Facebook, Inc. (FB)
Third Quarter 2021 Results – Prepared Remarks
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Thank you. Good afternoon and welcome to Facebook's third 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

Hey everyone and thanks for joining today.

We made good progress this quarter across a number of product priorities, and our community continues to grow. There are now almost 3.6 billion people who actively use one or more of our services, and I'm excited about our roadmap to keep building great new experiences for them.

As expected, we did experience revenue headwinds this quarter, including from Apple's changes that are not only negatively affecting our business, but millions of small businesses in what is already a difficult time for them in the economy. Sheryl and Dave will talk about this more later, but the bottom line is we expect we'll be able to navigate these headwinds over time with investments that we're already making today.

Before I get to our product update, I want to discuss the recent debate around our company.

I believe large organizations should be scrutinized and I'd much rather live in a society where they are than one where they can't be. Good faith criticism helps us get better. But my view is that what we're seeing is a coordinated effort to selectively use leaked documents to paint a false picture of our company.

The reality is that we have an open culture where we encourage discussion and research about our work so we can make progress on many complex issues that are not specific to just us. We have industry-leading programs to study the effects of our products and provide transparency into our progress because we care about getting this right.

When we make decisions, we need to balance competing social equities, like free expression with reducing harmful content, or enabling strong encrypted privacy with supporting law enforcement, or enabling research and interoperability with locking down data as much as possible. It makes a good soundbite to say that we don't solve these impossible tradeoffs because we're just focused on making money, but the reality is these questions are not primarily about our business, but about balancing different difficult social values. And I've repeatedly called for regulation to provide clarity because I don't think companies should be making so many of these decisions ourselves.

I'm proud of our record navigating the complex tradeoffs involved in operating services at global scale, and I'm proud of the research and transparency we bring to our work. Our programs are industry-leading. We have made massive investments in safety and security with more than 40,000 people and we are on track to spend more than $5 billion on safety and security in 2021. I believe that's more than any other tech company, even adjusted for scale. We set the standard for transparency with our quarterly enforcement reports and tools like our political ads archive. We established a new model for independent academic researchers to safely access data. We pioneered the Oversight Board as a model of self-regulation. And as a result, we believe that our systems are the most effective at reducing harmful content across the industry. And I think that any honest account of how we've handled these issues should include that.

I also think that any honest account should be clear that these issues aren't primarily about social media. That means that no matter what Facebook does, we're never going to solve them on our own. For example, polarization started rising in the US before I was born. At the same time, independent research shows that many countries around the world have flat or declining polarization, despite similar social media use there to in the US. We see this pattern repeat with other issues as well. The reality is, if social media is not the main driver of these issues, then it probably can't fix them by itself either.

We should want every other company in our industry to make the investments and achieve the results that we have. I worry about the incentives that we're creating for other companies to be as introspective as we have been. But I am committed to continuing this work, because I believe it will be better for our community and our business over the long term.

We can't change the underlying media dynamics, but there's a different constituency that we serve that has always been more important and that I try to keep us focused on: and that’s people.

Billions of people use our services because we build the best tools to stay connected to the people you care about, to find communities that matter to you, and to grow your small business.

And the reason we've been able to succeed for almost two decades is because we keep evolving and building. Facebook started in a dorm room and grew into a global website. We invented the News Feed and a new kind of ads platform. We became a mobile-first experience. And then we grew a whole family of apps that serve billions of people.

And there is so much more to build. Even with all the tools we have today, we still can't feel like we're right there together with the people we care about when we're physically apart. We can't teleport as holograms to instantly be at the office without a commute, or at a concert with a friend, or in your parents' living room to catch up. The creative economy and commerce tools are still nascent and there should be opportunity for millions of more people to make a living doing the work that they love.

Our three product priorities remain our focus on creators, commerce, and building the next computing platform.

A big part of our work with creators is our focus on Reels. Reels is already the primary driver of engagement growth on Instagram. It's incredibly entertaining, and I think that there's a huge amount of potential ahead. We expect this to continue growing and I am optimistic that Reels will be as important for our products as Stories is. We also expect to make significant changes to Instagram and Facebook in the next year to further lean into video and make Reels a more central part of the experience.

One aspect of this is giving all our apps the goal of being the best services for young adults, which we define as ages 18-29. Historically, young adults have been a strong base and that's important because they are the future. But over the last decade, as the audience that uses our apps has expanded so much and we've focused on serving everyone, our services have gotten dialed to be the best for the most people who use them rather than specifically for young adults. And during this period, competition has also gotten more intense, especially with Apple's iMessage growing in popularity and more recently, the rise of TikTok, which is one of the most effective competitors we have ever faced.

So we are retooling our teams to make serving young adults their north star, rather than optimizing for the larger number of older people. Like everything, this will involve tradeoffs in our products and it will likely mean that the rest of our community will grow more slowly than it otherwise would have. But it should also mean that our services become stronger for young adults. This shift will take years, not months, to fully execute, and I think it's the right approach to building our community and company for the long term.

Our next product priority is commerce. Helping people discover new products that they're interested in and reach customers inside our apps is going to unlock a lot of opportunity.

As Apple's changes make e-commerce and customer acquisition less effective on the web, solutions that allow businesses to set up shop right inside our apps will become increasingly attractive and important to them. We've built solutions like ads that can dynamically point to either a business's website or their Shop on our platforms depending on what will perform better for them, and that will help more businesses navigate this challenging environment.

Building a full-fledged commerce platform is a multi-year journey. Marketplace is already at scale and lots of people rely on it, especially now with supply chain issues that make it harder to get new products. Shops are getting more developed, and we have an exciting program planned for this holiday season where we're working closely with a number of the businesses that have invested the most in Shops to identify what works to find new customers and grow their business even faster. Our plan is to then scale those solutions even more broadly in 2022.

Beyond Reels and commerce, I also want to share some thoughts on our longer-term efforts to build the next computing platform and help bring the metaverse to life. This is a major area of investment for us and an important part of our strategy going forward.

I view this work as critical to our mission because delivering a sense of presence -- like you're right there with another person -- that's the holy grail of online social experiences. Over the next decade, these new platforms are going to start to unlock the kinds of experiences that I've wanted to build since even before I started Facebook. Along with those social experiences I expect a massive increase in the creator economy and amount of digital goods and commerce. If you're in the metaverse every day, then you'll need digital clothes, digital tools, and different experiences. Our goal is to help the metaverse reach a billion people and hundreds of billions of dollars of digital commerce this decade. Strategically, helping to shape the next platform should also reduce our dependence on delivering our services through competitors.

Building the foundational platforms for the metaverse will be a long road. We just released the 128GB Quest 2, replacing the 64GB model for $299. With EssilorLuxottica, we released our first smart glasses, and they're off to a strong start as well. But bringing this vision to life isn't just about building one glasses product. There's a whole ecosystem. We're building multiple generations of our VR and AR products at the same time, as well as a new operating system and development model, a digital commerce platform, content studios, and of course a social platform.

So to reflect the significance of this for our business, today we're announcing a change to our financial reporting. Starting next quarter, we'll begin disclosing financial metrics for Facebook Reality Labs separately from our Family of Apps. This will provide investors with additional visibility into the investments that we're making in augmented and virtual reality. In 2021, we expect these investments to reduce our overall operating profit by approximately $10 billion, and I expect this investment to grow even further for each of the next several years. Dave will share more about this later, but I encourage you all to tune into Connect on Thursday to hear more about our vision and our work here in more detail.

I recognize the magnitude of this bet on the future, and I am grateful for the support of our investors, the creative community, and the thousands of talented people working on this effort inside our company to bring this inspiring future to life.

And with that, here's Sheryl.

Sheryl Sandberg, COO

Thanks Mark, and hi everyone.

This quarter our total revenue was $29 billion, up 35% year-over-year. We saw solid revenue growth across all regions. And we continued to grow our user base.

We felt the impact of some big external factors in Q3. I want to explain some of the revenue softness we've seen, and what we're doing to mitigate the headwinds and help businesses over the crucial holiday period and beyond.

To start, let's take a step back. Over the past decade, we've seen more and more businesses shift online. When the pandemic hit, this digital transformation accelerated. We've invested in tools and products over many years to help businesses make this shift. So this acceleration drove very strong growth for us throughout the last few quarters.

We've been open about the fact that there were headwinds coming – and we've experienced that in Q3. The biggest is the impact of Apple's iOS14 changes, which have created headwinds for others in the industry as well, major challenges for small businesses, and advantaged Apple's own advertising business. We started to see that impact in Q2, but adoption on the consumer side ramped up by late June, so it hit critical mass in Q3. As a result, we've encountered two challenges. One is that the accuracy of our ads targeting decreased, which increased the cost of driving outcomes for our advertisers. And the other is that measuring those outcomes became more difficult.

On targeting, we're focused on improving campaign performance even with the increased limitations facing our industry. We're building commerce tools to help businesses reach more new customers and get more incremental sales. And over the longer term, we're developing Privacy Enhancing Technologies in collaboration with others across the industry to help minimize the amount of personal information we process, while still allowing us to show relevant ads. Progress in these areas will take time and will be a focus for us throughout 2022 and beyond.

On measurement, as we wrote in a recent blog post, we believe we are underreporting iOS web conversions. This means real world conversions, like sales and app installs, are higher than what's being reported for many advertisers, especially small advertisers. We're making good progress fixing this. We think we'll be able to address more than half of the underreporting by the end of this year. And we'll continue to work on this into 2022.

Another external factor is slowing e-Commerce growth. The strong e-Commerce growth in recent quarters was driven in part by the acceleration of the digital transformation that is now tapering off. I think most people see this in their own lives. There was a period of time when many people who were able to stayed at home and ordered things online much more. But now in many places things have opened up, and people are increasingly making purchases in person. That doesn't mean e-Commerce has stopped growing. Businesses are still making the shift online. But e-Commerce is no longer growing at the pace it was at the height of the pandemic.

These factors have been compounded for many advertisers by major global supply chain issues and labor shortages, which have left many consumer businesses with less inventory. This has reduced their appetite to generate demand from consumers, which has impacted advertising spend. Businesses in every region and across a range of verticals have been affected. At the same time we've also seen some impact from Covid surges around the world in places like South-East Asia.

Overall, if it wasn't for Apple's iOS14 changes, we would have seen positive quarter-over-quarter revenue growth. And while we and our advertisers will continue to feel the effect of these changes in future quarters, we will continue working hard to mitigate them.

Despite the headwinds, we remain confident about our future. We believe Facebook and Instagram are the best place for people to connect with their friends and families, build communities, and start and grow businesses. And we believe they're still the best platforms for advertisers to reach people where they are and get measurable outcomes. Our focus remains where it always has been, building products that help people connect and businesses grow.

Mark talked about video a moment ago. Not only is this a growing area for us overall, but we're also continuing to get better at monetizing it. More than 60% of video revenue now comes from mobile-first video, meaning videos that are shot vertically or are under 15 seconds. Over 2 billion people per month now watch videos that are eligible for In-Stream ads, which are ads shown before, during or after videos. And we're expanding access to Reels ads on Instagram to more advertisers with automatic placement and new creative formats.

Another area we're seeing good progress is in lead generation. Our products help businesses generate quality leads at scale and meet customers where they are on their preferred channel of communication, whether it's messaging, forms, or calls. In April, we started rolling out a new Conversion Leads optimization goal for higher quality leads, and advertisers can also integrate their CRM with Facebook via our Conversions API. Our tests show that on average advertisers see a 20% increase in lead to sale conversion rate when they use both the optimization goal and the integration.

Q4 is the most important quarter of the year for many businesses, large and small. As always, we're focused on making the holiday season a success for them. We're working to fix the measurement issues they're experiencing, and deliver the tools and products they need to grow. And we're rolling out a range of holiday shopping experiences to help people find great deals, support small businesses and good causes, and shop with local and Black-owned businesses.

We're bringing exclusive gifts to Shops that will be available when people checkout on Facebook or Instagram, like 20% off your first purchase and free shipping. Starting next week, we'll host daily Live Shopping experiences with companies large and small – brands like Walmart, Macy's, Benefit Cosmetics and Paintbox Nails – to educate shoppers and share exclusive deals.

And we're bringing back one of my favorite campaigns ever – Buy Black Friday – to showcase Black-owned small businesses during the holidays. It includes things like Buy Black collections in the Facebook and Instagram Shop tabs, and a weekly Buy Black Friday show with Live Shopping segments from up and coming Black-owned small businesses.

I want to close by saying how grateful I am to our partners around the world. And to our incredible teams who are working so hard to help people and businesses throughout this period.

Now, here's Dave.

Dave Wehner, CFO

Thanks Sheryl and good afternoon everyone.

We delivered solid results in the third quarter in the face of a challenging mobile platform landscape and an evolving macroeconomic environment.

Let's begin with our community metrics.

Our global community continued to grow even as we lapped elevated user growth in the third quarter of last year related to the pandemic. We estimate that approximately 2.8 billion people used at least one of our services on a daily basis in September, and that approximately 3.6 billion people used at least one on a monthly basis.

Facebook daily active users reached 1.93 billion, up 6% or 110 million compared to last year. DAUs represented approximately 66% of the 2.91 billion monthly active users in September. MAUs grew by 170 million or 6% compared to last year.

Turning to the financials.

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

Q3 total revenue was $29.0 billion, up 35% or 34% on a constant currency basis. We benefited from a currency tailwind and had foreign exchange rates remained constant with Q3 of last year, total revenue would have been $259 million lower.

Q3 ad revenue was $28.3 billion, up 33% or 32% on a constant currency basis.

On a user geography basis, year-over-year ad revenue growth was strongest in Rest of World at 50%. Europe, North America and Asia-Pacific grew 35%, 31%, and 28%, respectively. Europe, Asia-Pacific and Rest of World benefited from currency tailwinds, though to a lesser degree than in the prior quarter.

In Q3, the total number of ad impressions served across our services increased 9% and the average price per ad increased 22%.

Impression growth was driven primarily by developing markets, especially in Asia-Pacific. Pricing growth benefited from advertiser demand and lapping of Covid-related pricing weakness during the third quarter of last year. Though, as Sheryl noted, growth was hindered by three primary headwinds:

First, advertising spend was negatively impacted by performance and measurement headwinds related to Apple's ATT changes.

Second, we are seeing some macro headwinds as growth in online commerce has moderated from the elevated levels experienced earlier in the pandemic and businesses face supply chain disruptions.

Third, Covid resurgences in Southeast Asia have led to additional lockdowns and a curtailment of economic activity.

Other revenue was $734 million, up 195%, driven by strong Quest 2 sales.

Turning now to expenses.

Q3 total expenses were $18.6 billion, up 38% compared to last year. In terms of the specific line items:

Cost of revenue increased 38%, driven mostly by consumer hardware costs, core infrastructure investments, and payments to partners.

R&D increased 33%, driven primarily by hiring to support our core products and consumer hardware efforts.

Marketing & Sales increased 32%, mainly driven by marketing spend and hiring.

Lastly, G&A expenses increased 65%, driven primarily by higher legal-related costs and employee-related costs.

We added over 4,700 net new hires in Q3, primarily in technical functions. We ended the quarter with over 68,100 full-time employees, up 20% compared to last year.

Third quarter operating income was $10.4 billion, representing a 36% operating margin. Our tax rate was 13%. Net income was $9.2 billion or $3.22 per share.

Capital expenditures including finance leases were $4.5 billion, driven by investments in data centers, servers, network infrastructure and office facilities.

Free cash flow was $9.5 billion and we ended the quarter with $58.1 billion in cash and marketable securities.

We repurchased $14.4 billion of our Class A common stock in the third quarter and had $8.0 billion remaining on our prior authorization as of September 30th. Today we announced a $50 billion increase in our stock repurchase authorization.

Turning now to the outlook.

Starting with our results for the fourth quarter of 2021, we plan to break out Facebook Reality Labs, or FRL, as a separate reporting segment. As we have discussed, we are dedicating significant resources towards our augmented and virtual reality products and services, which are an important part of our work to develop the next generation of online social experiences. The new segment disclosures will provide additional information on the performance of FRL and the investments we are making.

Under this reporting structure, we will provide revenue and operating profit for two segments:

The first segment, Family of Apps, will include Facebook, Instagram, Messenger, WhatsApp and other services.

The second segment, Facebook Reality Labs, will include augmented and virtual reality related hardware, software and content. As Mark noted, we expect our investment in FRL to reduce our overall operating profit in 2021 by approximately $10 billion. We are committed to bringing this long-term vision to life and we expect to increase our investments for the next several years.

Ahead of the fourth quarter earnings call, we will share additional details about the reporting format of our segmented financials.

Turning now to the revenue outlook.

We expect fourth quarter 2021 total revenue to be in the range of $31.5 billion to $34 billion. Our outlook reflects the significant uncertainty we face in the fourth quarter in light of continued headwinds from Apple’s iOS14 changes, and macroeconomic and Covid-related factors. In addition, we expect non-ads revenue to be down year-over-year in the fourth quarter as we lap the strong launch of Quest 2 during last year's holiday shopping season.

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

Turning now to the expense outlook.

We expect 2021 total expenses to be in the range of $70-71 billion, updated from our prior outlook of $70-73 billion. We anticipate our full-year 2022 total expenses will be in the range of $91-97 billion, driven by investments in technical and product talent and infrastructure-related costs.

We expect 2021 capital expenditures to be approximately $19 billion, updated from our prior estimate of $19-21 billion. For 2022, we expect capital expenditures to be in the range of $29-34 billion, driven by our investments in data centers, servers, network infrastructure, and office facilities. A large factor driving the increase in capex spend is an investment in our AI and Machine Learning capabilities, which we expect to benefit our efforts in ranking and recommendations for experiences across our products, including in Feed and video, as well as improving ads performance and relevance.

We expect our Q4 2021 tax rate to be in the high-teens. Absent any changes to U.S. tax law, we would expect our full year tax rate in 2022 to be similar to the full year 2021 rate.

Please note that our outlook for 2022 expenses, capital expenditures and tax rate are preliminary estimates as we have not yet finalized our 2022 budget.

In closing, this was another solid quarter for our business despite facing some headwinds. And we believe the investments we're making in our current services, as well as new products and experiences, will enable us to remain the best place for people to connect and for businesses to advertise – both now and in the years ahead.

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