

Q1 2020 Earnings Call

Company Participants

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

Other Participants

- Brian Nowak, Analyst, Morgan Stanley
- Colin A. Sebastian, Analyst, Robert W. Baird & Co.
- Douglas Anmuth, Analyst, JPMorgan Chase & Co
- Eric J. Sheridan, Analyst, UBS Investment Bank
- Justin Post, Analyst, BofA Merrill Lynch
- Mark Stephen F. Mahaney, Analyst, RBC Capital Markets
- Ross Adam Sandler, Analyst, Barclays Bank PLC
- Youssef Houssaini Squali, Analyst, SunTrust Robinson Humphrey, Inc.

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 First Quarter 2020 Earnings Conference Call. (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 T. Crawford {BIO 5934723 <GO>}

Thank you. Good afternoon and welcome to Facebook's First 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 Annual Report on Form 10-K 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. Finally, we hope that everyone listening today is staying safe, the vast majority of us at Facebook are working productively from home and everyone on this call this afternoon has dialed in remotely.

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. Before we get started, I also just want to say that I know this is a very hard time for a lot of people. I know a lot of you are calling in from New York, where this has been particularly tough, although almost everyone has been affected by what's going on in some way. So I just want to start by acknowledging that and taking a moment to thank everyone working on the front lines to help all of us get through this.

There is a lot of uncertainty now about the world and what it will look like over the coming months, and Sheryl and Dave are going to give some more context on what that means for our business. The impacts on our business has been significant, and I remain very concerned that this health emergency and therefore the economic fallout will last longer than people are currently anticipating. And while there are massive societal costs from the current shelter-in-place restrictions, I worry the reopening certain places too quickly before infection rates have been reduced to very minimal levels will almost guarantee future outbreaks and worse longer-term health and economic outcomes.

So with that said, I want to use this time today to discuss how we're responding to COVID, what we're seeing across our services and some reflections on how we plan to run the company going forward. So our response has been focused on three areas; helping people stay connected while we're all part, assisting the public health response and working on the economic recovery, especially for small businesses. And I'll start with how we're assisting the public health response. The first step here is connecting people with authoritative health information and we built a COVID-19 Information center with authoritative information from health officials and governments and messages encouraging people to stay home that are coming from public figures they trust, and we put this COVID-19 Information Center at the top of everyone's Facebook app, and so far we've directed more than 2 billion people to it. Equally important is also limiting the spread of misinformation. We don't allow content that puts people at imminent risk of physical harm. So when people share hoaxes like that inhaling water cures COVID, which is both false and will be physically harmful if anyone does that, we take that down. For other types of misinformation, we partner with independent fact checkers who have marked more than 4,000

pieces of content related to COVID as false which has resulted in more than 40 million warning labels being seen across our services. Then, we know that these work because 95% of the time when someone sees a warning label, they don't click through to view that content.

Now beyond helping people broadly access high quality information, we're also focused on helping governments and health authorities get better data in a Privacy protective way to inform key policy decisions that they need to make as well. So we partnered with Carnegie Mellon to run a widespread symptom survey on Facebook and we're using their findings to produce daily county-by-county maps of the symptoms that people are experiencing across the country and soon globally as well. And since people experiencing symptoms is a precursor to them going to the hospital or getting more seriously ill, this tool can help local governments and health officials plan how to allocate scarce resources like, PPE and ventilators as well as determine when it's safe to start reopening an area or when an area will need to have tighter shelter orders if symptoms re-emerge. And just this morning, we announced that we're working to connect these symptom surveys to ground truth infection rate data from large serology and PCR studies that are funded separately by the Chan Zuckerberg Initiative in order to more accurately determine the true infection and exposure levels globally, on a local-region basis as well. So this is work that we're uniquely positioned to do, because Facebook is a global community and people use their authentic identities on our service. So that means that we can make sure that the data is meaningful. But we're very focused on doing this in ways that we know are going to be helpful to the health response and that protect people's privacy and human rights, which is why we've primarily focused on how aggregate data can help.

Now outside of Facebook, (inaudible) my work at the Chan Zuckerberg Initiative with alongside leading experts in Science and Health continues to inform my views on the best ways for us to assist in this health response, and also what we should expect going forward with this disease.

All right. So next I want to discuss how we're helping people stay connected with the people they care about, even while we can't be together during this period. So this is our core mission. And I'm proud of how we've supported people around the world during this time. We know that people especially rely on social apps in times of crisis and in times when we can't be together in person. And right now, we are experiencing both of those all around the world at the same time. So we're seeing major increases and uses of our services. For the first time ever, there are now more than 3 billion people actively using Facebook, Instagram, WhatsApp or Messenger each month. That includes 2.6 billion people using Facebook alone and more than 2.3 billion people using at least one of our services every day. In many of the places that have been hardest hit by the virus, messaging volume has increased more than 50% and voice and video calling have more than doubled across Messenger and WhatsApp.

In Italy, for example, we've seen up to 70% more time spent across our apps, Instagram and Facebook live view doubled in one week. And we've also seen time

and group video calling increased by more than a 1000% over March. In making sure that our services are stable and reliable during this period is the top priority. We're monitoring usage closely and adding capacity in our data centers, where we can. The investments we've made in shared infrastructure that, however, all of our different services over the years have helped us manage through this, but it has been a challenge while our teams have been working remotely.

Now I'm sharing these numbers to give you a sense of the surge in people relying on these services that we're seeing. Obviously, I wish the circumstances were different, and I don't expect that this exact spike in usage will sustain over a longer period of time. But in some areas, I think we are seeing an acceleration in a pre-existing long-term trends, like the dramatic increase in online private social communication, that is likely to continue. And if nothing else, this usage shows that for a lot of people around the world, these services are part of the social infrastructure that brings us together.

Now even before COVID-19, our product strategy is really focused on building out private/social platforms and enabling online commerce. So it's well aligned with what people need now. Last week, we announced a number of new product improvements around video presence, which has emerged as an especially critical part of the private social platform during this time. Our view is that video presence includes three categories; video calling, video rooms and live video, and we plan to lead and offer the best services for social uses in each of those different categories. Video calling was when you actually ring a person's phone or computer, and it's by far the most used to type of video chat. Between WhatsApp and Messenger, there are more than 700 million daily actives participating in calls. We are doubling the size of WhatsApp video calls from 4 to 8. This is important because WhatsApp is the most popular intending encrypted calling service. So if you care about privacy and encryption and you want to be able to reach anyone, you're probably using WhatsApp. Now you're going to be able to get your whole family or a larger group together on calls.

For video rooms, we announced a completely new product called Messenger rooms, and the idea here is that you can create a room for any active your event you want, send the link to your friends or have them discover your room on Facebook and then they could just drop in and hang out for a bit, and this is different from any other video presence experience because it is so (inaudible), you don't have to plan on an event and scheduled in advance if you don't want, but it could be much more spontaneous and fun, and I've really enjoyed getting to use this as we've been building out Messenger rooms internally and I'm looking forward to get in more people's hands around the world soon.

Live video is also particularly important right now. People are used to primarily live stream physical events, but since almost no one is planning physical events right now, live streaming has become the primary venue for many events, whether that's the pope's weekly mass on Facebook Live or DJs hosting dance parties on Instagram. Every day more than 800 million daily actives are engaging with live streams across workout classes, concerts and more. And we pivoted the Facebook

events team to help people create online events, including enabling people and small businesses to charge people who have join their events in order to support small businesses that rely on in-person services before.

The last area of our response that I want to discuss is how we're helping with the economic recovery, especially for small businesses. Sheryl will talk about this more, but with so many businesses forced to close their physical storefronts, more are looking to build their digital presences and those which already invested in their digital presences are increasingly viewing them as the primary storefront. So we're working on a number of ways to deepen this experience, helping people buy items and services directly within our apps, I mean we're going to have a lot more to share on this soon. Overall though, our business depends on the success of small businesses. So this is a moment where we feel that we're well positioned to be champions for small businesses interests and supporters of important infrastructure that they're going to need in order to move online.

One aspect of online commerce that I want to mention is the partnership that we just announced with Jio platforms in India. The largest Facebook and WhatsApp communities in the world are in India, and we think that there is an especially important opportunity to serve small businesses and enable commerce there over the long term. So by bringing together Jio Mart which is small business initiative to connect millions of shops across India with WhatsApp, we think that we're going to be able to create a much better shopping and commerce experience, and there's a lot more that we can do here and I'm looking forward to making progress with the team at Jio.

Now beyond our immediate plans to help respond to the pandemic, I also want to share some reflections on how we're planning to run the company during this period. I have always believed that in times of economic downturn, the right thing to do is to keep investing in building the future. And I believe this for a few reasons. First, when the world changes quickly, people have new needs and that means that there are more new things to build. Second, since many big companies will pull back on their investments, there are a lot of things that wouldn't otherwise get built that we can help deliver. And third, I believe that there is a sense of responsibility and duty to invest in the economic recovery and to provide stability for your community and stakeholders if you have the ability to do so. And we're in a fortunate position to be able to do this, along with our strong financial position and the important social value our services provide, we're planning to hire at least 10,000 more people in product and engineering roles this year, so we can continue building and making progress.

Now that said, with advertiser spending less than our business performance below expectations, we do plan to moderate some areas of our expense growth especially in business functions, we accepted that our profit margins will decrease this year as we continue investing, and Dave will share more on our financial outlook in a few minutes. But this economic pullback has certainly reinforced for me the importance of maintaining high margins. Our financial position has allowed us to continue investing and building products and making investments like our partnership with

Jio even when the underlying economic conditions are challenging. As always, I am grateful to everyone on this journey with us, and that's especially true during this period. As our services play an especially important role right now and helping people stay connected in assisting the public health response and working on the economic recovery. I really want to thank all of our employees, who are working hard to deliver these services and everyone who has believed in us and supported our company over the years to help us get to the point where we can deliver these services for people around the world.

So thank you. And with that, here is Sheryl to talk more about our business.

Sheryl Sandberg {BIO 15339456 <GO>}

Thanks, Mark, and hi everyone. As Mark said, this is an extraordinarily challenging time, it's a public health emergency, a global economic crisis and a time of great anxiety and personal tragedy for so many. My heart goes out to everyone on this call who has lost someone they love and to everyone for the many ways who are suffering. Mark talked about how our company has responded during this emergency to keep people safe and informed, how we see our responsibilities and how we are thinking about the future. I'm going to talk more about the impact we have seen in our business and what we are doing to help other businesses surviving recover in this changing landscape.

Our total ad revenue for Q1 was \$17.4 billion which is a 17% year-over-year increase. After a strong start to the quarter, we saw a significant impact on our business as a consequence of the pandemic from the second week of March onwards. This impact has not been felt evenly. We've seen strong growth in gaming and relative stability in technology and e-commerce, which is one of our largest sectors. There are a few contributing factors here: First, as people stay at home, these sectors are seeing more use of their products and services. Second, advertisers in these sectors tend to optimize for measurable objectives and we are generating sales at lower prices due to the overall reduction in ad demand. On the other hand, we've seen significant declines in travel and auto as these industries have been hit particularly hard. These trends are continuing in the first two weeks of Q2, and Dave will share more on this shortly.

Companies of all types are adapting to a world where people aren't walking into their stores are seeing their brand on Billboard. With more people spending time on our products and services than ever before, we are focused on continuing to deliver free and paid tools to help businesses reach the right people at the right time, and on finding new ways to support those struggling to keep the lights on and pay their employees. People are looking for businesses on Facebook and Instagram more than usual during this crisis, so our free products are particularly important than many brick and mortar businesses pivoting quickly online. Even in the United States, before the crisis, one in three companies didn't have a website because they can be expensive and difficult to set up even in the best of times. A Facebook page or Instagram business profile is free and in a matter of minutes established as a digital storefront.

Many are finding creative ways to engage their customers using our free products from gyms offering workouts on Facebook Live to stores and restaurants using WhatsApp and Messenger to reach customers with delivery options. In Thailand, when Penguin Eat Shabu closed the doors of its nine restaurants, they started selling to go boxes. They promoted them with Facebook posts and customers could order through Messenger and they got 350 sales in one minute. A second offer led to 2,500 hot spot sales, after initially putting their employees on unpaid leave, these sales increased their revenue and help restore employees to full pay. Marketers of all sizes have more limited budgets. So they need to make every dollar work as hard as possible. That means measuring the value of their advertising is more important than ever which is something our personalized ads provide. For years, we have made major investments in systems and tools that enable businesses to easily understand their return on investments. In the current environment, these investments are paying off.

We are also launching new products to help businesses adapt to changing circumstances. Our teams moved quickly to make gift cards available on both Facebook and Instagram, giving customers the option to support businesses by paying upfront for products and services they can use later. We also made it possible for people to create fundraisers for local businesses with a few simple clicks. Fundraisers have been available to support non-profits and people since 2015, but given the overwhelming interest in helping small businesses weather the storm, we made these tools available for businesses as well, something we never expected to do. We also launched temporary service changes to make it easier for businesses to share critical information like inventory updates, shipment details or new ways to buy. For example, if a restaurant needs to shift to a delivery model, they can now add food delivery links to their Facebook page or Instagram business profile, trading these products quickly in the current environment wasn't easy and I'm grateful to our products and engineering teams, who are executing so well working from home.

The Business Resource Hub we launched in early May is a one-stop shop where businesses of all sizes can find support and virtual training that can help them migrate online. People can take courses on everything from how to connect with customers via messaging and Facebook Live to add increased online sales. We are fortunate to be in a strong financial position. We can continue to pay all of our employees and contractors during this difficult time which is why we believe we have a real responsibility to help others especially small businesses around the world. In mid-March, we announced a \$100 million grant program to help 30,000 small businesses across to more than 30 countries, we call home. Applications opened this month and we are focused on getting cash into their hands as soon as possible.

Economic crisis hit vulnerable communities the hardest especially women and women of color and the families who depend on them. That's why half of the grants available in the U.S. are earmarked for women minority and veteran owned businesses. We have also worked closely with the U.S. Government Small Business Administration to spread the word to small businesses about how to apply for relief loans, reaching 30 million accounts across Facebook and Instagram with this information. Businesses aren't the only ones facing hardship, newsrooms are too. At a time when critical information is needed to keep the community safe, news

organizations are seeing steep declines in ad revenue. In late March, we announced a \$100 million investment to support the news industry, with \$25 million in grant funding for local news organizations and \$75 million in marketing spend to get money to publishers. We have a responsibility to help during this uncertain times by connecting billions of people when they are separated physically, getting vital health information on -- to people on a dramatic scale and helping small businesses survive.

I want to close by saying how grateful I am to our partners and teams around the world. During this unprecedented time, we are trying to stay closer than ever to businesses large and small as they adapt to these significant challenges. I also want to thank our teams for ensuring our services keep running and working so hard to launch new products, so we can continue making a real difference in people's lives. This is such a difficult period for everyone and we are grateful for the important work that is being accomplished by so many.

Now here's Dave.

Dave Wehner {BIO 2419389 <GO>}

Thanks, Sheryl, and good afternoon, everyone. Echoing Mark and Sheryl's comments, my thoughts are with everyone facing challenges during this difficult and unprecedented time. Before turning to results, I wanted to comment briefly on Facebook's operating posture during the crisis. We took early action to ensure that all employee -- our employees were safe and move to a global work from home stance on March 6th and the week prior to the WHO declaring COVID-19 a global pandemic. We are currently operating with over 95% of our full-time employees working from home, with safety being the number one priority for those essential workers who need to come into our data centers and other facilities. We have been able to both support our existing employees and onboard new employees throughout this period. While we are by no means operating at a 100% of capacity across every dimension of our operations, we have continued to ship new product releases, maintain service availability, review content and stay connected with our business customer. Given the circumstances, we have been pleased the dedication and professionalism with which the Facebook team is tackling the challenges presented by this crisis.

Now turning to the results. The COVID-19 pandemic is having a broad impact on our community metrics, revenue, expenses and business operations. Our community metrics reflected increased -- reflect increased engagement as people around the world have sheltered-in-place. It's gratifying that people are using our family of apps to stay informed and connect with people and organizations that they care about. In March, we estimate that on average 2.3 billion people used at least one of our services on a daily basis and that approximately 3 billion people were active on a monthly basis. We have seen increased usage across all of our services, particularly in markets that have been most impacted by the virus, including a surge in video and voice calling on Messenger and WhatsApp. People around the world have increasingly turned to Facebook as well. Daily active users reached 1.73 billion, up 11% compared to last year. DAUs represented approximately 67% of the 2.6 billion

monthly active users in March. MAUs grew 228 million or 10% compared to last year. We expect that we will lose some of this increased engagement when shelter-in-place restrictions are relaxed and life returns to a more normal cadence, which we all look forward too.

Turning now to the financials. Q1 total revenue was \$17.7 billion, up 18% or 19% on a constant currency basis. Had foreign exchange rates remained constant with Q1 of last year, total revenue would have been \$275 million higher. Q1 ad revenue was \$17.4 billion, up 17% or 19% on a constant currency basis. Again, the COVID-19 pandemic had an meaningful impact on our revenue. Revenue was strong from the beginning of the quarter through the first week of March when we began to see a steep slowdown in our ads business, particularly in countries that implemented shelter-in-place measures to reduce the spread of the virus. As Sheryl mentioned, there was a great deal of variability by vertical. During the last three weeks of March, travel and auto were our weakest verticals and we saw relative strength in gaming, technology and e-commerce. These trends have continued into Q2. We've seen relatively comparable pullbacks amongst large and small advertisers. COVID-19 had an impact across the globe in Q1. On a regional basis, ad revenue growth was strongest in Asia-Pacific at 21%, followed by U.S., Canada, Europe and Rest of World at 16% each.

Turning now to our price and volume metrics. In Q1, the total number of ad impressions served across our services increased 39% and the average price per ad decreased 16%. The growth of impressions was primarily driven by Facebook Mobile News Feed due to product optimizations we made prior to the pandemic as well as from increased engagement, that I talked about earlier. The decline in average price per ad was largely attributed -- attributable to the reduction in advertiser demand during the last three weeks of March. Other revenue was \$297 million, up 80% driven primarily by sales of Oculus products. As a reminder, we launched Quest in May 2019.

Turning now to expenses, Q1 total expenses were \$11.8 billion, up 1% on a reported basis, excluding the \$3 billion expense we reported in Q1 related to our settlement with the FTC, Q1 of last year that is, related to our settlement with the FTC, total expenses were up 35% year-over-year. Cost of revenue increased 23%, driven primarily by depreciation related to our infrastructure spend. R&D grew 40% and was driven primarily by investments in core product as well as our innovation efforts, particularly in AR-VR. Marketing and sales grew 38% and was driven by consumer and growth marketing. Finally, excluding the FTC expense from Q1 of 2019, G&A grew 49%, driven partially by an increase in estimated credit losses related to COVID-19. We had over 3,300 net new hires in Q1, primarily in technical functions and ended the quarter with over 48,000 full-time employees, up 28% compared to last year. As I mentioned earlier, we continue to recruit and onboard new employees successfully while in a work from home environment.

Operating income was \$5.9 billion, representing a 33% operating margin and our tax rate was 16%. Net income was \$4.9 billion or \$1.71 per share. Capital expenditures were \$3.7 billion, driven by investments in data centers, servers, office buildings and network infrastructure. We had \$7.3 billion of free cash flow in the quarter and we've

repurchased \$1.2 billion of our Class A common stock. We ended the quarter with \$60.3 billion of cash and investments. As I mentioned last quarter, though we booked the FTC expense in 2019, we did not pay the \$5 billion settlement amount until the -- after the first quarter of 2020 closed. In addition, this past week, as Mark mentioned, we signed an agreement to invest approximately \$5.7 billion into Jio platforms in India. Our strong balance sheet proved to be an important outset this quarter, enabling us to commit to a long-term growth priority in India even in the midst of a troubled global economy.

Turning now to the outlook. With the COVID-19 crisis, like all companies, we are facing a period of unprecedented uncertainty in our business outlook, certainly in the nearly eight years, I've been with Facebook. We expect our business performance will be impacted by issues beyond our control, including the duration and efficacy of shelter-in-place orders, the effectiveness of economic stimuli around the world and the fluctuation of currencies relative to the U.S. dollar. On the latter point alone, since the WHO declared COVID-19 as a pandemic, we have seen the U.S. dollar appreciate 5% relative to the foreign currencies we do business in. Given the increasing uncertainty on our business outlook, we are not providing specific revenue guidance for the second quarter or full year 2020. Rather, I would like to provide a snapshot of revenue performance in the second quarter thus far. There is a tremendous amount of macro uncertainty, so it's difficult to extrapolate performance based on a small sample of data.

After initial steep decrease in ad revenue in March, we have seen signs of stability reflected in the first three weeks of April, ad revenue has been approximately flat compared to the same period a year ago down from the 17% year-over-year growth in the first quarter of 2020. The April trends reflect weakness across all of our user geographies, as most of our major countries have had some sort of shelter-in-place guidelines in effect. We are understandably cautious, given that most economists are forecasting a global GDP contraction in Q2, which if history were a guide, would suggest that the potential for an even more severe advertising industry contraction.

In terms of expenses, we are continuing to monitor the COVID-19 situation and its impact on our business and operations and we'll adjust our plans accordingly. We expect to realize operational savings in certain areas, such as, travel, events and marketing as well as from slower headcount growth in our business functions. However, we plan to continue to invest in product development and to recruit technical talent. In addition, we have committed over \$300 million to date in investments to help our broader community during this crisis, which will have an impact on our financial performance this year. As a result, we expect total expenses in 2020 to be between \$52 billion and \$56 billion, down from the prior range of \$54 billion to \$59 billion. While this reflects a moderate reduction in the planned growth rate of total expenses, our overall expense growth in the face of expected revenue weakness will have a negative impact on our 2020 operating margins.

Turning now to capital expenditures. Our significant investments in infrastructure over the past four years have served us well during this period of high user engagement. We plan to continue to grow our CapEx investments to enhance and

expand our global infrastructure footprint over the long term. In 2020, we now expect capital expenditures to be approximately \$14 billion to \$16 billion, down from our prior range of \$17 billion to \$19 billion. This reduction reflects a significant decrease in our construction efforts related to shelter-in-place orders. Given the strong engagement growth and related demands on our infrastructure, this year's CapEx reduction should be viewed as a deferral into 2021 rather than savings [ph].

Turning now to tax. We expect our full year 2020 tax rate will be in the high teens, although we may see fluctuations in our quarterly rate depending on our financial results. Our thoughts are with those in the community who are facing health challenges during this crisis and with those healthcare workers on the front lines. We are also mindful of the challenges many businesses are facing in this crisis, including the 140 million small businesses who use our platform. Our focus is first and foremost on helping our broad community navigate these challenges.

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

Questions And Answers

Operator

(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 questions. Hope everyone is safe. I have two, just the first one for Sheryl or Dave. I appreciate all the color on the different ad verticals between gaming, e-commerce, travel and autos et cetera. I guess I'd be curious to hear about sort of what happened in the decline in the ad business you saw in March compared to the stability in April sort of what changed in those verticals? And then understanding you're not giving guidance, but talk to us about some of the key verticals that would be needed to sort of bring the business back to growth as we go throughout the year?

And then the second question for Mark, you talked a little bit about SMBs. Curious to hear about some of the key investment areas and initiatives you really think you need to execute on to make the SMB offering more comprehensive in 2021 and beyond?

A - Dave Wehner {BIO 2419389 <GO>}

Okay, Brian. Did you want to take that Sheryl.

A - Sheryl Sandberg {BIO 15339456 <GO>}

No, why don't you go first and I'll go second.

A - Dave Wehner {BIO 2419389 <GO>}

Okay.

A - Sheryl Sandberg {BIO 15339456 <GO>}

You take the first. I'll take the second.

A - Dave Wehner {BIO 2419389 <GO>}

Yeah, sure. Sorry, we are doing our coordination. So Brian, yeah, the trends that we saw in the end of Q1, we saw a pullback, pretty broad based pullback, especially concentrated in some of the areas that we talked about, things like travel and auto, but really kind of broad-based, large and small advertisers. We saw relative strength even then in a few categories like gaming, where you have always on campaigns that we're able to pick up some supply because the lower pricing kind of cleared at the levels that those advertisers were trying to acquire users at, so that is one of the benefits of the auction. And then e-commerce, we've seen -- it was not as strong as gaming, but we've seen that show signs of stability as well. And all of those trend sort of continued into Q2. So I don't think there's a lot of vertical shifts, but I think we see an e-commerce sort of do reasonably well. What we're seeing is really I think pretty straightforward, we're seeing people who are driving towards online conversion events do well because they're able to kind of bid in the auction and get those users and get those results that they're looking for. And people who are like looking for offline or more top of funnel brand, there we see more pullback instead.

A - Sheryl Sandberg {BIO 15339456 <GO>}

To your second question on SMBs. There's really two parts to this, one is what are we doing now to help SMBs weather the storm and come back to business and be able to pay their employees and the second is the ongoing ad work we do. On first, I think we've been really focused -- we came out early with our \$100 million grant program and we're rolling it out very aggressively around the world, trying to get money to people very quickly and we're building specialized products we never would have thought of before, fundraisers were something that we did for non-profits or people not small businesses. So in this very difficult time for SMBs, we're really focused on doing everything we can to help them survive and even thrive as they help transition online.

SMBs are also a major part of our business going forward, and on there, it's really the execution we do quarter-after-quarter to make our ads perform. We offer very personalized ads that can be directly targeted at small groups. We do that in a very privacy protective way and those ads are often most important for small businesses who can't afford to buy broad-based media. And so all of the work we do to continue to allow targeting all of the work we do to make the ads more personalized. All of the work we do to make free tools available which is important for all the online businesses who use our free tools, there were 140 million of them as well as the 8 million who are our advertisers and the funnel between us. That's the nuts and bolts of our business. We work on it every day. We're continuing to work on it every day through this crisis, and we'll continue beyond that.

A - Dave Wehner {BIO 2419389 <GO>}

Mike, we'll go to the next question.

Operator

Your next question comes from the line of Doug Anmuth from JPMorgan.

Q - Douglas Anmuth {BIO 5591566 <GO>}

Great. Thanks for taking the question. I have two, I think probably both for Mark. The first, I was hoping you could talk more about the functionality of WhatsApp and perhaps other platforms as you expand in India with the Jio platforms partnership. Now there are other markets where you could see something similar or is this strategy here unique to India? And then second, just given the increased engagement with communication tools and voice and video in particular, how is that translating into increased activity in the feed and within stories? Thanks.

A - Mark Zuckerberg {BIO 15103277 <GO>}

Sure, I can. I can speak to the first one and Dave can see if there are any stats in particular to share on the second one. And for commerce on WhatsApp more broadly, we're very focused on making it to that small businesses can have a presence on all of the apps, right. Facebook, Instagram, WhatsApp and Messenger and can communicate organically with people and then increasingly can do things that can help them drive transactions. So we've started rolling out things like catalogs in WhatsApp. We're working on payments to be able to complete transactions. And we've rolled out a new ad format, click to messaging ads, where basically a lot of small businesses and different businesses are finding that their message threads with people perform better for driving sales and their websites or other presences. They basically buy ads inside Facebook or Instagram, then send people through chat threads. And then as we build out all these tools around that -- around making those threads more valuable, we think that those ads will only increase in value which is the way we're currently thinking about that business.

In India with Jio. Jio has had this vision for a while, I want to be careful not to pick words in their mouth, but just from what they've basically described both to us and publicly about their Jio Mart vision is there are millions of small businesses and shops across India, and they want to try to help get them onto a single network that you'll be able to communicate with through WhatsApp and do payments online through WhatsApp. So I think that is a great -- very large example of how we can wire up and help small businesses in the country, where we have the largest WhatsApp community. But certainly all the products and technology that we're building to enable that partnership are going to be things that we want to do around the world. So we're very excited about working with them to drive this vision forward and then extending it everywhere over the coming months and years.

I mean Dave I don't know if you want to say anything about the second point. I think it's -- at a high level, I mean you may have stats that you want to share, but I think it's -- we have seen a broad-based increase in use of the products. It's hard to know what is just correlated with the pandemic versus people who are doing more video chat or messaging. So therefore they also connect more in other parts of the products,

but I do think overall we believe that providing a broad set of social tools for people is -- and just providing more value for people does accrue to all of the different services, which is important because as you know some of the services for our business we include ads in and some we don't.

A - Dave Wehner {BIO 2419389 <GO>}

Yeah. And the only thing I would add there is, we talked about 39% increase in ad impressions, and that's really driven by engagement increases on our Feed products and Stories products as well as the search that we've seen in the video and messaging. So it really wasn't limited to video and messaging, it was broad-based, as Mark said, and that's creating supply on the ad impression side as well.

Operator

Your next question comes from Justin Post from Bank of America Merrill Lynch.

Q - Justin Post {BIO 3469195 <GO>}

Great, thanks. Sheryl maybe you could talk a little bit about the ad auction dynamics. Are you seeing e-commerce and digital replace auto and other categories and how efficiently is that auction working? And secondly can you give us any color on percent of ads that come from direct response versus brand or maybe CPC bidding versus CPM? Thank you.

A - Dave Wehner {BIO 2419389 <GO>}

Or I can take that, Justin. In terms of the ad auction dynamics, yes, I mean we are seeing when one vertical is doing better than the other or people fall out of the auction. We have very dynamic concept, it's -- and so we're able to back fill that with other bids from other clients. So we're seeing a lot of bidding into the system from gaming and e-commerce as prices come down, it's also more economic and they can get the ROIs that they want so it's a natural way in which does that happens and you see a replacement effect there, so that's working well. Far more -- by far the majority of our revenue, we haven't given a specific number on what is direct response, but it's really for many years driven our business, it continues to drive our business, and I would say, if anything COVID is accentuated the importance of people who are bidding for online conversions, and so I think we've seen a fall-off in some of the more sort of broad-based brand advertising right now and really a focus on those things that are driving direct results today which isn't really surprising given the economic climate.

Operator

Your next question comes from the line of Ross Sandler from Barclays.

Q - Ross Adam Sandler {BIO 15948659 <GO>}

Hey guys. Just a follow-up to the last question, I think about four years ago, you mentioned that the top 100 advertisers were just under 25% of revenue and coming down. So I guess how does that mix look today? And then Dave, I think you

mentioned large and small advertisers were kind of pulling back in March and then into April at about the same rate, but any more pronounced decel from large versus small, any color there?

And then second question is, Mark you mentioned in your opening remarks that something along the lines of high margins are important to the company, especially given the economic environment. So how do you think about balancing levels of investment with revenue over the long term. Has you're thinking around that changed versus I think you mentioned that comment maybe two years ago, has anything changed in the way you're thinking about margins? Thank you.

A - Dave Wehner {BIO 2419389 <GO>}

Hey, Ross. It's Dave, I'll take that first one. Yeah, we've seen sort of a pullback of advertising from both large and small advertisers. And I would say, given the uncertain economic climate, we know SMBs are getting hit hard. But our business is quite diversified and there is no one size fits all for SMBs. We've got some businesses that are obviously suffering greatly from the shelter-in-place orders. And then we have SMBs who are also digital natives and have online objectives and those are doing relatively better. So we've got SMBs who are in gaming and e-commerce and alike. So we are seeing, I think, a fairly diverse range of SMBs. And I would say, in terms of the diversity of our business that's -- that remains very high. We're not concentrated. But we haven't updated that specific stat that we gave back four years ago, but we remain very diversified from an advertiser perspective.

A - Mark Zuckerberg {BIO 15103277 <GO>}

Yeah, I can talk to the margins a bit. Overall, I think during a period like this, there are a lot of new things that need to get built. And I think it's important that rather than slamming on the brakes now, as I think a lot of companies may, that it's important to keep on building and keep on investing in building for the new needs that people have and especially to make up for some of the stuff that other companies would pull back on, and I think that's, in some ways, that's an opportunity, in other ways, I think, it's the responsibility to keep on investing in the economic recovery. So that's in the near term. But the other reflection that I've had is that, I think if you're going to have a business which is primarily advertising, which is our plan after the long term, then I think you have to recognize that advertising is more volatile and sensitive to the macro economy, and therefore, if you're going to have this kind of a business, I think you really want to maintain high margins. So that way when we go through periods like this, you can make sure that we remain stable and healthy and able to keep on building the things that are important for the long term. So what I guess I'd want to -- just be clear on is that, we are willing to accept a reduction in margins in the near term, but we understand and I personally have an appreciation for the importance of maintaining high margins over time. So it's not that we're going to kind of take things down this year and then continue taking things down a lot in the future. I think over the coming years, if we invest a lot more now I think we are going to look for ways to manage expenses to make sure that we can maintain high margins over time.

Operator

Your next question comes from the line of Youssef Squali from SunTrust.

Q - Youssef Houssaini Squali {BIO 1506420 <GO>}

Great. Thank you very much. Two questions, Mark can you discuss the performance of your gaming platform, including Oculus so far. How satisfied are you with the traction there and what are you doing to better position the company to take advantage of the increased engagement we're seeing on other platforms competing platforms? And maybe Dave or Sheryl, can you speak to the trend you're seeing in markets where COVID-19 hit earlier say maybe January and February and how they're performing today and any learnings from these markets? Thank you.

A - Mark Zuckerberg {BIO 15103277 <GO>}

Sure. So I could talk a bit about games. We have a few big areas of investment here. One is just in our mobile apps, a massive amount of growth in live streaming. That's - I talked about Live Video in my opening remarks and people live streaming gaming content is certainly one big category that's growing quickly and that we're investing a lot in. So that I think is going quite well. We recently had some pretty big launches of an app in that area and we're going to keep on investing there.

And on the virtual reality side, this has always been a long-term vision. Quest has surpassed our expectations. I wish we can make more of them faster during this period. I do think that it's one of those areas where, as people can't go out into the world as much, the ability to have technology that allows us to be physically present or feel present even when we can't be physically together, whether that's Quest or portal or any of the software that we're building around video presence, that stuff has certainly seen especially large spikes in usage, and it's possible that this brings -- accelerate some of the trends around adoption of things like virtual or augmented reality. But I'm not sure what will happen there long term. But in the near term, I'm quite pleased with how Quest is doing, and I wish we could make more of them.

A - Dave Wehner {BIO 2419389 <GO>}

Youssef, I'll take the second part of that question. So I think it's probably the market that would be most instructive would be a market like China, but I think for us, China is a bit different because we don't have users in China. So the business there is trying to based advertisers reaching people outside of China. So it's hard to extrapolate too much from that. We did see a pullback of revenue in China earlier in the quarter and we have seen a recovery there and a recovery -- but one thing that's hard to know is part of that is really kind of mixed up in the verticals as well. China tends to -- for us index pretty highly with gaming and e-commerce and those segments are driven towards online outcomes where we're seeing relative strength. So it's hard to really read too much into the experience.

Operator

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

Q - Eric J. Sheridan {BIO 22465717 <GO>}

Thanks for taking the question. Maybe two if I can, one bigger picture one dovetailing all the comments around e-commerce. I'm curious if there's anything you're seeing in terms of the behavior of users on the platform that would make Q1 to accelerate or change the path of product development to capture some of the supply and demand you might be seeing as people want to sell in an omnichannel world and some of the demand that might be there on the buyer side to connect e-commerce broadly across Facebook's properties as an output of the current environment? And then Dave, maybe if I could just ask one quickly, I don't think you called it out, but I am curious if you could identify the credit loss assumption in the quarter and what the number might have been or is that something we might have to wait for the 10-Q for? Thanks so much.

A - Dave Wehner {BIO 2419389 <GO>}

Mark, did you want to -- do you want to take the e-commerce or do you want me to do both.

A - Mark Zuckerberg {BIO 15103277 <GO>}

I mean I can talk to it briefly, and then you can add to it, if you think that there is more. We are seeing increases in some of the consumer behavior around this, but I think the bigger thing is just that, for all the small businesses that we serve and a lot of small businesses that are out there that are still primarily physical, there is a -- there's been a big push to get online and to do more selling online. And I think that there are lots of opportunities for us to support them and building the tools that they need to do this. We're seeing a lot of businesses that were primarily physical now moving towards selling stuff online for the first time, and we're seeing a lot of businesses that already had a digital presence now really transitioned to having their digital presence be primarily -- be their primary presence. And that I think that that trend while there may be some short-term spike, I do think plays into a pre-existing long-term trend. And we'll certainly want to accelerate that aspect of our product road map to make sure that we can serve a lot of those businesses during this period when it can help them with the recovery and get through this. So we're working on a lot of work streams there. We'll hopefully have more to share over the coming weeks.

A - Dave Wehner {BIO 2419389 <GO>}

Yeah. Eric on the bad debt expense, that increased by \$193 million. So that'll be the number that's in the Q, and the majority of that relates to charges obviously that we're taking related to the COVID-19 pandemic and our views on collectability of certain accounts in that environment.

Operator

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

Q - Mark Stephen F. Mahaney {BIO 3027058 <GO>}

Thanks. Two questions. Mark, at the very beginning you talked about the economic fallout possibly lasting longer than people think. Just any detail behind that. Is there

something you're seeing in the data so that you've got reaction? And then following up a little bit on Eric Sheridan's question, these are these kind of events crisis can create new, I don't know, perhaps streams or whatever. So you talked about shopping. What about WhatsApp there's a surge in usage of WhatsApp, is there something that's happened that makes it more interesting more -- for long-term more interesting as a monetization vehicle because of the surge in usage of WhatsApp? Thanks.

A - Mark Zuckerberg {BIO 15103277 <GO>}

Yeah. I can take those two. I think that we'll see a meaningful economic hit, if I had to predict for the period of the health emergency. And so I think that, as Dave said in his comments, the efficacy of the shelter-in-place orders and how well that's going. I think will be a big determinant of how long and how painful the economic fallout is from this. So there's certainly a range of outcomes, I don't think I have any particular insight that that's not public or that you don't have. But I worry that this could be worse than at least some people are predicting.

The what was -- the other question was monetization on WhatsApp? I think that there is a huge opportunity on WhatsApp if for no other reason than that it has 2 billion people using it and we haven't done significant work on building out the business yet. I mean, we have some tools there, but we're still early in the phase of -- we've built out WhatsApp business, there is tens of millions of businesses that are signed up and that are using that. So it's -- there is tremendous demand, people want to communicate with businesses and we've been in the process of building out the infrastructure to do payments and more commerce ad units like what I mentioned around click to messaging ads are performing well. So I think all the indicators are positive, but it's just a generally untapped opportunity so far, and one that we're -- that I think it's very exciting to build out over the coming years.

A - Dave Wehner {BIO 2419389 <GO>}

I think Deborah is trying to say that there is one last question.

A - Deborah T. Crawford {BIO 5934723 <GO>}

Yeah. Thank you.

A - Dave Wehner {BIO 2419389 <GO>}

If we could just take one last question, please.

Operator

Your last question comes from the line of Colin Sebastian from Baird.

Q - Colin A. Sebastian {BIO 6373379 <GO>}

Great. Thanks for taking my question. I guess first, Dave, I was hoping I know this is not a key focus right now, but any updated thoughts or timeline on some of the targeting and measurement headline -- headwinds that you spoke about on the last

call. And then with respect to both the ongoing investment priorities as well as the slower growth in headcount, is there any way you could articulate which areas are seeing that slowdown versus those that are getting full support? Thank you.

A - Dave Wehner {BIO 2419389 <GO>}

Sure, Colin. I can take both of those. Yeah, I mean the targeting headwinds are having an impact on the business, but obviously that's dwarfed by the impact that COVID-19 is having right now. We continue to see the three factors around targeting and this hasn't changed the regulatory pressures with GDPR and CCPA and similar regulations. The moves by platforms that make third-party targeting and measurement more difficult than our own moves on launching privacy controls. So these are impacting the whole industry and we believe we're relatively well positioned. We've got a lot of first-party signal. That said, I think this will have a broad impact on return on investment and could affect what advertisers are able to find and acquire customers effectively for their businesses. They may not be able to grow as quickly as they otherwise could if that could have a negative impact on their growth and the economy and obviously revenue for us. So certainly, it's a challenging time to make it tougher for businesses to grow, but we're certainly continue to have that headwind in the longer term.

A - Deborah T. Crawford {BIO 5934723 <GO>}

Great. Thank you joining us...

A - Dave Wehner {BIO 2419389 <GO>}

And then sorry -- I forgot the investment priorities. We're continuing to focus on recruiting on the tech side. So product and engineering, so we're sort of fully going down that path. That's why it's our core product and sort of innovation efforts and we are slowing down headcount in business functions. So some of the functions related to things like advertising sales is slower in those departments, given the overall economic climate. And then there are certain areas that we're just finding efficiencies, there's less travel, there's less entertainment, and I think that may persist for quite some time. So we're seeing savings there and we're going to be looking at getting marketing efficiencies because obviously prices are coming down on the marketing front, so that we can get the same impact for less dollars and also look for efficiencies on marketing spend. So those are the areas that I would call out.

A - Deborah T. Crawford {BIO 5934723 <GO>}

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

A - Dave Wehner {BIO 2419389 <GO>}

Thanks everybody.

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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