

## Q2 2019 Earnings Call

### Company Participants

- Dave Wehner, Chief Financial Officer
- Deborah Crawford, Vice President, Investor Relations
- Mark Zuckerberg, Chief Executive Officer
- Sheryl Sandberg, Chief Operating Officer

### Other Participants

- Ben Schachter, Analyst, Macquarie
- Brent, Analyst, Jefferies
- Brian Nowak, Analyst, Morgan Stanley
- Colin Sebastian, Analyst, Baird
- Doug Anmuth, Analyst, JPMorgan
- Eric Sheridan, Analyst, UBS
- Heather Bellini, Analyst, Goldman Sachs
- Justin Post, Analyst, Bank of America Merrill Lynch
- Lloyd Walmsley, Analyst, Deutsche Bank
- Mark Mahaney, Analyst, RBC
- Mark May, Analyst, Citi
- Michael Nathanson, Analyst, MoffettNathanson
- Ross Sandler, Analyst, Barclays

### 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 Second Quarter 2019 Earnings 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 Crawford {BIO 5934723 <GO>}

Thank you. Good afternoon and welcome to Facebook's second quarter 2019 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](https://investor.fb.com).

And now, I'd like to turn the call over to Mark.

## **Mark Zuckerberg** {BIO 15103277 <GO>}

Thanks, Deborah; and thank you all for joining today. This was an important quarter for us. Our community and business continue to grow and there are now more than 2.7 billion people using Facebook, Instagram, WhatsApp or Messenger each month and more than 2.1 billion people who use at least one of our services each day. We continue to focus on our four priorities for the year: making progress on the major social issues, building qualitatively new experiences, building our business and communicating what we stand for more transparently.

I'm going to focus on the first two priorities today, but first I want to talk about the recent news that we reached a settlement with the FTC over our privacy concerns. As part of this, we've agreed to pay a \$5 billion fine; but even more importantly, we're making some major changes to how we build our services and run this company. This will require investing a significant amount of our engineering resources and building tools to review our products in the way as we use data. It'll also significantly increase our accountability by bringing the process for auditing our privacy controls more in line with how financial controls work at public companies at Sarbanes-Oxley.

We'll have to certify quarterly that we're meeting all our privacy commitments. And just as we have an Audit Committee of our Board overseeing our financial controls, we will now also have a new privacy committee of our Board that will oversee our privacy program and work with an independent privacy auditor that will report to this new committee and to the FTC. We're asking one of our most experienced leaders and product to take on the role of Chief Privacy Officer for product reporting to me and managing our privacy program.

We'll also be more rigorous in monitoring developers who access data through our platform. Together, we expect these changes will set a new standard for our industry. This is a major shift for us. We built services that billions of people trust every day to communicate with the people they care about. Privacy has always been important to the services we provide. And now it's even more central to our future vision for social

networking. It's critical that we get this right and we're going to build it into all of our system. It's going to take time to do this properly, and I expect it will take us longer to ship new products, especially while we're getting this up and running. I also expect that just as with the work we've been doing on safety and integrity, we're going to continue to identify and fix issues as we develop our systems. But our goal is to build privacy protections that are as strong as the best services we provide, and this settlement gives us clear requirements moving forward.

Now, turning to our company priorities. Our top priority is making progress on the major social issues facing the internet, including privacy and also elections, harmful content, data portability and more. In all these areas, I've advocated that I believe that the Internet would benefit from governments setting clear rules. I don't believe it's sustainable for private companies to be making so many decisions on social issues without a robust democratic process, either the right regulations will get put into place or we expect frustration with our industry will continue to grow.

This quarter, I spent time in Europe talking with policymakers about how this could work. I met with the President Micron to discuss the framework for harmful content. This is an area where I believe there could be an effective public process led by democratically-elected governments in Europe and perhaps in the US a process for industry standards and self-regulation. But we're not waiting for regulation to increase independent oversight. We just released our third transparency report, which shows the progress that we're making on many categories of harmful content, including hate speech and graphic violence. Those are the areas where we still need to do better, like bullying and harassment. I believe, more companies should release transparency reports that enumerate the prevalence of harmful content on their services. This would help companies and governments design better systems for dealing with it.

After next year, we're going to publish these reports quarterly so people can hold us accountable as the same cadence as these earnings call. We're also moving forward with our plans for an independent oversight board for decisions on content. I believe it's important that people can appeal the decisions and that we're creating systems that are transparent and that people can trust. We've been working with experts on freedom of expression around the world and we've gotten a lot of public input on how this could work, which we published in a report last month. We expect to form this oversight board by the end of this year. We also continue to invest heavily in protecting elections, including more advanced efforts to stop coordinated in authentic behavior, new ads transparency tool and more fact checking partnerships. Our adversaries are continually getting more sophisticated but recent elections in the EU and India show that our efforts are working. After the recent EU election, the former President of the EU parliament said that we met the commitments to fight election interference that I made in my testimony to the EU parliament. And that's, thanks to our efforts, the elections were much cleaner online. We'll continue building on these efforts as we approach the 2020 U.S. elections to make sure that we stay ahead.

Next, I know there's a lot to discuss in terms of policy. But I also want to discuss our second priority delivering qualitatively new experiences for our community. And there are few efforts here that I'm particularly excited about. The first is our privacy focused vision for the future of social networking, starting with secure, private and interoperable messaging. We're very focused on delivering this over the next five years, building on the foundation we have with Messenger and WhatsApp. With Messenger, we're rewriting the app from scratch to make it the fastest and most secure major messaging platform in the world and we're working towards making end-to-end encryption and reduced permanence, the default for all conversation. With that foundation, we're starting to explore how a private social platform could become the center of your social experience, for example, by bringing together all of your femoral stories from your different apps into one place. We're also building things like the ability to co-watch videos together. This shows something like video chat, which is growing quickly as a basic way that we all communicate can become more of a platform for more ways we want to interact privately in the future.

With WhatsApp which already has incredibly strong privacy and performance. We're more focused on building out all the ways you'd want to interact in this digital living room. WhatsApp status is already the most popular of femoral stories product in the world and we continue to see good momentum there with millions of small businesses using WhatsApp business. We're also building new tools like product catalogs that entrepreneurs around the world can use for free. This matters especially for the growing number of small businesses that don't have a web presence or that use private messaging platforms like WhatsApp as their main way of interacting with customers.

This connected to the next product area, I'm very excited about, which is commerce and payments. These are huge and important spaces and we have efforts in several major areas to deliver qualitatively better experiences than what exists today from Instagram Shopping, Facebook marketplace to payments across our apps to the new Libra projects that we announced to 27 other companies recently. These efforts are important both for our product experience and for our business. Once people are connected to their networks on social platforms. One of the biggest questions is how can we help them use those networks that they've created to create opportunity, and one of the best ways that we can do that is through commerce.

Instagram Shopping will improve the experience of browsing and shopping from your favorite brands and creators, while also giving emerging creators a powerful new way to build a business and sustain their community. Facebook marketplace gives people a way to buy and sell goods and a trusted network with real identities. Hundreds of millions of people are already using Marketplace monthly. We're also building ways for people to interact with businesses through messaging like WhatsApp business. These people don't like having to call businesses and would rather engage asynchronously over messaging as possible. Payments is the part of this that I'm particularly excited about. When I look at the kinds of private interactions that we can make easier, payments may be the most important for the long term. We're continuing to test payments on WhatsApp in India and are close to launching in other countries as well. In the future, we'll enable people to use the same payments account to send money to friends and businesses on WhatsApp,

shop on Instagram or make transactions on Facebook, being able to send money as easily as you can send a photo will open up new opportunities for businesses.

More broadly, I believe that there is an opportunity that help a lot more businesses access financial tools. Last month, we announced that we were working with 27 other organizations to form the Libra Association. The association will create a new currency called Libra, which we powered by Blockchain Technology, so Libra association will be independent of Facebook or any other member but we plan to support this currency across our services. The goal is to empower billions of people around the world who use services like WhatsApp but might be excluded from banking services, with access to a safe, stable and well-regulated cryptocurrency. There are lot of possibilities here and both Facebook and the association plan to work with regulators to help address all of their concerns before Libra will be ready to launch. We worked with other prospective members of the association to release a white paper outlining the Libra concept in advance, specifically, so that we could address these important questions out in the open and we're committed to working with policymakers to get this right.

The third product area, I want to highlight where we're focused on delivering a qualitatively better experience than what exists today, is in the future computing platforms of augmented and virtual reality. This quarter, we shipped Oculus Quest, our first All-in-One headset with no wires and full freedom of movement. It has gotten great reviews and we're selling them as fast as we can make them. More importantly, we've delivered an experienced that people keep using week after week and buying more content, there's still a lot more work ahead to develop this ecosystem and deliver the future VR and AR products that we dream of. But this is an important milestone. In a few years, we've improved the state of the art from the original risks, which cost \$600 and required to be tethered to a \$1,000 PC, to now Quest, which cost \$400 all-in and is a superior experience in many ways. There's going to be even more innovation over the next few years and we now have the platform that we're going to build on going forward.

The recent augmented and virtual reality will deliver a qualitatively better experience than traditional computing platforms, is that they deliver the feeling of presence. So you're actually there with another person or in another. The feeling of presence is so important to social interaction and how we're wired to interact as people. So even if it is taken longer than we expected to deliver the scale, I continue to believe that this will be one of the most important contributions we make to the way we all use technology over the long term.

So that's my update on our work on the major social issues we face and building new product experiences. We've made a lot of progress this quarter and have a lot more ahead. Our business continues to perform well and Sheryl is going to talk about that more in a minute. So this was also an important quarter because now we have a clear path forward, not just in terms of product and business, but in terms of guidance from regulators which sets clear expectations and gives us a foundation to build on. As always, thanks for being on this journey with us and now here is Sheryl.

## **Sheryl Sandberg** {BIO 15339456 <GO>}

Thanks, Mark, and hi everyone. It was a strong quarter for our business. Ad revenue grew 28% year-over-year and we saw strong growth across all regions and on both Facebook and Instagram. Mobile ad revenue was \$15.6 billion contributing approximately 94% of total ad revenue. As we've been discussing, we're making significant investments in safety, security and privacy, while continuing to grow our community and our business. We know we still have a lot of hard work ahead of us, but this quarter, once again shows that we can do both. We are committed to earning back trust through the actions we take. In the lead up to elections around the world, we're doing all we can to get ahead of threats and develop smarter technology. The European Parliament elections in May were an important test for us. We created an operation center in Dublin, to bring our experts together and make decisions quickly. We also worked closely with third-parties across the EU, including 21 fact checking organizations. As Mark shared, these investments are starting to pay off and we remain committed to doing everything we can to stop bad actors.

We are also focused on increasing transparency. At the end of June, we made our transparency tools available globally for ads about social issues elections or politics. These tools show who paid for an how much they spent and who saw the ad, helping people understand who is trying to influence their vote will help us better defend against foreign interference and other abuse. We're going to continue to make investments to protect our platform because it's the right thing to do and it's good for our business over the long term.

At the same time, we are focused on growing our business by helping advertisers grow theirs. Consumers often adopt new technologies first, and our competitive advantage is helping advertisers reach people where they are. We helped businesses make the shift to mobile and now we're helping them shift to stories, video and eventually messaging. We know that it's not enough to make these new formats available. We also need to make it easy for advertisers to create effective ads. We do this by launching new ad products and by improving our existing ones to deliver more value for people and advertisers.

One of our goals is to level the playing field for businesses of all sizes. We get small businesses free tools that previously only the largest companies could access. During National Small Business Week in May, we introduced automated ads to take the guesswork out of creating effective ads. Advertisers answer a few questions and get a customized marketing plan with up to six creative options targeting suggestions on a recommended budget. We also launched new video editing tools to help SMBs quickly create eye-catching video with images, they already have. Fernwood Fitness, a chain of women's health clubs in Australia use these tools to build a mobile first campaign. They targeted women interested in fitness and as a result, nearly doubled their conversions to new membership.

We're also focused on improving our existing ad products. We often get feedback from advertisers about how we can make small adjustments to our tools to better serve them. These basis point improvements allow us to create more value for

businesses over time. For example, we first rolled out our dynamic ads format four years ago, and since then, we have adapted the format to the needs of different verticals and surfaces. Frontier Airlines use dynamic ads to connect with travelers who recently looked at sites online but didn't book. This contributed to a nearly 3.5% increase in ad related bookings and a 2.5 times increase in ad related revenue. This quarter, we launched our latest variation dynamic ads and Instagram stories which show people ads for products they've already browsed on a retailers website or app. We're constantly making incremental improvements to Facebook Feed Ads. This quarter, we improved how quickly we refresh the ads people see. In the past, these ads were pre-selected at the beginning of a Feed session. Now the ads are refreshed while people are scrolling through their feed. This means people get more relevant ads which improves engagement and delivers a better return on investment for advertisers. In addition to improving our ad tools, we're investing in new ways for people to discover products, engage with brands and shop on our platforms.

On discovery more than 60% of accounts on Instagram use Explore every month to discover photos and videos related to their interests. This quarter, we started rolling out Ads and Explore on Instagram. This will give businesses a chance to reach new audiences and a place where they are already spending their time and learning about new product. On engagement, we're making it easier for people to connect with the brands and influencers, they love. Last month, we launched branded content ads on Instagram which allow businesses to promote creators post speed ads. Brands like Old Navy Sephora and Jack in the Box are reaching new audiences with these ads. Soon we'll expand this option, so that advertisers can do the same in stories.

On shopping, we're building new ways for people to shop directly on our apps. We're continuing our closed beta of checkout on Instagram and we launched a new feature this quarter that enables creators to tag products and their posts. This gives people an easy way to shop from their favorite creators without leaving the app. It's early days for shopping on Instagram but we're excited about this over the long run.

I want to close by saying how grateful I am to our partners around the world. Every day, they give us valuable feedback on how to improve our products, so we can help them grow their businesses. I also want to thank the Facebook teams who drive that growth and are making progress on the major social issues facing the Internet and our Company. I'm grateful for our team's tireless work and deep commitment. Thanks, everyone; and here is Dave.

## **Dave Wehner** {BIO 2419389 <GO>}

Thanks, Sheryl; and good afternoon, everyone. Let's begin with our community metrics. Facebook daily active users reached 1.59 billion, that's up 8% compared to last year led by growth in India, Indonesia and the Philippines. This represents approximately 66% of the 2.41 billion monthly active users in June. MAUs grew \$180 million or 8% compared to last year. In terms of our Family metrics, we continue to grow and estimate that on average more than 2.1 billion people used at least one of our apps on a daily basis in June, and more than 2.7 billion people were active on a monthly basis.

Turning now to the financials. All comparisons are on a year-over-year basis unless otherwise noted.

Q2 total revenue was \$16.9 billion, up 28% or 32% on a constant currency basis. Had foreign exchange rates remained constant with the second quarter of 2018, total revenue would have been approximately \$574 million higher. Q2 total ad revenue was \$16.6 billion dollars, up 28% or 32% on a constant currency basis. In terms of regional ad revenue growth, north America and Asia Pacific were strongest and both grew 30%, followed by Europe at 25%. Rest of world grew more slowly at 21% and was impacted by currency headwinds.

In Q2, the average price per ad decreased 4% and the number of ad impressions served across our services increased 33%. Similar to last quarter, impression growth was primarily driven by ads on Instagram Stories, Instagram Feed and Facebook News Feed. The year-over-year decline in average price per ad reflects an ongoing mix shift towards Stories ads and geographies that monetize at lower rates. Payments and other fees revenue was \$262 million, up 36%. This year-over-year growth was primarily driven by sales of new products, notably, Oculus Quest and the Rift S.

Turning now to expenses. Total expenses were \$12.3 billion, up 66%. This includes an additional \$2 billion expense accrued in connection with our \$5 billion settlement with the Federal Trade Commission. Absent this charge, our total expense growth rate would have been 27 percentage points lower. We ended Q2 with approximately 39,700 full-time employees, up 31%. Operating income was \$4.6 billion, representing a 27% operating margin. Absent the FTC accrual, operating margin would have been approximately 12 percentage points higher. Our Q2 tax rate was 46% and was higher than expected due to the tax treatment of the FTC accrual and the court ruling in the IRS versus Altera case.

In that case, the Ninth Circuit reversed a prior Tax Court decision addressing the tax treatment of certain share-based compensation expenses. We changed our treatment this quarter to reflect the Ninth Circuit opinion which resulted in a one-time income tax charge of \$1.1 billion. Net income was \$2.6 billion or \$0.91 per share. Absent the impact of the FTC accrual and the Altera ruling, our EPS would have been approximately \$1.08 higher. Capital expenditures were \$3.8 billion driven by investments in data centers, servers, office facilities and network infrastructure. We generated \$4.8 billion in free cash flow and ended the quarter with approximately \$48.6 billion in cash and investments. In Q2, we bought back approximately \$1.1 billion of our Class A common stock.

Turning now to the revenue outlook. We executed well in Q2 with a number of optimizations and product wins, particularly with the Facebook app that fell in our favor and help combat the overall trend of deceleration. However, we continue to expect that our constant currency revenue growth rates will decelerate sequentially going forward. We also expect more pronounced deceleration in the fourth quarter and into 2020 partially driven by ad targeting related headwinds and uncertainties.



Turning now to the expense outlook. We anticipate full year 2019 expenses to grow 53% to 61% compared to 2018. The \$5 billion in accruals we recorded in the first half of 2019 related to the FTC settlement represents approximately 16 percentage points of this anticipated expense growth. Absent the \$2 billion accrual we recorded in Q2, our 2019 expense outlook is essentially unchanged from last quarter. I want to reiterate that our agreement with the FTC involves implementing a comprehensive expansion of our privacy program, including substantial management and board of directors oversight, stringent operational requirements and reporting obligations and a process to regularly certify our compliance with the privacy program.

These efforts will require significant investments in compliance processes, personnel and technical infrastructure. In addition, these efforts will make some of our existing product development processes more difficult, time consuming and costly. We are lowering our 2019 capital expenditures outlook to \$16 billion to \$18 billion, down from our prior estimate of \$17 billion to \$19 billion. Our capital expenditures are primarily different by our continued investment in data centers and servers.

We expect our tax rate for the remaining quarters of 2019 to be approximately 16%. In summary, Q2 was another good quarter for Facebook. We're pleased with the further growth of our community and business, while we continue to make significant investments in privacy, safety and security.

With that, operator, let's open up the call 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. I have two. The first one on the core Facebook app, I was wondering if you could tell us a little bit more about the impact on engagement, as well as monetization from the redesign. Dave, I think, you mentioned some optimization and product wins. So what are you seeing on the core app, you guys now big way kind of engagement and monetization. And then can you talk to us a little bit more about some of the ad targeting headwinds that you foresee in 4Q and in 2020? Thanks.

### A - Dave Wehner {BIO 2419389 <GO>}

Sure, Brian. It's Dave. I think, on the Facebook app, I just say the DAU trend paints the picture broadly for Facebook. We're seeing stability in the developed markets and growth in the developing markets. And so, we're continuing to see solid performance on Facebook and we're pleased with the engagement levels that we're

seeing overall on the Facebook app. So I think, the first-half has been solid from that perspective.

And then the second question was on the ad targeting related headwinds. So we think of those in really three components. The first is regulatory as you think about things like GDPR and other impacts and how those will be rolling out globally. The second is platform changes as it relates to operating systems and more of a focus on privacy from the operating systems and the impact that that can have on measurement and also on targeting. And then, the third is our own product changes as we put privacy more front and center. So really it's the compounding of those three issues that are creating headwinds that we think are going to impact us as we get later in the year and into 2020.

## **Operator**

Your next question comes from Eric Sheridan from UBS.

### **Q - Eric Sheridan {BIO 17860961 <GO>}**

Thanks so much for taking the question. Maybe on a bigger, broader topic for everyone, on video; how do you see video evolving as a consumption mechanism on all of your platforms and in terms of how users consume video, what they're attracted by?

Second would be, how that's informing you investing in video content? How should we think about the investments going forward and how that might impact growth versus margins? And then third the opportunities on the advertising side that video might present over the next three to five years? Thanks guys.

### **A - Sheryl Sandberg {BIO 15339456 <GO>}**

So I think video has been pretty important. It's really followed technological change, if you think back even if four years you can't really take a video, a lot of videos buffered on your phone. And now, as you think about what people can do. They can consume video very easily on a phone. They can share video, they can take video. And so we're seeing very -- we're seeing a lot of interest along a lot of consumer products. It's also probably worth mentioning that video is within a bunch of our products. So we certainly have video in feed and people can put video into stories and different places. And we also have the specific Watch place where we're looking at original content

I think to the second part of your question which is how do we think about video content. Most of the content, people put up on Facebook video or other is user-generated that's also true of the watch content itself. We have made some investments there in creating a more dedicated place to watch video. So while a lot of the content is still provided by people in a way that we're not covering costs. We do have a strategy of investing in great content that really starts the flywheel growing -- going and we've been pretty pleased, I mean it's not the biggest effort anyone has, but we've had some hits from Tom and tied to time and time to read table Park to

sorry for your loss, and we're seeing some really nice engagement numbers on these shows. And the best of them actually carry over into the Facebook community because the best of the people creating those shows and starring in those shows are also engaging with Facebook, and I think the vision Mark laid out for this all along is that, we should do video in a pretty social way.

When you think about video ads, video ads are pretty exciting, because it's obviously a firm asset marketers have long loved. I think one of the challenges we've had is training the market that you can't just take your TV ads and put them on video. I'm sorry, put them on mobile or put them into Facebook because they don't perform the same way. The best TV ad is 30 seconds it build slowly to a story, the product reveal is usually at the very end, the best mobile first ad or ad-on Facebook gets to the main point or gets for the product in the first three seconds captures your attention, much more quickly, we sometimes talk about it as some stopping creative where you actually want to stop and Watch, I think the good news, we have here is that mobile first video on Facebook right now is now over 50% of video revenue. So that shows real growth people understanding they need to do it differently, but we've still got a pretty long way to go. And we are seeing good results. I'll share an example McDonalds used mobile app video ads in Facebook and Instagram News Feed and Stories to launch a limited addition called the Big Mac range in the UK. They had a 16.5% lift in ad recall and then Nielsen's study showed a nearly 20% incremental reach on Facebook versus TV.

So I think that shows that when video is done well, it can have a really big impact on companies large and small on our platform.

**A - Dave Wehner** {BIO 2419389 <GO>}

And then, Eric, I think you asked about margin impact. I'd just say that the video content budget is already factored into the guidance that we're providing on expenses.

**Operator**

Your next question comes from Ross Sandler from Barclays.

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

Hey, guys, can we just go back to the deceleration comment. So we appreciate the color you just gave, Dave. But at the same time you said that, the impression growth in 2Q was driven by Instagram Stories, Instagram Feed and then Facebook Feed. And so if those are kind of the current drivers and we're likely to continue to see those send in the future. What specifically do you see is slowing down in 4Q in 2020. Is that core Facebook any additional color on like the surface that might slow down from some of these changes? Thanks a lot.

**A - Dave Wehner** {BIO 2419389 <GO>}

Sure. Ross, I mean if you remember, we're seeing good impression growth across Instagram Stories, Instagram Feed and Facebook Feed. So we're seeing good

impression growth across all of those. We are seeing faster growth in impressions coming from Stories and then also coming from geographies that monetize at lower rates on things like Facebook News Feed. So even though we're seeing good impression growth that's impression growth it's flowing through at a lower price point. Then, the way that growth was driven in the prior year. So that's contributing to some of the deceleration specifically as we look out into the remainder of 2019. When we get into Q4, we're going to be similar to how we had good product wins in Q2, we also had several product optimizations in Q4 that contributed a strong performance that quarter. So we're going to have a tougher compare on that basis. So just broadly, I think we expect the revenue deceleration trend that Q2 is not mark a reversal of that, but we expect to kind of return to constant currency revenue growth deceleration as you get into the remainder of 2019.

## **Operator**

Your next question comes from Doug Anmuth from JPMorgan.

## **Q - Doug Anmuth**

Thanks for taking the question. One for Mark and one for Dave. First Mark, how are you thinking about the opposition that you've received so far around Libra. Has it changed your view of the timeframe at all in terms of rolling out the currency. And then second, Dave Just, you talked about the higher demands of privacy. Can you just talk about how that could impact expense growth as you think about 2020 where in the past you've talked about more moderate expense growth for next year? Thanks.

## **A - Mark Zuckerberg {BIO 15103277 <GO>}**

Sure. So on Libra and similar to our approach on some of the important social issues that we face around encryption and content regulation and things like that. We get that these are really important and sensitive spaces. So our approach has been to try to have a very open dialog about this, right. If Facebook from a few years ago would have probably just up and tried to release a product on our own. And now the approach on all of these fronts is to outline the ideas in the values that we think an eventual service should have.

We've opened a period of, however, long it takes to address regulators and different experts and constituents questions about this and then figure out what the best way to move forward is and that's certainly what we're planning to do with Libra. So we worked with the 27 other members of the association to publish the white paper to put the idea out there expecting that this is a very important and heavily regulated area and there were going to be a lot of questions. We're going to have to work through that. So I think we're currently in the process of doing that. We are trying to provide a safe and stable and well-regulated product. So that's always been the strategy and we'll continue to engage it here.

## **A - Dave Wehner {BIO 2419389 <GO>}**

And then, Doug, you were asking about the impacts on expense growth. We're not giving guidance, specifically on the 2020 expense outlook. But the privacy efforts do require significant investments obviously and compliance processes, people and then technical infrastructure and those are factored into the 2019 operating expense outlook. One of the impacts that I'd point to you is it's also a reallocation of resources around privacy. So that will have an impact on our overall product development as well. So that's something that I factor in both in terms of just the overall impact to the business, not purely just the expense side.

## **Operator**

Your next question comes from Lloyd Walmsley from Deutsche Bank.

### **Q - Lloyd Walmsley {BIO 15125459 <GO>}**

Thanks. Two of I can. First, can you just talk to us about early learnings from the test Instagram checkout and what some of the key hurdles are to kind of scaling that more broadly? And then secondly, on OpEx, it looked like you saw a fairly meaningful step up from Q1 to Q2 despite fairly limited head count growth. So just wondering if there's anything you would point to there that might explain why those are diverging a little bit in that quarter?

### **A - Sheryl Sandberg {BIO 15339456 <GO>}**

I'll talk about checkouts. So checkout is in, we talk a lot on this call about early stage things, this is earlier than that. We are in a very small closed beta with 23 brands, which for Facebook is about small as something could be. On -- obviously as I said, small, but there is working with the brands, we're pretty excited by their feedback. We're not in a rush to scale this quickly. We're always focused on the consumer experience and we want to make sure we really get this right. I think the way to think about checkout is kind of in a larger picture of what we're trying to do in terms of commerce and shopping on our services and apps across the board, which is, we obviously have a lot of consumer engagement in our products and that's great. We obviously have felt some good and robust ad tools that are helping us grow our business quarter-after-quarter. If we can help people close the loop a little more, so they are looking more directly products that makes our ads more valuable. If we can help people checkout and pay for the products and even buy the products, it makes the consumer experience better, it also closes the loop on the data and measurement we're going to need going forward. So we're excited about these efforts for doing a lot across the board, all of them are in their early stages. And we think about this primarily from a consumer and closing the loop point of view more than a monetization in and of itself point of view.

### **A - Dave Wehner {BIO 2419389 <GO>}**

And then, Lloyd, you were asking about the step-up on the costs side in Q2 versus Q1. Couple of things that I'd point to, the cost of revenue was up 49% in Q2 and that's really the flow-through of depreciation that you're seeing from the big CapEx build cycle that we've been in and that's starting to flow through in the cost profile of the business. And then if you look at the G&A line, obviously, that was impacted by the accrual for the FTC settlement, as well as some other legal expenses including

the SEC settlement. So you had some G&A expenses that were higher in the quarter as a result of that.

## Operator

Your next question comes from Heather Bellini from Goldman Sachs.

### Q - Heather Bellini {BIO 2268229 <GO>}

Great. Thank you so much. I wanted to follow up on two comments. One, watch the -- Sheryl was just talking about related to checkout. I'm just wondering if you could share what the feedback has been so far from the brands that are in the closed beta and how this has helped maybe some stats if they have them like how it helped maybe conversion for the brands that are doing it versus maybe the traditional way they were selling on Instagram. So if you have anything, you could share there.

And then, Dave, just back to Ross' comment related to the deceleration that you're referencing, I mean, in the past you'd given us a little bit more specificity, not too much, but you've said kind of mid-single digit or low-single digit decel. Just wondering if there is any other color you could provide us here for the back-half in 2020 when you're painting this at a high level? Thank you.

### A - Sheryl Sandberg {BIO 15339456 <GO>}

Yeah, on the checkout beta, it's just really small and really early. We definitely hear that it decreases ad friction in the shopping experience with 23 brands in a product, that's just too small for us to take any real learnings. We are working with them on iterating the product experience for now.

### A - Dave Wehner {BIO 2419389 <GO>}

And, Heather, on the deceleration, we're simply guiding that we would expect that we would see constant currency revenue deceleration sequentially with that being more pronounced on a constant currency basis in Q4, again, due to the tougher comp for us in Q4, not giving specific quantitative guidance on that at this point.

## Operator

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

### Q - Justin Post {BIO 3469195 <GO>}

Great. Thank you. Mark, from the outside, it's really hard to tell what's going on in the regulatory environment and status with the regulators. I guess, good news on the FTC settlement, but the new investigation has being started. I just wonder if you could just give us high level to the extent you can, is the Company making progress with regulators both here and in Europe, and how you feel about that. And then, Dave, if you could, talk about Europe since GDPR implementation. Has it really been a meaningful difference in your ad revenue growth rates there versus other regions? Thank you.

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**A - Mark Zuckerberg** {BIO 15103277 <GO>}

Sure. So I can talk about the regulatory picture overall. Over the last few years, we focused a lot on a number of major social issues, everything from preventing election interference to reducing harmful content to protecting privacy. Now, I'm out talking a lot about data portability. And on each of these, I think that there is work that we can do and that we certainly have a responsibility to really make sure that we perform well on them. But at the end of the day, when our systems are mature, there is still going to be trade-offs between important values that we all have something on content between free expression and civil discourse and we're moving hate and things like that. Those are hard questions that at some level, we're always going to do the best that we can, but we think that having a more democratic process for setting with some of those norms are would be helpful.

On privacy, there are really important questions about how you define what you want the system to be in terms of how much are you locking down data versus are you making it portable for -- to enable competition and innovation, and academic research and things like that. So we believe that there needs to be a regulatory framework in place for each of the major issues that I just talked about. And my broader concern is that, if that doesn't get put in place then frustration with the industry I think will continue to grow. And so we're trying to do our part to help advocate for a good regulatory framework in each area and they will come in different forms. So in some places, we'll -- there will be laws passed and others might be working with regulators and having some structural rules imposed on us like with the FTC settlement, in other areas, it might be self-regulation like around, content and speech and in the United States. That's what I I'd expect because of the, first amendment here is a strong protections on speech.

So this is important overall, we're very focused on it. I do think we are making progress on working through the issues and addressing them. We're I think in a much stronger place in elections now. Our content systems are getting more mature, there's a lot of more work to do in each of those. But I think we are making progress. And as said this is a global problem, not just these are global problem, not just American one. So working with folks across Europe and the other continents as well is important too.

**A - Dave Wehner** {BIO 2419389 <GO>}

Hey Justin, it's Dave. As I noted in my comments. Europe is growing more slowly than North America and APAC. That said, we had a strong quarter and we're pleased with results in currencies factor in that delta as well. Overall, we did see Europe had a re-acceleration of growth in Q2 versus Q1. And part of that is lapping the GDPR implementation. So I think overall we're kind of pleased with what we're seeing around Europe, but it's still growing more a little more slowly than North America and APAC.

**Operator**

Your next question comes from Mark May from Citi.

**Q - Mark May** {BIO 4280734 <GO>}

Thanks for taking my questions. First, we've seen nice improvement in the rate of expense growth lately. And on the Q4 call, you said you expected in 2020 the expense growth will be more in line with revenue growth. Just curious if that is something that you still feel comfortable with? And then secondly in terms of WhatsApp and WhatsApp status specifically, what are your plans as it relates to ads on WhatsApp status? Have you tested here or have any plans to test? Thank you.

**A - Dave Wehner** {BIO 2419389 <GO>}

Yeah. Thanks, Mark. So in terms of, in terms of our overall expense outlook. Our current outlook for 2019 does suggest that we'll see margins come down this year versus 2018. Even if you were to set aside the \$5 billion FTC accrual. We're not providing specific guidance for 2020 or beyond. The investment priorities remain the same. In addition to the privacy investment priorities that we outlined today will continue to invest in key areas like core product infrastructure, innovation, video and content and safety and security over the long run. So we're not at this point providing any more specific guidance on 2020.

**A - Sheryl Sandberg** {BIO 15339456 <GO>}

WhatsApp Status ads are not available. We're very focused for WhatsApp on the consumer experience. But I will take a minute to talk about Stories ads in general, because I think eventually depending on our ability to use data across platform that applies to WhatsApp it's probably pretty important part of the story that's going on with Facebook right now. So we do have Stories ads available across Facebook, Instagram and Messenger, and I think one of the most important things we learned as we were doing it transition to mobile is if we made it easy for our advertisers to place the ads, make sure they understood the measurement they were having and also make sure the ad format worked, businesses would move more quickly. Usually people move before businesses people move to mobile before businesses and we certainly saw the same with Stories. But I think one of the successes you are seeing we're having right now is that we are helping people move to Stories more quickly because of the lessons we learned.

So for example, automatic placements, what automatic placements do is they convert Feed ads into a Stories format and deliver the ads wherever they get their best results. And I think it's product innovations like that that have gotten us to 3 million advertisers. So rather than across the three properties we have available Facebook, Instagram and Messenger. So rather than go to every advertiser both through our sales force and through our online tools where we sell and say we have a new format, you need to create the new format, you need to figure out the placement being able to just take what they are already doing like Feed ads, converted into Stories and place at anywhere helps us move people into these formats. It's also a case of we have a lot of inventory on this. And so there is a real benefit right now to being an early adopter, the pricing is very attractive. And so we think the mix shift to Stories is the big opportunity for us and advertisers over time. I'll say one more thing, which is that Stories don't monetize right now at the same



rate as News Feed. We're optimistic about the growth over the long run, but we are as always very prudent and careful on the consumer experience.

## Operator

Your next question comes from Mark Mahaney from RBC.

### Q - Mark Mahaney {BIO 3027058 <GO>}

Thanks. I just wanted to focus on WhatsApp and I know you've had WhatsApp payments in beta in India, you launched that last year. Could you just talk about the -- if there are any particular factors that are causing a delay in that and maybe just takes a long time for a product like that to really gain traction, but is it consumer awareness of it is it regulatory push back is their technical hurdles and what does that tell you about the and maybe nothing but what does that tell you about the ability to take that WhatsApp monetization or payments functionality embedded with WhatsApp and launched it in other markets. I said, I know you said you're going to launch in other countries, but what are the lessons from India tell you about the pacing of that? Thank you.

### A - Mark Zuckerberg {BIO 15103277 <GO>}

So it's a regulatory approval question in India at this point and we had a license to roll it out as part of an initial test, the test went better than we even expected it would. I mean for a product that you would expect to need to be widely available to be useful, right, in order to -- for someone to know that they can send money to someone else. Even a limited test the feedback was very positive. So I'm quite confident that when we can roll this out broadly it's going to be meaningfully valuable to the user experience. We're also working beyond India, in a number of other countries and hope to have this rolled out to a large percentage of the people who use WhatsApp within the next year. So that's the goal, we're pushing forward on all of these issues and should have more to talk about soon.

## Operator

Your next question comes from Michael Nathanson from MoffettNathanson.

### Q - Michael Nathanson {BIO 2009061 <GO>}

Thanks. I have two, one for Sheryl and Dave and one for Mark. So Sheryl and Dave, you noted the growth I guess in Europe this time in acceleration. And can you talk a bit about maybe the regional development of Stories and either the embracing the advertising community or the user community by region. And then, for Mark on the answer on currency arguably Crypto is going to take a long time to you to get approval or to build a product. Do you see building a fiat currency wallet for Facebook and Instagram. I know it's about WhatsApp but how does another title wallet non-crypto wallet develop if it takes a while for the other products to rollout meaning Crypto takes a while for approval. So does non-crypto fiat currency become an opportunity for you?

**A - Dave Wehner** {BIO 2419389 <GO>}

Hey, Michael, it's Dave. I guess we're not really providing detail on region. I would say Stories is today from an impression growth perspective really about Instagram Stories. So it maps where we've got good adoption of Instagram globally. So we're certainly seeing good growth in places where Instagram is strong, including the U.S., so that's been good to see. And as we continue to work on Facebook Stories, we'll have more opportunity as well with Facebook and will map to the reasons where Facebook is stronger. So I think we're seeing good growth on Instagram. I think that will continue and continue to drive impression growth and then we hope to continue to make progress on Facebook where we're seeing growth, but it's off a smaller base.

**A - Mark Zuckerberg** {BIO 15103277 <GO>}

And on payments, I mean, the short answer is, yes, we're very focused on payments with fiat currencies as well and making it so that when you pay in one service, whether it's WhatsApp or and Instagram Shopping or in Marketplace your credentials can be shared and there's a shared payment system across all those things. So that's a -- certainly a big area for investment.

Overall these areas around commerce and payments, I think are one of the most exciting areas of product development for the next several years. I mean the way that we kind of see the products now is we've helped people map out and wire up their networks over the last several years, and now in each of these apps we have opportunities to help people get more value from the networks that they've created in some of that is going to be on the social side, especially around creating communities and groups and some of it is going to be more on the economic and opportunity side and there we're doing a whole lot of projects. I know that we Libra is the one that has gotten the most attention recently, but it's really just one of a set of things everything from Instagram, Shopping which is going to help people connect to brands and emerging creators to Facebook marketplace, which is more consumer-to-consumer paying and buying and selling used goods to things like WhatsApp business, which is more about connecting with small businesses and then across the payment landscape, helping people do payments and existing currencies and also trying some newer approaches that can hopefully bring down the cost of doing payments around the world. We're just very excited about all the -- everything in this area and it's one of the biggest areas that we're focused on for the next several years.

**Operator**

Your next question comes from Ben Schachter from Macquarie.

**Q - Ben Schachter** {BIO 6923071 <GO>}

Mark in 1Q, you mentioned specifically that GDPR had an impact on the business. I was just wondering if you can give an update on that? And then longer term on Facebook, you focused a few times now on buying and selling goods there. Just wondering if you can comment on how you think of services versus goods for

example monetizing recommending a house painter versus selling a widget. And also can you talk about the timing of how marketplace might evolve? Thanks.

**A - Mark Zuckerberg** {BIO 15103277 <GO>}

Yes, I don't know, Dave if you want to talk about the GDPR impact. And then I can end.

**A - Dave Wehner** {BIO 2419389 <GO>}

Yeah, Ben. So, just in terms of GDPR I kind of address that earlier, we do see that having an impact in Europe that we did see a re-acceleration in growth in Europe, as we have lapped the initial implementation of GDPR. So that's promising, but we continue to see Europe growing just a bit slower than the rest of the regions. But overall, not a whole lot of additional color to provide there.

**A - Mark Zuckerberg** {BIO 15103277 <GO>}

Yeah and in Marketplace, we definitely are going to focus on some of the areas that you talked about including jobs is already a pretty meaningful focus where a lot of people do find jobs and business is less jobs through Facebook. I don't want to, I don't know what our last public status here. So I'm not going to attempt to site something but it's meaningful. And the business model around this is probably not going to be charging for listings but advertising. And in order to promote things both in and what we're doing on Instagram with shopping and in Facebook Marketplace and in the general approach to payments is providing as affordably as possible to improve the user experience and complete transactions which will of course make the tools more valuable for businesses overall and should make the ad prices go up. And that should be the primary thing that we're focused on. Someone just handed me a piece of paper, which says that we have helped 1 million people find jobs. So there is the stat.

**Operator**

Your next question comes from Colin Sebastian from Baird.

**Q - Colin Sebastian** {BIO 6373379 <GO>}

Great, thanks. A couple from me. First off, any update on the higher profile for groups in the Facebook app and any perspective on how that's impacting engagements. And then Mark, the five-year timeline for the privacy focused vision. I guess, I wonder if we get a better sense for what the key milestones are along the way and why that's a five-year outlook perhaps versus the shorter period? Thank you.

**A - Mark Zuckerberg** {BIO 15103277 <GO>}

Yes, I could take both of those. So in the Facebook app overall after helping people connect with friends and family, helping people connected with communities is the next most important social problem that we believe we can help address and that's just going to be an area of increasing value in the product. That is going well since we started rolling that out after F8, I think Dave may have mentioned this earlier, but

in case you didn't just to emphasize this point I think part of the -- our strong performance over the first half of this year, a meaningful part of our overperformance compared to what we had expected is because of strength and engagement in the Facebook app over that period. So that's -- it's generally going well overall and we're very optimistic about communities in particular going forward is one of the drivers of that. What was the second question?

**A - Dave Wehner** {BIO 2419389 <GO>}

The five-year.

**A - Mark Zuckerberg** {BIO 15103277 <GO>}

Right, okay. So on that's on the privacy vision. So for the next year to two a lot of the work that we need to do is just about getting the architecture right. Right so establishing, we have to rewrite the networks on Messenger and on Instagram to be more client and server oriented to be end-to-end encrypted. We're working on interoperability, that people will be able to choose to use between the services. These are pretty big technical projects. We want to make it so that the infrastructure that these services are built on is the most secure and most reliable and fastest and most widely available of any of the major messaging platforms out there, we think that that's the foundation to build a successful private platform on. Then we need to do things like what we're doing with WhatsApp business, which is building up the business ecosystem and that's just something that our playbook on this but this is a multiyear journey where first we deliver the consumer product experience, then we create organic business experiences and then only as the last step, are we really able to ramp up having business that pay for things that are meaningful for them within that. So it's not that you're not going to see progress on that along the way, you'll certainly see milestones every six months or 12 months. But before this is really the biggest driver of our business, I do think that that's going to be a number of years.

**A - Deborah Crawford** {BIO 5934723 <GO>}

Great. Operator, we have time for one last question.

**Operator**

Your last question comes from Brent Thill from Jefferies.

**Q - Brent** {BIO 1556691 <GO>}

Thanks, Dave. I think a lot of us are having a hard time reconcile that the tougher comp in Q4. It was your easiest comp and you just accelerated your constant currency growth in the quarter. So I guess, just, is there any change in terms of the visibility or the contracts that you're putting together that lead you to that, any other color. I think there is a number of questions, just trying to understand why you have such strong conviction in that decel?

**A - Dave Wehner** {BIO 2419389 <GO>}

Hey, Brent. So in terms of the outlook. Remember, we don't have contracted revenue. We are constantly working from an auction perspective. So our forecasts are based on supply and demand and how we see the different product launches playing into that different optimizations that we make. So there's a lot of granularity that goes into thinking about how revenue will progress that ultimately it's going to depend on the supply and demand characteristics in that given quarter when we do that and we see that we expect constant currency deceleration. And when we get to Q4 we're going to be lapping some particularly successful optimizations that we had in Q4 and that's going to contribute to more of a decel in Q4 than we think we'll see in Q3. So that's the reason I'm characterizing the guidance the way I am.

**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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