

Q3 2020 Earnings Call

Company Participants

- David Wehner, Chief Financial Officer
- Deborah Crawford, Vice President, Investor Relations
- Mark Zuckerberg, Founder, Chairman and Chief Executive Officer
- Sheryl Sandberg, Chief Operating Officer

Other Participants

- Brent Thill, Analyst, Jefferies
- Brian Nowak, Analyst, Morgan Stanley
- Doug Anmuth, Analyst, JP Morgan
- Eric Sheridan, Analyst, UBS
- Heather Bellini, Analyst, Goldman Sachs
- Justin Post, Analyst, Bank of America Merrill Lynch
- Mark Mahaney, Analyst, RBC Capital Markets
- Michael Nathanson, Analyst, MoffettNathanson
- Youssef Squali, Analyst, SunTrust Robinson Humphrey

Presentation

Operator

Good afternoon. My name is Mike and I will be your conference operator today. At this time, I would like to welcome everyone to the Facebook's Third Quarter 2020 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. (Operator Instructions) This call will be recorded. Thank you very much.

Ms. Deborah Crawford Facebook's Vice President of Investor Relations, you may begin.

Deborah Crawford {BIO 5934723 <GO>}

Thank you. Good afternoon and welcome to Facebook's Third Quarter 2020 Earnings Conference Call. Joining me today to discuss our results are Mark Zuckerberg, CEO; Sheryl Sandberg, COO and Dave Wehner, CFO. Before we get started, I would like to take this opportunity to remind you that our remarks today will include forward-looking statements. Actual results may differ materially from those contemplated by these forward-looking statements.

Factors that could cause these results to differ materially are set forth in today's press release and in our quarterly report on Form 10-Q filed with the SEC. Any forward-looking statements that we make on this call are based on assumptions as of today and we undertake no obligation to update these statements as a result of new information or future events. During this call, we may present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release.

The press release and an accompanying investor presentation are available on our website at investor.fb.com and now I'd like to turn the call over to Mark.

Mark Zuckerberg {BIO 15103277 <GO>}

All right, thanks everyone for joining us today. I hope you're all staying safe and doing well. We had another strong quarter as people and businesses continue to rely on our services to stay connected and create economic opportunity especially during these tough times. Now 2.5 billion people around the world use one or more of our apps, each day. More than 200 million businesses use our free tools and there are more than 10 million active advertisers across our services. Most of these are small businesses which otherwise would have had a much harder time moving online and reaching customers during this pandemic and that's something that I'm really proud of. And before I cover other topics, the election is of course top of mind for everyone right now, so I want to start there.

I've discussed our effort many times on previous calls, but I want to take a few minutes to reiterate how far we have come since 2016. Four years ago, our security teams were looking for traditional threats like hacking but what we ended up seeing was something new: coordinated interference campaigns using fake accounts. They try to spread misinformation and discord and since then we've built the most advanced systems in the world to find and remove these threats and it shows in the numbers. In the years since, we've taken down more than 100 networks including from Russia, Iran and China, and we blocked millions of potentially abusive accounts every day. No other company has systems nearly as advanced.

We've also taken industry leading steps to make ads transparent so people know who is trying to gain their support. Anyone who wants to run a political or social issue ad has to go through our authorization process first and between March and September, we rejected ads 2.2 million times before they could run for trying to target the U.S. without authorization. We also built the ads library where you can see any ad that is running on Facebook or Instagram even if it's not targeted to you. For political and social issue ads, you can see you paid for the ad and what audience the ad reached, making political advertising on Facebook more transparent than any other medium.

We are very focused on voter suppression. We're working closely with experts in the space, including civil rights leaders and I am grateful for their guidance here. Our policies prohibit misrepresentations of when and how to vote and content meant to intimidate people into not showing up to polling places like claiming that I [ph] will

be there. And we recently expanded these policies to include implicit misrepresentations like for example claims that you will get COVID by voting in person. From March through mid-October, we removed more than 135,000 pieces of content in the U.S. for breaking these rules.

Now, these are all changes we've made in the last four years and it helped us protect the integrity of more than 200 different elections around the world, including in the EU, India, and Indonesia. And they've been important for stopping abuse as have next week's vote in the U.S. The 2020 has also brought new challenges. COVID raises questions about how people will vote safely, which will lead to higher levels and voting by mail and I'm worried that with our nation so divided, an election results potentially taking days or weeks to be finalized, there is a risk of civil unrest across the country.

And given this, companies like ours need to go well beyond what we've done before. That's why we've taken additional steps to help people register to vote however they're comfortable, to clear up confusion about how this election will work and reduce the chance of uncertainty and unrest. It would take too long for me to cover everything we've done in detail, but I'd like to mention a few things. First we ran at the largest voting information campaign in American history. We estimate that we've helped 4.4 million people register exceeding the goal that we set for ourselves this summer. We also estimate that in September. We hope to 100,000 people sign up to be poll workers and South Carolina saw a 20% of their total sign-ups to-date over a single weekend that we ran that recruitment drive.

We're also taking a number of additional precautionary steps. As of this Tuesday, we blocked new political and social issue ads from running the week ahead of election day and after the election. We're doing this because, well, I generally believe that the best antidote to bad speech is more speech. In the final days of an election, there may simply not be enough time to contest new claims.

If any candidate or campaign tries to declare victory before the final results are called we'll put a notification of the top of people Facebook and Instagram feed letting them know the results aren't final yet and we'll put an informational label on candidate's post saying the same. We're also attaching an informational label to content that seeks to delegitimize the outcome of the election or any particular voting method. And when there is the projected winner, we'll send people notifications letting them know and we'll show them in the voting information center we've been displaying at the top of our apps.

Finally, we've made a number of important content moderation decisions in recent weeks, including banning QAnon and Holocaust Denial Content, as well as rejecting ad that discourage vaccines. To be clear, this is not a shift in our underlying philosophy or strong support of free expression. Instead, it is a reflection of the increased risk of violence and unrest and an increased risk of harm associated with vaccine misinformation as we near an approved COVID vaccine.

Even the strongest free expression advocates don't think you should be able to yell 'fire' in a crowded theater because they recognize that your actions or speech should not be able to put people in imminent risk of physical harm and our policies here try to balance free expression and safety as well. And that's what we're doing.

Next week will certainly be a test for Facebook. Our systems have been tested in many elections over the last few years. Election integrity is and will be an ongoing challenge and I'm proud of the work that we have done here. I also know that our work doesn't stop after November 3, so we will keep anticipating new threat evolving our approach and fighting to protect the integrity of the democratic process and the right of people to make their voices heard around the world.

Now with that all said, I want to spend the rest of our time talking about our product work. We are making significant investments in hiring to develop a range of new products across the spectrum from messaging, to Reels, to our commerce efforts, to our longer term AR and VR platform work through Facebook Reality Labs. Dave will share more on the scope of those investments in just a few minutes. But while we face intense competition in every area of what we do, I'm proud of the product that we keep delivering for our community.

Now, first on messaging. Private messaging continues to be one of the fastest growing forms of communication. Now it's roughly 100 billion messages exchanged every day on WhatsApp alone. But these conversations are still often fragmented across different apps and people tell us that they want to be able to use the active they like best to reach everyone who they want to message. To address this, we've been working on a long-term infrastructure project so that people message across apps and we've now started rolling out an update to Instagram that brings the best features from Messenger and creates a better messaging experience across both apps and early feedback has been positive thus far.

This quarter we also extended Reels, a new way to create and discover short entertaining videos. People have always come to Instagram to express themselves and be entertained and the community has been telling us that they want a way to make and watch short-form videos for a while now. The early results make me quite optimistic here. I also want to say I have been impressed by the AR effect that have been built by more than 400,000 creators on our AR platform. There's obviously a lot of competition in this space as well, but I think that we're going to bring something new and higher quality that delivers value for creators and people who want to watch this content.

This quarter we also took major steps forward in building the next computing platform. We launched Quest 2, our most advanced virtual reality headset right in time for the holidays. It delivers a real sense of presence like you're right there with another person or in another place then, and we've worked to make it accessible to more people. It's lighter, faster, has a sharper screen and a new price point of just \$300.

Pre-orders have outpaced the original Quest pre-orders by more than 5x and have surpassed our expectations. We're also laying the foundation for AR glasses which will be the Holy Grail of delivering a sense of presence but will not be taking you away from the physical world. One day, you're going to be able to sit down for dinner with your parents, even if they're on the other side of the country or look up directions, to have them out your phone and take yourself out of the moment. We're working on the building blocks for true consumer AR Glasses and in the meantime, we are partnering with Luxottica, the maker of Ray-Ban and Oakley to build our first Smart Glasses which we'll launch sometime next year.

Supporting small businesses also continues to be a major focus for us and it's more important now than ever. Sheryl, is going to cover this in more detail shortly, but I want to call out a few new products that we've shipped: the Facebook Shops app that gives people a dedicated place to shop and find products; the Facebook Small Business Suite lets businesses easily manage their presence across our apps; and Paid Online Events lets businesses, creators and educators make money by livestreaming classes, talks and other events. In WhatsApp, we just announced how we're going to make it easier for people to buy products directly within a chat and integrating WhatsApp Business features with Facebook Shops so that way when a small business sets up a shop, they can now establish or will be able to establish a commercial presence across Facebook, Instagram and WhatsApp all at the same time.

We continue to see how personalized advertising is helping small businesses find customers, grow their businesses and create jobs. I continue to believe that we need new regulation that allows for personalized and relevant ads while protecting people's data and privacy. And I worry that some proposals, especially in the EU and actions planned by platform companies like Apple could have a meaningful negative effect on small businesses and economic recovery in 2021 and beyond.

This is one of the policy questions that we're going to need to continue showing up and engaging on for the future of the Internet. There are very different visions of that future held in different parts of the world. Some are motivated by different values and others by strategic advantage. We're going to have to stand up strongly for our vision of an Internet where every individual can have access to free services and every small business can have access to the same kinds of tools to grow and create jobs that the big companies have.

I'm grateful to everyone at Facebook and all of our partners who are working to make this vision a reality. I'm proud of all the new products and experiences we've been able to deliver this year, and as always, thank you for being on this journey with us. Now I will hand it over to Sheryl

Sheryl Sandberg {BIO 15339456 <GO>}

Thanks, Mark, and hi, everyone. I join Mark in thanking all of you for joining us today. This was a strong quarter for us and more businesses shifted online to reach customers to tell their stories and sell virtually. Our total ad revenue for Q3 was \$21.2

billion, which is a 22% year-over-year increase. Our largest verticals were ecommerce retail and CPG and we continue to see broad growth across sectors such as advertisers continue to optimize for measurable objectives like sales and website visits.

The digital transformation has been underway for years, but the pandemic has accelerated it dramatically. As Mark said, we now have more than 200 million businesses using our free tools across our platform every month to create virtual storefronts and communicate with customers. We also now have more than 10 million active advertisers across our services every month. The vast majority of which are small and medium-sized businesses. These businesses rely on personalized advertising to reach potential customers and grow.

According to the U.S. Census Bureau, before the pandemic, ecommerce's share of U.S. retail sales with steadily increasing by an average of one percentage point a year for the past four years. This share left by four percentage points in Q2 alone. That's four years of change in less than 100 days. That doesn't mean we will continue to see sustained acceleration. This may simply be future growth being pulled forward. But it is increasingly clear that the economic recovery will be driven by businesses finding customers and selling online.

As the number of businesses going digital accelerates during the pandemic, we have accelerated our efforts to support them. On the product side, our teams have been working around the clock to build new tools that make operating online simple and efficient. This quarter we released Facebook Business Suite, a new interface for businesses to manage their pages and profiles across our apps, helping them save time and stay up-to-date with customers.

We also expanded Facebook and Instagram Shops, Instagram Checkout and launched the Facebook Shops apps, so businesses can showcase their products and consumers can discover brands and buy things they love. And with more and more businesses using livestreaming when they can't host events in person, we introduced paid online events to help them generate revenue.

On WhatsApp, there are now more than 40 million people viewing a business catalog every month. So we created a new shopping button to make it even easier for people to discover a catalog and find something they'd like to buy. Soon, you'll also be able to click on WhatsApp icon on a Facebook Shop to chat directly with the business.

As well as improving our products. We are also helping business owners learn the skills they need to thrive online. Our business resource hub provides training to small businesses and everything from getting setup online to engaging with customers and has been visited tens of millions of times since its launch just in March. As the needs of our community evolve, our training changes too. We launched a new partnership with Coursera to train job seekers in skills like social marketing that are becoming ever more critical in a digital economy. We have also

built on the success of our summer of support training program, which reached more than 17 million people by launching a new three-month season of support to help businesses make the most of the holidays. This includes our Buyback Friday initiative to support Black-owned businesses and their communities.

While we continue to invest in helping businesses, we are equally focused on keeping our platform safe. Last month, we took an important step by agreeing along with YouTube and Twitter to a common set of definitions of hate speech and other harmful content. This was done in partnership with the World Federation of Advertisers and the Global Alliance for Responsible Media. There is more work to do, but we're headed in the right direction as we continue to develop industry-wide standards.

I want to acknowledge that despite these strong results, we faced significant headwinds, which Dave will talk about more. There is an important debate taking place about the way companies use data including for online advertising. We welcome this debate and have been advocating for new rules for the Internet in a range of areas from privacy and harmful content to election integrity and data portability. While we face greater scrutiny than ever before, we are also experiencing more demand from businesses for both our free and paid tools, especially our personalized ad products.

As this debate continues. It is important that we don't lose sight of the hugely important role personalized ads play for small businesses. Small businesses can't afford the broad mass marketing campaigns that big brands can. A good example is Glamnetic, a beauty brand specializing in magnetic eyelashes, which started in a one-bedroom apartment in Los Angeles, a little more than a year ago. Co-founders Ann and Kevin post photos and videos on Instagram and Facebook and used personalized ads to reach people they think might like their products including women between 18 to 50 who are interested in beauty and cosmetics.

We also advertise to people who have visited their website made possible by personalized ads technology which help them identify customer hotspots to focus on like California and New York, Texas Ohio and several southern states. They saw a 9x increase in revenue in Q3 versus 2019 and doubled their revenue month-over-month. While so many businesses are struggling this year, this has helped them to grow from 5 employees to 35.

There are countless stories like Ann and Kevin's among the over 10 million advertisers on our platform. For many small and medium-size businesses, personalized advertising which uses data safely and in a privacy protective way is the secret ingredient that makes their success possible. These businesses have the potential to be the driving force of the economic recovery in the months and years ahead as long as they can continue to rely on the data-driven tools they use day in and day out.

We're living in a time of deep uncertainty. The next few months or quarters will continue to be precarious for so many businesses. Whatever happens, we will remain focused on keeping people connected and supporting businesses as they make the transition online.

I want to close by saying how grateful I am to our partners big and small, old and new around the world and to our incredible teams who are working hard every day to make a real and very positive difference in people's lives. Now here's Dave.

David Wehner {BIO 2419389 <GO>}

Thanks, Sheryl and good afternoon, everyone. Let's start with our community metrics. In September, we estimate that approximately 2.5 billion people used at least one of our services on a daily basis and that approximately 3.2 billion people used at least one of our services on a monthly basis. Facebook daily active users reached 1.82 billion, up 12% or 197 million compared to last year. DAUs represented approximately 66% of the 2.74 billion monthly active users in September. MAUs grew by \$291 million or 12% compared to last year.

Turning to the financials. All comparisons are on a year-over-year basis unless otherwise noted. Q3 total revenue was \$21.5 billion, up 22% or 21% 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 \$114 million lower. Q3 ad revenue was \$21.2 billion up 22% or 21% on a constant currency basis.

The acceleration in advertising revenue growth from Q2 to Q3 was largely driven by strong advertiser demand resulting from the accelerated shift from offline to online commerce that we saw in connection with the pandemic. We are seeing particular strength among small and medium-sized businesses. We are proud of the role that our services are playing and helping people stay connected and businesses reach consumers during these challenging and uncertain times.

On a user-geography basis year-over-year ad revenue growth rates improved in all regions compared to Q2. Asia-Pacific and Europe were strongest and grew 30% and 25% respectively. Both regions benefited from currency tailwinds. U.S. and Canada grew 20%. Rest of the world grew 12% and was impacted by foreign currency headwinds.

In Q3, the total number of ad impressions served across our services increased 35% and the average price per ad decreased 9%. Impression growth was driven by both Facebook and Instagram. The decline in average price per ad was primarily driven by the ongoing mix shift towards geographies and stories ads which monetize at lower rates although year-over-year pricing trends improved from the second quarter due to broad improvements in advertiser demand coupled with slower impression growth. Other revenue, was \$249 million, down 7% primarily due to the timing of a new product launch as we transitioned to Quest 2 which we began selling in the fourth quarter.

Turning now to expenses. Q3 total expenses were \$13.4 billion, up 28% compared to last year. In terms of the specific line items, cost of revenue increased 33% driven primarily by infrastructure-related investments, including both depreciation and operational expenditures. R&D increased 34% driven primarily by hiring and investments in our innovation efforts notably, Facebook Reality Labs, as well as core product.

Marketing and sales increased 11%, a slower growth rate than prior quarters due to a slowdown in consumer marketing and hiring. Lastly, G&A expenses increased 33% driven primarily by higher legal related expenses. We added over 4,100 net new hires in Q3 primarily in technical functions. We ended the quarter with over 56,600 full-time employees, up 32% compared to last year. We continue to be pleased with our ability to recruit onboard and retain talent in this environment.

Operating income was \$8 billion representing a 37% operating margin. Our tax rate was 4%, which reflects a one-time benefit related to a tax election to capitalize certain R&D expenses for tax purposes. Net income was \$7.8 billion or \$2.71 per share. The one-time tax benefit, resulted in EPS being \$0.31 higher. Capital expenditures were \$3.9 billion driven by investments in data centers, servers, office buildings and network infrastructure.

In Q3 we announced that our 17th data center will be in Gallatin Tennessee and will be 100% supported by renewable energy. Facebook recognizes the urgency of addressing climate change and we are committed to help tackle this global crisis. That is why in Q3, we set a new goal to reach net zero carbon emissions for our value chain in 2030. This is an addition to our current plans for our global operations to achieve net zeros carbon emissions and be 100% supported by renewable energy by the end of 2020 and beyond.

Free cash flow was \$5.9 billion. We repurchased \$1.7 billion of our Class A common stock, completed the \$5.8 billion investment in Jio Platforms Limited and ended the quarter with \$55.6 billion in cash and marketable securities.

Turning now to the outlook. As expected, in Q3 we saw Facebook DAUs and MAUs in the U.S. and Canada declined slightly from Q2 levels, which were elevated due to the impact of the pandemic. In Q4, we expect this trend to continue and that the number of DAUs and MAUs in the U.S. and Canada will be flat or slightly down compared to Q3.

Turning now to revenue. We expect our Q4 year-over-year ad revenue growth rate to be higher than our reported Q3 rate driven by continued strong advertiser demand during the holiday season. Additionally, Oculus Quest 2 orders have been strong, which should benefit other revenue. Looking ahead to 2021, we continue to face a significant amount of uncertainty. We believe the pandemic has contributed to an acceleration in the shift of commerce from offline to online and we experienced increasing demand for advertising as a result of this acceleration. Considering that

online commerce is our largest ad vertical, a change in this trend could serve as a headwind to our 2021 ad revenue growth.

In addition, we expect more significant targeting and measurement headwinds in 2021. This includes headwinds from platform changes notably on iOS 14 as well as those from the evolving regulatory landscape. There is also continuing uncertainty around the viability of Transatlantic Data transfers in light of recent European regulatory development and like other companies in our industry, we are closely monitoring the potential impact on our European operations as these developments progress.

Turning now to expenses. We expect 2020 total expenses to be in the range of \$53 billion to \$54 billion narrowed from our prior range of \$52 billion to \$55 billion. We anticipate that our full year 2021 and total expenses will be in the range of \$68 billion to \$73 billion, driven by continued investments in product development and technical talent as well as a return to more normal levels of spend in areas like office operations and travel. However, these are preliminary estimates as we have not yet finalized our 2021 budget. We expect 2020 capital expenditures to be approximately \$16 billion, unchanged from our prior outlook. For 2021, we anticipate capital expenditures be in the range of \$21 billion to \$23 billion driven by investments in data centers, servers network infrastructure and office facilities, our outlook includes spend that was delayed from 2020 due to the impact of the pandemic on our construction efforts.

Turning now to tax. We expect our Q4 2020 effective tax rate to be in the mid-teens and our full-year 2021 tax rate to be in the high-teens. In summary, we are proud of the role that our services are playing in keeping people and businesses connected through these difficult times. At the same time, we are continuing to invest aggressively in new products and experiences to better-serve our global community.

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

Questions And Answers

Operator

We will now open the lines for our question-and-answer session. (Operator Instructions) Your first question comes from the line of Brian Nowak from Morgan Stanley.

Q - Brian Nowak {BIO 16819013 <GO>}

Thanks for taking my question. I have two: one for Mark, one for Dave. Mark, there's a lot of different types of consumer behavior on the platform for messaging, posting video, stories, shopping, et cetera. I'd be curious, as you sort of look at the way in which people are using the products now versus the start of the year pre-COVID, what's changed the most that surprised you, and how does that sort of impact your product priorities as you continue to make sure you're delivering value for your

advertisers over the next couple of years? Then Dave, I wanted to ask one about the initial 2021 OpEx guide and you mentioned sort of R&D and technical talent. Are there any specific projects or initiatives where you sort of look at and you say these areas really need to invest materially harder next year than you may have this year? Thanks

A - Mark Zuckerberg {BIO 15103277 <GO>}

Sure. Thanks for the question. In terms of what behaviors we really saw with COVID it was an increase in -- Well, first of all, there was an increase in almost everything across the board, which I think was somewhat temporary and is now returning to baseline levels of growth, which is partially what we're seeing. But in terms of some of the more permanent trends, I think more people are doing kind of synchronous forms of connection so voice calling and video calling. I think we're seeing continue to be elevated in a lot of areas. We're seeing a stronger need for community. That's been a theme that we've seen for a while, but I think especially with COVID and people feeling a little more isolated that has grown the need to do that online. So we're really going to double down and invest in that area to help even more than we are today, building out the infrastructure for communities as a foundation going forward. People have more time, they want entertainment so we're seeing video and gaming and things like that grow as well and that seems to have been sustained. That's on top of all the commerce trends where I don't think we know exactly which way this will turn as David and Sheryl both said whether this is a sort of a one-time shift towards a dramatic increase in the amount of commerce to tapping online versus continued a trend that we will see but certainly, we haven't seen any decline or return to baseline off of the quite elevated levels of online commerce behavior that we see both from consumers and small businesses

A - David Wehner {BIO 2419389 <GO>}

Hey, Brian. I'll take that second question. As Mark outlined in his prepared remarks, we're making significant investments in hiring across a wide range of new products. I'd probably talk about big investments that we're making in our longer term ARVR work through Facebook Reality Labs, as well as continued investments in areas like messaging, commerce and reels. The other thing that I would mention on the 2021 total expense guide is that we expect to have higher expenses from office operations and travel once we have seen larger parts of the workforce return to the office. We estimate that in 2020 we saved approximately \$1.5 billion on those expenses and in 2021 we would be kind of working up a higher employee count which is ultimately what drives those expenses. So we would expect to see a snapback of some of those savings.

Operator

Your next question comes from the line of Eric Sheridan from UBS.

Q - Eric Sheridan {BIO 22465717 <GO>}

Thanks so much. Maybe I'll try to also. First maybe following up on Brian's question the Dave answered it, but turning it back to Mark. Mark, we'd love to understand your philosophy around what you think the company needs to either invest in or sort

of South for the unlock on augmented reality of the long-term and sort of a broad-based consumer and enterprise platform, but to be, that's where the next wave of computing, but you've talked about in the past, what do you see a sort of a 3 to 5 year roadblock you're investing against in key unlock you're looking for in the business? Maybe, Sheryl, if I could just ask you, probably the number one question we get from investors is that all the innovation you guys are doing on the commerce side whether it'd Facebook Shops or transformation of Instagram around shopping and checkout given the way you framed your statements around the shift in commerce and real-time as we continue through this COVID period, how are those sort of platforms positioned to capitalize very short term Q3 into Q4 and how are you thinking about the ability for those shifts to be there for advertisers and commerce participants in 2021 and beyond? Thanks.

A - Mark Zuckerberg {BIO 15103277 <GO>}

Sure. Well, I can take the first one in terms of some of the milestones for the next computing platform. I think that there are few things that I'm really looking for. So there is virtual reality, there is augmented reality and then there is the whole kind of operating system of sort of spatial computing in 3D around that and there are pieces that need to come together in each of those. VR we are the most advanced in. The big milestone that I'm focused on here is we want to get to 10 million active units in our VR systems because we think at that point that's when it will become the ecosystem will really be able to be self-sustaining and accelerated where independent developers will be able to start. It will really economically makes sense for independent developers to prioritize the Oculus platform above alternative gaming platform is because the installed base will be sufficiently large that they will get good returns. Right now we're funding a lot of the content development ourselves, but we hope that that at some point in the next few years we'll reach that. And we feel like we have line of sight to that. Part of building out AR is going to be a little bit harder in that VR people do at home. It's meant to be pretty immersive. Obviously, you want the headset to be as small and comfortable as possible, but fundamentally, it's not the type of thing that you're going to be wearing down the street that you need to really have a very kind of stylish or socially acceptable form factor just yet. Whereas I do think to have viable augmented reality consumer glasses you need to clear a number of technological hurdles to make it so that all of that technology fits in what would be kind of a normal maybe stick consumer Valassis form factor. So these are our -- there are a number of fundamental technological advances that still need to be made there, which is why I think that that product is still a few years out, but it's one that we're very excited about. The work that we're doing on VR and AR will share some of kind of the operating system and ecosystem around them of 3D development and spatial development and that's also shared across some of AR effects and things that we're seeing people use in reels and the camera and Instagram and Facebook and Messenger and that work, I think is going quite well. There are hundreds of thousands of creators and developers and people building for that but all of those pieces basically need to come together for the ecosystem to work and I've been very impressed and excited by the progress that our teams have made on this. I think that the new Quest2 product is extraordinary. I love using it and I'm really proud of the work that we've done there.

A - Sheryl Sandberg {BIO 15339456 <GO>}

So let's talk about commerce. We've been focused on making commerce more convenient, more accessible, secure across our apps for people and businesses. We always we're at the top of the funnel for discovery and for connecting people to many businesses and products around the world and we saw, even before the pandemic, an opportunity to keep moving people down that tunnel. What happened with coronavirus is we just massively accelerate -- this shift massively accelerated and we really doubled down on shipping commerce products so that we could help the now 10 million small businesses who advertise but the hundreds of millions who really rely on our free tools so that they would be able to pivot online. Mark mentioned shops in his remarks. We launch this very quickly in Q2 and we're seeing -- it's early, but we're really pleased with the progress we've just announced expansion to WhatsApp we're building for Facebook. We're building for Instagram and I think what we see is that acceleration really works and it's good because we can provide these tools to small businesses, but it also accelerates our ad revenue. I'll share an example, there is an indigenous brand called sister sage they make handcraft and wellness products like soaps, and they were founded by sisters and before coronavirus, they were selling at local farmers markets and mall kiosks. So that obviously just went away overnight. They pivoted to Facebook and Shopify, were able to put themselves online and then used our targeted ads and have a had 9x return on ad sales and have increased their sales by over 2.5x during this and so what we see is that when we help provide the commerce tools it can help the small businesses that rely on us and it can also drive our ad revenue.

Operator

Your next question comes from the line of Justin Post from Bank of America.

Q - Justin Post {BIO 3469195 <GO>}

Great, thank you. Mark, on prior calls you mentioned that eventually margins have to kind of -- expense growth kind of has to match revenue growth. So interesting in the midpoint of your range 32% expense growth does that show some optimism on revenues or are you investing in some products that could pay up with some revenues down the road? Just thinking about the progress with messaging you have a deal with DD in Brazil and opening up with other platforms. Is that something you're excited about over the next couple of years of starting to really show some revenues? Thank you.

A - David Wehner {BIO 2419389 <GO>}

So Justin, why don't I take the first part of that which is on the expense growth guidance. There we're not giving guidance on revenue growth and there is not implied guidance on revenue growth. So at the midpoint, you've got that right. It's sort of in the low 30s on an expense growth basis. That's fairly consistent with where our headcount growth is right now and that really reflects the opportunities we see to invest. We've been successful with hiring and retaining talent. We've got a lot of priorities given everything we have seen from COVID and the shift to online with commerce with messaging and also the big investments that we're making for the long term in Facebook Reality Labs. So I think it's clear that we would expect there to

be a margin decline next year based on that guidance, but we're not giving specific revenue guidance at this time. Then, Mark, do you want to cover the messaging?

A - Mark Zuckerberg {BIO 15103277 <GO>}

Sure. I think the short answer is yes, I think the goal is to build out a commerce platform around messaging with all of the tools, starting with Facebook Shops which we've already announced will be coming to WhatsApp and Messenger so any small business will be able to set up a shop and how that kind of automatically establish a presence in those services too. We're building out a number of tools around business messaging so that people can follow-up and complete transactions and get support through messaging and then payments so that people can complete transactions too. One of the early monetization products that is working quite well are these click to messaging ads. So that way someone can get -- a business can run ads in Facebook or Instagram and if the destination for that ad can take the person to a chat thread either in Messenger or WhatsApp to kind of further build out the relationship with the consumer or complete a transaction and that's growing quite well. I'm quite excited about that. But overall, this is a big priority is building out all these commerce tools both so that small businesses and all kinds of businesses can do this kind of commerce in Facebook and Instagram but also within messaging, like you say.

Operator

Your next question comes from the line of Brent Thill from Jefferies.

Q - Brent Thill {BIO 1556691 <GO>}

Thank you. If you could just maybe talk a little bit about the real engagement in what you're seeing so far. I know it's early, but any observations there. Thank you.

A - Mark Zuckerberg {BIO 15103277 <GO>}

I'm happy to jump in here. I'm quite excited about the progress here. It's still quite early. We've expanded reels into more than 50 countries. We've launched a number of new features. The results are encouraging. There is a lot more work to do here as well, and I don't have any specific numbers to share here, Dave, I assume you don't have any specific numbers that you would share either.

A - David Wehner {BIO 2419389 <GO>}

Yeah, that's right. I think we're encouraged by the initial results. But it's still early.

Operator

And your next question comes from the line of Heather Bellini from Goldman Sachs.

Q - Heather Bellini {BIO 2268229 <GO>}

Great, thank you. I had 2 questions. Mark, I know you've been asked a lot about AR/VR on this call, but I was wondering if you could share with us how do you think

about the advances you're making on that front, helping to drive differentiation from an e-commerce perspective and how much of a competitive differentiator can you work be here as commerce obviously continues to accelerate online? Then I just had a quick one for Dave about any update on the percentage of revenue from the top 100 advertisers that could have missed that? Thank you.

A - Mark Zuckerberg {BIO 15103277 <GO>}

Yeah, I think your question on augmented reality is a really good one because it hits on the fact that we mostly talk about it as a long-term new kind of platform but in the next couple of years, I also think that there will be opportunities to build this kind of features into our mobile app in an increasing way to kind of help people express themselves like they're doing in reels and stories. I mean our cameras. We have as you probably know rolled out a number of augmented reality commerce tools and ad format. So the types of things like for cosmetics people can try on lipstick or sunglasses to see what they would look like on them. We think we can get to the place where for more kind of items that you might buy to put in your house, we'll be able to offer a lot more of that stuff, being able to visualize what it would look like in your living room just through your camera and augmented reality tool. Try on clothes, different things like that over time. There is a lot of this work that I think will help out by building new innovative experiences in our mobile app and all of that is also contributing to building up this longer term development platform around 3D and facial computing, that will be very foundational to all of the VR and AR work longer term as well.

A - David Wehner {BIO 2419389 <GO>}

Heather, it's Dave. We don't have an update on the top 100 advertisers statistic, but I would say that we continue to see strong growth from our small and medium-sized advertisers in the quarter continued strength with our direct response to advertisers. So we're really pleased with the broad base of advertisers that we saw in the quarter and helping those advertisers connect with consumers in this challenging climate. So really pleased with what we're seeing on that front

Operator

Your next question comes from the line of Doug Anmuth from JP Morgan.

Q - Doug Anmuth

Thanks for taking the questions. One for Mark and then one for Sheryl or Dave. Mark, you touched on interoperability briefly, I was hoping you could talk about your rollout efforts thus far and how we should think about the key benefits and milestones there. Then Sheryl or Dave, would you still expect IDFA to have the same degree of impact on your business as you did 3 months ago whenever it is that actually rolled out or is it possible that the delay has benefited you with more time to work around and leverage other datasets and therefore minimize the impact? Thanks.

A - Mark Zuckerberg {BIO 15103277 <GO>}

I can speak about interop. It's been a long-term infrastructure project that we've been working on to make it so that people can send messages between the apps. We started rolling out interoperability between Messenger and Instagram messaging and that's live in a lot of countries around the world now including in the U.S. The initial feedback I think it's been quite positive as it brought a number of features to Instagram that we previously had only had in Messenger. The big benefit, the way that I think about this is that in a lot of countries around the world there is a primary messaging app that most people use. In the U.S. that doesn't quite exist in the same way. iMessage is certainly the leading messaging app but of course, people on Android can't use it and there still is a quite large portion of the population is on Android, so the messaging experience in the U.S. is very fragmented, compared to what you would experience if you were in India or China or Brazil or a lot of countries in Europe. Which I think just makes it confusing. It means that people have to have all these different apps to reach people that they're not sure where to reach people. It makes a little bit harder to build out the business ecosystem because now businesses have to work across all these different places. So our goal is to make it so that people could just choose one of our apps that they prefer using the most for messaging and can reach all the people who they want to reach across all of our different apps from whichever of the apps is their favorite and of course they can continue using multiple if they want. This is going to be a choice that people have but I think it should simplify things and make it so that these three different networks that we've had between Messenger, Instagram and WhatsApp can start to function a little bit more like one connected interoperable system. That's the vision. There is more work to happen here. We, of course, want to bring in WhatsApp to that interoperability as well. There are more features we want to add, even to the Messenger Instagram interoperability, but it's good to see that starting to roll out after what has been a pretty large engineering and infrastructure projects.

A - David Wehner {BIO 2419389 <GO>}

Doug, on IDFA I guess iOS 14 more broadly, obviously, Apple did delay the implementation of certain elements of their iOS 14 launches that relates to some of the privacy initiatives. So I think that impact won't be felt in Q4 where prior we would expect to have seen that in Q4. So I think it's mainly a delay in the impact rather than it's a change in the impact. So we're going to experience that in 2021 specifically as it relates to IDFA. It's going to have a disproportionate impact on app installs and thus our audience network. So that's obviously a big challenge for app developers who are looking to grow their business in what is a difficult time. So we think that challenge will remain and when that implementation happens but in terms also of whether there is work that we can do to mitigate that impact that businesses reach out to us all the time on how they can continue to run effective ads in the face of these platform changes. We're looking at various options but our best view is that there are going to be significant headwinds next year as a result of these changes, specifically on iOS 14.

Operator

Your next question comes from the line of Michael Nathanson from MoffettNathanson

Q - Michael Nathanson {BIO 2009061 <GO>}

Thanks. I have one for Mark and one for Sheryl. Mark, I want take you back to Section 230 in yesterday for a second. It seems like you the most comfortable CEO about making changes to law so I wonder what are the changes that you had proposed? Does that pack proposal in June resemble where we need to go and what do you think the cost of these changes would be for Facebook? Then for Sheryl, we talked about the acceleration of more business embracing Facebook through this crisis. Can you talk a bit about what verticals, maybe had been lagging within their move to Facebook and Instagram and maybe how this crisis has accelerated certain verticals to spend more than they had before?

A - Mark Zuckerberg {BIO 15103277 <GO>}

I can talk about the first one. At this point, we have the benefit of seeing how different countries have adopted different types of regulation and getting to understand how that either makes the problems more effective for dealing with them or in some cases makes it harder and actually creates worse results. So the approaches that I think seem to have worked best by looking at what France and a few other countries have done is basically one which focuses on creating a transparent process where companies have to report how they're doing moderation, reporting on how much harmful content of different categories is visible, the portion of the content on the service and what percent of it our content moderation systems can get to before people need to report it to us. I think a system like that that basically requires companies to meet certain thresholds or show improvement basically aligns incentives in the right way to encourage companies to minimize the amount of that harmful content that people are seeing. There are plenty of examples where there are other regulatory regimes that I think point towards -- that are counter-productive or basically require companies to do things that aren't quite getting it the most important aspect to the problem. As one example, in some countries there are rules, saying, you have to get to certain content within a short period of time and that I think is good on its face but I think the reality is, that's a piece of content that's going to not be seen by many people, maybe it's not as urgent to deal which is one that is going to be problematic but is going to be seen by a lot of people. You really want to get to that sooner. So treating all content equally compared to just looking at the prevalence of how much bad stuff people are seeing I think is going to be less effective overall. So it's hard for me to speak to the cost to Facebook or other companies specifically because this is pretty nuanced stuff and a lot of it will depend on specific language or details and how this learns. But I do think at this point there are enough examples and other countries that you can kind of get a sense of what helps create a more healthy ecosystem and what doesn't.

A - Sheryl Sandberg {BIO 15339456 <GO>}

So on verticals, our growth is very broad-based and it's especially important for small to medium-sized businesses. These businesses have faced huge challenges in the pandemic and they've needed to become digital often for the first time. So the free tools we provide to get themselves online, online presence, mobile presence have been more and more important and personalized ads are more and more important. The use of data which we can do in a very privacy-protective way to let them buy the

audiences they want are increasingly important. Big companies can afford to buy broad-based ad campaigns that hit countries or whole geographies. Small companies can't so survival and the economic growth and the increasing ability to stay afloat and higher has really been driven across the board by SMBs. Now some verticals have experienced more of this certainly e-commerce is the leading example but there are a lot of other businesses that evolves also lend themselves to online. Education is growing nicely, retail. There are others like travel and auto that will have lagged during this but are starting to rebound as well. I also while we're talking about verticals want to take the opportunity to say that I think there is a bit of a misunderstanding about the size of political ads on our services. In Q3 combined political ads and government spending altogether was still low single-digit percentages of ad revenue in the U.S. and globally and it's not a top 10 vertical in the U.S. or globally as well.

Operator

Your next question comes from the line of Mark Mahaney from RBC.

Q - Mark Mahaney {BIO 3027058 <GO>}

Okay, a question for Sheryl. Sheryl, you talked about an acceleration in ad revenue associated with I guess the build down of social commerce. Could you double-click on that a little bit more and explain that? And is it just that as the inventory becomes more transactionable, it's more valuable and therefore marketers are willing to bid more for it? Just explain that link between the growth in commerce activity on the network and the acceleration in ad revenue? Thank you.

A - Sheryl Sandberg {BIO 15339456 <GO>}

I think the acceleration I was talking about is really an acceleration to businesses moving online. There were just a lot of businesses that before the pandemic were consistently offline businesses. They sold locally, they advertise locally, you walked into their store and bought. And what the pandemic -- and this was already changing. Businesses were already going online, but we just have seen massive acceleration in businesses doing things online whether it's finding customers letting you know they're open, selling curbside, pickup. When people can't walk into stores all over the world, they had to reach customers a different way. That acceleration has really powered our business. That's why there are 200 million small businesses or businesses using our free tools, because a lot of these businesses had to get online for the very first time.

That's why we have 10 million advertisers because once you have an online presence, once you're doing things to reach customers online and even delivering products not in person, you see that acceleration. And so it is that overall acceleration onto online commerce. Some of our ecommerce tools that's really I think increase the number of small businesses all over the world that are using our free tools and our advertising with us.

Operator, we're going to take one last question.

Operator

Your last question comes from the line of Youssef Squali from Truist Securities.

Q - Youssef Squali {BIO 1506420 <GO>}

Great, thank you very much. One question for Mark and one for Dave. Mark online gaming is in the margin opportunity for you. I was wondering how you see your position today. Just as you compete with very entrenched players like Twitch and YouTube, what do you need to do to win longer term? And is VR and AR and the work you're doing potentially a competitive advantage over time? And then Dave, just given the amount of cash that you guys have on the balance sheet, I think you've just added \$5.9 billion in free cash flow this past quarter -- would a change in the administration and prospects for maybe higher capital gains and dividend taxes change your way on how to manage or how you guys are managing your capital allocation and returned short term? Thank you.

A - Mark Zuckerberg {BIO 15103277 <GO>}

I can talk about gaming. So this is an area that I'm very excited about. I think it's a big growth area and one that I enjoy a lot personally. So we're doing a number of things here and I think you're right that the longer-term virtual and augmented reality projects do help here, both in the near term and the long term. It's also just a very exciting area of gaming. But most people are using gaming through our services, through the Facebook gaming initiatives that we have. People stream games using our live tools, people want to be able to build a community, I think our features and our just kind of social focus as a company means that we are better-able to serve game streamers who want to build out a community across our service. That part is going quite well. It is growing quickly and we just launched our cloud initiative, which plugs into both the Facebook gaming work that we're doing and the ads work that we do around helping game companies get new customers. It's sort of not a completely different approach. It's sort of plugs into the core things that we do. So you're basically seeing gaming combined with video and the community and its work that we're doing in order to just kind of grow all of those at once. Over the longer term I think the VR piece will obviously come into that as well. Some of the cloud gaming stuff that we're doing will of course be useful for VR as well and we're building a big community around that on Oculus, but this I do think will be a very exciting growth opportunity and ability to offer a lot of innovation over the coming years.

A - David Wehner {BIO 2419389 <GO>}

Yes. Thanks, Youssef. So on our capital allocation, our focus is in investing in growth and continuing to make sure that we make the investments to drive the long-term growth of the business. That includes investing in our core product as well as investing in some of our longer-term initiatives like Facebook Reality Labs. This past quarter, we made an important strategic investment in Jio Platforms. So that was a significant outlay of capital. We continue to have an active share repurchase program authorized by the Board and we'll certainly factor in any changes in the tax

landscape, but I wouldn't expect that to necessarily lead to a shift in our fundamental approach.

A - Deborah Crawford {BIO 5934723 <GO>}

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

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for joining us. You may now disconnect your lines.

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