Meta Platforms, Inc. (META)
Second Quarter 2024 Results Follow Up Call
July 31st, 2024

Operator: Good afternoon. My name is Krista and I will be your conference operator today. At this time, I would like to welcome everyone to Meta's Second Quarter Results Follow-Up Q&A Call.

All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. If you would like to ask a question, please press star one on your telephone keypad. To withdraw your question, again press star one. We ask that you limit yourself to one question. And this call will be recorded. Thank you very much. Kenneth Dorell, Meta's Director of Investor Relations, you may begin.

Kenneth Dorell: Thank you. Good afternoon and welcome to the Follow-Up Q&A call. With me on today's call are Susan Li, CFO, and Chad Heaton, VP of Finance.

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 earnings 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 will present both GAAP and certain non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release.

The earnings press release and an accompanying investor presentation are available on our website at investor.fb.com. And now I'd like to turn the call back over to the operator for the first question.

Operator: Thank you. We will now open the lines for a question-and-answer session. To ask a question, please press star one on your touchtone phone. To withdraw your question, again press star one. We ask that you limit yourself to one question. Please pick up your handset before asking your question to ensure clarity. If you are streaming today’s call, please mute your computer speakers. And your first question comes from Michael Nathanson with Moffett Nathanson. Please go ahead.

Michael Nathanson: Thanks. I just have two quick ones on cost view. In your answer on employee headcount growth, you talk about a ramp in employee hiring. We've already seen that come through the past couple quarters. Anyway, can you help us frame how you think about the normal level of headcount growth from this point on?

And then we talk about meaningful expansion of losses at Reality Labs. What are the factors that would contribute to that maybe change in the run rate we've seen? Is depreciation a factor as you increase CapEx? Anything on the factors driving Reality Lab losses would be helpful. Thanks.

Susan Li: Thanks, Michael. On your first question -- coming into this year, we talked about how we were basically working through a hiring underrun that was a result of a prolonged hiring freeze that we had last year.

And so that is the bulk of what you're seeing the hiring that has happened in 2024 represent. so basically working through the hiring underrun is where the majority of hiring is going now. We aren't giving guidance for 2025, in part because we haven't started our budget, but generally, our approach towards headcount allocation is to really be taking a pretty ruthless look at, what places we can we shift resources from -- areas that are sort of no longer particularly critical or high priority, to the highest priority areas going into 2025.

So, I expect that we will be very focused in the parts of the company that are growing heads, and I expect we'll be pretty disciplined about the longer-term headcount trajectory.

On your second question, we haven't updated any of the guidance on Reality Labs. I think we reiterated the prior guidance on Reality Labs. So, I don't think I said anything about a change in run rate. Our expectations for Reality Labs, of course encompass the full set of ambitions in the area, both our work in MR, in AR, in the Metaverse.

So we are investing really across a pretty broad array of efforts there. Within that envelope, we are certainly seeing that we are shifting some energy towards AR glasses in particular. I think the traction that we have seen with the Ray-Ban Meta glasses and the product market fit and demand for the product out of the market, and the overlap with our AI efforts where the glasses form factor is really such an intuitive way to bring an AI assistant with you around that sees what you see and hears what you hear. So, we're definitely trying to accelerate our glasses efforts in the Reality Lab space.

Operator: Your next question comes from the line of James Lee with Mizuho. Please go ahead.

James Lee: Great. Thanks for taking my questions here. Susan, when you look at search results on Meta AI, does that help you maybe improve commercial intent and relevancy for your ad targeting? For example, I was thinking of maybe travel, people searching for travel, people searching for local advertising, maybe looking for a gym nearby.

And secondly, and just to double-click on your prior statement about investing ahead, but we'll also offset by increased efficiency, maybe help us understand that approach a little bit. This approach here is to neutralize maybe high depreciation expenses with high efficiency? Can you help us understand where you are looking within the organization to lower your cost base? Thank you.

Susan Li: Thanks, James. So, in terms of, the types of queries that we're seeing on Meta AI, we're seeing early signs that Meta AI is helping people leverage our apps for a range of new use cases. We see that a lot of people are using Meta AI for learning and information gathering type use cases, things like how-to advice, knowledge-based questions, writing assistance. We're also seeing a large number of people find value in using Meta AI for coaching.

So, there's a range of queries. We're pretty early in the journey with Meta AI and I think that, over the coming quarters, we are going to continue to iterate on it. We're going to broaden availability to new languages and countries and that's going to help us. We're going to ship new features and improvements, and that's going to help us make the Meta AI experience increasingly rich and engaging for people, which is really where our primary focus is right now.

On the second question about headcount -- being disciplined about the way that we are thinking about allocating headcount. This is a place where we are really trying to be very disciplined and ruthless about the way we are prioritizing in here, in part because it allows us to invest in infrastructure, which is just such a critical part of our AI ambitions right now.

Operator: Your next question comes from the line of Ken Gawrelski with Wells Fargo. Please go ahead.

Ken Gawrelski: Thank you. Hi, Susan. Two questions, please. First, on the growth mix, it shifted more to pricing from just from impression growth. How should we think about the balance between impression growth and pricing going forward and what does that mean for '25 and '26 growth drivers? Are you looking to achieve some kind of balance there?

And then maybe on the second, and this is more kind of an ecosystem question on the AI side, is how far in Meta's view are we away from seeing a proliferation of third-party AI applications? We've seen some select AI applications mostly from the largest scale spenders today, but when do we see the ecosystem flourish like we did with mobile internet or desktop internet? Is this an element of time or is it capabilities on the model side? Thanks.

Susan Li: Thanks, Ken. Taking your question in pieces. So, on the first question, the trends in impression growth and price per ad growth are somewhat related because we are operating an auction.

So, the year-over-year growth in reported price per ad may have accelerated from Q1, but there's a lot that goes into that, not least of which are the auction dynamics that come from impression growth slowing down from Q1.

Now one thing we keep a close eye on in order to understand the value that advertisers are getting from their ads is the average cost per action, and that is a complex metric for us because there are many different objectives that advertisers optimize for and those different objectives can have quite different values depending on whether it's an app install or a web conversion, et cetera.

But overall, we feel good about the cost per action trends we're seeing. We think that those are healthy. And as we continue to get better at driving conversions for advertisers, that will have the effect of lifting price per impression over time because we're delivering more conversions per impression served, meaning the impressions are higher value, which is the way that I would frame it as opposed to impressions getting more expensive.

And ultimately, driving conversions for advertisers is really what we are trying to do as opposed to, for example, optimize for a particular price or just drive impressions independently of conversions.

On the second question, which is about the proliferation of third-party AI applications and when that will happen. It's clearly, I think, very early in the development of that ecosystem. But as Mark said, the pace of capability development is really what is getting ourselves and our peers excited, and just the pace at which the models are advancing and then our ability to build on those to create good tools for creators.

And so, we announced that we're rolling out AI Studio in the U.S. That enables people to create AI characters which are fully customizable and conversational Ais. You can do it from a template, you can do it from scratch based on your personal interests. And then Creator AIs are extension of characters and creators can build an AI within Instagram or on the web that can answer common DM type questions and Story replies and they can use that to connect with their followers.

So, we're excited about the opportunity for both of those to become really useful features and for a healthy and active Creator AI ecosystem to flourish on top of the tools that we are building.

Operator: Your next question comes from the line of Dan Salmon with New Street Research. Please go ahead.

Daniel Salmon: Okay, great. Good afternoon, everyone. Susan, your outlook comments obviously emphasize the growth of infrastructure-related costs in 2025. Could you add a little bit of color on how that might impact different expense lines? We assume that's mostly in cost of revenue, but maybe there's some in R&D as well.

And then any color on the balance of depreciation versus cash expenses that you can add? Just love to hear any more that can help us out with the models tonight.

Susan Li: Thank you, Dan, for the question. So, as it pertains to CapEx, one of the things I want to be really clear about is we have seen significant growth this year in CapEx. We expect another year of significant growth in 2025. And, we are not in a position to quantify this yet, as I mentioned on the call, in part because the infrastructure planning process is -- it's very dynamic.

In fact, when you are trying to build large training clusters and to land the capacity that you need, you often end up spinning up multiple projects and parallel pathing multiple options because there are many reasons why one option or another will end up not becoming feasible in the process of trying to build capacity.

So, for us, a lot of the uncertainty in 2025 comes around evaluating those parallel paths and the fact that there's a lot of uncertainty about how each individual path may pan out. But, again, we think, in all cases that we expect that 2025 will be another year of significant CapEx growth.

Now, to the specific question about how it might impact expense lines. It is both in cost of revenue and R&D. The expenses that flow through R&D really capture the depreciation and operating expenses of the infrastructure that is used to support AI research across the company. And then the expenses that flow through cost of revenue really are more around supporting the sort of core ads ranking and recommendation use cases.

We haven't really commented on the mix of depreciation versus cash expenses next year. Obviously, depreciation is from the footprint that we've already built flowing through but we are also commencing new projects in '25 that will require cash outlays and then we'll end up depreciating through future year P&Ls.

Operator: Your next question comes from the line of Rob Sanderson with Loop Capital Markets. Please go ahead.

Rob Sanderson: Yes, thank you. Thanks for taking the question. I want to go back and revisit commentary you shared last quarter, or Mark was sharing last quarter, just on the discussion for potential of revenue displacement as you invest in scaling up GenAI products. And I think the general interpretation was this was maybe a shift in AI capacity away from core AI into strategic AI, obviously core AI driving monetization today, GenAI, no near-term monetization.

So, first, is that the correct interpretation? And if so, are you talking about a shift of allocation of new capacity or are we actually shifting some capacity away from core?

And then second on that is, does the decision to delay training in the EU provide any relief on capacity demands?

Susan Li: Thanks, Rob. So, on the first question, clarifying the comments from last quarter. Our compute needs outstrip our available data center capacity right now. Given the focus that we have on accelerating our GenAI efforts, the new capacity that we've been bringing online is really going more towards GenAI than towards other workloads.

We've also had to do a little bit of shifting capacity around to free up capacity for GenAI training. And altogether, we expect that that will result in some foregone revenue growth from ads and organic content ranking improvements that we would have otherwise made, but that has been factored into our Q3 outlook. And we generally expect this to be to be a near term dynamic until we start bringing additional data center capacity online next year, which will meet our capacity needs.

On your second question around the EU, we're working with regulators to address their concerns, so we can develop and improve our AI products based on the information that people choose to share on our platforms. I would say, generally, I would expect training capacity to be a big driver of future CapEx needs. I think that will be the case, regardless of how things progress in Europe.

Operator: Your next question comes from the line of Shweta Khajuria with Wolfe Research. Please go ahead.

Shweta Khajuria: Thank you for taking my question. I guess I just wanted to ask about how -- if it is fair to think of the return, and you've been asked this question many different ways, but if we think about the incremental revenue that's generated, expected to generate, call it next year or this year versus prior years, and the incrementality that we see attributed to AI, is that a good way of thinking about the contribution of AI, or the return from your AI investments? Thank you.

Susan Li: Thanks, Shweta. I'm going to do my best to answer this question and let me know if I didn't address the heart of it.

So, the incremental revenue that you see this year and largely next year, coming from the ads business, that will primarily be a function of the investments that we have been making in the core AI work that goes into the ongoing ads performance improvements as we make our ranking, delivery, targeting, et cetera systems, more performant over time.

We are certainly investing in core AI as a part of the infrastructure growth next year. At the same time, a lot of the CapEx that we are building next year is in service of training foundation models for our GenAI efforts, where we are really much earlier, and we don't expect that to be a meaningful driver of revenue in '24 or '25.

But we expect that they will open up revenue opportunities in the future and we've talked about some of those -- making the core ads business better by making ads increasingly personalized at scale, growing business messaging, particularly in developed markets, obviously monetizing the consumer experience that we hope to build with Meta AI, and then also making it easier to create content for core organic engagement. But again, those I think will all play out over a longer period of time.

Shweta Khajuria: Okay, thank you very much.

Operator: Your next question comes from the line of Stephen Ju with UBS. Please go ahead.

Stephen Ju: Hi Susan. So, I was pleasantly surprised to hear you talk about games and entertainment sectors as being one of the larger contributors to your growth here, and I think this is a sector that's seen some tough times post-pandemic and even post-IDFA deprecation. So, what's changed from a product perspective that you've been able to revitalize spending from that segment?

And digging in a little bit in terms of your commentary from the APAC-based advertisers and what they're doing. I think a couple of quarters ago, you gave us all a sort of food for thought to really think beyond a larger e-commerce platform. So, can you update us on the makeup of these advertisers and whether the audience they are targeting has evolved over time? Thanks.

Chad Heaton: This is Chad. I can start with your first question. I'll start broadly about verticals. We saw a continued healthy year-over-year growth across verticals in Q2. We mentioned that came from online commerce, gaming, and entertainment and media. But the rate of growth did come down relative to Q1 across pretty much all the verticals.

In terms of gaming specifically, as I said, year-over-year growth remains strong but decelerated in Q2. That was primarily driven by slower growth among China-based advertisers. We don't have anything more specific in terms of products or features that launched. Again, more recently, it has been a vertical that we've seen strength in. And we saw strength again in Q2.

Susan Li: On your second question, Stephen, we shared previously that two-thirds of our China ad revenue came from advertisers outside the top 10 spenders in China in 2023. I think that's the comment that you're referring to.

We don't have an update on that for this year, but I would say it continues to be a diverse advertiser base. And more broadly, I think we are continuing to see a longer-term trend of growth from China-based advertisers.

Again, there's obviously variability in growth rates period to period. There was clearly an impact, from COVID, but I think it's been over the last several years a strong contributor to growth for us and we expect it to remain so. And again, most of our China-based ad revenue continues to come from a longer tail of advertisers.

Operator: Your next question comes from the line of Mark Zgutowicz with The Benchmark Company. Please go ahead.

Mark Zgutowicz: Thank you. Susan, two quick ones if I could. On the CapEx side of things, I'm just curious if you would contemplate managing free cash flow in the negative growth territory next year to fulfill another big step up you've discussed in terms of investment?

And then just a clarification on Reels inventory growth. You mentioned a higher conversion of Reels ad units which would suggest lower growth in ad load here just going forward. But if you could just maybe balance that with a comment on just short video in general offering more inventory units to sell, I guess what's the messaging here in terms of next 12 months, if you will, growth in ad units here with Reels versus the last 12 months? Just trying to get, I guess, a picture there. Thanks.

Susan Li: Thanks, Mark. I'll take that first question. We haven't really guided on free cash flow. Again, I would say there is a big range of CapEx outcomes that we're working through right now based on different data center options in different places. So, I think there's a lot going on. It's really a very dynamic planning area for us right now and we'll have more clarity on that at the Q4 call.

Chad Heaton: So, in terms of Reels inventory growth, I guess speaking broadly, we are in a period where say last year, we ramped Reels ad load pretty significantly. And so, we certainly don't have opportunities in front of us to continue to increase ad load at that rate.

I would say at this point, with respect to Reels, we're focusing on optimizing the level of ads just by launching and testing new experiences for ads to deliver in Reels. One example of that would be back-to-back ads in Reels where in Q2 we started showing some ads more closely together in Instagram Reels, including back-to-back when we have more relevant and engaging ads to show.

We're also, over on the Facebook side, we're focused on video unification, where Facebook has a lot longer form video that monetizes at a lower rate than short form. And so, we expect that mix of video shift more to short form over time as part of that video unification works, which should benefit monetization efficiency of a video on Facebook.

So, we have a lower ad load still on Reels than we do, say, in Feed and Stories. There are opportunities there as we look forward. But I wouldn't expect them to be growing at the rate that they have historically.

Operator: Your next question comes from the line Richard Greenfield with Lightshed. Please go ahead.

Richard Greenfield: Hi, thanks for taking the question. You haven't updated us on number of advertisers in a long time. I don't know if you're comfortable. I think the last time it was like 12 million. But regardless of what the actual number is, I wanted to just hone in on Mark's commentary around the impact of AI to help advertisers make content.

Obviously, video ads with AI isn't ready yet. But I'm sure over the next 12 or 18 months it will be. Is there any way you can give us a sense of how many of -- what percentage even, of Meta's advertisers today actually make video ads versus just static images or text? Just trying to understand how much it could change the amount of advertisers and suppliers into your advertising funnel over the course of the next couple of years. Or anyway of thinking about that question or topic. Thanks.

Susan Li: Thanks, Rich. We have not updated this, as you mentioned, and I don't think we're sharing the number of advertisers who create video ads. Having said that, I would emphasize Mark's comments that we are really evolving our ads products and features to make it easier for advertisers to use a lot of the new GenAI-powered features that we're building.

We've been very pleased with the reception of our GenAI ad creative tools so far, we've seen good usage retention, performance games, even at the stage we are today, which is very early, over a million advertisers actually used either image expansion, background generation, or text variation in the past month, and we're seeing particularly strong adoption of our image expansion feature, especially among smaller online commerce advertisers. And we're seeing, again, improved performance gains from advertisers who are using these.

So we are focused on continuing to expand the capabilities of our existing creative generation tools in the future. We want to introduce more interactive features to help advertisers fine-tune images that they generate through text prompts, for example. We want to make it easier to incorporate brand input and to allow advertisers to optimize the ad creatives based on what advertisers feel makes the ads unique to their brand, so working with them to better tailor their image and text generation capabilities to brand colors, logos, that sort of thing, and adding new formats.

So we're very early here, I think there is a lot of work that we'll be undertaking over the next years, frankly, to make it easier for advertisers to continue generating personalized at scale.

Kenneth Dorell: Krista, we have time for one last question.

Operator: Certainly. Your last question comes from the line of Aaron Kessler with Seaport Research. Please go ahead.

Aaron Kessler: Great, appreciate the last question. I had just a couple questions on the maybe Family of Apps. think the growth slowed a little bit for the other category, just any updates on messaging revenues, et cetera? And just any more color on the legal costs, if you can quantify that at all, in terms of the Q2 G&A? Thank you.

Chad Heaton: In terms of FoA growth, I think we've saw strong growth there. In terms of messaging specifically, click to messaging continues to be a strong area of growth for us. I would say business messaging -- paid messaging also continues to grow nicely for us. So I don't know that we have new stats to share here but this continued to be a great area of growth for us in Q2.

Kenneth Dorell: Aaron, this is Ken. The one thing I would also add is that within that segment we are lapping a pricing change with the business messaging product in June of last year, so we started lapping that later in the quarter, and then we're also lapping more of the broader roll-out of Meta Verified, so that's contributing to the results in Q2.

Aaron Kessler: Got it, that's helpful. And then just anything on the legal costs?

Susan Li: Yes, on the legal side. Our Q2 G&A expenses include the settlement with the state of Texas, and so that has been fully accrued for. G&A expenses were down 12% year over year since we also lapped large legal-related expenses from the second quarter of 2023.

Kenneth Dorell: Great. Well thank you, everyone, for joining us. We look forward to speaking to you again soon.

Operator: This concludes today's conference call. Thank you for your participation and you may now disconnect.