services in the coming years, we're going to continue to focus on this.

We're also focused on other types of creators beyond video, and some of the most interesting emergent behavior we're seeing is creators using a lot of different types of content to engage their communities. We launched Live Audio Rooms this quarter as well as podcasts. We also launched Bulletin, our publishing and subscription service for writers, with features to help them find and grow their audiences, including integrations with Groups, Facebook Live and Live Audio Rooms.

To help grow the creator economy overall, we're going to keep our creator tools free to use through 2023, and we recently announced that we're investing \$1 billion in creators across Facebook and Instagram. I'm optimistic that creators will get more opportunities to do the work they want, and that's going to lead to people hearing lots of new voices across our different services.

Commerce

The second area that I want to talk about today is commerce. Our goal here is to create better experiences for people interacting with businesses, and to help businesses grow even more on our platforms. Our approach is to work our way down the stack and build world class services at every layer of commerce – starting from discovery at the top of the stack all the way down to payments. Just like we want to be the best place for millions of creators to make a living, we also want to be the best place for businesses to grow as well.

We started here by building world class ads tools to help businesses reach potential customers and help people discover new products and services that they might like. But what we've found is that when these ads link offsite, you often land on a webpage that's not personalized or not optimized or where you have to re-enter your payment information. That's not a good experience for people and it doesn't lead to the best results for businesses either. So our next phase here is focused on building out Shops,

Marketplace, and business messaging in WhatsApp and Messenger to create more native commerce experiences across our apps.

There's a lot of work here to do to support all of the business tools natively that already exist for the web, but as we bring more of this online and enable more of this, it's going to create a superior consumer experience and it's going to convert better for businesses. This is going to lead to more businesses investing in building out their presences across our services, and that will lead to even more diversity of products for people to discover and interact with. This is a long term strategy and it's going to take a while before it's meaningful -- especially given the scale of our ads business already -- but I'm confident that it's the right long term bet and product direction.

As we work our way down the stack from discovery in ads to native commerce storefronts, we're also making progress on payments at the same time. WhatsApp payments are now available to everyone in Brazil as well as India. Lots of people are already using this as a simple and secure way to send money to friends. We're adding new payments features in Messenger in the US like QR codes. We also just announced that we're making Facebook Pay available outside our apps for the first time, which means you'll start seeing it as a checkout option on the web -- and especially in web views that you see within our apps after clicking on ads or other business content.

Commerce experiences are now accessible across most of our services and we have a full roadmap of deeper integrations that I'm excited about in the months ahead.

Next Computing Platform

The third area I want to talk about is building the next computing platform. We're continuing to invest heavily in building technology and products to deliver a full sense of presence. This is going to be critical for unlocking the next generation of social internet services.

Quest 2 in particular continues doing well, and it keeps getting better monthly as we release regular software updates, including most recently our Passthrough API so developers can start building mixed reality experiences on Quest. The range of content and experiences that we're seeing keeps broadening as well to the point where there are a lot of popular virtual reality experiences beyond games at this point. The most popular apps on Quest are social, which fits our original thesis here that virtual reality will be a social platform and that's why we're so focused on building it. But we're also seeing compelling use cases in other forms of entertainment, as well as work, creativity, and fitness.

Looking ahead here, the next product release will be the launch of our first smart glasses from Ray-Ban in partnership with Essilor Luxottica. The glasses have their iconic form factor, and they let you do some pretty neat things. I'm excited to get these into people's hands and to continue to make progress on the journey towards full augmented reality glasses in the future.

The Metaverse

Now, the areas that I've discussed today -- creators, commerce, and the next computing platform -- they're each important priorities for us and they're each going to unlock a lot of value on their own. But together, these efforts are also part of a much larger goal: to help build the metaverse. I'll be sharing a lot more about this in the months ahead, so I wanted to discuss this now so you can see the future we're working towards and how our major initiatives across the company are going to map to that.

So what is the metaverse? It's a virtual environment where you can be present with people in digital spaces. You can kind of think about this as an embodied internet that you're inside of rather than just looking at. We believe that this is going to be the successor to the mobile internet.

You're going to be able to access the metaverse from all different devices in different levels of fidelity -- from apps on phones and PCs to immersive virtual and augmented reality devices. Within the metaverse, you're going to be able to hang out, play games with friends, work, create, and more. You're basically going to be able to do everything that you can on the internet today as well as some things that don't make sense on the internet today, like dancing.

The defining quality of the metaverse is presence -- which is this feeling that you're really there with another person or in another place. Creation, avatars and digital objects will be central to how we express ourselves, and this is going to lead to entirely new experiences and economic opportunities.

I think that overall this is one of the most exciting projects that we're going to get to work on in our lifetimes. But it's going to take a lot of work, and no company is going to be able to build this all by themselves. Part of what I've learned over the last five years is that we can't just focus on building great experiences -- we also need to make sure we're helping to build ecosystems so millions of other people can participate in the upside and opportunity of what we're all creating. There will need to be new protocols and standards, new devices, new chips, new software -- from rendering engines to payment systems and everything in between. In order for the metaverse to fulfill its potential, we believe that it should be built in a way that is open for everyone to participate. I expect this is going to create a lot of value for many companies up and down the stack, but it's also going to require significant investment over many years.

I see our focus here as a continuation of our work to build technology that brings people together. In many ways, the metaverse is the ultimate expression of social technology. Some of the experiences I've dreamed of building since well before I started Facebook are only starting to become possible now. If you look at the investments we've made over the years, you can see this vision gradually starting to come into focus, and you can see why we're so excited about it.

In addition to being the next generation of the internet, the metaverse is also going to be the next chapter for us as a company. In the coming years, I expect people will transition from seeing us primarily as a social media company to seeing us as a metaverse company. There's a lot that we need to do to get there, and there will be many exciting milestones along the way, including some we'll share in the months ahead. But in the meantime, I just want to take a moment to thank everyone in our community, all of our partners and employees, and everyone who has supported us so far. I continue to be grateful to be on this journey with all of you.

And now, here's Sheryl.

Sheryl Sandberg, COO

Hi everyone. Thanks Mark. I hope you're all safe and healthy.

This was a strong quarter for our business. Our total revenue for Q2 was \$29.1B, which is a 56% year-over-year increase. We've seen strong growth in all regions and across most verticals. Our strongest

verticals are those that have performed well throughout the pandemic, including E-commerce, Retail and CPG. And we're also seeing continued recovery in others, like travel, that were hit hard by Covid.

Our performance continues to be driven by the ongoing digital transformation, which has accelerated during the pandemic, and our long-term investments in tools and products to help businesses make the shift online.

Not long ago it was much harder and much more expensive for businesses to create a digital presence, take orders online, and reach customers remotely. Our tools and products make these things easier and more accessible. Businesses and creators can set up Pages, Profiles and Shops on Facebook and Instagram. They can engage with customers directly in Groups, or through Messenger and WhatsApp. And they can tell their stories in creative ways with Reels, Stories, or by going Live on Facebook and Instagram.

With personalized ads they can easily reach the people most likely to be interested in their products or services for just a few dollars. This has helped so many businesses – especially small businesses – find success when reaching people in person has been much harder.

A great example is The Pizza Cupcake, a family-owned baking business in New York City. They've been selling at pop-up shops since 2018. But when Covid hit, pop-up locations shut down and catering events cancelled. So in March last year they became an E-commerce business. In Q3, they tested their first Facebook ad campaigns in the New York/Tri-State area, and by the following quarter ramped up their budget to sell across 28 states. They've since made three new hires and plan to start shipping nationwide this year, so they've expanded production, which has also led to jobs being created at fulfillment centers in Maryland, Florida, Arizona, and California.

We're constantly working to improve the effectiveness of our ad products to help businesses like The Pizza Cupcake reach customers and get a great return on their investment. We're doing this through investments in machine learning, and monetization of newer surfaces like Stories and Reels.

In all of this, we're planning for the long-term. Mark talked about some of the key elements of our strategy going forward, so I'll focus on the strategy for the ads business. If you think about the journey we've been on over the past decade or so, we started with desktop ads on the right hand side of people's feeds, then consumers shifted to mobile, and we put ads in News Feed. Then quarter after quarter, year after year, as we've created great new consumer products – like Stories or Reels – we've found the right ways for advertisers to reach consumers within these products. And we're constantly working to make our ads deliver more for businesses, and be more relevant for people.

To support the growth of our ads business over the next 10 years, it's going to take a similar effort. We need to build on our success by developing innovative new products and discovery experiences, while giving everyone more control over their personal information. To build the next era of personalized experiences, we're focused on product innovations in four areas:

The first is discovery. We want to keep making our apps the best places to discover products and businesses you'll love. For example, we're testing a new experience in News Feed where you can tap to browse content from businesses on topics like beauty, fitness, or clothing. And we're using context to make smarter recommendations about which ads to show, so if you're watching a travel video, we could show ads for hotels and flights.

The second area is commerce, which Mark touched on a moment ago. We're building a modern commerce system across ads, community tools, messaging, Shops and payments. It's all about creating a personalized, seamless customer journey, where it's easier to discover a product, buy it, pay for it, and have it delivered to your doorstep.

The third area is privacy-enhancing technologies. We know businesses are experiencing challenges because of platform changes. We want to make sure they can continue getting great results through privacy-safe personalized ads long into the future. So we're collaborating across the industry to develop new technologies to help minimize the amount of personal information we process, while still allowing us to show relevant ads and measure their effectiveness.

The fourth is building tools that help businesses beyond marketing. We want to help solve all kinds of business needs, whether it's customer relationship management, business messaging tools, or hiring through Facebook Jobs. We're helping people run their business across our apps easily with Facebook Business Suite. We're making it easier to message customers across our apps from a single interface. And we're expanding our Messenger API for Instagram as customers increasingly rely on messaging instead of phone calls.

The digital transformation is a long-term trend that isn't going away. By focusing on innovation in these four areas, we will continue to help businesses of all sizes make the shift online and reach customers with privacy-safe personalized advertising.

As ever, I'm grateful to all the businesses who work with us. And I continue to be amazed by our teams all over the world. Throughout this period we've been really lucky to have so many brilliant people working hard to keep people connected, and help businesses survive and thrive online.

Now, over to Dave.

Dave Wehner, CFO

Thanks Sheryl and good afternoon everyone.

We delivered strong results in the second quarter as our services continue to help millions of businesses reach customers around the world.

Let's begin with our community metrics.

We estimate that approximately 2.8 billion people used at least one of our services on a daily basis in June, and that approximately 3.5 billion people used at least one on a monthly basis. Our global community continued to grow even as we lapped elevated user growth in the second quarter of last year related to the pandemic.

Facebook daily active users reached 1.91 billion, up 7% or 123 million compared to last year. DAUs represented approximately 66% of the 2.90 billion monthly active users in June. MAUs grew by 194 million or 7% compared to last year.

Turning to the financials.

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

Q2 total revenue was \$29.1 billion, up 56% or 50% on a constant currency basis. We benefited from a currency tailwind and had foreign exchange rates remained constant with Q2 of last year, total revenue would have been \$982 million lower. On a two-year basis, Q2 total revenue growth decelerated to 72% from 74% in the first quarter.

Q2 ad revenue was \$28.6 billion, up 56% or 51% on a constant currency basis.

The macroeconomic environment for online advertising remains very strong. As Sheryl noted, the growth in advertising revenue was largely driven by verticals that have performed well during the pandemic, such as online commerce and consumer packaged goods. In addition, we saw improved growth trends in verticals that were particularly challenged during the pandemic, such as travel, entertainment and media.

On a user geography basis, ad revenue growth accelerated in all regions as we lapped the second quarter of last year, which was the period hit hardest by the pandemic. Growth was strongest in Rest of World at 86%. Europe, Asia-Pacific, and the US & Canada grew 63%, 56%, and 48%, respectively. Europe, Asia-Pacific and Rest of World all benefited from currency tailwinds.

In Q2, the total number of ad impressions served across our services increased 6% and the average price per ad increased 47%.

Impression growth was driven primarily by developing markets, especially in Asia-Pacific, while pricing growth benefited from broad-based strength in advertiser demand. Recall that in the second quarter of 2020, the effects of the pandemic contributed to elevated impressions and depressed prices, which we are now lapping.

Other revenue was \$497 million, up 36%. Other revenue growth continues to be driven by Quest 2 sales, though the rate of growth slowed in the second quarter as we entered a seasonally slower sales period. We also recorded a revenue adjustment for returns related to the Quest 2 foam facial interface recall.

Turning now to expenses.

Q2 total expenses were \$16.7 billion, up 31% compared to last year. In terms of the specific line items:

- Cost of revenue increased 41%, driven primarily by consumer hardware costs, payments to partners, and core infrastructure investments.
- R&D increased 37%, driven primarily by hiring to support our core products and consumer hardware efforts.
- Marketing & Sales increased 15%, mainly driven by hiring and marketing spend.
- Lastly, G&A expenses increased 23%, driven mostly by employee-related costs and legal expenses.

We added over 2,700 net new hires in Q2, primarily in technical functions. We ended the quarter with over 63,400 full-time employees, up 21% compared to last year.

Second quarter operating income was \$12.4 billion, representing a 43% operating margin. Our tax rate was 17%. Net income was \$10.4 billion or \$3.61 per share.

Capital expenditures including capital leases were \$4.7 billion, driven by investments in data centers, servers, network infrastructure and office facilities.

Free cash flow was \$8.5 billion. We repurchased \$7.1 billion of our Class A common stock in the second quarter and we ended the quarter with \$64.1 billion in cash and marketable securities.

In terms of our sustainability efforts, we remain focused on achieving our goal to reach net zero emissions for our entire value chain in 2030. In June we released our second annual Sustainability report which details our work towards achieving our objectives.

Turning now to the outlook.

Similar to the second quarter, we expect that advertising revenue growth will be driven primarily by year-over-year advertising price increases during the rest of 2021.

In the third and fourth quarters of 2021, we expect year-over-year total revenue growth rates to decelerate significantly on a sequential basis as we lap periods of increasingly strong growth. When viewing growth on a two-year basis to exclude the impacts from lapping the Covid recovery, we expect year-over-two-year total revenue growth rates to decelerate modestly in the second half compared to the second quarter rate.

We continue to expect increased ad targeting headwinds in 2021 from regulatory and platform changes, notably the recent iOS updates, which we expect to have a more significant impact in the third quarter compared to the second quarter.

As noted in recent earnings calls, we continue to monitor developments regarding the viability of transatlantic data transfers and their potential impact on our European operations.

Turning now to expenses.

We expect 2021 total expenses to be in the range of \$70-73 billion, unchanged from our prior outlook. The year-over-year growth in expenses is driven primarily by investments in technical and product talent, infrastructure, and consumer hardware-related costs. Our expense outlook reflects our commitment to invest ahead of the compelling long-term growth opportunities we see across our product portfolio.

We expect 2021 capital expenditures to be in the range of \$19-21 billion, unchanged from our prior estimate. Our capital expenditures are driven primarily by our investments in data centers, servers, network infrastructure, and office facilities.

We expect our full-year 2021 tax rate to be in the high-teens.

In closing, we are pleased with the strong performance of our business and remain committed to innovating on behalf of the people and businesses who use our services around the world.