

Facebook, Inc. (FB)
Third Quarter 2021 Follow Up Call
October 25th, 2021

Operator: Good afternoon. My name is France, and I will be your conference operator today. At this time, I would like to welcome everyone to Facebook's Third Quarter Results Follow up Q&A.

All lines have been placed on mute to prevent any background noise. To ask a question, please press one and then the number four on your telephone keypad. This call will be recorded. Thank you very much. Ms. Deborah Crawford, Facebook Vice President of Investor Relations, you may now begin.

Deborah Crawford: Thank you. Good afternoon, and welcome to the follow up Q&A call. With me on today's call is Dave Wehner, CFO, and Susan Li, V.P. of Finance. Before we get started I'd 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 certain non-GAAP financial measures. The 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 back over to the operator for the first question.

Operator: Thank you. We will now open the lines for a question and answer session. To ask a question, press one then the number four on your touchtone phone. Please pick up your handset before asking your question to ensure clarity.

If you are streaming today's call, please mute your computer speakers. Your first question will be from the line of Michael Nathanson with MoffettNathanson. Please go ahead.

Michael Nathanson: Thanks. Hey, Dave. How are you?

David Wehner: Hey, Michael.

Michael Nathanson: So firstly, thanks for giving us a lot of time to ponder on the IDFA changes. I remember talking to you last summer. Now that it's upon us what have you learned that may have surprised you?

Clearly things are coming a bit more disruptive given the guide, but where have the biggest surprises been? What sectors have maybe been hit the hardest? And any update on the rollout of the Aggregated Event Measurement adoption, client feedback, anything to help us there? I really appreciate it. Thanks.

David Wehner: Sure. Yes. I mean, I think we have, I think, been out in front of saying that we expected this to be disruptive for the industry and it clearly has been. It's been difficult to forecast exactly how advertisers would react to the rollout.

I would say we've seen the impact probably be a little bit more disruptive than we anticipated. I think just the retooling of all of the – all of the targeting and measurement to basically work for aggregated events is just it's difficult especially for smaller advertisers with smaller budgets.

So I think it's certainly been – it's certainly been challenging. Obviously the areas that are hardest impacted are those with offline objectives. So the two I'd probably call out there, online commerce and gaming.

Online commerce as a vertical continues to grow but it contributed less to our growth than in prior quarters, and it has been – I think the ATT headwinds is a big part of it, but there's also a broader macroeconomic overlay where we had a big acceleration in ecommerce growth last year due to COVID.

So it's a little bit hard to unpack where we are, kind of what's – how to kind of pull out what exactly the different drivers of it are, but we do think the ATT headwinds are a big part of it.

Gaming also has been challenges – particularly challenged this quarter, and app objectives took a hit from Apple's changes and from what we've seen from third-party reports, Apple's changes seem to have helped shift share to Apple's own captive app-install advertising business, so it's clearly been beneficial for Apple, so that's -- I think that's something that we've seen.

I don't know if there's anything you wanted to add on some of the Aggregated Event Measurement Adoption or anything on that front, Susan?

Susan Li: Yes, I think echoing what Dave mentioned earlier, we had a range of expected impact from the ITT changes and ultimately what we've seen is in that range but it's really on the higher end of what we had expected, and I think the underreporting of web conversions has really been a bigger issue than we expected, but it's something that we're very focused on helping to mitigate through better modeling techniques.

Michael Nathanson: All right. Can I just ask -- thanks, Susan, on the idea that you guys improved underreporting into the end of the year is -- does the report maybe -- has Apple changed any of their own tools or privacy limits that may be helping on closing the reporting gap?

Susan Li: Has Apple made any changes to their own tools? Sorry, was that the question?

David Wehner: To help with the situation?

Michael Nathanson: Yes, have you seen any..

David Wehner: I think it's more work we're doing on the modeling front to try and improve the attribution of conversion events.

Susan Li: Yes.

David Wehner: So I think it's more work that we're doing to try and bridge that gap rather than helpful work that Apple's doing. So...

Susan Li: Yes, their tools are in the ecosystem, like SKAN, and we're seeing that there are measurement issues and so we're trying to mitigate that.

Michael Nathanson: Thank you, guys.

David Wehner: Thanks, Michael.

Operator: Our next question is from Alan Gould with Loop Capital. Please go ahead.

Alan Gould: Yes, thank you. With respect to Facebook Reality Labs, can you give us some sense of how much that cost you last year? And are there any milestones that we should be looking for as you roll out your investment into this area?

David Wehner: Yes, thanks, Alan. We'll be providing historic detail when we do the segment breakdown for Q4. Obviously that continues to be a growth area, so we've increased the investment over time and that will be reflected in the breakout when we provide it, but I'd say stay tuned for a more granular historical breakdown when we report in Q4. We're just giving a snapshot of the impact in 2021.

In terms of milestones, there's obviously a wide range of products that we've been launching in this space. The Quest products, we launched the Ray-Ban Stories product, there'll be additional product rollouts, both in the sort of hardware arena and in the software and experience arena, so I think that's something to look at.

I would also encourage you to join Facebook Connect on Thursday, Mark and the FRL team are going to be talking about a lot of the different initiatives we have in this area and be sharing some of the experiences that we expect to roll out, so that's probably going to be the best opportunity to see where that vision is heading.

Alan Gould: OK, thank you, Dave.

David Wehner: Yes, thanks, Alan.

Operator: Our next question is from Brian Fitzgerald with Wells Fargo. Please go ahead.

Brian Fitzgerald: Thanks, guys. I wanted to follow up on the -- on the measurement undercounting conversions by 50 percent, I think the blog --- 15, 15 -- I think was the blog post.

David Wehner: Yes.

Brian Fitzgerald: So when you guys talk about, by year end we should be able to cut that in half. So just for clarification that means hey, we're going to be undercounting by 7 percent as we roll into '22. So just clarification on that point.

And then when you talk about applying A.I. and machine learning to trust and safety, as you lean into Reels and video, is it -- is it harder to police that then syntax or images, is there more -- are you more prone to A.I. biases in video -- cleaning up video versus cleaning up some of the traditional media?

David Wehner: Thanks, Brian. On the underreporting, and Susan correct me, but one of the things I would say is it tends to be really client sized does effect this. So when we have a larger advertiser it's easier to model the conversion. So what we'll do is we'll probably be more effective at correcting for the underreporting for larger advertisers and it will take -- it'll take more time to correct it.

So I think it's the underreporting that we get to. It just sort of gets - maybe we get the 7 percent but that's not -- that's not consistent across client. So that's where we're saying this tends to be something that's more disruptive for smaller advertisers because it's harder to model when you've got smaller budgets and smaller cohorts because of the aggregated event approach as opposed to individual attribution.

Brian Fitzgerald: Got it.

Susan Li: Yes, that's right. The 15 percent's an aggregate number, we do expect that number gets reduced by half by end of year and we hope to make more progress in 2022 plugging the other half.

But the distribution is very variable by advertiser size. I think we'll get very close to correct for large advertisers but it will just take much longer for smaller advertisers.

David Wehner: Yes. And on number two, I mean video's already a big part of the experience so we - we obviously use A.I. and machine learning to look at content today but it's -- it is something that is a ongoing effort area of investment to be able to understand what content is out there and how it -- how it applies to our community standards. But we apply our community standards to video content as well as text based content.

Brian Fitzgerald: Awesome. Thank you.

David Wehner: And by the way, for stuff like -- certainly for like -- it gets less play but certainly for things like kind of more content that violates things like nudity and that front, we're able to use A.I. and machine learning to catch that whether it's video or not.

So that's a pretty clear example of where we're using A.I. to make sure that the content doesn't violate even if it's video.

Brian Fitzgerald: Got it. Thanks.

David Wehner: Yes, thanks, Brian.

Operator: Our next -- our next question is from Stephen Ju with Credit Suisse. Please go ahead.

Stephen Ju: OK. Thank you. So hi, Dave. So ...

David Wehner: Hey there.

Stephen Ju: Presumably you're undercounting the events so the advertiser is still getting the benefits. So kind of similar to what SNAP said the other day. I think the value that you're providing to the advertisers is probably pretty much the same.

So I was wondering if you can characterize -- I guess for -- I guess the very long tail advertisers are -- is there a certain percentage in the overall revenue in which Facebook is acting as principal as well as the agent in terms of spending on behalf of your clients because they have a certain fixed budget and there's a certain ROI goal that they're trying to achieve. And in your view you are still delivering on that.

Susan Li: So ...

Stephen Ju: I guess in a follow -- yes, go ahead. Yes.

Susan Li: Sorry. Go ahead.

Stephen Ju: And yes, I was just wondering if you can talk about how many business profiles and how many advertisers you might have ended the third quarter with since it's been a little while since you guys have updated us with those metrics? Thanks.

Susan Li: So on the first question we're seeing -- we're definitely seeing that the data limitations from ATT are resulting in performance drops in addition to measurement drops, so I think those are two sort of separate things.

Now the measurement drops are something that we can mitigate, and that's something that we're actively working on in the short-term, and then the performance drops are something that we are working on sort of longer-term mitigations either for in terms of figuring out how to do better modeling with more limited data or in the longer-term things like our own sort of first-party Shops and things like that.

The other thing related to the measurement piece is because you're unable to measure as effectively you're also unable to target as effectively. The explicit targeting parameters are still available, but a lot of the targeting now is done

around the – is predicting which users will be most likely to engage with this ad per the objective that the advertiser is looking for.

And so, to the extent that we can't measure that correctly we aren't able to target those users – to target those users as effectively either.

David Wehner: Yes, so those two things definitely do intersect. And then, Stephen, on your second question I don't think we've updated the 200 million businesses using our free tools and 10 million advertisers, so that's – I think those are still the latest numbers that are out there, but we haven't provided an update lately on that.

Stephen Ju: Got you. All right, thank you.

David Wehner: All right. Thanks, France. You can go to the next one.

Operator: Thank you our next question is from Richard Greenfield with LightShed Partners. Please go ahead.

Richard Greenfield: Hey, thanks for taking the question. Yes, I just want to literally follow up on that last comment you just made, Dave, about the targeting. How much of that is structural? Meaning obviously the measurement, you're figuring out solutions. You're going to figure it out.

It's not the ads that aren't working. It's literally measuring them, but on the targeting side how much of that is structural versus are there solutions? I'm saying you have them today, but are there solutions to get around that overtime to solve not just the measurement but also the targeting side?

And then, two, you called out a few issues that are going to be – or you and Sheryl called out a few issues that are impacting Q4 and beyond. Was wondering as you think about sort of the high and the low end of your Q4 range, are any of those more important or that we should think of as heavily weighted within those three major items?

And then just a housekeeping point on iOS 15, is there any more issues to worry about in terms of IDFA and ATT that come up with iOS 15 that we aren't even talking about yet?

Susan Li: So on the first question, I think in terms of whether there are structural solutions. So there are solutions that are oriented around moving the conversions to being first party as much as possible.

So if those can be conversions that occur on our platform like the messaging ads, leads ads, shop ads, et cetera, that's a – that's a more structural solve and we can improve targeting over time.

The third party piece, that is a place where we are working very hard to improve our modeling to performance targeting over time even with less third party data, but I think there's more uncertainty in terms of how that plays out.

David Wehner: And in terms of the high end and low end of the range, I think we're certainly going to be watching how advertisers react to the challenges with the Apple platform and how that intersects with pricing as we get into the stronger demand season for Q4, because it's going to affect pricing and ROI, and when you have higher prices we'll just have to see what is the advertiser reaction in that environment, as it relates to the targeting on the iOS platform.

As the -- the other factor's going to be what do the supply chains look like as we get into the thick of the holiday season, are those getting mitigated over time, are -- do people have inventory?

If you look at kind of the overall kind of data that we see out there, retailers' inventory to sales ratio is -- was quite low I think in the most recently reported census data in the U.S., so there's clearly an inventory challenge going into Q4, and we'll just have to see how that plays out.

I think that could be a factor that would push us towards the low end of the range if there's ongoing supply shortages for clients and they pull back on advertising as a -- as a result of that.

iOS 15 does have additional privacy features, things like -- I think auto-generated emails and other items that can affect targeting.

We don't think in aggregate those are as significant a headwind as the iOS 14 ATT changes, which were fundamentally profound, but there are sort of ongoing headwinds and we would expect kind of ongoing challenges from platform changes over time, so when we think about the outlook, we expect that there's going to be additional platform changes and also regulatory changes as well that could affect targeting and measurement going forward.

So yes, I think this is just an ongoing reality of being in the business that we're in, and kind of working through those challenges both from a platform and regulatory perspective.

Richard Greenfield: Thanks for the very comprehensive answer. Appreciate it.

David Wehner: All right, great, thanks, Rich, and France, you can go to the next question.

Operator: Our next question is from Jason Helfstein with Oppenheimer. Please go ahead.

Jason Helfstein: Hey thanks, everybody. So I guess we're all kind of trying to distill your comments into more -- so it sounds like you're not seeing the supply chain headwinds but it is a concern, and the worst of the iOS should have happened in the third quarter, however it's -- basically you're saying that there's a different mix of advertisers in

the fourth quarter so we don't know how those advertisers will react to the iOS changes relative to the mix in the third quarter?

Is that -- is that the best way to kind of summarize the way you're thinking about the guidance with knowing that the supply chain is a risk we just can't quantify it yet?

Susan Li: No, I don't think we -- I think we do think we're seeing supply chain impact and we have already in Q3, but it's very difficult for us to quantify and the supply chains are closely interlinked with sort of other macroeconomic effects that we're seeing right now.

I do think the sort of worst of the iOS headwinds manifested in Q3; we expect those headwinds to be ongoing in Q4, which is reflected in our guidance, and in terms of the Q4 impact, seasonally Q4 is a really strong marketing season, so prices typically go up as part of those marketing campaigns, that has been true historically, and this Q4 will be the first time we see this particular interaction of the sort of impacts on targeting measurement and performance from ATT, the sort of Q4 stronger demand season and whatever other macroeconomic affects are at play here, including the renormalization of ecommerce growth including increasing supply chain headwinds. So I think that's all been baked into the Q4 outlook.

Jason Helfstein: And just a quick follow-up, is there any way to talk about the impact kind of brand versus DR in the third quarter, was one particularly stronger or weaker than the other?

David Wehner: Yes, I mean I think -- the clear impact from the ATT changes was to the direct response business but obviously that's -- the vast majority of our revenue is response based. So we're seeing it especially in those off -- those third party conversion categories, things like online commerce and gaming.

We've got direct response channels that Susan alluded to in areas like click-to-messaging, lead generation, which are not as impacted by those changes because those are conversions that are basically happening on platform.

But brand was less affected by these changes and -- but given that DR has been such an important part of our business and our growth, it's obviously impacting the overall outlook.

Jason Helfstein: Got it. Thank you.

David Wehner: Yes, thanks, Jason. France, you can go to the next question.

Operator: Our next question is from Ygal Arounian with Wedbush. Please go ahead.

Ygal Arounian: Hey, good evening guys. Been talking a lot about the ad effectiveness and measurement. I was wondering if you could maybe look at the impacts from cost simply from the advertiser view and thinking about cost for action and what kind of cost per action inflation they've seen, how advertisers are reacting to that.

Are people pulling budgets off the platform as far as you can tell? Are they holding off in investments, are some potentially spending more to -- so that -- so that they don't lose sales?

Anyway we could kind of think of it from their -- from their perspective and point of view and then in terms of the impact of the ad effectiveness, is there any way to qualify or quantify rather exactly how much it's being impacted, like how less effective it is? Thanks.

David Wehner: Yes. I mean in terms of how advertisers are reacting to increased price, I mean I think the simple answer is we're -- I think how they're reacting to the challenges is we're seeing that impact ad budgets and ad budget growth. So that's part of the reason we were calling it as a headwind for Q3 and into Q4.

So I think it's about budget growth for the advertisers as they face these challenges and that's what's leading to -- leading to the commentary on headwinds and the outlook range.

In terms of quantifying how much it's being impacted, we've talked about some elements of quantifying, like the underreporting issue specifically, but I don't know if we had -- I don't think we've provided much beyond that, Ygal.

Ygal Arounian: All right. Thanks. If I could maybe just one follow-up on that on the measurement side and sort of a lot of investment from you guys over the coming quarters to try to narrow that gap.

And how important are you hearing from advertisers the necessity for third party measurement to kind of come in and work with what you guys are doing to help kind of close the loop or fill in the rest of the gap?

David Wehner: Yes. I mean, I think there what we're trying to do is -- as best possible for that lost individual conversion data -- model, what it -- since we lose the direct signal, can we model what the signal is from the advertising that you're doing so we've got a proxy measure of how effective the advertising is so that advertisers can be allocating budgets appropriately?

So that's -- one thing we're doing. Where we're using aggregated data, can we model more effectively? How effective the advertising is, and does that help advertisers understand where to allocate budgets? And we think we would -- we would benefit from that.

And then secondly, as Susan mentioned, we're trying to move more signal onsite whether that be through some of our products like click to messaging ads, lead gen ads, also Shop ads where things like ecommerce conversions are being done onsite, so that's the sort of work we're doing on both of those fronts.

Ygal Arounian: Great. Thank you so much.

David Wehner: All right, thanks. We can go to the next question, France.

Operator: Before we do, as a reminder if you would like to register for a question, you may press the one followed by the four. And our next question is from Aaron Kessler with Raymond James. Please go ahead.

Aaron Kessler: Great. Thanks, guys. Maybe just a couple of questions on the Facebook Reality Labs for the \$10 billion kind of operating losses that were seen there this year. Can you just help us maybe qualitatively give us a little more color around where those losses are? Is it primarily R&D or other areas?

And then second, just the MAU growth may have missed. I think it slowed pretty significantly for APAC and Rest of World in the quarter. Just anything you would call out there? Thank you.

Susan Li: Yes. On the FRL side the sort of -- that investment spans, a lot of products. It's a very broad product portfolio, but the sort of biggest driver of cost, as is true for our sort of -- the company as a whole, is headcount related costs followed by basically a lot of R&D, R&D OpEx, and then the cost of actually manufacturing all of the devices.

David Wehner: Yes, and thanks for the question, Aaron. So on overall MAU growth, I think it's -- for Facebook it's a -- it's a mixed story across the globe. We've seen continued DAU and MAU growth, but that growth has slowed as we've reached saturation of Internet users in some markets like we have, for instance, globally we've seen that in markets like Brazil similar to what we have seen previously in the U.S. and Canada.

So I think that's certainly an impact that we're seeing in some of those bigger global markets. Globally Facebook engagement remains sort of well above 2019 levels largely due to an increase in video engagement, but in 2021 we've seen some softening versus 2020 due to a decline from COVID engagement spikes as well as just the overall competitive environment, specifically in video from companies like TikTok as Mark talked about.

Aaron Kessler: Got it. And do you plan to shift over to the Facebook family metrics as we go into '22 or is there any timeline on that?

David Wehner: We don't have any timeline that we're updating on that. I mean, we do think that the family metrics are the best measure of our overall size and the overall kind of full picture of the business as well as our impression growth metrics and price growth metrics which reflect the broader family.

Aaron Kessler: Got it. Thank you.

David Wehner: Yes.

Operator: Our next question is from Justin Patterson with KeyBanc. Please go ahead with your question.

Justin Patterson: Great. Thank you, and good afternoon. First with ...

David Wehner: Hey, Justin.

Justin Patterson: ... the step up in CapEx, how much -- how should we think about the mix of just investment going to areas with faster versus longer depreciable lives? And then second, curious if you could share any updates around how you're thinking about WhatsApp monetization? Thank you.

David Wehner: Yes. In terms of CapEx we're continuing to invest heavily on the data center front, but we're also going to be doing a fair amount of server and server purchases next year. The latter will have, obviously, shorter depreciable lives than the data center front, so we'll, obviously, update that mix and that outlook over time.

I would say that the expense profile that we outlined, the \$91 billion to \$97 billion takes into account the depreciation expenses related to infrastructure as one of the cost drivers going into 2022 as well.

On the WhatsApp monetization front, the area that we're continuing to see good performance in is click-to-messaging ads. That's more developed for click-to-Messenger, but click-to-WhatsApp is also -- continues to be a grower for us from a monetization perspective. And we're continuing to invest in our business messaging ecosystem to make that more effective for advertisers.

And we've announced and we have not closed the Kustomer acquisition, but we're still optimistic we can get that in place and we think that will be helpful to the overall business messaging ecosystem over time.

Deborah Crawford: Operator, we're going to ...

Justin Patterson: Thank you.

Deborah Crawford: ... take one last question.

David Wehner: Thanks, Justin.

Operator: Very good. Our last question then will be from Tom Champion with Piper Sandler. Please go ahead.

Tom Champion: Thank you. Good afternoon. Dave and Susan, just curious, are you using the SKAN network? Curious if it has any efficacy? And then related to what you saw with iOS during the third quarter, was there incrementally worse performance as the quarter progressed perhaps as a result of new software releases subsequent to iOS 14.5, or was this primarily one time in nature as an impact emerging in June and July?

And maybe just the last one if you could comment on it. I think Sheryl talked about improvements to targeting and she mentioned an industry consortium approach. Just curious if you could elaborate on this if I heard it correctly and kind of what form that would take? Thank you.

Susan Li: Yes. We are using SKAN, and it's the -- I think a number of the -- we've had some measurement issues related to SKAN. Also, there's some limitations also on the conversions that you can receive. So, for example, SKAN let's you receive conversions for app install campaigns but not for reengagement campaigns.

So there's just some -- there are issues like that that make it less effective, obviously, than kind of the previous world with IDFA, but we are making additional launches in the future to try and help work through some of these gaps.

David Wehner: And, Tom, as well, that -- that's sort of been specifically challenging games vertical, which is the -- was a challenged one from a growth perspective in Q3.

I'd say, there's also that and the macro picture on games, which is we do think there was really strong games demand in during COVID lockdowns when a lot of people were engaged on games. So there's also kind of an overlay of the macro effect there. So that's something to think about.

I didn't have anything further to elaborate on the consortium approach so I don't know if I have a whole lot to add to what Sheryl said there, Tom.

Tom Champion: OK. Thank you.

Deborah Crawford: Great.

David Wehner: Yes. Thanks, Tom.

Deborah Crawford: Thank you for joining us today. We appreciate your time and we look forward to speaking with you again.

David Wehner: Great. Thanks, everybody.

Operator: And this concludes the conference call. Thank you for joining us. You may now disconnect your lines.