

Facebook, Inc. (FB)
Second Quarter 2019 Results Conference Call
July 24th, 2019

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 Second Quarter 2019 Earnings 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. If you would like to ask a question during that time, please press star then number one on your telephone keypad. This call will be recorded. Thank you very much. Ms. Deborah Crawford, Facebook's Vice President of Investor Relations, you may begin.

Deborah Crawford, VP Investor Relations

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.

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

Mark Zuckerberg, CEO

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 this 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 our first two priorities today, but first I want to talk about the recent news that we reached a settlement with the FTC over 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 in building tools to review our products and the ways

we use data. It will 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 with 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 in 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 build 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 our systems. 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 have 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 the internet would benefit from governments setting clearer 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 President Macron to discuss a 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 we're making on many categories of harmful content, including hate speech and graphic violence, but also 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 at the same cadence as these earnings calls.

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 co-ordinated inauthentic behavior, new ads transparency tools, 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 elections, 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 thanks to our efforts the elections were much cleaner online. We'll continue building on these efforts as we approach the 2020 US 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. There are a few efforts 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 conversations. 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 ephemeral stories from your different apps into one place. We're also building things like the ability to co-watch videos together. This shows how something like video chat, which is growing quickly as a basic way we 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 ephemeral 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 connects 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 to Facebook Marketplace to payments across our apps to the new Libra project that we announced with 27 other companies recently. These efforts are important both for our product experience and our business. Once people have connected to their networks on social platforms, one of the biggest questions is how can we help them use those networks that they have created to create opportunity, and one of the best ways to 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 in a trusted network with real identities. Hundreds of millions of people already use Marketplace monthly. We're also building ways for people to interact with businesses through messaging, like WhatsApp Business, because people don't like having to call businesses and would rather engage asynchronously over messages if possible.

Payments is part of this I'm particularly excited about. When I look at the kinds of private interactions 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 there's an opportunity to 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 will be powered by blockchain technology. The 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 a lot of possibilities here, and both Facebook and the Association plan to work with regulators to help address their 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 experience that people keep using week after week, and buying more content. There's still a lot of work ahead to develop this ecosystem and deliver the future of 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 Rift, which cost \$600 and needed to be tethered to a \$1000 PC, to now Quest, which costs \$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 we're going to build on going forward.

The reason augmented and virtual reality will deliver a qualitatively better experience than traditional computing platforms is that they deliver the feeling of presence -- that you're actually there with another person or in another place. The feeling of presence is so important to social interactions and how we're wired to interact as people. So even if it has taken longer than we expected to deliver this at 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.

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 a have a lot more ahead. Our business continues to perform well, and Sheryl is going to talk more about that in a minute.

But this was also an important quarter because now we have a clearer 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's Sheryl.

Sheryl Sandberg, COO

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 are 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 ad, how much they spent, and who saw the ad. Helping people understand who's 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 are 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 give 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 and 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, used these tools to build a mobile-first campaign. They targeted women interested in fitness and as a result, nearly doubled their conversions to new memberships.

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 used Dynamic Ads to connect with travelers who recently looked at flights online but didn't book. This contributed to a nearly 3.5x increase in ad-related bookings and a 2.5x increase in ad-related revenue. This quarter, we launched our latest variation – Dynamic Ads in Instagram Stories – which show people ads for products they've already browsed on a retailer's 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 50% of accounts on Instagram use Explore every month to discover photos and videos related to their interests. This quarter we started rolling out Ads in Explore on Instagram. This will give businesses a chance to reach new audiences in a place where they are already spending their time and learning about new products.

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 in Instagram which allow businesses to promote Creators' posts as feed 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 in 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 that 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 am grateful for our teams' tireless work and commitment.

Thanks everyone, and here's Dave.

David Wehner, CFO

Thanks Sheryl and good afternoon, everyone.

Let's begin with our community metrics.

Facebook daily active users reached 1.59 billion, 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, 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 & 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 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 a court ruling in the IRS vs. 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 helped 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 53-61% compared to 2018. The \$5B 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 \$2B 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 \$16-18 billion, down from our prior estimate of \$17-19 billion. Our capital expenditures are driven primarily 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.

Operator: Your first question comes from the line of Brian Nowak from Morgan Stanley.

Brian Nowak: I have two. The first one on the core Facebook app, I was wondering, can you talk 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, I guess now Big White, 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 2020?

David Wehner: Sure, Brian. It's Dave. I think on the Facebook app, I'd just say that 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 engagement levels that we're seeing overall on the Facebook app so think first half's been solid from that perspective.

And then the second question was on the ad targeting-related headwinds. So we think of those new in really 3 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 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 3 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.

Eric Sheridan: 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 will be how that's informing your investing in video content? How should we think about investments going forward that might impact growth versus margins? And then third, the opportunities on the advertising side that video might present over the next 3 to 5 years?

Sheryl Sandberg: So I think video has been pretty important. It's really followed technological change. If you think back even 4 years, you couldn't really take a video - a lot of videos buffered on your phone. And now, if 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 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 feeds, people can put video into Stories and different places. We also have this specific Watch place where we're looking at original content.

I think 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 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 flying 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 vs. Time to Red Table Talk to Sorry For Your Loss. And we're seeing some really nice engagement numbers on those shows.

And the best of them actually carry over into Facebook community because what's best is when 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 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 format that 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 on Facebook because they don't perform the same way.

The best TV ad is 30 seconds. It builds 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 to the product in the first 3 seconds, captures your attention much more quickly.

We sometimes talk about it as "thumb 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 still got a pretty long way to go.

We are seeing good results. I'll share an example. McDonald's used mobile-opt video ads in Facebook and Instagram News Feed and Stories to launch a limited edition called a Big Mac Range in the U.K.

It had a 16.5% reach in ad recall, and the Nielsen 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.

David Wehner: 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.
- Ross Sandler: Can we just go back to the deceleration comment. Totally 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 the current drivers, and we're likely to continue to see those ascend in the future, what specifically do you see as slowing down in 4Q and 2020? Is that core Facebook? Any additional color on the surface that might slow down from some of these changes?
- David Wehner: Sure, Ross. I mean if you remember, we're seeing impression growth across Instagram Stories, Instagram Feed, and Facebook feeds. 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 are seeing good impression growth, that impression growth is flowing through at a lower price point than 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 have several product optimizations in Q4 that contributed to 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 a marked 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.
- Douglas Anmuth: One for Mark and one for Dave. First, Mark, how are you thinking about the opposition that you received so far around Libra? Does it change your view of the time frame at all in terms of rolling out the currency?
- And then second, Dave, you talked about the higher demands of privacy. Can you just talk about how that could impact the expense growth as you think about 2020 where in the past, you talked about more moderate expense growth for next year?
- Mark Zuckerberg: Sure. So on Libra, and similar to our approach on some of the important social issues that we faced 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 dialogue about this.
- Facebook from a few years ago would have probably just showed up and tried to release a product on our own, now the approach on all of these fronts is to outline the ideas and 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 that there were going to be a lot of questions. And we're going to have to work through that. So I think we're currently 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 here.

David Wehner: And then Doug, you were asking about the impact on expense growth. We're not giving guidance specifically on the 2020 expense outlook, but the privacy efforts do require significant investments obviously in compliance processes, people and technical infrastructure, and those are factored into 2019 operating expense outlook.

One of the impacts that I'd point to 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's factored in as well terms of the overall impact of the business, not just purely the expense side.

Operator: Your next question comes from Lloyd Walmsley from Deutsche Bank.

Lloyd Walmsley: Two if I can. First, can you just talk to us about early learnings from the test of Instagram Check Out and what some of recent hurdles are to kind of scaling that more broadly?

And secondly, on OpEx, it looks like you saw 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?

Sheryl Sandberg: I'll talk about Checkout. So, Checkout is in -- we talked a lot 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 as small as something could be.

Obviously as I said small - but working with brands, we're pretty excited by their feedback. We are 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 built 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're more looking directly at products, that makes our ads more valuable.

If we can help people check out and pay for the products and even buy the products, it makes the consumer experience better and it also closes the loop on the data and measurement we're going to need going forward.

So we're excited about these efforts. We are 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.

David Wehner: And then Lloyd, you were asking about the step up on the cost side in Q2 versus Q1. A 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 have 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.

Heather Bellini: Great. Thank you so much. I wanted to follow-up on 2 comments. One, which -- that 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 where they were selling on Instagram? So if you have anything you can share there.

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

Sheryl Sandberg: Yes. On the checkout data, it's just really small and really early. We definitely hear that it decreases friction in the shopping experience for the 23 brands and products. That's just too small for us to take any real learnings. We are working with them on iterating the product experience for now.

David Wehner: 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.

Justin Post: Mark, from the outside, it's really hard to tell what's going on the regulatory environment and status with regulators. I guess good news on the FTC settlement. But the new investigations being started, just wondered if you can give us high-level to the extent that 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 can talk Europe, since GDPR implementation, has there really been a meaningful difference in your ad revenue growth rates there versus other regions?

Mark Zuckerberg: 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 talking a lot about data portability. And on each of these, I think that they -- there's 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 are still going to be trade-offs between important values that we all have, I mean, on content between free expression and civil discourse and removing hate and things like that. And 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 what 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 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 at each area and it will come in different forms.

So in some places, there will be laws passed. In others, it might be working with regulators and having some structural rules imposed on us like with this FTC settlement. In other areas, it might be self regulation like around content and speech in the United States. That's what I'd expect because of the First Amendment here and such 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 more work in each of those but I think we are making progress. And as I said, it's a global problem, not just a user global problem, not just an American one so working with folks across Europe and other continents as well is important, too.

David Wehner: 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 and currency is a factor in that delta as well.

Overall, we did see Europe had a reacceleration 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 a little more slowly than North America and APAC.

Operator: Your next question comes from Mark May from Citi.

Mark May: First, we see 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?

David Wehner: So 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, we'll 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.

Sheryl Sandberg: On WhatsApp Status ads, they're not available. We're very focused for WhatsApp on the consumer experience. But I will take a minute to talk about story ads in general because I think eventually, depending on our ability to use data across platforms that applies to WhatsApp, it's probably a 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 this

transition to mobile is if we made it easier for our advertisers to place the ad to make sure they understood the measurement they were having and also make sure the ads format worked, businesses would move more quickly.

Usually, people move before businesses, so people moved to mobile before businesses and we certainly saw the same with Stories. But I think one of the successes you're 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 -- across the 3 properties we have available, Facebook, Instagram and Messenger.

So rather than go to every advertiser both through our sales force and 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, convert it into Stories and place it anywhere helped us to move people into these formats.

It's also the case that we have a lot of inventory on this. And so there's a real benefit right now in early adopters that pricing is a very attractive. So we think the mix to Stories is a 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 are 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.

Mark Mahaney: I just wanted to focus on WhatsApp. And I know you've had WhatsApp Payments in beta in India. You've launched that last year. Can you just talk about the - are there any particular factors that are causing a delay in that and maybe just takes a long time for product like that to really gain traction, but is it consumer awareness of it, is it regulatory pushback? Is there technical hurdles?

And what does that tell you about the -- maybe nothing, but what does it tell you about ability to take that WhatsApp monetization or payments functionality embedded in WhatsApp and launch in other markets? I know you said you were going to launch it in other countries, but what are the lessons from India that tell you about the pacing of that?

Mark Zuckerberg: 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 for a product that you would expect to need to be widely available to be useful, right, in order for someone to know that they can send money to someone else.

Even in 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 percent 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 we should have more to talk about soon.

Operator: Your next question comes from Michael Nathanson from MoffettNathanson.

Michael Nathanson: I have 2, one for Sheryl or Dave and one for Mark. So Sheryl and Dave, you noted the growth, I guess, in Europe this time, an acceleration. Can you talk about maybe the regional development of Stories and either the embrace from the advertiser 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 either get approval or to build the product. Do you see building a fiat currency wallet for Facebook and Instagram?

I know it's WhatsApp but how does another type of wallet, a non crypto wallet develop if it takes a while for the other products to roll out? Meaning crypto takes a while for approval, so does non crypto, and fiat currency becomes an opportunity for you?

David Wehner: 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 we'll map to the regions 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.

Mark Zuckerberg: 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 Instagram Shopping or Marketplace, your credentials can be shared and there is a shared payment system across all those things.

That's certainly a big area for investment. Overall, these areas around commerce and payments, I think, are one of the most exciting areas in product development for the next several years. 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. Some of that is going to be on that 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 Libra is the one that's gotten more 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, or things like WhatsApp Business, which is more about connecting with small businesses.

And then across the payments landscape, helping people do Payments in existing currencies and also trying some newer approaches that can hopefully bring down the costs of doing payments around the world. We're just very excited about 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.

Benjamin Schachter: Mark, in 1Q, you mentioned specifically that GDPR had an impact on the business, so just wondering if can give an update on that. And then longer term on Facebook, you focus a few times now on buying and selling goods there.

Just wondering if you can comment on how you think about 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?

Mark Zuckerberg: Yes. I don't know, David, if you want to talk about the GDPR impact?

David Wehner: Yes. So just in terms of GDPR, I kind of addressed that earlier. We do see that having an impact in Europe though we did see a reacceleration in growth in Europe as we've lapped the initial implementation of GDPR, so that's promising. But we continue to see Europe growing a bit slower than the rest of the regions, but overall, not a whole lot of additional color to provide there.

Mark Zuckerberg: Yes. And in Marketplace, we definitely are going to focus on some of the areas that you talked about. Including jobs, which is already a pretty meaningful focus where a lot of people to find jobs and businesses list jobs through Facebook.

I don't want -- I don't know our last public stat is here so I'm not going to attempt to cite 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 what we're doing in Instagram with shopping and in Facebook Marketplace and the general approach to Payments is providing it as affordably as possible to improve the user experience and complete transactions,

which will, of course, make the tools more valuable for businesses over all 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.

Colin Sebastian: Great, thanks. A couple from me. First off, any update on the higher profile for Groups in the Facebook app? And any perspective for how that's impacting engagement?

And then Mark, the 5-year timeline for the privacy focused vision, I guess, I'm wondering if we can get a better sense for what the key milestones are along the way and why that's a 5-year outlook perhaps versus a shorter period?

Mark Zuckerberg: Yes. I can take both of those. So in the Facebook app overall, after helping people connect with friends and family, helping people connect 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 he didn't, just to emphasize his point, I think part of the our strong performance over the first half of this year, a meaningful part of our over-performance compared to what we had expected is because of strength in engagement in the Facebook app over that period.

So that 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?

David Wehner: The 5-year...

Mark Zuckerberg: Okay, so that's on the privacy vision. So yes, for the next year or two, a lot of the work that we need to do is just about getting the architecture, 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 now, which is building up the business ecosystem.

And that's just something that -- our playbook on this is that this is a multiyear journey where first, we deliver the consumer product experiences then we create organic business experiences and then only as the last step are we really able to ramp up having businesses pay for things that are meaningful for them within that.

So it's something you're not going to see progress on that along the way. You'll certainly see milestones every 6 months or 12 months. But before this is really the biggest driver of our business, I do think that's going to be a number of years.

Deborah Crawford: Great, Operator, we have time for one last question.

Operator: Your last question comes from Brent Thill from Jefferies.

Brent Thill: Thanks. Dave, I think a lot of us are kind of having a hard time reconciling the tougher comps in Q4. It was your easiest comp and you just accelerated your constant currency growth in the quarter.

So I guess, is there any change in terms of the visibility or the contracts that you're putting together that lead you to that? And other color? I think there's a number of questions just trying to understand why it's such a strong conviction in that decel.

David Wehner: 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 products 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. But ultimately, it's going to depend on the supply and demand characteristics in that given quarter.

When we do that, 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.

Deborah Crawford: 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.