Meta Platforms, Inc. (FB)
Second Quarter 2022 Results – Prepared Remarks
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Deborah Crawford, VP, Investor Relations

Thank you. Good afternoon and welcome to Meta Platforms' second quarter 2022 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, thanks for joining today.

Our family of apps continues to grow, even as we navigate a challenging macro environment. We now reach more than 3.6 billion people monthly across our services. The number of people using Facebook daily continues to grow, including in the US, although we saw an expected decline in monthly actives due to internet blocks related to the war in Ukraine. Engagement trends on Facebook have generally been stronger than we anticipated, and strong Reels growth is continuing to drive engagement across Facebook and Instagram.

That said, we seem to have entered an economic downturn that will have a broad impact on the digital advertising business. It's always hard to predict how deep or how long these cycles will be, but I'd say that the situation seems worse than it did a quarter ago.

In this environment, we're focused on making the long term investments that will position us to be stronger coming out of this downturn -- including our work on our discovery engine and Reels, our new ads infrastructure, and the metaverse. We're also focused on being rigorous about measuring returns and sizing these investments correctly.

Now on our last call, I discussed that based on the revenue growth we were seeing in 2021, we kicked off a number of multi-year projects to accelerate our business. I still believe these projects are important, but given the more recent revenue trajectory we're seeing, we're slowing the pace of these investments and pushing some expenses that would have come in the next year or two off to a somewhat longer timeline.

Given the continued trends, this is even more of a focus now than it was last quarter. Our plan is to steadily reduce headcount growth over the next year. Many teams are going to shrink so we can shift energy to other areas, and I wanted to give our leaders the ability to decide within their teams where to double down, where to backfill attrition, and where to restructure teams while minimizing thrash to the long term initiatives. The fact that we hired a lot of people earlier this year means that our reported year-over-year headcount growth will still be substantial for the next few quarters, but it should continue to decline over time.

This is a period that demands more intensity, and I expect us to get more done with fewer resources. We're currently going through the process of increasing the goals for many of our efforts. Previously challenging periods have been transformational for our company and helped us develop our next generation of leaders. I expect this period to be no different. I expect we'll find a way to keep investing in our top priority areas, and I think we're going to come through this period as a stronger and more disciplined organization.

Next, I want to discuss how we're doing in our high priority areas.

To understand where we're going, it's important to keep in mind that there are two major technological waves that we're riding in our business. The first wave driving our business today is AI. The second longer term wave is the emergence of the metaverse.

One of the main transformations in our business right now is that social feeds are going from being driven primarily by the people and accounts you follow to increasingly also being driven by AI recommending content that you'll find interesting from across Facebook or Instagram, even if you don't follow those creators. Social content from people you know is going to remain an important part of the experience and some of our most differentiated content, but increasingly we'll also be able to supplement that with other interesting content from across our networks. Reels is one part of this trend that focuses on the growth of short-form video as a content format, but this overall AI trend is much broader and covers all types of content, including text, images, links, group content, and more. Building a recommendation system across all these types of content is something we're uniquely focused on.

Right now, about 15% of content in a person’s Facebook feed and a little more than that of their Instagram feed is recommended by our AI from people, groups, or accounts that you don’t follow. We expect these numbers to more than double by the end of next year. As our AI finds additional content that people find interesting, that increases engagement and the quality of our feeds. Since we’re already efficient at monetizing most of these formats, this should increase our business opportunity over that period as well.

Reels engagement is also growing quickly. I shared last quarter that Reels already made up 20% of the time that people spend on Instagram. This quarter we saw a more than 30% increase[1] in the time that people spent engaging with Reels across Facebook and Instagram. AI advances are driving a lot of these improvements, and one example is that after launching a new large AI model for recommendations, we

[1] Sequential increase from Q1’22 to Q2’22 based on the last month’s average in each quarter.

saw a 15% increase in watch time in the Reels video player on Facebook alone. So I think that there are many improvements like this that we'll continue to make.

As we're building our discovery engine though, I want to be clear that we're still ultimately a social company focused on helping people connect. One social trend that we're seeing is that instead of people just interacting in comments in their feeds, most people find interesting content in their feeds and then they message that content to friends and interact there. This creates this flywheel of discovery, and then social connection, and inspiring those people to create more content themselves. In Instagram, for example, we see that Reels makes up more than half of content reshared in messages. So our strategy isn't about public vs social content and interaction -- it's really about enabling a flywheel that compounds both.

Alright, next, onto ads. We face a number of challenges here in the near term, but the investments we're making should give us a comparative advantage over the longer term.

One near term challenge is the growth of short-form video. Reels doesn't yet monetize at the same rate as feed or stories, so in the near term, the faster that Reels grows, the more revenue that actually displaces from higher-monetizing surfaces. Now in theory, we could mitigate this short term headwind by pushing less hard on growing Reels, but that would be worse for our products and business longer term since we're confident that Reels will grow engagement overall and quality will eventually monetize closer to feed. Our work on ads monetization efficiency for Reels is actually making faster progress than we'd expected. We've now crossed $1B annual revenue run rate for Reels ads, and Reels also has a higher revenue run rate than Stories did at identical times post launch. So the bottom line is I think we're on track here, and we just need to push through this one.

The second challenge is the signal loss from Apple's iOS changes. As I've discussed before, our approach here is to grow first-party understanding of people's interests by making it easier for people to engage with businesses in our own apps -- whether that's through business messaging, shops, or new ads products. For example, Click-to-Messaging is part of our business messaging strategy that is growing quickly -- with 40% of our advertisers already using this format.

The AI wave that we're riding is a tailwind for all of these solutions. Advances in AI enable us to deliver better personalized ads while using less data. It powers automated messaging and creation tools that let businesses run better performing campaigns -- which is particularly important for small businesses that don't have big marketing departments and that have been hit hard by Apple's policy changes. Overall, there's a lot of work to do here -- and a lot of the investment is in AI compute capex -- but I'm confident that if we invest in building the new infrastructure we need, then we’re going to come out of this downturn with even more superior ad products and a meaningful technology advantage over other industry players.

Of course the third challenge we're facing here is the macroeconomy. We can't control the timing of when things will bounce back, but I'll note that periods like this are when marketers re-evaluate their budgets and are even more focused on finding the highest performing advertising. In the last recession, we invested in our ads business through the downturn and came out stronger on the other side. And I'm focused on making sure we do the same today.

If AI is the major technological wave we're riding today, then the last priority I want to discuss is about the metaverse technological wave that we’re currently building.

The metaverse is a massive opportunity for a number of reasons. Most importantly, it enables deeper social experiences where you feel a realistic sense of presence with other people, no matter where they are – whether you're playing games or working for hours at a time, or you're just jumping in for just a minute at a time to say hi to a friend or collaborate on a project quickly. By helping develop these platforms, we're going to have the freedom to build these experiences the way we and the overall industry believe will be best rather than being limited by the constraints that competitors place on us, and our community, and on small businesses. Given some of the product and business constraints we face now, I feel even more strongly now that developing these platforms will unlock hundreds of billions of dollars, if not trillions, over time. This is obviously a very expensive undertaking over the next several years, but as the metaverse becomes more important in every part of how we live – from our social platforms and entertainment, to work and education and commerce – I'm confident that we're going to be glad that we played an important role in building this.

The next milestones to look out for are the continued expansion of Horizon, our social metaverse platform, and the continued improvement of our avatars platform. How you express yourself and interact in the metaverse, as well as the commerce around that, these are the areas that we're most focused on. We'll be launching a web version of Horizon that will be accessible on all platforms later this year, which should dramatically increase the number of people who can use Horizon. We also just launched our avatar store with digital clothes from leading fashion houses, and we're going to continue expanding that selection and the fidelity of our avatar system overall.

On the hardware front, later this year we'll release Project Cambria – and the experience here is getting pretty awesome. It'll be a high-end device focused on professional users and work, with high resolution color mixed reality. I'm really looking forward to getting this one out. This is just one milestone on the long term path, but I think people are going to be pretty blown away by this.

Okay -- so those are the areas I'm most focused on right now, and that I think are going to have the greatest impact on our products and business over the next few years and much longer. Periods like this can be tough, but I really think that the additional focus and discipline are going to make us stronger over time.

In addition to our business, this is also a period of transition for our leadership team. Before I hand it over to Sheryl for what will be her last earnings call, I want to thank her for everything that she has done for Meta, for our community, and for so many small businesses around the world. It's really hard to overstate how big of an impact that Sheryl has had on so many different parts of what we do, and on me personally.

At the same time, Javi and Marne are talented leaders who I've worked with closely for many years. They're the type of people whom I've kept giving more and more responsibility to and they just keep crushing it, so the expanded roles are well deserved. I think they're going to do a great job carrying our business forward and expanding it in some exciting new ways.

We also shared the news this afternoon that Dave Wehner will be transitioning into a new role as our Chief Strategy Officer, overseeing our strategy and corporate development teams. Dave has done great work as our CFO, and I'm really looking forward to continuing to work with him in this new role.

As part of this, we’re also promoting Susan Li to be Meta's new Chief Financial Officer starting later this year. Susan is an incredibly talented executive and I think she'll be an excellent CFO. She already runs our financial planning process and plays an important role on our leadership team -- and this transition is something we've been working on for years.

And with that, I'm going to hand it over to Sheryl.

Sheryl Sandberg, COO

Thank you Mark – for those kind words and for being a great leader and friend for the last 14 years. It has been an enormous privilege to work with you to help build this remarkable company.

I’d like to focus on Q2 before making some wider observations about the business. Our total revenue in Q2 was $28.8B, a decrease of 1% year-over-year. Foreign exchange trends had a significant impact in Q2, in particular the depreciation of the Euro relative to the Dollar. On a constant currency basis, we would have seen 3% revenue growth year-over-year. Similar to last quarter, we saw solid growth in APAC and other parts of the world outside of North America and Europe, where it's been a more challenging environment.

These continue to be turbulent times for the global economy. Many of the macro factors having an impact on our revenue are continuations of things we’ve seen in previous quarters, such as the continued impact of the war in Ukraine and the normalization of e-commerce after the pandemic peak. But there are also new challenges with rising inflation and uncertainty around a looming recession.

We know that recessions put pressure on marketers to make sure their ad budgets are spent in the smartest way possible. We’re focused on helping them run efficient marketing campaigns that get the best possible return on investment, including helping them shift their ad strategies on our platform in line with user trends and our own evolving ads solutions.

I want to pick up on some of the themes Mark just touched on that show how we’re doing this: Reels monetization; evolving our ads system; and AI and Machine Learning.

First, Reels monetization. We launched ads in Reels last year. It’s growing quickly, and we see it as an area where there is significant potential for growth in the future. It’s going to take time, but we have a playbook from our experience with Stories. Our focus right now with Reels is ramping up ad load, improving performance, and making sure the ads are easy for advertisers to create. We’re also using AI to better understand the content being published in Reels, so users can connect to the content that is most relevant to them, and marketers can also show more relevant ads.

A good example of a brand seeing results with Reels Ads is Wild Alaskan Company, a sustainable seafood delivery business that is consistently adopting and testing our latest ad tools. When they tested adding Reels to their campaign they saw a 36% increase in Return on Ad Spend, a similar uplift in new subscribers, and a 26% lower cost per new subscriber.

Second, adapting our ads system to do more with less data. In the short and medium-term, we’re working to improve and evolve our ads solutions. We’re helping advertisers improve the performance of their ads by growing onsite data conversions with products like Lead ads, which make it easier for businesses to generate leads, and with business messaging products like Click-to-Message ads, where you click on an ad in your Facebook or Instagram feed and it opens a chat with the business in Messenger, Instagram or WhatsApp.

Business messaging is an area where we see big potential. We estimate that one billion users are messaging with a business each week across WhatsApp, Messenger and Instagram. Click-to-Message is already a multi-billion dollar business for us, and we continue to see strong double-digit year-over-year growth. These ads are proving particularly popular with SMBs in emerging markets like Brazil and Mexico, many of whom are new advertisers to Meta who come to us to advertise solely in this format. We're making it easier to create these ads directly from the WhatsApp Business app, which will help small businesses looking to find customers and grow. And big brands are incorporating business messaging into their campaigns, like Paramount Studios, who used Click-to-Messenger to promote their blockbuster movie Top Gun: Maverick and drive ticket sales. As more brands turn to messaging, paid messaging provides new ways to sell, support and market right on the chat thread.

We're also investing in privacy-safe ways to improve targeting and measurement. For example, we're continuing to invest in improving our Conversions API, which creates a direct, reliable, and privacy-safe connection between advertisers' marketing data and Meta. And over the longer term, we're developing privacy enhancing technologies to help minimize the personal information we process while still allowing us to show relevant ads and measure performance. One example is Private Lift, which we're currently beta testing with a number of large advertisers. This is a measurement solution which helps advertisers understand how their campaigns are performing, while adding extra layers of privacy to limit the information that can be learned by the advertiser or Meta.

While we develop these solutions, we're also collaborating across our industry on technologies and other standards that will support privacy-safe personalized advertising over the long-term.

Third, on AI and Machine Learning, I want to emphasize Mark's point that this is a really important part of how we improve our ads ranking and measurement capabilities. AI-driven products like Advantage Detailed Targeting and Advantage Lookalikes help to increase the audience for an ad campaign if it's likely to improve performance.

AI is also an important part of how we continue to grow video monetization. A moment ago, I touched on how we're using it in Reels. We've also launched AI-based tools to make it simpler to create video ads for Instagram Stories. And we're continuing to test ways for advertisers to transform static images with music and motion so they appear more like video.

Turning to the business more broadly, there's no doubt that we're going through a transition period, and doing so at a time of global economic uncertainty. But despite the current challenges, I'm very confident for the long term. We're facing a cyclical downturn, but over the long run the digital ad market will continue to grow. Advertisers will go where they get the highest return on investment and ability to drive their business. We believe we will continue to show up very favorably compared to other advertising options.

Meta is a company that has shown extraordinary resilience. We have demonstrated time and time again that we are prepared to move quickly and at scale to respond to changes in consumer behavior, the macroeconomic landscape, and the needs of our advertising partners. And we have demonstrated time and time again that when we build products they scale globally. We have made big transitions – like the shift from desktop to mobile, or from Feed to Stories. We innovate relentlessly and are always laser focused on execution, delivering tools and products that help advertisers drive business results. The investments we're making in Reels, our discovery engine, business messaging, retooling our ads system, and especially in helping to build the metaverse, represent enormous opportunities for our business and our partners.

I want to thank the teams that have helped us achieve remarkable success for our business and the millions of other businesses who have grown using our tools and products. I want to thank our partners – large and small – who we learn from every day. And I want to thank our investor community – your support has helped us to be the innovative and resilient business that we are.

I look forward to continuing to serve on Meta's board, where I'll have a front row seat to Meta's success in the years ahead.

And now, here's my amazing colleague Dave.

Dave Wehner, CFO

Thanks Sheryl and good afternoon everyone.

Let's begin with our consolidated results. All comparisons are on a year-over-year basis unless otherwise noted.

Q2 total revenue was $28.8 billion, down 1% or up 3% on a constant currency basis. Had foreign exchange rates remained constant with Q2 of last year, total revenue would have been approximately $1.3 billion higher.

Q2 total expenses were $20.5 billion, up 22% compared to last year. In terms of the specific line items:

Cost of revenue decreased 4%, as growth in core infrastructure investments and content-related costs were more than offset by a reduction in Reality Labs loss reserves as a result of the announced price increase of Quest 2.

R&D increased 43%, mainly driven by hiring to support Family of Apps and Reality Labs.

Marketing & Sales increased 10%, mainly driven by hiring and marketing spend.

Lastly, G&A increased 53%, mainly driven by legal-related and employee-related costs.

We added over 5,700 net new hires in Q2, the majority in technical functions. We ended the quarter with over 83,500 full-time employees, up 32% compared to last year. Our second quarter growth rate reflects our hiring progress earlier this year, however we anticipate headcount growth will slow throughout the rest of the year due to the reduction in our hiring plans.

Second quarter operating income was $8.4 billion, representing a 29% operating margin.

Our tax rate was 18%. We recorded a loss of $172 million under interest and other expenses, driven mainly by unrealized losses on equity investments. Net income was $6.7 billion or $2.46 per share.

Capital expenditures, including principal payments on finance leases, were $7.7 billion, driven by investments in servers, data centers and network infrastructure. The big step up in capex both year-over-year and sequentially related to server spend, including for our AI infrastructure.

Sustainability remains a key focus of our infrastructure efforts, and in June we published our third annual sustainability report. The report demonstrates continued progress on our sustainability initiatives.

Free cash flow was $4.5 billion. We repurchased $5.1 billion of our Class A common stock in the second quarter and we ended the quarter with $40.5 billion in cash and marketable securities.

Moving now to our segment results.

I'll begin with the Family of Apps segment.

Q2 Total Family of Apps revenue was $28.4 billion, down 1%.

Q2 Family of Apps ad revenue was $28.2 billion, down 1% or up 3% on a constant currency basis.

Advertising revenue growth slowed throughout the second quarter as advertiser demand softened. The deceleration has been broad-based across verticals, and we believe businesses are lowering their advertising spend in response to the increased economic uncertainty. Foreign currency headwinds also increased throughout the second quarter. While it wasn't a factor contributing to the deceleration in Q2, we're also continuing to face targeting and measurement headwinds such as Apple's iOS changes, which we believe are contributing to the growth challenges across the digital advertising industry.

On a user geography basis, year-over-year ad revenue growth was strongest in Asia-Pacific and Rest of World at 13% and 11%, respectively, with both regions benefiting meaningfully from strong growth in click-to-messaging ads. North America and Europe declined 4% and 12%, respectively. Foreign currency was a headwind in all international regions, with Europe and Asia-Pacific experiencing the largest impacts.

In Q2, the total number of ad impressions served across our services increased 15% and the average price per ad decreased 14%.

Impression growth was driven by Asia-Pacific and Rest of World. The year-over-year decline in pricing was driven by a reduction in advertiser demand, the mix shift in ad impressions towards lower-monetizing surfaces and regions, and foreign currency depreciation.

Family of Apps other revenue was $218 million, up 14%, driven by the WhatsApp Business API.

Family of Apps expenses were $17.2 billion, up 23% driven mainly by employee-related expenses, legal costs and infrastructure costs.

Family of Apps operating income was $11.2 billion, representing a 39% operating margin.

We estimate that approximately 2.9 billion people used at least one of our Family of Apps on a daily basis in June, and that approximately 3.6 billion people used at least one on a monthly basis.

Facebook daily active users were 1.97 billion, up 3% or 60 million compared to last year. DAUs represented approximately 67% of the 2.93 billion monthly active users in June. MAUs grew by 39 million or 1% compared to last year. Europe DAUs and MAUs declined sequentially and were negatively impacted by the loss of users in Russia and Ukraine.

Within our Reality Labs segment, Q2 revenue was $452 million, up 48%, driven primarily by Quest 2 sales.

Reality Labs expenses were $3.3 billion, up 19% due to growth in employee-related costs and R&D operating expenses that were partially offset by the previously mentioned reduction in loss reserves.

Reality Labs operating loss was $2.8 billion in the second quarter.

Turning now to the outlook.

We expect third quarter 2022 total revenue to be in the range of $26-28.5 billion. This outlook reflects a continuation of the weak advertising demand environment we experienced throughout the second quarter, which we believe is being driven by broader macroeconomic uncertainty. We also anticipate third quarter Reality Labs revenue to be lower than second quarter revenue. Our guidance assumes foreign currency will be an approximately 6% headwind to year-over-year total revenue growth in the third quarter, based on current exchange rates.

In addition, as noted on previous calls, we 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 2022 total expenses to be in the range of $85-88 billion, lowered from our prior outlook of $87-92 billion. We have reduced our hiring and overall expense growth plans this year to account for the more challenging operating environment while continuing to direct resources toward our company priorities.

We expect 2022 capital expenditures, including principal payments on finance leases, to be in the range of $30-34 billion, narrowed from our prior range of $29-34 billion.

Absent any changes to U.S. tax law, we expect our full-year 2022 tax rate to be above the Q2 rate and in the high teens.

In closing, we are in the midst of an economic cycle that is having a broad impact on the digital advertising business. We are being disciplined on spending while still investing in those areas that will position to drive growth as the economic environment improves.

Before opening up the call for questions I wanted to say how pleased I am that Susan Li will serve as our next CFO when I step into my new role in November. Susan and I have worked side by side for the last 10 years, and she is an outstanding leader for the team.

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