

Facebook, Inc.
Third Quarter 2019 Follow Up Call
October 30th, 2019

Operator: Good afternoon. My name is Jessa, and I will be your conference operator today. At this time, I would like to welcome everyone to Facebook's third quarter 2019 results follow-up Q&A call.

All lines have been placed on mute to prevent any background noise. To ask a question, please press star then the 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: Thank you. Good afternoon, and welcome to the follow-up Q&A call. With me on today's call is 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 certain non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release.

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

Operator: Thank you. We will now open the lines for a question-and-answer session. To ask a question, press star followed by the number one on your touch-tone phone. Please pick up your handset before asking your question to ensure clarity. If you are streaming today's call, please mute your computer

speakers. Your first question comes from the line of John Blackledge from Cowen. Please go ahead.

John Blackledge: Great. Thank you. Just a couple questions. On OpEx, in 3Q, cost of revenue growth decelerated fairly significantly. Just I'm curious, any color there? And also, sales and marketing growth was a bit lower than expected, if there's any color there.

And then, my second question was on the 3Q ad impression growth, where you called out the core Facebook feed as the leading driver. I know you mentioned this on the call, Dave, but if you could remind us again, in order, if possible, of the key drivers of the core Facebook feed impression growth in 3Q. Thank you.

Dave Wehner: Yes, sure, John. Yeah, on the core -- the cost of revenue growth, you'll note that we saw depreciation go down sequentially. And the majority of our cost of revenue continues to be depreciation associated with our infrastructure spend. And so, COR just grew 30% in Q3, versus 49% in Q2.

So I wanted to -- I'll give you two contributing factors to that slowdown. The first is, we're transitioning our server decommissioning approach from an individual rack basis to an entire data hall at once.

And as a result of that change, we're using some of our current servers longer and therefore depreciating them over a longer period. And this is a temporary change as we transition to this hall-based depreciation model.

So we're going to -- once we get kind of -- we start replacing all of the servers on a hall basis, we'll go back to the old lifetime. But we're getting some extended life out of our servers because of this. That's the biggest factor.

The other thing is that we're lapping some significant growth last year and our ads integrity expense growth. And so, that stabilized a little bit. So, those are the two factors on the slowdown in cost of revenue growth.

Marketing and sales, there were some Q2 launches in AR/VR and associated marketing campaigns, so that's one thing that I'd call out there as being a little bit higher in Q2 versus Q3.

John Blackledge: OK. And then on the -- on the core Facebook feed, impression growth being the number-one driver that you called out, if you could just remind us again what drove the feed impression growth at core?

Dave Wehner: Sure. I think what we're seeing is a couple factors. You talked about some of the optimizations that we made in terms of -- in terms of things like ad load as it relates to managing internal promotions, and so that had an impact in -- especially internationally, in terms of the impact on that, and then overall just good engagement growth, as well, on Facebook, and especially good -- we saw good feed engagement growth in U.S. and Canada, so that was positive.

So, I think there was a few different factors going on. But a combination of, I think, good core engagement growth, as well as some of the optimizations around how we're using our internal inventory.

John Blackledge: Do you include the Facebook Marketplace in that kind of rolled-up feed? Or is that separate?

Dave Wehner: It's relatively small compared to overall feed. I think...

John Blackledge: OK.

Dave Wehner: I'll have to check on that, but we'll get back to you later on the call on that, if we can. I don't know.

John Blackledge: OK, great. OK, sounds good. Thank you.

Dave Wehner: Great. Thanks.

Operator: Your next question comes from the line of Jason Helfstein from Oppenheimer. Please go ahead.

Jason Helfstein: Thanks, two questions. First, is there -- given that expenses came in kind of -- clearly at the low end of the expectations for this year, is there a specific kind of line that you thought you got greater than -- or you're on target to get greater than expected leverage from, that kind of next year creates kind of a tougher comp as we're trying to think about how to model the expenses next year?

And then, you've got a lot of emerging -- what do I want to call them -- verticals, right, Marketplace, now News, Messenger, WhatsApp. Is it reasonable to ask you to rank as far as in order when we start to see revenue from those?

I mean, in the -- on the call, you guys talked about tests that are happening with Messenger and the automotive. Can you comment if Facebook News ultimately will have ads in it? And then, kind of -- and then, any comments on plans to monetize Marketplace or WhatsApp? Thanks.

Dave Wehner: Sure. I mean, on the expense growth, we talked a little bit about the cost of revenue, depreciation change. That obviously was -- there was a benefit there that we got with the extended life of servers. We took a benefit in Q3. So that's one of the things that did factor into the overall expense growth.

And also, headcount growth is 28%. We do plan on re-accelerating that next year, so I talked about that. Obviously, our execution on that will drive some of the -- some of where we fall in the range of cost guidance that I gave. And then, marketing is another expense that is going to be quite variable and will depend on the ROI that we see from doing that.

So, that's some of the color that I would give there. We do expect to continue to see cost of revenue growth that relates to the big CapEx build that we've had, so that will factor into the growth next year.

In terms of emerging verticals, we're already monetizing Marketplace with ads. So some of the areas where we're seeing kind of good growth in, I'd say, newer product, obviously, Stories is the biggest one. I think we're seeing opportunities with Instagram Explore and putting ads into Instagram Explore.

Marketplace -- ads in Marketplace is also a positive. On the messaging side, we're seeing click to messaging ads perform very well. So those are some of the bigger areas of growth and opportunity.

I think some of the areas that we're investing in for the long run are things like Instagram Shopping. Those are much smaller, but have opportunity in the long run.

Operator: Your next question comes from the line of Michael Levine from Pivotal Research Group. Please go ahead.

Michael Levine: Two questions, guys. One, I'm just trying to understand, as you're talking about the deceleration in Q4 and some of this being a function of some of the signals basically rolling off, I mean, are you -- are you already seeing -- because I'm guessing what would happen is that ROIs would decline in -- then conceivably your more direct response-driven advertisers would conceivably reduce what they're willing to pay, I mean, is that -- is that the sequence of events?

And then, a second question about campaign bid optimization, where I feel like there's a little bit of uncertainty. I'm hearing from advertisers as to whether you guys were going to make that mandatory in the front half of next year.

Dave Wehner: So, yeah, I mean, in terms of how the signals play into the revenue forecast, yeah, it just relates to what ability advertisers have to get good conversion on their ads to ultimate end business outcomes.

And if we don't have targeting and measurement that's as effective, that will play into their willingness to pay, because they see a lower conversion rate on their spend. On the -- I don't actually -- I'll try and find out -- we'll try and find out the answer on the campaign bid optimization. I don't know the answer to that question, Michael.

Michael Levine: But if you'd -- on campaign bid optimization, at least in some of the work I've done, I'm seeing good results. Like, are you -- is it a fairly big initiative? Are you seeing it make a difference in terms of clients, ROIs, and ensuing spend?

Dave Wehner: Yeah, I mean, we -- overall, we believe that we can do a better job of helping clients optimize if they give us what they're trying to optimize against. So, yes, we know what they're trying to drive from a real business outcome perspective through things like Facebook Pixel and other techniques.

It's very helpful for us to drive better business outcomes for them. So, that is where we think the industry is heading overall. But I don't know the specific answer to your question around mandatory.

Operator: Your next question comes from the line of Aaron Kessler from Raymond James. Please go ahead.

Aaron Kessler: Great. I have a couple of questions. First, maybe -- you talked about kind of the tougher comp in Q4, as well, versus last year, although last year did see about a three point decel. Were you talking about kind of the ad load specifically? Because you did see number of ads increase, I guess sequentially, last year maybe from some of those initiatives.

And then second, just on the depreciation real quick, there seems to be a decent lag between kind of that higher CapEx we've seen in the last couple years, versus the depreciation we're seeing. Can you just maybe reconcile that? Thank you.

Dave Wehner: Sure. The tougher comp that we talked about was driven on a couple things, one -- more on the -- on the demand side and the pricing side, how the ad auction is operating and optimizing, so that more impacts price.

And then, we were in a -- still in a very high growth -- very high growth phase for Instagram on both the Feed and Stories side and benefited from ad load optimizations there, as well. So lapping those were the two factors that I cited as being the tougher comps in Q4. So, those are kind of the two product factors.

In terms of the depreciation question, keep in mind that a lot of the cyclical build that we had was related to data center, and those are pretty long-lived assets. So, it takes time for those to play into the overall depreciation schedule.

Obviously, there are some server -- significant server spend, as well, and those depreciate at a shorter timeframe, much shorter timeframe than data centers, which is the -- effectively the building, so that has a building lifetime as opposed to a server lifetime.

And we've been doing a lot of data center builds, so there's a lot of halls that we've built and those depreciate over a long life cycle. So, that's why those take longer to sort of flow through to cost of revenue.

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

James Lee: Hey, thanks for taking my questions. Dave, maybe can you help us understand the implications for engagement, specifically with the initiative to support free speech?

I assume you're going to have more content as a result and that's a positive for engagement. Is that fair to say? And relating to that, you have 35,000 people filtering content now, with the increased content that's coming up. Do you need to increase the staff, as well?

And also, secondly, from a product perspective, any update on Watch or IGTV? Because when Mark talked about product priority going into 2020, he mentioned IG Check outs and Messenger and unified payment but he did not mention Watch or IGTV at all.

I was wondering, is that still a priority for the company? And if so, maybe help us understand, what are the key frictions that you try to resolve in terms of increased adoption there? Thanks.

Dave Wehner: Sure. Thanks, James. In terms of your first question, I don't really think there's a direct correlation, I think, between the values that Mark is outlining around free speech. I think this really has to do with a fairly limited subset of how we treat -- how we treat speech around political figures and how we fact check it or do not fact check it.

So, I don't think that has any bearing that I'm aware of on sort of content engagement or the amount of content that goes to our reviewers. So, I don't think any change there. I mean, we're continuing to invest in our contractor resources for content review and ad review. And so, we would continue to ramp those expenditures, and that's factored into the guidance for expenses in 2020.

Watch and IGTV remain areas that we're continuing to invest in, not big from a revenue perspective at this point. I think what we're really trying to do is get product market fit and intentional viewing behavior where people are coming and it is additive to overall engagement on Facebook and Instagram TV -- on Instagram.

I think we're seeing good signs there. But I think we're still early in that, and they're not going to be big revenue opportunities in the near term or 2020.

James Lee: And, Dave, any follow-up on the MAU number or DAU for Watch? I think you've haven't updated in a while, and also time spent, as well. And also, lastly, I think someone had asked about mobile monetization, monetization on mobile messaging. Is it fair to say you want to get comfortable with the regulation, potentially get federal regulation kind of in place before thinking about monetization on mobile messaging? Because it's a little bit more personal, a one-on-one basis?

Dave Wehner: So in terms of -- in terms of stats around Watch, we haven't updated them since June. I think then we said there were 720 million MAU and 140 million DAU that spend at least one minute on Watch. No update in those numbers.

In terms of the monetization of mobile messaging, yeah, I'm not aware of any -- there's no -- we're not doing -- the choices around monetizing messaging

aren't related to regulatory reasons. It's really -- there are really product reasons and a focus on -- and a focus on just driving usage and engagement on WhatsApp and Messenger as the primary focus.

And we do have ads in inbox in messaging, and then we're seeing good adoption of click to messaging ads for Messenger and testing those in WhatsApp-- testing those for WhatsApp. But that's driving really -- that's driving messaging threads out of our feed and Stories products.

Operator: Your next question comes from the line of Shyam Patil from Susquehanna. Please go ahead.

Ryan Lister: Hi, it's Ryan on for Shyam. So first, you talked a little bit about lapping optimizations in the ad auction as a factor in the Q4 rev decel. So, just wondering if you could give us any examples of what those optimizations were.

And then, second, on the 2020 revenue decel, is that off of the Q4 growth rate or the 2019 overall growth rate? Thanks.

Dave Wehner: Sure. Not a lot of -- I mean it's not a lot of specifics on the ad auction optimizations. It's really just the mechanics of how the auction prioritizes and bids and how deep we go in the auction and the like. So, no specifics beyond that.

On the 2020 revenue decel, yes, my comments in the script were that it was around deceleration from the Q4 growth rate. So, expect to see less pronounced deceleration off the Q4 rate, obviously, than we are expecting, where we guided to mid- to high-single-digit deceleration from Q3 to Q4. And then, as you go into 2020, it's less pronounced deceleration off that Q4 rate.

Operator: Your next question comes from the line of Craig Huber from Huber Research Partners. Please go ahead.

Craig Huber: Yes, hi, thank you. I guess my first question -- Facebook News, I'm just curious from your vantage point, how significant do you think this can be for the publishers out there that are going to be participating? And maybe what's the revenue -- how are they going to get paid for this? Or is it just a traffic issue from their vantage point? That's the first question.

Dave Wehner: Yeah, so we are paying -- we are paying some publishers for content. So, that is an opportunity for publishers. And it's a dedicated place on Facebook to find news and it will be news based on a select group of partners and based on people's interests and topic sections. And there's also an opportunity for publishers to convert people to subscriptions, so that's a benefit for publishers.

So it is a -- we're hoping this is an opportunity for people in the news industry to get more subscriptions and also get additional revenue. So that's the -- that is part of the goal of it.

Craig Huber: There's not a revenue share on the advertising front? Or is there?

Dave Wehner: There is.

Craig Huber: There is, OK. And my next question, Dave, you've mentioned this in the past, as well, but you talked about on the prior call how Stories does not monetize as well as Newsfeed. I was just wondering if that gap is closing at all right now.

Dave Wehner: That gap -- yes, haven't updated it. There continues to be a significant gap between Stories and Feed. And the dynamics of impression growth with Stories is where we're seeing a lot of Stories impression growth has had a downward pressure on CPMs with Stories.

So, as long as we're in a mode where Stories impression growth is growing quickly, which we're in now, we don't expect that gap to close, even as we bring more demand into Stories, because we're seeing good supply growth but not demand growth.

Operator: Your next question comes from the line of Hao Yan from Citi. Please go ahead.

Hao Yan: Thank you. I was wondering if you can share some of the learning lessons from the Libra launch process. Any updates on the 2020 launch timetable, as you last announced? And will U.S. be included in the first batch of launch market?

Dave Wehner: No, there's no update right now on the timetable on the 2020 launch. I mean, we're in a holding pattern as far as getting to a point where we've got regulatory approval.

I don't think we've got good visibility on the timing of that at this point. And what we said is that we're going to -- we'll only launch when we've got regulatory approval in the U.S.

Operator: Your next question comes from the line of Alan Gould from Loop Capital. Please go ahead.

Alan Gould: Thank you. My question has been asked.

Operator: Your next question comes from the line of Brent Thill from Jefferies. Please go ahead.

Brent Thill: Thanks. On the CapEx guide for next year, it looks like a pretty significant step down in the growth. I'm just curious if you can just comment some of the efficiencies you're gaining? I know it was a big build-up. If you can just add a little more color around how you're thinking about that?

Dave Wehner: Sure. I mean, I think we've seen in 2019 that that CapEx growth rate come down, and we expect again in 2020 a more modest rate of growth in CapEx.

So, there are obviously -- we talked about secular factors driving capital intensity in the business, like serving an increasingly higher mix of users in Asia. But we've also been in a pretty significant cyclical data center build, and that's moderated, so I think that's some of the benefit you see coming

through.

At this point, we built some additional capacity. And so, I think we've been able to bring down the data center spend growth rates as a result of that. But we do continue to believe that we'll need to invest and grow CapEx as the business grows.

Brent Thill: In the delta between U.S. ARPU and the rest of the world, it's obviously a fairly large gap. When you think about your conviction around closing that gap, the most important driver is to helping close that. How do you think through that?

Dave Wehner: Well, the -- I think there's -- it really tracks to the ad market opportunity per user. And so, as we grow more quickly in markets where there's a lower ad market size per capita, I don't think we're going to see that gap close.

Ultimately, you've got to grow the GDP and ad markets in those countries. So I think the big factor there is mix, and it continues to be mix, and we've continued to grow disproportionately quickly in markets where there's a lower ad market opportunity per capita.

So, that's really what's driving it. So, I think while we continue to, I think, improve engagement over time and we improve our monetization products, you've got that headwind of growth in lower ARPU markets.

Operator: Your next question comes from the line of Kevin Rippey from Evercore ISI. Please go ahead.

Kevin Rippey: Thanks for taking the questions. One, it seemed like there might have been a modest sequential pickup in the number of outages, certainly on Instagram, sequentially. Did that impact revenue growth at all?

And then, second, as it relates to the guidance on revenue, is your comment that the pace of deceleration should be flowed through on a quarter-by-quarter basis or does it relate to the full year relative to the Q4? Thanks.

Dave Wehner: Sure. On the first question, I'm not aware of any pickup in outages affecting Instagram revenue growth, so -- at least it's not anything that I'm aware of, so I'd say that that's not a factor that we've looked at as driving any revenue results in Q3.

In terms of the pace of deceleration, we haven't been specific about the quarterly flow of that. And we've really just talking about a full year -- full-year deceleration versus Q4 of 2019.

Kevin Rippey: Got it, thanks.

Operator: Your next question comes from the line of Brian Fitzgerald from Wells Fargo. Please go ahead.

Brian Fitzgerald: Thanks, guys. And Rob's on, as well. He might have already asked -- and sorry if this question has already been asked, as well. I've been jumping around calls. But I just wanted to know to what extent you feel the engineering for combining the messaging platforms on the backend, what inning are you in on that?

And maybe related to Steven's question, is it -- are you splitting the workloads there between figuring out monetization features and engineering those? Or is that coming later or still unifying the backends? Thanks.

Dave Wehner: Yeah, Brian, it's a big task. And so, I mean, I do think that that just weighs in on just overall engineering prioritization and messaging interoperability as -- important priority for the messaging teams. And I think that does come with a tradeoff to how we deploy engineering against monetization.

So, that is a big effort, and I think we're still in early innings on that. And so, I think that does have some impact in terms of how we prioritize the roadmaps on those teams. So I think it's a correct assumption that it's delayed some of our monetization efforts in messaging.

Brian Fitzgerald: Got it, thanks, Dave.

Operator: Your next question comes from the line of Ron Josey from JMP Securities. Please go ahead.

Andrew Boone: Hey, Dave. It's Andrew on for Ron. Thanks for taking our questions. I've got two, please. The first just on Instagram Shopping, that launched about two years ago. Can you just talk about the throttles of moving that more towards just a wider release?

And then secondarily, on Brent's question, on kind of the regional ARPU mix, is there something beyond geographies, though, that drives the structural difference between, say, Europe and U.S. and Canada?

Dave Wehner: Sure. I'll take both of those, obviously. Instagram Shopping, I think -- look, there's a big difference between having ads and having a full shopping experience where you can go in and immediately tap inventory and know size, color, availability, shipping terms, and the like, and having that built into an Instagram experience, a native Instagram experience. So, I think there's a lot of work that needs to be done there, both on the Instagram side and on the partner side.

So, I think we're still early in building out all of those -- all of that functionality and all of those integrations. And I think that's going to take time and why we're early in that. In terms of the regional ARPU mix, I mean, I think there's a few things.

I'd say the biggest thing is the -- U.S. and Canada is pretty much pure high GDP per capita, high ad market per capita market, whereas the E.U. includes Eastern Europe, it includes Turkey, so you're picking up growth countries like Poland and Turkey, Ukraine, different areas like that which are lower ARPU and having higher growth. And so, that's where -- that's the big structural difference.

You do also have lower engagement in some of those markets than you do in the U.S. and Canada. So, you've got some lower ARPU as it relates to that, even when you have countries that are probably similar in terms of ad market per capita. So, a few different factors come into it.

Deborah Crawford: Operator, we're going to take one last question.

Operator: Thank you. Your last question comes from the line of Rohit Kulkarni from MKM Partners. Please go ahead. Rohit Kulkarni, please go ahead.

Rohit Kulkarni: Hey, sorry, I was on mute. And thank you for squeezing me in. Any update on kind of share buyback? And how much should you have available, given the CapEx guidance for next year? Anything we should read into that, as to how your share repurchase program might shake out next year?

Dave Wehner: Yeah, obviously, our primary focus is investing on growth and maintaining a strong financial position, but that does leave capital available for share repurchases.

And we are committing – we are committed to offsetting dilution with share repurchases, and we've also made opportunistic repurchases from time to time. There's no change in having those two components as part of our long-term capital allocation strategy going forward, so I think you'll see us do both over time.

And then one other -- one other item, just circling back to the News, there was a question about ads in News. We actually do not currently have ads in the News tab today, so we are paying some publishers, but there are not ads in the News tab today.

Deborah Crawford: Great. Thank you. Thank you, everybody, for joining us today. We appreciate your time, and we look forward to speaking with you again.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for joining us. You may now disconnect your lines.