

**Operator**

Good afternoon. My name is Jay, and I will be your conference operator today. At this time, I would like to welcome everyone to the Facebook third quarter 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. (Operator Instructions)

Thank you very much. Ms. Deborah Crawford, Director of Investor Relations, you may begin.

**Deborah Crawford**

Thank you. Good afternoon, and welcome to Facebook's third quarter earnings conference call. Joining me today to talk about our third quarter results are Mark Zuckerberg, CEO; Sheryl Sandberg COO; and David Ebersman, CFO.

Before we get started, I'd like to take this opportunity to remind you that during the course of this call, we will make forward-looking statements regarding the future events and the future financial performance of the company. We caution you to consider the important risk factors that could cause actual results to differ materially from those in the forward-looking statements in the press release and this conference call. These risk factors are described in our press release and are more fully detailed under the caption Risk Factors in our quarterly report on our Form 10-Q filed with the SEC on July 31, 2012. In addition, please note that the date of this conference call is October 23, 2012, and any forward-looking statements that we make today are based on assumptions as of this date. We undertake no obligation to update these statements as a result of the new information or future events.

During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release.

This call is being broadcast on the Internet and is available on the Investor Relations section of the Facebook website at [investor.fb.com](http://investor.fb.com). A rebroadcast of the call will be available after 6 p.m. Pacific time today. The earnings press release and an accompanying investor presentation are also available on our website. After management's remarks, we will host a Q&A session.

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

**Mark Zuckerberg**

Thanks, everyone, for joining us. I'm going to use this time today the same way I will use it on most of these calls, to talk about our vision and strategy.

Our mission is to make the world more open and connected. We do this by building services that give people the power to share whatever they want and stay connected to whomever they want, no matter where they are. For at least the next few years, there are three pillars to our strategy. First, we want to build the best and most ubiquitous mobile product. Second, we want to build a platform so that every new app that gets created can be social and enable people to share. And, third, we want to build a strong monetization and economic engine to build Facebook into one of the world's most valuable companies.

I'm going to give an update on where we are in building each of these pillars. Let's start with mobile. I think our opportunity on mobile is the most misunderstood aspect of Facebook today. Most people underestimate how fundamentally good the trend towards mobile can be for Facebook. This is because there are three trends that are kind of compounding together. First, mobile will give us the opportunity to reach way more people than desktop. Second, people on mobile use Facebook more often. And, third, long term, I think we're going to monetize better per amount of time spent on mobile than desktop. All of these combined together make mobile a much larger opportunity for us than I think most people realize.

Now let's go through each of these points. First, we should be able to reach more people on mobile than desktop. To us, this isn't really controversial. In the coming years, there could be billions more smartphones than desktop computers. We already reach more than a billion people worldwide, including 600 million on mobile, growing quickly and up from 376 million last year. Facebook is the most widely downloaded app on basically every smartphone platform, so we're well positioned to reach the growing smartphone population.

Second, people use our mobile app to visit Facebook more frequently. Somebody who uses only our desktop product has only a 40% likelihood of using Facebook on a given day, but someone who uses mobile has a 70% likelihood of using Facebook on a given day. This thought is surprising to many people and very good news for our opportunity on mobile. Another thing I've found encouraging is that we've shown that we can really increase mobile engagement.

Over the past year, a lot of people gave us feedback that our mobile apps were just too slow. So we took the time to rewrite them to make them faster. And since we released the new faster iOS app, we've seen an 80% increase in iOS News Feed loads and more than a 20% increase in iOS

engagement in terms of likes and comments. We haven't released the rewritten Android app yet, but we have many more updates on the way. So people on mobile are already more engaged than people on desktop, and there's a lot more we can do to help drive deeper mobile engagement as well.

Third, as people spend more time using Facebook on mobile, the business question becomes how much money we can make from that time. I believe that over the long run we're going to see more monetization per time spent on mobile than on desktop. Now, this isn't proven yet, but we're committed to getting there. The reason why I believe this is that on mobile, monetization has to be integrated deeply into our product. On desktop, we've built a multibillion-dollar business with ads on the side, separated from people's primary experience.

But on mobile, we believe ads will be more like TV – high quality and integrated into the experience rather than off to the side. Mobile is a forcing function for us to rethink these experiences to be in mind. Since monetization needs to be integrated directly to the core product experience, I've now asked each product group to own the mobile monetization experience for their product. This is already unlocking a lot of ideas and creativity, and we're starting to see higher-quality monetization experiences in terms of better ad products for people and better results for advertisers.

Finally, I want to dispel this myth that Facebook can't make money on mobile. This may have seemed true earlier this year because we hadn't started trying yet. Today, after just six months of ramping up our mobile ad business, we're already at a point where 14% of our ad revenue this quarter is from mobile. That's about \$150 million. And the most important thing to understand here is that we're just getting started with our mobile product development and monetization.

So on mobile, we have these three forces compounding together. We can reach more users, those users visit Facebook more often, and I think we will make more money. So I'm excited about this opportunity.

Next I want to talk about platform. At a high level, for our platform the last five to 10 years has been about getting everyone in the world connected and mapping out all the relationships between people. The next five to 10 years are going to be about all the apps and experiences that are now possible to build now that all these connections have already been mapped out. The social graph is a new sort of critical infrastructure for companies.

Since the majority of the people use their services are on Facebook, increasingly developers are building social apps. Today, eight of the top 10

iOS apps integrate with Facebook, and 40% of the top 400 apps use our SDKs. We believe that social apps will be the best products in every business category. In some categories, it may be an abrupt, disruptive, or revolutionary change, and in others, the change may be more subtle or roll out more slowly over time.

But over the next five to 10 years, we believe that the best products in every category will be social. We've already started seeing this, with media and Games, and in the future we expect to see this in areas like commerce and even finance. One question I often get is what's our business here? As these apps get built and industries get transformed, why is this good for Facebook? We believe that over time, the more value we provide, the more revenue we'll be positioned to get back, whether that's through developers buying ads, running our ads through our network, using our Payments service, or other possible ways. We're committed to building a sustainable and profitable platform.

Now, I want to talk specifically about Games for a bit, because I think the story here is a little misunderstood as well. Overall, gaming on Facebook isn't doing as well as I'd like, but the reality is that there are actually two different stories playing out here. On the one hand, our Payments revenue from Zynga decreased by 20% this quarter compared to last year. But the interesting thing is that the rest of the Games ecosystem has actually been growing. Our monthly Payments revenue from the rest of the ecosystem increased 40% over the past year since Payments has been adopted. This evolution is pretty encouraging.

Additionally, I want to talk about Instagram. This is really a platform success story. We got to know them because they built a social integration with us that a lot of people really liked, and both companies saw the opportunity to do even more together. When we agreed to acquire them, Instagram had 27 million registered users. Today, they have more than 100 million. The most recent comScore reports show that in the U.S., there's more mobile time spent on Instagram than on Twitter. By giving Instagram access to some of the tools we have internally here at Facebook, they can grow even faster than they would have alone.

Finally, I want to switch gears and talk a bit about monetization. The most important thing to understand here is that we're just getting started on this. I'd like to mention a few of the monetization products I'm most excited about before handing it off to Sheryl to go into more detail on them.

We just rolled out a new product called Mobile App-Installs. Every developer wants more people to use their app. We can provide distribution to help developers increase discovery of their apps. I'm excited about this, because

it helps developers with one of the biggest problems they face. I'm also excited about this because it's truly a mobile-first ad product. A lot of what the desktop web is optimized to do is allow you to click from page to page, which just isn't the basic behavior on mobile. On mobile, you have to install an app first, so installs are way more valuable. I'm excited to see how developers use our mobile app product.

We've also been rolling out Facebook Exchange and a product called Custom Audiences. The idea is that we want to improve our targeting capabilities so that it's easier for marketers to reach their customers and so their ads are relevant and interesting to people on Facebook. This will create much better experiences for everyone using our product.

I'm also excited about the Gifts launch we're in the early days of. I think there's an opportunity here to bring more commerce to Facebook over time, and Gifts is a logical first step. People already send millions of birthday messages a day using Facebook, and a lot of them have asked to be able to do more. Gifts provides us with the opportunity to learn about how people buy things and will hopefully help us build better services in the future.

And of course beyond these products, there's a lot more we plan to do. And I look forward to talking about those things on future calls. So thanks for taking the time to be here with us today and giving me an opportunity to report on how we're doing in the three core areas our strategy: mobile, platform, and monetization. We have a lot going on right now, and I'm excited about the progress we're making.

## **Sheryl Sandberg**

Thanks, Mark. We made a lot of progress in our advertising business in the third quarter. Our total third quarter revenue was \$1.26 billion, with \$1.09 billion coming from advertising. This represents a 32% year-over-year increase in overall revenue and a 36% increase for advertising. With a billion people using Facebook monthly, we have created the largest, most engaged community of real people in the world. Building on this extraordinary asset, the goal of our advertising business is to transform how people and businesses connect. Our scale and targeting capabilities make Facebook increasingly important for marketers – brand marketers, direct marketers, local businesses, and developers – as they move customers all the way through the marketing funnel.

For brand marketers like Walmart and Procter & Gamble, Facebook offers the ability to reach customers, build awareness, and drive positive association, affinity, and consideration. We help brand marketers develop ongoing and often daily relationships with customers, in many cases for the

first time. Facebook is starting to combine the science of CRM with the scale of brand marketing.

For direct marketers like Amazon and Capital One, working with Facebook can achieve high ROI by tapping into our incredibly accurate targeting capabilities. This represents a significant opportunity for us in a \$55 billion global market. For the 12.8 million local businesses that already have Facebook pages, our products, including location and interest targeting and Offers, deepen customer relationships and drive sales. With tens of millions more local businesses around the world not yet on Facebook, we offer a simple path for SMBs to go digital and drive customers into their stores.

And for developers, we spur app downloads and installs and help them reengage customers to generate revenue. Facebook is uniquely positioned to succeed in this rapidly growing global market.

We believe that each of these market segments could over time become multibillion-dollar opportunities for us. To realize this potential, we're focused on three priorities. One, building products that create value for every type of marketer. Two, demonstrating that value to marketers. And, three, taking advantage of the opportunity we have in mobile.

I'll start with the first, products. In Q3, we increased our investment in monetization products. The result has been rapid innovation and new product introductions to serve each of the market segments more effectively. I will highlight four.

Custom Audiences, introduced in early September, helps marketers use their customer lists or other data to target Facebook ads in a privacy-protected way. This allows them to send the right message to the right person at the right time. For example, an automaker can advertise to customers who are looking to buy new car. We frequently see a match rate of over 50% and sometimes as high as 95%, which we believe to be much higher than industry norm.

In September, we expanded the rollout of FBX, the Facebook Exchange, which allows businesses to bid on specific impressions in real time. For example, if a customer visits a home-furnishing website to view a particular rug, the business can deliver Facebook ads to remind him that the rug is still available.

A month ago, we reintroduced Offers, which provides businesses a powerful new way to acquire new customers and drive loyalty. Every time someone claims an offer on Facebook, he or she creates a story that is shared with friends. Since launch, approximately 100,000 pages have created an offer, and approximately 30% of offer claims are coming from mobile devices.

Finally, we launched Promoted Posts, which make it easy to turn any page post into an ad. This simplicity is especially valuable for local businesses. Since launching in Q2, we have seen promoted posts from over 300,000 pages, over 25% of which are new advertisers to Facebook.

These new products enable marketers to achieve more of their objectives on Facebook. And more importantly, by improving the targeting and quality of our ads, we also create a better experience for our users.

But we know it's not enough to roll out new products. Our second strategic priority is to prove the value of our products to marketers. Brand marketers increasingly recognize that they can have impact on Facebook similar to that on TV. Our daily reach is more than three times larger than the total viewing audience for this year's Super Bowl, and it happens every day. Prominent brand marketers such as McDonald's and Gerber have publicly recognize the high ROI Facebook delivers. We have shown that Facebook ads drive sales and ring cash registers. Based on studies of more than 60 campaigns, we learned that 70% of those campaigns showed a return on ad spend of three times or better, and 49% showed a return of five times or better.

Samsung Mobile USA's experience demonstrates the value our ads deliver. Samsung used Facebook to build awareness of their new Galaxy S3 smartphone, reaching 105 million people and driving a 10-point lift in brand favorability among relevant customers. Even better, they determined that customers who saw the ads bought their new phone at an 85% higher rate than those who didn't. As a result, the company realized more than \$129 million in sales attributable to Facebook, nearly a 13x return on advertising spend.

Our new targeting capabilities, Custom Audiences and FBX, greatly increase the value Facebook provides direct marketers by significantly increasing efficiency through better precision. MGM Resorts International has been testing Custom Audiences to provide offers on hotel stays to repeat guests. After seeing returns on advertising spend range from 3x to 12x, they're expanding their use of this product.

Initial results from beta partners show that FBX ads can achieve results equal to and often greater than those of other ad platforms. For example, MediaMath found their clients achieved 40% better performance on FBX than other platforms. Tell apart clients using FBX experienced a 10-times return on ad spend at a cost per acquisition comparable to other platforms.

Our other products are demonstrating similar results. Lawson, a leading convenience store chain in Japan, used Facebook Offers to advertise a discount on fried chicken. Over half a million people claimed the offer, 92%

of whom did so from their mobile device, generating a 7x return on advertising spend. And Sam's Chowder House, a local restaurant, used Promoted Posts to drive a 19% increase in both their number of guests – in both their monthly number of guests and monthly gross revenue.

Finally, I want to talk about our progress in mobile. Marketers want to reach mobile customers, because that's where people are spending more of their time. We believe that no one is better positioned than we are to help marketers capitalize on the transition to mobile. Our mobile user base is huge, growing, and even more engaged than our desktop users. And, importantly, we deliver an experience that works for ads, since a significant portion of time on Facebook Mobile is spent using News Feed.

In Q3, we saw marketers embrace News Feed on both mobile and desktop as a growing part of their advertising strategies. This is driving results, given that page post ads in News Feed on both mobile and desktop are more than eight times as engaging as page post ads on the right-hand side. Advertisers are also seeing a 10x greater ad recall per impression. We see significant opportunity for future revenue growth from products and mobile News Feed, such as paid search ads and Mobile App-Install Ads, which we launched just last week. We also recently announced that we're working with partners to test mobile ads and apps off of Facebook on both iOS and Android. We only started our mobile monetization efforts in March, and already in the third quarter, 14% of our advertising revenue came from mobile.

Many of the products I've highlighted in this are early in their history and will take time to generate revenue and scale, but our results to date suggest that we're on the right track. We're rapidly launching and scaling products that deliver value for marketers. We're increasingly demonstrating the value that Facebook ads can deliver, and we have become one of the largest mobile advertising platforms in less than eight months.

Now I'll hand it over to David.

### **David Ebersman**

Thanks, Sheryl, and good afternoon, everyone. I want to build on Mark and Sheryl's comments and share our progress in the areas of user growth, revenue, and financial performance.

Let's start with users. We ended September with 1.007 billion people using Facebook, up 26% from a year ago. 584 million people accessed Facebook each day on average in September, up 28% from the prior year. We grew monthly and daily users in all geographic regions, led by Brazil, India, and Japan. Mobile continues to drive our user growth, and we ended Q3 with 604 million monthly mobile users, up 61% versus last year. None of the user



numbers include Instagram, which as Mark mentioned passed 100 million registered users and continues to grow.

We're pleased that engagement patterns remain impressively strong around the world in terms of visitation as well as content shared and feedback created, as measured by likes and comments. We still see 58% of our monthly users coming back to Facebook each day, even with more than a billion people using Facebook, including later adopters, and despite a constantly evolving competitive environment. This speaks to the value of our service and the strength of our network.

Now turning to revenue. As Sheryl said, total revenue was up 32% from last year, and ads revenue was up 36%. If exchange rates had stayed constant, total revenue would've increased 38% and ad revenue 43%. Over the first two quarters of 2012, our ad revenue growth with constant exchange rates was 38% and 33%, so our Q3 number of 43% demonstrates we're seeing positive impact from our recent investments in monetization. Ad revenue growth was driven by a 27% increase in the number of ads delivered and a 7% increase in the average price per ad. The increase in ads delivered is similar to the year-over-year rate of user growth, as the reduction in ads per user from engagement shifting to mobile was generally offset by product changes that increased ad inventory.

In terms of ad price changes versus last year, the 7% increase was driven primarily by the ramping up of ads in News Feed, as these ads continue to have higher levels of user engagement as measured by click rates and therefore a higher price per ad compared to ads in the right-hand column. In the U.S. and Canada, where the shift to mobile continues rapidly, price per ad increased by 20% relative to last year. And price per ad also increased significantly in Asia and rest of world. Europe remains challenging, with price per ad down from a year ago.

Payments and other fees revenue in the third quarter totaled \$176 million, up 13% from last year but down 9% compared to the second quarter, driven by a decline in payments from Zynga. Payments revenue from non-Zynga developers in aggregate continued to grow from Q2 to Q3. In Q3, Zynga represented 43% of our Payments revenue, down from 51% in Q2 and 62% in Q3 last year.

Including its ad spend, Zynga comprised 7% of our total revenue this quarter, down from 10% in Q2 and 12% in Q3 last year. An additional reminder on Payments: In Q4, we plan to recognize revenue from four months of Payments transactions, for accounting reasons noted in our last 10-Q and repeated on slide 10 of the earnings slides on our website. In terms of revenue per user, worldwide ARPU increased 4% versus Q3 2011.

North America and rest of world ARPU increased by around 20% each, while Europe and Asia ARPU each increased by a few percent, with Europe negatively affected by exchange rate changes.

Turning now to expenses. Our Q3 GAAP expenses were \$885 million, an increase of 64% from last year. Excluding the effect of stock comp, our remaining expenses increased 57% to \$737 million, driven by head count growth and investments in infrastructure. We ended the quarter with just over 4,300 employees, a quarter-over-quarter increase of 9%. We plan to continue to invest aggressively in the business in Q4, with a sharp focus on the three priorities Mark described.

We view the product development investments we're making in mobile and platform as critical to drive continued user growth and deepen engagement and to grow our strategic importance for developers and advertisers. We're also investing more in monetization in order to build out and improve the products we offer advertisers and also to fund new initiatives such as Gifts. We had GAAP operating income of \$377 million in the third quarter. Including the effects of stock comp, our operating income was \$525 million, representing a 42% non-GAAP operating margin.

Our GAAP tax rate for Q3 was 116%, driven by the unusual amount of stock comp this year, a portion of which is not tax deductible. Excluding the effect of stock comp, our non-GAAP tax rate was 40%. For Q4, we expect our GAAP and non-GAAP tax rates to be similar to Q3 before our GAAP tax rate returns to more typical levels in 2013.

The amount of cash tax we pay will be significantly different from the tax provision I just described due to deductions from vesting of RSUs and exercise of options. At today's stock price, we estimate tax deductions of over \$10 billion that will reduce our cash tax payments in 2012 and in the future. Driven by our tax provision in Q3, we reported a GAAP net loss of \$59 million or \$0.02 per share. Excluding stock comp and its tax effects, we had a non-GAAP net income of \$311 million or \$0.12 per share.

Turning to cash metrics, we purchased \$171 million of property and equipment in Q3 and acquired another \$161 million of equipment financed through capital leases. For 2012, we expect to come in at the low end of the CapEx range we provided last quarter, which was \$1.6 billion to \$1.8 billion. In Q3, we also paid \$300 million upon closing the Instagram acquisition, and we ended Q3 with \$10.5 billion in cash and investments. In Q4, RSUs that we granted employees between 2007 and 2010 will vest and settle for the first time.

On the vesting dates, we'll withhold from employees approximately 120 million shares, and we'll pay income taxes for the employees. The total tax payments will equal the value of the 120 million shares on the vesting dates or approximately \$2.4 billion at today's stock price. As we previously disclosed, we expect to fund the tax payments from cash on hand and our amended term loan facility. After the withholding dates, the 120 million shares will no longer be considered outstanding for accounting purposes, reducing our shares that are used to calculate EPS.

In closing, we're pleased with our business progress over the past few months and how we're positioned for the future. We're excited about the product development investments we're making in order to build out better and deeper social experiences for the people who use Facebook, and we're focused on executing on our advertising, Payments, and new business opportunities to translate our product successes into a strong and valuable business.

Now let's open the call for questions.

## **Question-and-Answer Session**

### **Operator**

(Operator Instructions) Our first question comes from Justin Post with Bank of America Merrill Lynch. Your line is open.

### **Justin Post – Bank of America Merrill Lynch**

Great. A couple questions for you on mobile. First, can you talk about total engagement as you look at individual users, both on PC and mobile? Are you seeing that engagement grow if you add up both in minutes or likes or other metrics? Can you talk about total engagement of your user base and how that's trending? And then thanks for the mobile disclosure, 14% of revenues. Can you say – last quarter you gave us kind of how you were ending the quarter. Can you say if that mobile was kind of accelerating as the quarter progressed? Thank you.

### **David Ebersman**

Sure. I can take both those questions. So first of all, in terms of engagement on mobile and web, we continue to see that content created is growing across the world, and feedback, which we measure in terms of likes and comments, continues to grow well as well. So the engagement story on Facebook continues to be a strong one that we're pleased about.

In terms of the sort of Feed revenue, at the end of the second quarter, we disclosed that at that point we were running at about \$1 million a day, and we used that metric because we'd just started ramping up towards the end of the quarter, so we felt like giving you the numbers for the whole quarter was not representative of where we were. Those numbers continued to ramp through the quarter. We ended the third quarter with more than \$4 million a day coming from Feed and about three-quarters of that coming from mobile Feed. But going forward, I think we'll stick to the metric of mobile as a percentage of revenue.

### **Operator**

Our next question comes from Gene Munster with Piper Jaffray. Your line is open.

### **Gene Munster – Piper Jaffray**

Good afternoon, and maybe just following up on Justin's question, can you talk – obviously you guys have been putting the pedal to the metal, and I think, Dave, you just kind of gave some metrics around the impact to the overall experience. But first question is, is there anything that makes you believe that the acceleration in mobile is impacting the experience? And second, can you talk about any sort of cannibalization from the desktop to mobile in terms of ad revenue?

### **Sheryl Sandberg**

Yeah, I can take this. We're carefully monitoring user engagement and sentiment, and we're pleased with the results so far. We look at how users are engaging on our platform. And as we've increased the number of ads in News Feed, we've been carefully monitoring that engagement. Our revenue's growing, and that means, as I discussed, we have a lot of new clients. We also have a lot of clients and customers who are spending more with us. So we're seeing increased revenue and increased budgets from them. Some of the revenue also is moving over from the right-hand column to News Feed, and that's part of our strategy. We are putting more emphasis on the products that are running through News Feed, rolling out products, because that's where the natural ad format is for mobile.

### **Operator**

Next we have the line of Scott Devitt with Morgan Stanley. Your line is open. Once again, Mr. Devitt with Morgan Stanley, your line is open. Next we have Youssef Squali with Cantor Fitzgerald. Your line is open.

### **Youssef Squali – Cantor Fitzgerald**

So I was just wondering if you can maybe give us some examples of instances where you guys are already seeing better monetization on mobile than on desktop. And, David, can you just quantify the contribution of Instagram in the quarter, both top and bottom line, if possible?

**Sheryl Sandberg**

We've been working on ad products that monetize on mobile, as I said, into News Feed. And so one example of a product that's uniquely mobile is Mobile App-Install Ads that Mark mentioned and I mentioned as well. That's an experience that's uniquely mobile, and it's a good example of an ad product that really works in that format.

**David Ebersman**

In terms of Instagram, we closed the acquisition towards the end of the third quarter, so the impact was next to zero, certainly zero on the top line, and next to zero on the bottom line. In the fourth quarter, we will have expenses both from the employees and the investments we're making in Instagram and also the amortization of the intangible assets that we acquire.

**Sheryl Sandberg**

And to add one more thought on monetization on mobile versus desktop, which I think is the heart of the question, if we're measuring engagement and the results from page post ads, comparing them when they're placed on the right-hand side to those that are being placed in News Feed. And comparatively, the ones in News Feed – and that's on both mobile and desktop – are eight times more engaging, and we see 10 times the ad recall. And that makes sense, because News Feed is where a lot of the engagement on Facebook takes place, so by moving those promoted posts or page posts into News Feed, we're increasing engagement and results as well.

**Youssef Squali – Cantor Fitzgerald**

Thank you.

**Operator**

Next we have Heather Bellini with Goldman Sachs. Your line is open.

**Heather Bellini – Goldman Sachs**

Great. Thank you very much. I had a question for Mark. I guess I was wondering, given the monetization products that you mentioned at the start of the call, if you could maybe rank-order for us – how would you rank those

in terms of their ability to drive revenue in calendar 2013, and which ones should be watching most closely? Thank you.

### **Mark Zuckerberg**

Yeah, I mean, I look at it in terms of we're building a lot more integrated ad products now, right? And if you look at where we were historically, most of the ad inventory was in this right-hand column. It was a separate experience. And we had this ad team and their job was to kind of drive that service, and they could provide that service to every other product team. So the Messages team focuses on building the best Messages product, and now when they can run that on the side to make money.

Now what we're basically doing is we've told every product team that they're responsible for the advertising experience within each of their products, so the News Feed team is coming up with better ad experiences than just being able to run kind of general ads on the side. And what we're seeing is that across each of these consumer products that we have, we're just getting more tailored advertising experiences. So I think there are multiple ways to look at it. I mean, you can look at it by market segment for advertisers, or you could look at it by consumer product; that tends to be how I look at more. But I mean whether it's a News Feed or the mobile apps that we're building, or Timeline or any of these things, I think we're just going to see a lot better products for both users and advertisers.

### **Operator**

Our next question is from Scott Devitt with Morgan Stanley. Your line is open.

### **Scott Devitt – Morgan Stanley**

Okay, great. We got it this time. And, sorry, I got cut off, so if you've answered, just pass. But, Mark, you mentioned ad network in your commentary, and you also discussed search as a business opportunity for Facebook in the middle of the quarter at an event. And so just wonder if you could talk a little bit more about those opportunities in terms of the approach that you would take to build businesses such as that. And then secondly, David, you mentioned changes in the ad product as a driver for growth in ads served, and what were those changes that were made? Thanks.

### **Mark Zuckerberg**

Sure. So on platform, the basic approach that we have is we think that almost every product category is going to get transformed in some capacity,

some abrupt, some kind of subtle transitions over time, where we think that at the end of this process, the winning products in every category are going to be social ones. And one question that I get frequently is just how, if we enable companies to build better products, how does Facebook make money from that? And I think it's a fair and good question, because then we have to build our platform in a sustainable and profitable way.

But rather than focusing too early on, on trying to figure out exactly what the economic relationship is going to be with each of these partners, what we're primarily focused on is just enabling these companies to grow. And the basic idea is that there are many different ways that we make money from the different platform partners, right? So most of the companies that develop with us – probably shouldn't say most – but a lot of them buy a lot of ads with us, right, and are some of our biggest advertisers, if you look at the list of advertisers. We're running a few tests now where on mobile apps and on desktop, some developers are running our ads on their sites, and that's another way that we can get a revenue share and can get some revenue and profit from these developers growing in engagement.

We obviously have the Payments system as well, so developers can integrate that, and we take a cut of that. And there may be other ways in the future that make sense as well that we can talk to developers about exploring. But the basic idea is that we are first focused on helping developers transform these categories, and then we believe that there are going to be a number of different ways of that that revenue can come back to us.

### **David Ebersman**

So, Scott, you were asking about the comments I made that in the quarter, this quarter, the number of ads we showed grew at a similar rate to user growth after – in the recent past we've been growing ads more slowly because of the shift to mobile, and the product changes helped to offset that. So one product change, for example, would be in this quarter we showed ads in News Feed on both mobile and personal computers, and the year-ago quarter we didn't. We have made other changes through the period of time, several of which I think had a positive impact on the number of ads we show per page on personal computer use.

### **Operator**

Next we have the line of Ross Sandler with Deutsche Bank. Your line is open.

### **Ross Sandler – Deutsche Bank**

Great. Just two quick questions. First for Mark on the platform, one of the things we all hope to see Facebook do one day is kind of monetize your strong distribution without touching the user experience with ads. We assume that you guys have thought about this quite a bit, so is there any strategy in the works where you guys could potentially charge for API calls or something that isn't related to the advertising products? And then, David, a question about the geographic revenue mix. So most of the ad acceleration happened in the U.S. Most of your other regions on a local FX basis decelerated a little bit. So have the new mobile ads been rolled out in those other regions yet, or is that a catalyst that we will see in the coming quarters? Thanks.

### **Mark Zuckerberg**

Well, I'll just talk a bit about how we're thinking about platform monetization. One of the reasons why we favor approaches like having developers buy ads or run our ads or accept payments is that we end up getting a portion of revenue or the value that's created, as opposed to if you were doing something that was tied to our cost spend, then that's – it's a less-efficient way to get value for that value that we're helping other folks create. So it's definitely something that we think about.

But, again, one theme that I talked about earlier was how each product group now is in charge of the ads experience for that product, and what you're seeing the platform team build are things like Mobile App-Installs, which is an advertising product for providing distribution for developers, and that's one of the things that I'm really excited about. It's a mobile-first product, it's for developers, a lot of folks who aren't traditionally Facebook developers still want to spread their apps on mobile, so I think it has a lot of potential.

### **David Ebersman**

In terms of the geographic mix for our advertising revenue, the new products that are most important to us, or were most important in the third quarter, which is the ads in News Feed, are adopted or were adopted more quickly by our U.S. clients than globally, and that's what we would expect just given how these things tend to play out. But if you look at ad revenue year over year across the world, actually Asia and rest of world grew at a faster rate than the U.S. did, and Europe grew a little bit more slowly. So while I do think the U.S. has grown more in terms of dollars because the base is bigger, we're pleased with how we're growing across the world with, again, Europe lagging a bit more than we'd like.

### **Operator**



Next we have the line of Mark Mahaney with Citi. Your line is open.

**Mark Mahaney – Citi**

Great, thanks. I hate to ask about desktop, but I will. It looks like the desktop ad revenue actually declined sequentially. Is that just normal seasonality, FX, or is there any color there? I'd assume that you'd expect that to normally grow sequentially? And then could you talk about where you think advertisers are in terms of developing good creative for sponsored story ads? We've seen mixed success in kind of the ads we've tried to track to date. Do you feel that that's a process, six-month, 12-month process, of advertisers really coming to grips with the most effective way to display those ads? I know it's a – you have to do work, they have to do work. Where do think the advertisers are in doing the work to help that product? Thank you.

**David Ebersman**

I'll take the first one. I don't think the desktop trend is a seasonal one. I think that we opened up a lot of inventory on mobile in this quarter, and so we had advertisers who shifted some spend that might've been on the desktop computer into mobile feeds, because our relationships with advertisers – they're not different advertisers on the two sets of devices, so I think that's the trend you're seeing there.

**Sheryl Sandberg**

On the question of where advertisers are, as I said before, we're a third thing, we're not TV, we're not search. We are social advertising. And I would say our clients are in different parts of that adoption curve. We have clients who have done a lot with us. They've now increasingly, especially this year, seen the results and seen how it affects their actual in-store sales. And they really understand it, and they're doing more and more. We have some clients who haven't done as much and haven't quite figured out how to do this. And I think it's going to be a slow but steady progression. We see more people doing more and understanding how to make social ads really work for them.

We're also working hard at developing better tools. So some of the things we're announcing and working with – if you think about Custom Audiences, Custom Audiences enables you, an advertiser, to segment to different parts of their customer segment different ads. That's really important for making those ads perform better as well. And all the work we're doing on measuring is also really important, because by measuring, we not just prove the results we have to marketers, but we then get results, which we can then use to improve the ads.

## **Operator**

Next we have the line of Jordan Rohan with Stifel Nicolaus. Your line is open.

### **Jordan Rohan – Stifel Nicolaus**

Thank you so much. I hope this question comes across okay. Click-through rates may indeed be high on the Feed. I'm curious if you're able to measure how many of these clicks are accidental and intentional or due to the smaller form factor of smartphones? Put another way, do you see difference between the click-through rates in the Feed between small-form-factor handsets, which are mobile, and larger-form-factor tablets, which may also be considered mobile, but where one could see fewer fat-finger clicks? Separately, do you have any feel for post-click conversion rate metrics that could enable an advertiser to equate the value of a click from Facebook, whether it's mobile, desktop, or wherever, and a click from Google or – and how you think about that?

## **David Ebersman**

I think on the first question, I mean, there are inadvertent clicks on every platform for every company that shows advertising, so it's just something for us to continue to be aware of and monitor, but I don't think it's a specific issue to Facebook, and I do think over time it's the kind of issue we'll be able to make good progress at managing.

## **Sheryl Sandberg**

On the second question, which is basically the efficacy and the value the ads provide, it really depends upon what the different products are and what people are measuring. We are seeing our products create great value and create increasing value in many cases for our customers. But different people are measuring different things. So with brand advertisers, they're looking for a brand lift, all the brand metrics people look at, ad recall, affinity, and then sales, which we've just started the process of measuring this year. With other advertisers like Mobile App-Installs, they're looking for those mobile apps to be installed, and we're measuring all of those across the spectrum.

## **Operator**

Next we have the line of Doug Anmuth with JPMorgan. Your line is open.

### **Doug Anmuth – JP Morgan**

Great, thanks. Just wanted to ask two questions. First, just going back to ads in the News Feed, can you talk about where you think you are now in terms of coverage and inventory levels versus where you could potentially be going forward? Just trying to get an understanding here for how much more gains there are from inventory versus advertisers, more advertisers coming on board and driving pricing up higher? And then secondly, can you talk a little bit about the early benefits that you might be seeing from the Facebook Ad Exchange, how much inventory has been opened up here, and is there any chance that the Ad Exchange can help stabilize the sequential desktop declines that you're seeing? Thanks.

### **Sheryl Sandberg**

On the mobile ads, as you've seen, we've definitely put a lot more ads into Feed as part of growing the mobile revenue. I think you'll see us increasingly put ads in Feed as well, but there's a lot of growth that comes not from just more ads in Feed, but from better ads in Feed. Every time an ad is more targeted, more relevant, the marketer gets better value, and it's better for the people in Feed. And if you look at the types of ads we have in Feed, while we're really pleased with the progress of increasing our mobile revenue, we also think we have a long way to go in making those ads better, more relevant, higher value. And we're at the very beginnings of that. We're measuring across all our different ad products the value they provide for marketers and people, and I think you'll see a lot of progress in quality, and we believe that progress in quality will translate to revenue as well.

On the Facebook Ad Exchange, it's really early. We just took the Facebook Ad Exchange out of beta in September. We're not really seeing breakdowns of how much each product is generating in terms of revenue, but that one is small, and we are going to scale each product as we feel comfortable that they're a great experience for people and for our marketers.

### **Operator**

Next we have the line of Brian Wieser with Pivotal Research. Your line is open.

### **Brian Wieser – Pivotal Research**

Thanks for taking the question. Can you dimensionalize the nature of your advertiser base between small advertisers versus large brands that work with agencies? And secondarily, can you talk through the geography of the advertisers, not the users, but how the breakdown diverges? And specifically with mobile, is much of it coming from the U.S. versus internationally? Thank you.

## **Sheryl Sandberg**

When we think about the four key marketer segments we have – brand, direct, local businesses, and developers – they’re all very important to our revenue in advertising. And they’re important in different ways. The brand advertisers are really important for the engagement they drive and the reach that they’re buying and the sales they’re able to generate. The direct marketers, as we’ve done more with FBX, Custom Audiences, those products work across the board, but they’re particularly important for direct marketers.

The local business story is a very good one this quarter. We’ve long believed, and I’ve long believed, that this is the Holy Grail of the Internet, that local businesses have the ability to really generate a lot of revenue and provide a lot of value for the people who see those ads. But it’s just really hard to get local businesses online. We’ve had great numbers of local businesses who are using our free products. We have 12.8 million have Facebook pages, 8 million of them use that page monthly, and over 3.5 million post weekly.

But what you saw this quarter with the launch of Promoted Posts is a really big step function in converting those people who are using our free page product into paying customers. With over 300,000 pages using Promoted Posts, 25% – more than 25% of those are from new advertisers. So we’ve always had this thesis that people will use our free products and then as we roll out products that are easy and simple for local businesses, we’ll see broad adoption. And I think we really saw that here.

And with developers, we continue to iterate on both the Payments side and the advertising site. We think Mobile App-Install Ads – this is very early and I want to stress how early it is – but they’re also very promising.

## **David Ebersman**

In terms of advertising revenue by geography, the discussion I’ve provided thus far was by user geography. You were asking about where the revenue is attributed if you focus on where the advertiser comes from, where we’re going. As you would imagine, the revenue is going to skew more to the developed world in that kind of a comparison, because you have large global companies that are trying to advertise to users throughout the world, more than you have people in developing markets who are trying to reach people in the United States, for example. So if you were to pick the U.S. as an example, the by-advertiser attribution of our ad revenue to the U.S. is going to be considerably – maybe not considerably but a bit higher than if you look at it by attribution in terms of user geography.

## **Operator**

Next we have the line of Daniel Ernst with Hudson Square Research. Your line is open.

## **Daniel Ernst – Hudson Square Research**

Yes, good afternoon. Thanks for taking my call. Mark, sort of a big-picture question for you. As you've transitioned to more of a mobile environment where on the web, Facebook is essentially a platform that applications run on, to the mobile environment, where Facebook for the most part is an application that runs on other people's platforms, whether it's Apple or Android from Google.

And how does that change the opportunity, the way you look at the business long term? And as a related matter to that, as you look to monetize the Open Graph network with so many applications and websites that link into you, what do you see as the opportunity to begin to push the ad network beyond mobile into other websites and use your social data to actually push ads outside the network? And could that be a business that takes a life of its own above advertising on your own, by itself? Thanks.

## **Mark Zuckerberg**

Yeah, I think it's a good question. And this is why in my opening remarks I spent a bunch of time talking about how I think that in this counterintuitive way, I think a lot of folks have the question that you have of whether the fact that iOS or Android are these mobile platforms, is that a worse environment for Facebook? And I think what we've found that is because of these three compounding factors – more users, more time spent, and the ability to have more monetization, which we're not there yet, but we think we're going to get there – that we're actually much better positioned on mobile than we were on desktop before. And I think some of the trends and data points that we're laying out here today kind of start constructing that case a bit more.

In terms of the actual platform, we're really an information-sharing platform. We never were an environment for running apps, right? Even on desktop, when you have these games that are very deeply connected to Facebook, they're not building in some kind of Facebook environment. They're basically building websites that connect with Facebook and make it so you can pull your friends in and then use Facebook for distribution and sharing. So what I see on mobile is I don't think that developers are going to be building apps that are literally inside the Facebook app. But what we do see is a lot of success in getting developers to connect their apps to Facebook.

So I mentioned these stats where eight of the top 10 iOS apps are connected to Facebook, and 40% of the top 400 iOS apps have the Facebook SDK and are using that in some capacity. So to me, that's a good sign. And we don't directly compete with iOS or Android to be a platform for developers as an environment for building apps. And we think that we can basically build an environment, or build this information platform that goes across iOS and Android and mobile web and every other mobile platform that's out there where every developer who's building anything on any of those can use Facebook. And we think that that puts us in a really strong position.

### **Operator**

Next we have the line of Rory Maher with Capstone Investments. Your line is open.

### **Rory Maher – Capstone Investments**

Thanks. First question's for Mark, and then I have one for Sheryl. A lot of the call has been taken up by creating better monetization products for some of your advertisers. And I've been hearing recently about some kind of juxtaposition between user rules and advertising rules. And I know a lot of people point towards the Burger King ad that the app got pulled because people were de-friending people. I'm just curious, is improving -kind of making that process more clear, is that part of your strategy to kind of build out more monetization products? And how do you manage between that and your users? And then Sheryl, you said, I think – I don't want to misquote, but I think the payments from Zynga were down about 20%. Other games were up about 43%. Did we see similar movements in advertising from games on your platform to acquire users?

### **Sheryl Sandberg**

Just starting off with the Burger King, that Burger King thing, if I'm thinking of the right thing, was many, many years ago. It was an old app that was -

### **Mark Zuckerberg**

It was violating our policy.

### **Sheryl Sandberg**

It was violating our policies by encouraging people to de-friend. I literally think it might've been two or three years ago. That's long gone.

But in terms of the balance between good experiences for users and good experience for marketers, we don't think these are in conflict. We really think they work together. When an advertisement is better for people because they like it better, it also creates more value for marketers. And so our strategy going into that strategic priorities we have is to build products that create value for all of these marketers, measure that value, make it all work on mobile. And we're not really trading off the user experience versus the marketers' experience when we do this well. When we do this well, we launch products like Offers that see broad adoption and see people passing it off to their friends.

In the Offers example, since launch just this quarter, 100,000 pages created an offer. And of our top 100 offers, on average three-fourths were done by non-fans. That means that people are passing this through the social ecosystem, and their friends are finding it valuable. That's an experience that's great for people and great for marketers.

### **David Ebersman**

To answer your question about Zynga – or I guess about really advertising in general – as our Games ecosystem has become more diversified in terms of the companies who are doing well, generating Payments revenue for us, we would imagine and do see a – also diversification of ad spend from those developers.

### **Deborah Crawford**

So, operator, we have time for one last question.

### **Operator**

Our final question, then, will come from Anthony DiClemente with Barclays. Your line is open.

### **Anthony DiClemente – Barclays**

Thank you very much. Sheryl, just wondering, if you could point to any particular success stories on sources of off-line demand generation ad dollars that maybe you could point to? I imagine early on a lot of the sources would be from online, be it display or fulfillment. But is there anything, for example, like print media dollars moving over from newspapers or magazines or otherwise? And then another question on the competitive environment, perhaps for Mark. Just wondering what you're seeing in terms of users and engagement in international markets where there are other social media platforms that are – any comments there? Is Facebook

complementary in some of those markets? And how are you seeing kind of local behavior in terms of users and engagement? Thanks.

### **Sheryl Sandberg**

To your first question, which is where the budgets are moving from as Facebook revenue increases, it's really client by client, account by account, how people are doing their spend. We do know that every time we compete for a dollar of advertising, we're competing against every other opportunity a customer has, whether that's off-line or online. And our goal is to compare really favorably across all of those.

I think the way we're really doing that now is by putting more products into the market that do a better job of serving the different needs of our different market segments. I think one question people have had is, God, you guys are rolling out so many products. Why? And why are you doing that? And how does that all tie together? And for us, we're very clear. We have four market segments. We have three priorities. But we need multiple products to serve those different market segments, and that's what you're seeing from us. And I think that's what enables us to compete against all the other advertising opportunities out there.

### **David Ebersman**

In terms of the competition, I mean, we compete in all markets for user attention and time and things like that, and the competition looks different from market to market. So it's sort of hard to give you a blanket answer to that question.