

Q3 2018 Earnings Call

Company Participants

- David M. Wehner, Chief Financial Officer
- Deborah Crawford, Vice President, Investor Relations
- Mark Elliot Zuckerberg, Founder, Chairman & Chief Executive Officer
- Sheryl Kara Sandberg, Chief Operating Officer & Director

Other Participants

- Anthony DiClemente, Analyst
- Brent Thill, Analyst
- Brian Nowak, Analyst
- Douglas T. Anmuth, Analyst
- Eric J. Sheridan, Analyst
- Heather Bellini, Analyst
- Justin Post, Analyst
- Lloyd Walmsley, Analyst
- Mark A. May, Analyst
- Ralph Edward Schackart, Analyst
- Ross Sandler, Analyst

MANAGEMENT DISCUSSION SECTION

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 third quarter 2018 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. This call will be recorded. Thank you very much.

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

Deborah Crawford {BIO 5934723 <GO>}

Thank you. Good afternoon, and welcome to Facebook's third quarter 2018 earnings conference call. Joining me today to discuss our results are Mark Zuckerberg, CEO; Sheryl Sandberg, COO; and Dave Wehner, CFO.

Before we get started, I would like to take this opportunity to remind you that our remarks today will include forward-looking statements. Actual results may differ materially from those contemplated by these forward-looking statements. Factors that could cause these results to differ materially are set forth in today's press release and in our Quarterly Report on Form 10-Q filed with the SEC. Any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these statements as a result of new information or future events.

During this call, we may present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. The press release and an accompanying investor presentation are available on our website at investor.fb.com.

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

Mark Elliot Zuckerberg {BIO 15103277 <GO>}

Thanks, Deborah, and thank you all for joining us today. We had a solid quarter, and our community and business continue to grow quickly. 2.3 billion people now use Facebook every month, and 1.5 billion every day. Revenue grew 33% year over year to \$13.7 billion.

Last quarter, for the first time, we also shared the number of people who use at least one of our apps each month. We believe this is a better way to measure our community over time because so many people use more than one of our apps. There are now more than 2.6 billion people using Facebook, WhatsApp, Instagram or Messenger each month, up from around 2.5 billion last quarter. But now, on average, more than 2 billion people use at least one of our services every day.

Today, I want to talk about our strategy overall as we navigate challenges and opportunities on several fronts. For one, we're seeing the way people connect shifting to private messaging and stories. We have great products here that people love, but it will take some time for our business to catch up to our community growth.

Two, we're seeing video grow dramatically across the ecosystem. And while Watch is now growing very quickly, we're well behind YouTube and still working to make this a unique people-centric experience. Three, we continue to face increased safety and security threats. We've significantly improved our systems here, but we have more to do.

So let's start with messaging and stories. Public sharing will always be very important, but people increasingly want to share privately too, and that includes both just smaller audiences with messaging and ephemerally with stories. People feel more comfortable being themselves when they know their content will only be seen by a smaller group and when their content won't stick around forever. Messaging and stories make up the vast majority of growth in the sharing that we're seeing.

On messaging specifically, we think we've built the best messaging apps in the world. People now send around 100 billion messages each day using our services that even our

second most popular service, Messenger, has a higher daily message volume than SMS had globally at its peak. And this isn't just text. People share more photos, videos and links on WhatsApp and Messenger than they do on social networks.

We are leading in most countries, but our biggest competitor by far is iMessage. And in important countries like the U.S., where the iPhone is strong, Apple bundled iMessage as a default texting app and it's still ahead. In countries where there's more competition between iOS and Android, like much of Europe, people tend to prefer our services.

Now, it's worth noting that one of the main reasons people prefer our services, especially WhatsApp, is because of its stronger record on privacy. WhatsApp is completely end-to-end encrypted, does not store your messages and doesn't store the keys to your messages in China or anywhere else. And this is important because if our systems can't see your messages, then that means that governments and bad actors won't be able to access them through us either.

Our roadmap focuses on continuing to make WhatsApp and Messenger even simpler, faster and adding basic utility features like payments. We found that every time we make our services faster and simpler, people communicate more. We'll also keep pushing our messaging services to be more private and secure, and we believe this will continue to be a competitive advantage for us.

On the business side of messaging, our first step has been to enable people to connect with businesses organically in ways they find useful, and then the second step is to give businesses additional paid tools to increase those interactions. We're well into step one at this point, with more than 3 million accounts on WhatsApp Business. We'll begin step two with a couple of products, paid messaging and ads in Stories.

And by making businesses pay to send messages, we believe it will make them more selective with what they send. Payments will make each of these services more useful for people and businesses, even though we don't plan to profit from it directly. I'll update with more progress on each of these efforts in the next few quarters.

On Stories, we are even better-positioned. People now share more than 1 billion stories every day. We lead in almost every country. There are a couple of reasons we've focused on building Stories in all of our apps. First, I just think that this is the future. People want to share in ways that don't stick around permanently, and I want to make sure that we fully embrace this.

Second, Stories is a medium like feeds that can feel very different in very different contexts. So just like most major social apps have feeds, including Pinterest, Twitter, or LinkedIn, but you wouldn't say that those services do the same things, I think many services will have Stories in the future too, but will serve different functions.

Now, while this effort is going well, we're also working through a couple of challenges here. One is that while WhatsApp Status and Instagram Stories immediately took off and have been huge successes, Facebook Stories started off slower. It's now growing quickly

and I think we'll be in a better position soon, but our effort to shift Facebook from News Feed first to Stories first hasn't been as smooth as I had hoped. But this is important for the Facebook community long term.

Another challenge is that we're earlier in developing our ads products for Stories, so we don't make as much money from them yet as we do from feed ads. We're following our normal playbook here of building out the best consumer products first and focusing on succeeding there before ramping up ads. I'm optimistic that we'll get ads in Stories to perform as well as feed over time, and that the opportunity will be even bigger because it looks like Stories will be a bigger medium than feed has been.

But I want to be up front that even assuming that we get to where we want to go from a feed-only world to a feed plus Stories world, it will take some time and our revenue growth may be slower during that period like it was while transitioning our products to mobile.

Now, talking about messaging and Stories raises the question of what's the future of our feed product and the Facebook app overall. On feed specifically, people continue to use them heavily and we don't expect that to decrease. From a business perspective, feeds will drive the majority of our growth over the next couple of years, at least until Stories become an even bigger driver.

On the Facebook app overall, what we see is that we are generally stable, although we may be close to saturated in developed countries while we continue to grow quickly in developing countries. For a few years, we saw a trend where people's time was increasing primarily because they were consuming more video and public content, even as they interacted with friends and family less. But people were telling us what they wanted was to interact with people more. So we didn't think that this trend was sustainable.

We've made a number of changes this year to focus the product on meaningful social interactions, and those generally seem to be working. That means the trends in how people are interacting have improved, even though we've purposefully reduced time spent on things like lower-quality viral videos and news to achieve this.

While there's a lot to do to improve News Feed, our roadmap for the Facebook app is very focused on a few priorities: Stories, which we've discussed; video, which I'll get to in a moment; and a much bigger focus on communities and groups.

If the last 10 years have been about friends and family, then the next 10 years will be about your communities as well. When we say communities, we mean both helping people connect with people who share their interests, which is a major need in people's lives, and also building out specific services for bringing people closer together, like helping you find someone to date, or find a job, or buy and sell things, or grow your small business, or create an event, or start fundraisers, or bring together a group to volunteer.

A lot of these services are growing quickly. Hundreds of millions of people now belong to meaningful communities that are a central part of their social support structure.

Marketplace is now used by 800 million people and is emerging as one of the most popular places to buy vehicles online. On jobs, our new tool has helped people find more than 1 million jobs. On fundraisers, in the last year we've helped people raise more than \$300 million for charities on their birthdays alone. And I'm looking forward to rolling out dating across the world soon too.

These are services that generally benefit from having everyone you know connected on a single platform. And while people may not spend as much time on some of these tools as they do in News Feed, these are very high-value activities for our community.

Now, we're seeing a similar dynamic in Instagram, where there's still a lot to improve in feed, but we're increasingly focused on other experiences as well. But in Instagram, instead of focusing on communities, we're very focused on helping you explore your interests. So this will take the form of IGTV, which I'll discuss more in a minute, plus new shopping experiences and really building out Explore. These areas have huge potential for serving our community and a lot of potential for businesses as well. For example, Explore is already about 20% of the time that people spend in Instagram. But unlike feed, we haven't built any ads experience for it yet, so that's an opportunity.

Now, I want to discuss what we're seeing with video specifically, since it's such an important and growing area. Our efforts here have grown, but we've had challenges reconciling all this passive video consumption with what people uniquely want from us, which is meaningful social interaction.

Video has grown a lot on our services, but as I mentioned earlier, we hit a dynamic where when it grows in feeds in Facebook and Instagram, it displaces some social interactions, and people tell us it makes the experience less valuable even though they're spending more time on it.

So the solution to this has been building separate video experiences outside of our feeds with Watch on Facebook and IGTV on Instagram. And what we found is that when people seek out video experiences intentionally, they don't displace social interactions as much, and the quality of the experience is generally higher. We've also been able to build experiences that help creators build communities around their content, which fits our mission and our focus to encourage meaningful interactions.

At this point, Watch has really hit its stride and it's growing incredibly quickly, about 3x in the last few months in the U.S. alone. IGTV is still earlier in its development, but I think we have a good sense of how to make it work as well. To be clear, these services are still well behind YouTube, which is our primary competitor in this space, but they're growing very quickly.

Now, that said, beyond the mission challenges of video displacing social interactions, there is also a business challenge, which is that video monetizes significantly less well per minute than people interacting in feeds. So this means that even though we've made video more community-oriented and minimized displacement of social interactions, as

video grows, it will still displace some other services where we'd probably make more money.

From a mission and a business perspective, though, we still believe this is the right thing to do. Video is a critical part of the future. It's what our community wants as long as we can make it social, and I think will end up being a large part of our business as well.

All right, next I want to talk about safety and security. So let me start by saying that last month, we had a serious security issue. Our teams did well to find and close the vulnerability quickly, but we have a long road ahead to prevent these kinds of attacks in the future. Over the last couple years, though, we've done a lot of work and made a lot of progress. We still have at least a year before our systems are at the level that we want, but they're getting better every day, and that's both technology and people.

Our systems for proactively identifying harmful content are improving. Our systems for detecting interference in elections are a lot more mature now. The upcoming elections will be a real test of the protections we've put in place. With a community of more than 2 billion people, we will see all the good and bad that humanity can do. And we will never be perfect, but I'm proud of the work that we're doing here.

We've reduced the incentives to spread misinformation. We're partnering more closely with governments and outside experts to improve security, including here in the U.S. And we set a new standard for transparency in advertising. This quarter alone, we've found and taken down foreign influence campaigns from Russia and Iran attempting to interfere in the U.S., UK, Middle East, and elsewhere, as well as groups in Brazil that have been active in their own country. We still have a lot of work to do in all of these areas that I've talked about.

News Feed continues to be very important. We're building the best messaging and stories and community tools in the world. Our video services are getting better and growing quickly, and we still have a lot of work to do on safety. And we're also heavily investing in AR and VR, as well as hardware for bringing people closer together, like Portal for video presence and Oculus Quest, the all-in-one VR experience that delivers rift like quality with no wires attached.

So with all of this ahead, I expect 2019 to be another year of significant investment. Dave will say more about this in a moment, but I want you to know that looking out beyond 2019, I know that we need to make sure our costs and revenue are better matched over time; and that's something that I'm focused on as well.

So, overall, this has been an important year. It's been a tough year, but we've built products that I'm proud of and we've made a lot of progress on some of our hardest issues. As always, I appreciate your support. And thank you for being a part of this journey with us.

And now, here is Sheryl.

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Bloomberg Transcript

Sheryl Kara Sandberg {BIO 15339456 <GO>}

Hi, everyone.

It was another good quarter for our business, with ad revenue up 33% year over year. Our growth was broad-based across regions, marketer segments and verticals. Mobile ad revenue grew 40% to \$12.5 billion, making up approximately 92% of our total ad revenue. Since Facebook launched its first ad products, we've been in the business of growing our clients' businesses, from the largest brands in the world, to the entrepreneur in her living room.

Over 90 million businesses rely on Facebook pages to reach potential customers for free. In a global survey, half of small businesses with a presence on Facebook said that they are hiring because of growth they're able to achieve through our platform. More than 6 million advertisers are active across Facebook, Instagram and our other services. With more than 2 billion people using at least one of our services every day, we're the best place for these advertisers to show people ads that work.

We know that our continued growth depends upon maintaining the trust of the people who use our services and earning our clients' business each and every day in a very competitive environment. Every time I meet with clients, I tell them that we want to be the best minute and the best dollar, euro or peso they spend. As we look ahead to 2019 and beyond, we're focused on continuing to build our clients' businesses and ours by helping advertisers reach consumers where they are and making ads better.

First, helping advertisers connect with people where they are. Consumers often adopt new technologies before businesses do. Our competitive advantage is helping advertisers close that gap. We've done this before on desktop, mobile and News Feed. In the early days, we helped businesses deliver personalized marketing at scale on desktop. With the shift to mobile, we've helped companies large and small build their mobile presence.

Now, we're doing it again with stories, messaging, Marketplace and Watch. Today, the primary way advertisers are reaching people on our services is through Facebook News Feed and Instagram Feed. Feed ads on Facebook and Instagram represent the majority of our revenue growth and the majority of opportunities for marketers to generate ROI.

Quarter after quarter, we make improvements that help advertisers use feed ads to launch new products, find new customers, build awareness and increase sales, all in a highly efficient way. We're always working to enable more marketers to achieve their goals through mobile feed, and we see continued opportunity here going forward.

At the same time, as Mark mentioned, more and more consumers are using stories and private messaging in addition to the time they spend in News Feed and Instagram Feed. Because our services share a common platform, advertisers can use the same tools to buy across all our ad services.

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Bloomberg Transcript

Building on the strength of ads and Instagram Stories, we rolled out ads in Facebook Stories in Q3 and announced plans to introduce ads in WhatsApp Status next year. We know it's not enough to make a new format available. We also need to make it easy for advertisers to optimize their campaigns.

In Q3, we improved how ads from News Feed look in Stories. This is important for advertisers like Pandora, which uses Facebook and Instagram to reach potential listeners. Previously, they would buy Instagram Story ad separately and develop unique creative each time. Now, with automatic placements, our technology converts their horizontal video and captions from Facebook into a design that looks native to the vertical Instagram Stories format. For Pandora, this resulted in a 10% lower cost per view than their stand-alone campaigns simply by checking a box in our ad tool.

When it comes to messaging, we have an opportunity to help people and businesses connect in ways that are valuable for both. On Messenger, over 10 billion messages are sent between people and businesses every month. It's still early, but we're exploring how we can help advertisers reach people in Messenger through sponsored messages and inbox ads.

For WhatsApp, we're growing our business ecosystem starting with the WhatsApp Business model app on Android. In August, we launched the WhatsApp Business API to help larger companies send useful information such as boarding passes or delivery confirmations. This paid messaging model will ensure that companies are selective about what they send and don't clutter people's chats. As always, people will be able to block any business they want with one tap. As we build the business on WhatsApp, we're determined to maintain the simple private user experience that people love.

That's also true for Marketplace and Watch. Last year, we started allowing advertisers to extend their News Feed ads to Marketplace, helping businesses reach people where they already shop. In Q3, we expanded Marketplace ads to nearly 70 marketers. It's early days, but advertisers are seeing good results.

With Facebook Watch, we've been working closely with advertisers to better fit their current planning and buying process for video. In Q3, we introduced a way for advertisers to buy video placements from a selection of the most engaging publishers, choose specific content categories they want their ads to play alongside, and pay only for ads that are watched to the end. Again, it's still early, but we're pleased with advertiser interest and results so far.

We have a big opportunity to help our large and growing advertiser base expand to new platforms and formats to reach potential customers. Our service makes it possible for every business to access the same tools as the largest brands. We start by making it simple for small businesses to transition from using our consumer apps to using our business tools, and then we make it easy to run more sophisticated campaigns.

This has been true every step of our journey so far, from online to mobile and now for messaging and stories. In the future, this will include opportunities with the new VR/AR

platforms that we're creating as well.

We're also focused on making ads better. One of the top things people tell us about our ads is that they want them to be relevant. We create value for people when we show ads they are likely to find useful, for advertisers when we deliver ads to the right audience, and for our own business by performing this match effectively.

Our business model is and always has been to connect people and businesses with relevant marketing messages without sharing people's personal information. Protecting people's privacy is incredibly important because people and businesses will only use our services if they feel Facebook can be trusted and if sharing on our platform is safe. That's why we're making significant ongoing investments to better protect privacy and security.

In Q3, we completed the shutdown of partner categories and tightened our standards for Custom Audiences. These changes help protect peoples' privacy and ensure that advertisers have more oversight of the information they use for advertising. We also continue to invest heavily in technology and people to remove bad content as quickly as possible and prevent it from going up in the first place, while giving advertisers more control over where their ads are placed.

This quarter, we added more tools for advertisers to see where their ads might appear in Audience Network, Instant Articles and instream placements like Watch. They can block their ads from running in videos or articles from certain publishers or categories of content and review all of their placements at the end of each campaign.

Making ads better also means increasing efficiency for advertisers. In Q3, we expanded campaign budget optimization so advertisers of all sizes can now set a single budget, and our system automatically finds the best opportunities across each of those segments. Improvements like this one add up and help businesses maximize the value they're gaining from our products over time. This is critical for small businesses that don't have large advertising budgets or expertise, and it's an important way we support economic growth and job creation around the world.

As we wrap up the year, I want to thank our clients for their partnership and their continued feedback which helps us improve. And I also want to thank our teams at Facebook for helping these businesses reach their customers and grow.

And now, here is Dave.

David M. Wehner {BIO 2419389 <GO>}

Thanks, Sheryl, and good afternoon, everyone. Let's start with our community metrics. Daily active users on Facebook reached 1.49 billion, up 9% compared to last year, led by growth in India, Indonesia and the Philippines. This number represents approximately 66% of the 2.27 billion monthly active users in Q3. MAUs were up 199 million or 10% compared to last year.

Note that our Q3 2018 community metrics reflect an update to our calculation methodology. This resulted in the removal of the small percentage of accounts or approximately 15 million DAU and 9 million MAU worldwide. This change will modestly impact our year-over-year user growth rates until we lap it next year. Further details are included in the earnings slides on our IR website.

Turning now to the financials, all comparisons are on a year-over-year basis, unless otherwise noted. Q3 revenue was \$13.7 billion, up 33% or 34% on a constant currency basis. Had foreign exchange rates remained constant compared to last year, Q3 total revenue would have been \$159 million higher.

Q3 total ad revenue was \$13.5 billion, up 33% or 35% on a constant currency basis. In terms of regional ad growth, Asia Pacific was strongest at 38%, followed by Europe and North America at 34% and 33%, respectively. Rest of world ad growth trailed at 26% due to both currency weakness and economic challenges in Latin America.

Mobile ad revenue was \$12.5 billion, up 40%, and represented approximately 92% of total ad revenue. In Q3, the average price per ad increased 7% and the number of ad impressions served across our services increased 25%, driven primarily by feed ads on Instagram and Facebook.

Our impression growth in Q3 came primarily from product surfaces and geographies that monetize at relatively lower rates. For example, ads in Instagram Stories contributed to our impression growth this quarter, although these ads currently monetize at lower rates compared to feed ads. Payments and other fees revenue was \$188 million, up 1%.

Turning now to expenses. Total expenses were \$7.9 billion, up 53%. We ended Q3 with approximately 33,600 full-time employees. That's up 45%. The majority of our new hires in the past year have been in technical functions. Operating income was \$5.8 billion, representing a 42% operating margin. Our Q3 tax rate was 13%. This was lower than we expected because we did not take the one-time charge that we anticipated due to the Ninth Circuit Court withdrawing its decision in the Altera case.

Net income was \$5.1 billion or \$1.76 per share. Capital expenditures were \$3.3 billion, driven by investments in data centers, servers, network infrastructure and office facilities. In Q3, we generated \$4.2 billion in free cash flow and ended the quarter with approximately \$41.2 billion in cash and investments. In the third quarter, we bought back approximately \$4.3 billion of our Class A common stock.

Turning now to the revenue outlook, in Q4, we expect that our total revenue growth rate will decelerate by a mid to high single-digit percentage compared to our Q3 total revenue growth rate. Several factors are contributing to this deceleration. First, we expect more of our impression growth to continue to come from product services and geographies that monetize at lower rates. Second, we are seeing some impact from data privacy initiatives on pricing growth. And third, as we focus more of our product efforts on the growth of Stories, its more prominent placement on Facebook will displace some ad impression opportunities.

Turning now to the expense outlook, we anticipate our full-year 2018 total expenses will grow approximately 50% to 55% versus our prior range of 50% to 60%. We anticipate that full-year 2018 capital expenditures will be approximately \$14 billion to \$14.5 billion compared to our prior estimate of \$15 billion.

Turning to tax, at current stock prices, we expect that our Q4 tax rate will be in the mid-teens. As a reminder, fluctuations in our stock price will impact our tax rate.

I'd also like to share our initial outlook on 2019 operating expenses and CapEx. As Mark mentioned, we plan to continue to invest aggressively across the business and expect that full-year 2019 total expenses will grow 40% to 50% compared to full-year 2018. We also expect that full-year 2019 capital expenditures will be approximately \$18 billion to \$20 billion, driven by a continuation of our data center build strategy that seeks to put in place adequate capacity ahead of our needs. We anticipate that our full-year 2019 tax rate will be in the mid-teens.

The third quarter marked a period of both solid revenue growth across the globe and heavy investment as we make progress on our mission to bring the world closer together. We are confident in our ability to improve the products that our community loves as well as to provide innovative new experiences in the near and long-term.

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

Q&A

Operator

We will now open the lines for a question-and-answer session. Your first question comes from the line of Doug Anmuth from JPMorgan.

Q - Douglas T. Anmuth {BIO 5591566 <GO>}

Thanks for taking the questions. I just wanted to ask two. First for Mark, I was just hoping you could talk a little bit more about some of the challenges that you see for Stories within Facebook relative to their stronger adoption in Instagram and for WhatsApp Status. And then also, what if Stories don't gain traction on Facebook over time here? How do you think about that for the platform as well?

And then, secondly, for Dave, just on OpEx for 2019, the 40% to 50% growth, should we think about that as still the same buckets of spend that you've been talking about over the last year or so, and does their prioritization change at all for next year? Thanks.

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

Sure, so I can take the first part. I think a lot of this is really basic. When I say that we got started slower on Facebook, that starts with literally rolling out on Facebook a number of months after we had rolled out on either WhatsApp or Instagram. And then the initial

version of what we shipped I just think wasn't as high-quality as where it needed to be. It wasn't as fast. There were bugs. And we've been working on dialing that in.

I'm less worried at this point about it not working because we're starting to see it really take off. Certainly, with different groups of people, it's stronger on Instagram or WhatsApp or Facebook, but across all three at this point, it's growing. And as I said in my opening remarks, I think we're going to be a lot better positioned here in Facebook in the next year.

A - David M. Wehner {BIO 2419389 <GO>}

Hey, Doug. It's Dave. Just on the 2019 expense growth guide, a lot of that is consistent with what we've been talking about as our big investment areas. If you look at just head count growth in the past year, it's up 45%. So that compensation expense base that we're bringing into 2019 is really factoring into the overall growth guidance for the total expense guide, so that's a big factor there.

In addition, we've been investing significantly in CapEx, and those investments are starting to flow through the P&L in terms of depreciation. And then I'd point to significant investment areas like AR/VR efforts, the content ecosystem around video, and the ongoing investment in safety and security.

Operator

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

Q - Eric J. Sheridan {BIO 17860961 <GO>}

Thank you so much, maybe one for Sheryl. When you think about some of the friction points you're trying to solve for on either the creative side or the selling-through side with respect to video and Stories, maybe you could call out some of the conversations you're having with advertisers and how you see some of the moves Facebook can make to solve for those friction points looking out to 2019 and beyond. Thanks so much.

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

Thanks for the question. We have a very large and growing advertiser base, and that gives us we think a really strong position to get people into new formats. When you do that, a couple of things really matter. One is that the format of an ad really has to match the format of the consumer experience. So the right ad in News Feed is different than the right ad in an Instagram or a Facebook story is different than the right ad in Watch, which would be video-only. And so making these new formats of ads is actually hard for people and expensive. And so we're working hard on tools to make the formats easier, and I talked about one of those examples before.

What's nice is that the same targeting, the same measurement systems really work. Because we are looking to show relevant ads to the right person at the right time, the systems we have that understand in a privacy-protected way what ads people are likely to

be more interested in, those work, whether you're in Stories or Watch or Instagram Feed or News Feed.

And the other thing is that our systems for measuring the effectiveness of ads, which help advertisers get all the way through to their ROI, which help them bid in our system, also work. And so we take the advertiser base, we take the systems we have for targeting and measuring ads, and then we help advertisers move to the new format. And I think that's the process we're on.

Operator

Your next 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, last quarter, Dave, you made some comments about a multiyear margin outlook, and I appreciate the comment this quarter about engagement in the feed, et cetera. I was just curious when you thought about that margin outlook, how do you think about the one or two key drivers of News Feed monetization over the next few years, given you expect to be flat overall engagement?

And then secondly on Watch, I'm wondering, Mark. Could you just talk about the key one to two steps you need to sort of clear in order to drive higher Watch and video engagement to sort of catch up with some of the competitors? Thanks.

A - David M. Wehner {BIO 2419389 <GO>}

Hey, Brian. It's Dave. In terms of what we're seeing as opportunities, I mean, we continue to see good growth opportunities for revenue across both Facebook and Instagram, including both feed and Stories. I think in terms of impression growth, you're going to have more opportunities in Stories, probably more opportunity on Instagram, but good revenue growth opportunities in both places. So that's obviously what we're looking for when we look forward. Beyond that, I don't have much to update on in terms of any more specific revenue outlook.

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

And to the video questions, the biggest thing that we need to do is make sure that the video experience is people-centric and that we're helping creators build community and we're helping people interact with each other. Our journey with video has been a little bit funny, in that people really want to watch a lot of video. And to a large degree, we've had to limit its growth and we had to do the things so we can stop limiting it.

The things that have caused us to limit it are, on the one hand, when we see passive consumption of video displacing social interactions, that's not something that we've wanted because we feel like that's what Facebook is. We build social products that help people interact. There are lots of places in the world that you can go to consume content,

but we're the Internet service that people use to help connect with other people and we're not going to let passive consumption get in the way of that.

So we needed to figure out a way so that video can grow, but people can also keep on interacting doing what they tell us that they uniquely want from Facebook. And now, I think we're starting to work through what the formula is going to be so we can take some of those rate limits off and let video grow at the rate it wants to. And I think that's a very exciting opportunity ahead, and that's one of the reasons that I'm very optimistic about the Watch growth that we've started to see recently up about 3x in the last few months in the U.S. alone.

Operator

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

Q - Justin Post {BIO 3469195 <GO>}

Thank you. Mark, first, on Facebook engagement. There are some questions about usage. And when you look at the engagement, do you see it stable? I think you mentioned that earlier. And does that include some of the changes you've made on video earlier in the year?

And then, secondly, some usage may be moving over to Instagram. When you look at Facebook plus Instagram, how do you feel about how that usage is trending? Thank you.

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

Sure. So I mean across the whole family of apps, I mean all of this engagement is growing quickly and we're very happy with how we're enabling people to share. As I said, the vast majority or the majority of the growth that we're seeing in sharing is coming from private messaging and story sharing. So that's kind of the big thing.

The basic story that we've seen within the Facebook app is, over the last few years, the amount of time that people were spending in the app was increasing primarily because people were consuming more public content, like passive video consumption and news. But it was coming at the expense of people interacting with each other as much. So interactions were down. And we got a lot of feedback from people saying that's not what they wanted.

We don't think that that's what we're uniquely here to do. It's not the mission of the company. So we felt like that was not sustainable. So we've made a lot of shift this year, which I've talked a lot about on a bunch of these calls, to encourage more meaningful social interactions instead. And we have seen that those changes have improved the trajectory of how people are interacting.

Now, at the same time that we have intentionally reduced time spent on certain things, like lower-quality viral videos, some news, some passive content, but that's what I was talking about before when I said that now the trend - and you can kind of look at it in

developed markets and developing. In developed markets, it is stable and we feel like we're pretty close to saturation in a lot of countries, like the U.S. And in developing countries, where a lot of people are still getting on the Internet, it continues to grow at a fast rate. And we think that there's a lot more connecting in community that people want there.

So that's kind of what we're seeing overall. Across the whole family, I would say it's very positive. On Facebook overall, I feel like we have a handle on what the drivers of this are and we're kind of driving it to be what people tell us they want and what we think is going to be sustainable over time. That's the picture that we have.

Operator

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

Q - Ross Sandler {BIO 15948659 <GO>}

Great. Two questions. Dave, you mentioned 4Q revenue is going to have a mid to high-single digit deceleration. That's a tad better than what you stated 90 days ago. So just I know it's a small change, but I think folks on the line are looking for anything incremental in terms of what you're seeing. Has anything improved? And then, any initial read on what kind of deceleration we can expect to see in 2019, if at all, as you start turning on the ads on WhatsApp?

And then, one for Sheryl. The shopping experience on Instagram, how do you compare, I guess, just the overall commercial intent on Instagram compared to Facebook? And what do you think that says about the long-term monetization potential for Instagram versus Facebook?

A - David M. Wehner {BIO 2419389 <GO>}

All right. Ross, I'll start off on that. I think the outlook that we're giving for Q4 deceleration is broadly consistent with the outlook that I gave last quarter with the benefit of a little bit more visibility. I'd just reiterate the points that I'd made in the earnings script around what's driving that deceleration.

And as far as to how that plays into 2019, we're not providing a specific revenue outlook for 2019. We continue to see good growth opportunities across the platform on both Facebook and Instagram and feed and Stories. Those are going to be the drivers. I would characterize the launch of Status apps on WhatsApp as being a much smaller thing than a driver of 2019 revenue growth, and it's going to be more about Instagram and Facebook. The same factors that I discussed impacting Q4 growth will likely continue to play out to some extent in 2019, but we've got a lot of good growth opportunities for next year.

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

When you look at the Instagram Shopping experience, we're seeing some really nice growth. We have 90 million people tap to reveal product tags and posts every month to learn more about them, and we're putting real investments behind this. In Q3, we rolled

out Shopping in Stories globally and began testing the Shopping Channel in Explore. And so, we think the opportunities are big.

As you think about commercial intent in Facebook versus Instagram, there's so much activity on both. We think there's a lot of opportunity for people to have commercial intent, if not have it when they start, but develop it because they see things they're interested in, in both. Instagram can be more interest-based in some places than Facebook. So there are places in Instagram like Fashion or like Shopping that have very high signal, and that gives us I think a very strong opportunity there.

Operator

Your next question comes from the line of Lloyd Walmsley from Deutsche Bank.

Q - Lloyd Walmsley {BIO 15125459 <GO>}

Thank you. Two questions, if I can. First, just, Mark, your comments in prepared remarks on Stories having potential to be a bigger medium than News Feed suggests that the engagement is a net positive in terms of time spent or sessions per user. Is that the right way to interpret that as you see people engage in this they actually spend more time overall?

And then, second question for Dave. Last quarter, you guided to kind of long-term operating margins in the mid-30s range. The guidance on OpEx for next year kind of implies we may already be there. Is that the right interpretation and should we expect it to be kind of stable beyond that based on some of the comments from Mark about recognizing that revenue and costs should be matched over the long-term? Any help you could give there would be great.

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

So on Stories, I don't know if we've given any metrics on time spent or anything on that side. But what I can say is that all of the trends that we've seen suggests that in the not too distant future people will be sharing more into Stories than they will into feeds, and that the whole market across all of the Stories type of products will be bigger in a market where people are sharing more moments from their days into Stories-type products than into feed-type products.

And this happened very quickly, right? I mean this whole trend is much newer than the trend with News Feed and feeds overall and it continues to grow incredibly quickly. So we just see that there is a lot of upside there.

Now, on the flip side, I try to be very careful in my remarks to be clear that this is one of those situations where the community growth that we're seeing is outpacing the progress that we've made so far on developing the ads in that space. And I think we'll get there over time, where the performance for Stories ads will converge with what we have seen in feed. And I think that the opportunity will be bigger because there will be more in Stories – or more Stories overall than in feed. But I can't tell you just yet what that timeframe is

going to look like, but I think we're well-positioned over the long-term because we're leading in Stories in basically every country.

A - David M. Wehner {BIO 2419389 <GO>}

And, Lloyd, on the margin question, as I mentioned, 2019 will be a big investment year. So I would expect us to have the biggest change in our margin structure to happen in 2019 and for it to moderate from there. It's hard to be too prescriptive about 2020 and beyond, but I think the biggest change will be 2019.

Operator

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

Q - Brent Thill {BIO 1556691 <GO>}

Thanks. Just on Europe, there's been a more pronounced deceleration. Just curious in terms of how you think about the stabilization there going forward in your model and maybe a little more color on the pricing.

A - David M. Wehner {BIO 2419389 <GO>}

Yeah. Hey, Brent. It's Dave. I think, I guess, if you're talking about DAU and MAU, Europe is stable on that front in terms of Facebook overall. The accounting methodology change did affect how Europe sequential growth rate came in, but really stable if you kind of take that aside. And we had some impact from GDPR over the last two quarters. So I think, from that perspective, it is broadly stable for Facebook there.

European growth rate I think was healthy from a revenue point of view. So I think we're still seeing good growth in Europe on the revenue front, and a lot of the similar dynamics playing out in Europe as in the rest of the world where you see good impression growth opportunity, especially in areas like Instagram and Stories contributing to overall ability to drive revenue growth.

Operator

Your next question comes from the line of Mark May from Citi.

Q - Mark A. May {BIO 4280734 <GO>}

Thanks for taking my questions. You seem confident that Stories will ultimately be a more effective canvas both for users and businesses and maybe even more so than the feed, but you also talked the transitional challenges. What specifically are those challenges? And since Instagram is further along with Stories, are there any things you're seeing with Instagram Stories monetization that gives you line of sight to reaching monetization parity, not only at Instagram, but also at core Facebook eventually?

And then maybe just a second one. In addition to Stories, Mark also discussed how private messaging is also a growth use case. In private messaging, the company has,

understandably so, been cautious on the monetization side. So just curious if you could discuss how optimistic you are about building a meaningful business around private messaging.

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

I can take those. When you think about the transition or people using feed versus Stories, there are a couple of things that are different. One is just the format. And again, we have a lot of experience at this. People had display ads or search ads before they really did Facebook ads, if you look back a decade. And teaching people here is what a Facebook ad looks like was a new format people had to understand. Then, as we moved into more photos with Instagram, more videos, a video ad on Facebook or Instagram is a very different thing if they perform well. They need to be natively social than a video ad that runs on TV.

So Stories is a new format. It has multiple pictures, multiple screens, words and phrases intermixed in a different way. And so again, that's a new muscle for advertisers. I think we're getting people up the curve well this time. We've learned that we can't just rely on teaching our clients and teaching the ad agencies to do it, but helping them do that. And so some of the tools we've rolled out that I talked about where we can take your Facebook pictures and your posts and make it a story, that makes that process faster.

I think when you think about the long-term monetization opportunities, it's really going to depend upon the time people spend. The amount of ads we would feel comfortable inserting into a consumer experience really depends upon how many different things you go through. So if you spend more time in Stories, they'll be need to be more engaging because there will be fewer ads in there.

Now that may be possible because there's high, high, high engagement in Stories. So we're going to have to see the length and how quickly people scroll through them to see how many ad opportunities there are and to see how effective those ad opportunities are. Our business depends upon the amount of ads that we can share and the effectiveness of those ads, which drives up ROI and ultimately the price.

When you think about messaging, if we've already made the transition in a big way to feed, if we are starting to see real success in Stories, messaging is in a much earlier stage. And what we're doing on Messenger and on WhatsApp are really making sure that businesses can connect with people, and then in the early stages of testing messaging. So we think paid messaging, as we've talked about.

And WhatsApp is interesting because by virtue of paying, businesses are going to have to be careful about the content they send. You're not going to send a lot of things people don't want to see if you're paying for them. And so really focused on the consumer experience there and figuring out over time.

The last thing I'll say is that I think these things are more connected than people realize, in the sense that we're already seeing some nice traction with click-to-Messenger ads. So one of the things advertisers are trying to do when they're in feed and ultimately when

they're in Stories is drive to transactions and real engagement, one-on-one with a consumer is often part of that.

So a click-to-Messenger ad takes advantage of having both of those platforms so that businesses can deepen their relationship with the consumer. And I think those experiences and the interaction between them, we're even in earlier days there, but I think we have a lot of opportunity to explore there.

A - David M. Wehner {BIO 2419389 <GO>}

And, Mark, this is Dave. I just wanted to add in. I think you asked about line of sight on monetization parity on Stories versus feed. It's obviously hard to say that because they're both dynamic, they're auctions, there's a lot going on. But I would say that at least in the near term, the impression growth opportunity is significant on Stories. Pricing will take time. So as we bring more formats to Stories and bring more advertisers to Stories, we can build up that demand and balance that out with supply. But I think in terms of it converging on feed from any pricing perspective, that's a journey that's going to take years, not quarters. So it's going to take time.

Operator

Your next question comes from the line of Anthony DiClemente from Evercore.

Q - Anthony DiClemente {BIO 21089686 <GO>}

Thank you very much for taking my question. Just really one for Mark, which is, I don't think anyone has asked much about the security investments that Facebook is making. And when I talk to investors, people are curious whether it's one-off or recurring. And so as you think about 2019, the magnitude of the resources that the company plans to deploy to protect privacy, to protect security, it sounds like you're in or will be in, hopefully, a better position to ward off bad actors than you were prior to the 2016 election.

But I just wonder. Do you look at this as an endless arms race, or is there some point in this investment where you might be able to get some better efficiencies on those investments, also relative to others in the industry who are making investments that don't seem quite as sizable as Facebook's? Thanks.

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

This is a really important question. I do think that we are up against sophisticated adversaries who will continue to evolve. So there is a large element of this, which is an arms race. And when you're talking about security issues and some of the safety and content issues, these are not problems that we fix. They're problems that you manage over time and try to reduce and prevent issues from coming up, but there's no silver bullet where you do the thing and then you're done.

That said, I do think that we were quite behind where we needed to be a couple of years ago. We started a roadmap, which we said was going to be about a three-year roadmap. I

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think that we have some confidence in that timeframe, which takes us through the end of about 2019, to get our systems to the level that we generally think that they should be at, where we're building AI systems that can flag content that might be problematic to a much larger security and review team that can manage the larger volume of stuff that our tools are flagging to them.

We're judging our success by, go through all of the categories of harmful content and behavior, whether it's terrorism, or self-harm, or hate speech, or just any different kind of thing that you'd be worried about. We're judging our success by how proactive can we get, so what percent of the stuff that we're taking down are we identifying before other people identify it for us. We've started issuing transparency reports so we can be held publicly accountable on this.

What we see internally is that generally every week and every quarter that goes by, we're getting better and better at this. But I anticipate that it will be about the end of next year when we feel like we're as dialed in as we would generally all like us to be. And even at that point, we're not going to be perfect because more than 2 billion people are communicating on the service. There are going to be things that our systems miss, no matter how well-tuned we are.

But I think we're making progress. We've made a lot of progress in the last couple of years on content overall. Elections are a special case, an extremely important special case of the content and safety issues and security issues that we face. But across all of the different types of content issues of people trying to spread hate or incite violence. We are making progress, and I feel good about the progress that we're making. And I think we will continue investing more. But I do think that to some degree the last few years and next year are probably going to be the biggest growth in the investment in the security efforts that we'll see.

Operator

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

Q - Heather Bellini {BIO 2268229 <GO>}

Great. Thank you. I just had two questions and I guess maybe you just touched on some of this, Mark. But the CapEx growth that you guys gave for next year, how far ahead should we think about you guys building out capacity? And can you help us think about the ongoing trend, in particular in light of your comments that you just made about how you'll feel about being more dialed in at the end of 2019? But how do we think about kind of that continued growth and CapEx number? And is there anything there that's a one-time item?

And I guess the other question would just be related to Stories. And I guess, I'm just wondering, I know it's early days in terms of advertisers putting ad units in there at this point. But given that you've got the technology that converts to creative and kind of help people with that process of how to do a good Stories ad, how effective do you think that's been in terms of helping to drive their adoption of this ad unit thus far?

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A - David M. Wehner {BIO 2419389 <GO>}

Heather, I'll take the first question regarding CapEx. So, yeah, we are investing ahead of user growth, given the long lead time in deploying data centers and network capacity. So we are building some capacity ahead of our immediate needs. So that is playing into it. But we're also making investments to support the core growth of the business. There's a lot of compute that goes behind, things like feed ranking and ads ranking. We think there is good ROI to putting more servers behind things like choosing the right ad for the right impression opportunity that we have. So we are putting more compute behind that.

And then, I'd also make the comment that a lot of our growth is coming from markets in Asia, our top growth countries were India, Indonesia and the Philippines. So we're building capacity to serve that Asian peak and those users are at a lower ARPU. So that impacts the overall capital intensity. So we're continuing to invest and we're seeing increased CapEx in 2019, albeit at a much slower growth rate than we had in 2018.

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

I'll talk about Stories and I'll share a fun and, I think, important example. We know that when people are using more of the opportunities to reach consumers, their returns often go up. So the fun example is the Furbo Dog Camera. They're a Taiwanese company. They built this camera where you can see/talk and you can see and talk and toss dog treats to your dog when you're not at home. They ran a video ad campaign across Facebook and Instagram Stories and they targeted people with dog-related interests and used Custom Audiences to exclude people who had already purchased their product. By running across Facebook Stories and Instagram Stories, they drove 20% more leads than our other digital campaigns. So anecdotally, with our early, early adopters, we can see that we believe the increased opportunities here really work, and we have other examples like this.

In terms of how early it is for adoption, it's super early. We just rolled out the ability to do this in August, and we have to drive awareness and drive people into trying it. And even when we make it super easy for people to get their ads into the right format, from the smallest mom-and-pop to the largest brands, people want to understand the creative of their ad and it needs to be in a format they feel comfortable. So as more people use Stories, we think they will increasingly feel comfortable in Stories. But we have a long road ahead of us even with tools that make it easy to drive awareness and adoption. We think once we do, the returns will be good.

A - Deborah Crawford {BIO 5934723 <GO>}

Operator, we are going to take one last question.

Operator

Your last question comes from the line of Ralph Schackart from William Blair.

Q - Ralph Edward Schackart {BIO 7200102 <GO>}

Good afternoon. Maybe switching gears to feed, you talked about it being a major growth driver and a lot of opportunities for improvement. Can you maybe share some perspective on what those opportunities look like from both a user, as well as an advertiser? And then also, maybe just more longer-term, how can feed continue to be a strong growth driver? Thanks.

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

I can take that. When you think about feed, what people are doing is sharing. They're sharing in Instagram and Facebook. And that means there's, in many ways, almost limitless opportunity for consumers to do more. I think we've made some strong changes on Facebook in terms of meaningful social interactions, and I think the history of our ability to develop and iterate on consumer products shows that we can help people as they evolve, share the things they want to share, and have a very meaningful and important experience in feed as they're sharing.

Feed is fundamentally about information being pushed to a consumer and us helping figure out what is most interesting and most engaging and I think, in many ways, positive for people. And I think the product teams, led by Mark, have done a great job of that over time and you're seeing the continued investment there. Along with that, goes the advertising opportunities. As there are more Stories and feed, as more people are engaged in Facebook and increasingly in Instagram, that gives us more opportunities just on the supply side of ads.

On the demand side, all of the things we do to get more advertisers active in our system, means we'll have more ads to choose from, to make those ads more relevant, to measure the ROI of those ads so that people can then iterate and, again, make those more relevant. I think we've made real improvements there, but I think there's a lot more we can do.

And one of the ways I talk to people about it is just ask what percentage of the ads do you see in your feed are as good as the very best posts you see from friends. And I think most people will honestly say that certainly compared to a few years ago, those ads are much more relevant to them, but not all of them. And you can see in that example, even in your own feed, the opportunities we have to improve, finding the right ad and giving it to the right person at the right time, which drives businesses all around the world and drives our business as well.

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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