Facebook, Inc.
Fourth Quarter 2019 Follow-Up Q&A Call
January 29th, 2020

Operator: Good afternoon. My name is Christina, and I will be your conference operator today. At this time, I would like to welcome everyone to Facebook's fourth quarter and full year 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.

The 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: 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 Jason Helfstein from Oppenheimer. Your line is open. Please go ahead.

Jason Helfstein: Thanks. Two questions. So historically media, more targeted ads usually result in higher monetization per ad, which is obviously a positive for you. Any way how you could help us understand how much of the revenue today is coming from large, as opposed to small- and medium-sized advertisers? Or just any other metric to understand where we are along that journey?

And then the second question. Obviously, I mean, you're guiding us to -- we can kind of get to pretty specific numbers for kind of a margin range for this year. Is there a way to think about a pull forward in expenses as we're all trying to think about how to model margins in 2021? And just color around how you're thinking about expenses this year versus some normal pattern? Thank you.

Dave Wehner: Sure, Jason. Let me see what I can do on both of those questions. We really haven't broken out how much is coming from large versus small and medium advertisers.

In general, over the last several years, we've seen our business diversify more, so we've seen our -- we've seen the higher -- the largest advertisers grow more slowly than the next tiers. So our business has gotten a little bit more diversified over time.

But obviously we still have a number of large advertisers. And when you start to get out into the long tail of the 8 million advertisers, the vast, vast majority of those are very small, in terms of their contribution to revenue. But we haven't really given any specifics on that.

In terms of long-term margin outlook or kind of comments on that, really not providing anything kind of beyond 2020 at this point. And as you said we've given sort of the total expense outlook range for $54 billion to $59 billion. And we've provided some comments about revenue growth.

So I think you can get a reasonable perspective on 2020. But beyond that, it's simply too early to provide guidance. Clearly, the ads business is inherently a high margin business. But we are continuing to invest in other areas.

Operator: Your next question comes from Mark Shmulik from AllianceBernstein. Your line is open. Please go ahead.

Mark Shmulik: Yes, hi, thanks. Question on the revenue deceleration and guidance going into next year. You talked about a few different kind of headwinds, one on ad targeting and the second just around the maturization of the business.

Can you share a little bit more about how we think about some of those headwinds? Are they more short-term oriented? And how much of that is a little bit kind of baked in how we think about trajectory going forward? Thanks.

Dave Wehner: Sure. I mean overall, we were pleased with Q4, had a strong holiday season, despite it being abbreviated. Really, when we look into 2020, our view is really unchanged. We continue to expect deceleration going forward. We talked about some of the factors in that.

I double-clicked on the headwinds and the -- sort of the three elements there being regulatory, the mobile operating system and browser platform changes, and then our own rollout of tools, like OFA. You know, those are really consistent themes that I've been hitting over the last several quarters, so not new.

I think as I said last quarter, the majority of the ad targeting headwinds continue to be in front of us rather than behind us, so we have seen some impact from those already. You know in terms of the maturity of the business, this is simply a scale issue, especially in our more developed markets.

So we're seeing good, positive trends around our apps, but they're already big and successful. So as we have revenue growth opportunities like Stories and more recently Instagram Explore, these are significant opportunities, but they're on top of what is already a large business. So, again, I don't -- nothing surprising, very consistent with the outlook we had for 2020 a quarter ago.

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

Ron Josey: Great, thanks for taking the question, Dave. Maybe one quick follow-up and then another one. Just on the last question, I think you mentioned we're seeing some impact already on the ad targeting and the headwinds are more in front of us.

That impact already, is that more than you expected maybe that you saw in Q4, or just as you expected, and getting back to overall how we think about guidance and the decel.

And then the second question is just around U.S. ad revenue and the deceleration there. Was that the targeting issues that we're seeing? I know you said it was in line with expectations, but wondering if it's targeting issues. Maybe it's competition or maybe six less shopping days. Anything you can point to, to help out there would be great. Thank you.

Dave Wehner: Yeah, I mean, I would say in terms of the ad targeting headwinds, pretty much as expected in Q4. I would say if you go earlier in 2019, I would say we actually probably saw the targeting headwinds not manifest as quickly as we had expected. But -- in Q4 itself, I think it was pretty in line with what we expected.

But we, again, continue to expect that as you see like, CCPA rollout, and as you see more changes from the OS and browsers we're going to get more of that headwind.

And then we rolled out OFA to everyone now and it's unclear as to how that's going to -- how broadly that's going to be adopted. There's obviously a lot of variance on how that could play out. And so that's -- those are all factors.

In terms of U.S. ad revenue, I would say there, again, I would point towards the fact that it is the -- it is in many ways the most mature market. We're seeing good engagement on Facebook and Instagram, but we're also -- we've already seen I think very good Instagram adoption and Instagram revenue growth in those -- in the U.S. and Canada. There's probably more opportunity to benefit from faster Instagram growth outside the developed markets.

So I think, again, very consistent with what we expected and consistent with just talking about the overall scale of the business and how the new revenue growth opportunities are within the perspective of that already very large business.

Operator: Your next question comes from Jason Bazinet from Citi. Your line is open. Please go ahead.

Jason Bazinet: If I could circle back to the comments that you made on the last call regarding sort of more headwinds to come as it relates to the regulatory changes and some of the browser changes, philosophically, when you guys are managing all of the complexity that's going on globally with very disparate regulations, what is your philosophy?

In other words, is it sort of lowest common denominator? Is it you just adapt to whatever regulations exist at the time in that geography and sort of wait until you learn more about what changes will occur?

In other words, I'm just trying to get -- like, how -- are you trying to get ahead of the curve? Or is it sort of shoes will drop as regulations change? Thanks.

Dave Wehner: Well, I mean, I'd say -- you know, philosophically, we'd obviously like a more consistent regulatory regime. It's certainly why we have -- you know, we've supported, for instance, federal privacy regulation as opposed to state by state type of regulations, like CCPA.

There's a variety of different things we're doing with the GDPR controls. We rolled those out globally. So we're trying to take global approaches when appropriate. You know, things like OFA has rolled out globally. That certainly is very consistent with giving people controls around how we use signals from third-party websites and services.

So I think we're trying to adopt a global approach. But depending on how regulation rolls out, we're going to have to look at it at a case-by-case basis to make sure that we're compliant.

Ultimately, it's -- we're going to have to adapt to whatever regimes exists out there, and if it's fragmented, we'll have to deal with that, as will everybody else in the sector, as well.

Operator: Your next question comes from Rich Greenfield from LightShed Partners. Your line is open. Please go ahead.

Rich Greenfield: Hi thanks for taking the question. You know, Dave, as you think about the cost -- the cost base that you gave out for 2020, is there any way to think about how much of that cost, in terms of what you're building towards in aggregate, how much of that relates to things that are not generating revenue?

And I don't mean by safety and security, but if you think about things like Oculus and sort of kind of the real long-term projects that you have at Facebook, is there any way to segment kind of how much of that now overall cost base isn't literally tied in any way to a business of today that's really driving meaningful revenue that's any revenue at all?

Dave Wehner: Yeah, thanks, Rich. We haven't broken out the spend that way. I would say that we are investing across the board. And I would say the majority of the growth that we see and the expense comes from three factors broadly -- the growth in infrastructure spend what I'd call core R&D, and innovation efforts particularly around AR/VR.

So it's clearly one of the factors that's contributing to expense growth. But the majority of our spend growth is really related to overall driving the core business, as well as investing in some of the efforts around safety and security and privacy supporting the core business.

You know, in addition, we're investing in areas like content though that is generating engagement on the core platform. Those are generally places where we're kind of -- we have a test budget, and we're looking at driving engagement as opposed to driving monetization. But, yeah, we haven't broken out things like AR/VR spend.

Operator: Your next question comes from James Lee from Mizuho Securities. Your line is open.

James Lee: Great. Thanks for taking my question. Hey, Dave, I was wondering if you can maybe elaborate the settlements, $500 million with the state of Illinois? And are these kind of legal fees potentially recurring? Are there any like pending litigation uncertainty with state governments that we should be thinking about? Thank you.

Dave Wehner: So -- yes, as you know, James, the big driver on G&A was legal settlements, and that was particularly that settlement related to BIPA, which is the Illinois Biometric Information Privacy Act. That was a $550 million settlement. Most of that, but not all of it, flowed in through Q4 that we had made a prior -- because we had made a prior accrual on that.

You know, in terms of -- you know, in terms of kind of the overall fines and regulatory environment we have seen and will continue to see increased regulation in our sector, and I think fines and the threat of fines are a reality that comes with that.

And we're focused on investing to be compliant with new evolving regulations, so there is expense that comes with that to us and obviously to everyone else in the industry, as well.

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

Aaron Kessler: Great. Thank you. Just going quickly back to the Q4 growth, can you -- in terms of the tougher comp on impressions growth that we saw last year, maybe how much did that contribute to the -- a little bit of slower growth that we saw in Q4, in the quarter?

And just quickly on the expense guidance. It still seems a bit, I mean, conservative of $54 billion to $59 billion. Is there any kind of key investment areas we should keep in mind as we think about 2020? Thank you.

Dave Wehner: Sure. So, yeah, impression growth was strong across our services at 31% year over year, but that was a deceleration from the 37% growth in Q3. And we are lapping periods of higher ad load growth, particularly on Instagram Feed and Stories in Q4.

We saw -- you know, we continue to see healthy growth on Facebook app in terms of impressions on all regions. And then again, where we're seeing the growth is in places like Instagram Stories, where CPMs are still at a significant discount to Newsfeed. It remains relatively early days for Stories and pricing is lower. That's an opportunity for advisers, as well.

In terms of the 2020 expense guide, I can circle back around to that. Again, there's no one thing that leaps out in terms of expense growth. We're growing across the board.

The majority of the growth is coming from the three factors that I had mentioned on Rich's question. It's growth in infrastructure spend, it's core R&D related to kind of the core family of apps products, and then it's also our innovation efforts, particularly in AR/VR.

Operator: Your next question comes from Andy Hargreaves from KeyBanc. Your line is open. Please go ahead.

Andy Hargreaves: Thanks. So on the commerce stuff, so I understand the basic idea of reducing friction sort of helps sales and that feeds back into ads. But I'm wondering, is there any new pricing models for any of that, shoppable ads, that kind of thing, that does give you sort of a direct tie to sales volume?

And somebody sort of asked this on the call, but on the impediment side, I wasn't quite clear. So are the key impediments to rolling this out broader integrations with different systems or fraud protection? Or can you just walk through what needs to happen to roll that out more broadly?

Dave Wehner: Yep, sure. So, yeah, I mean I would say overall, the big revenue opportunity for commerce across all of our apps for the near and medium terms is ads. And so we're seeing a lot of customers discover and purchase through Instagram and Facebook. E-commerce and retail are amongst our largest verticals.

Now as we build out additional services, like Checkout and Instagram Shopping, there will be the potential for some additional take rate there, but this is very, very small and will remain so for the foreseeable future. So I think I would really point towards this helping power our overall ads business and making more seamless -- you know, seamless and more valuable ads by making transactions easier.

In terms of what's challenging, it's kind of some of the things that you outlined. It's building Checkout and Commerce is about providing that more seamless and integrated experience, and so it takes hard work and coordination with partners to make those experiences great.

There's issues about who is responsible for the different areas of service with customers. And so I think we're learning all of those things and we're adopting very -- you know, a slow path towards rolling it out. It's going to take time.

You know, we're -- we think there is an opportunity in the long run for this. But it remains very early. And I think Sheryl talked about sort of hundreds of customers for things like Instagram Shopping, which in the perspective of Facebook's business is very, very small.

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

Craig Huber: Yeah, hi. Got a few questions, if I could ask. Normally you give out the percent of mobile advertising as a percent of the total. I think the last two quarters was about 94 percent. Was that true here in the fourth quarter?

Dave Wehner: Yeah, Craig, we've just retired that because at this point it's sort of like -- -- it's effectively all of our business practically as we get into those percentages.

So we felt that that was a legacy disclosure when we were making the mobile transition. And at this point, it's -- you know, we just have deprecated that just because it's basically all a mobile business now, except for a small legacy desktop business. So, no change in trend there.

Operator: Your next question comes from Dan Salmon from BMO Capital Markets. Your line is open. Please go ahead.

Dan Salmon: Hey, Dave and Deborah. Thanks for taking the question. I had two. Dave, just to come back to the majority of headwinds being in front of the company still, do you expect that to manifest itself in 2020? Or is this a timeline that you could see potentially going beyond that?

And then just quickly, search ads started to roll out a bit more broadly in the quarter. I know it's early days, but any comment on the traction of those units? Any verticals that were particularly (inaudible)…

Dave Wehner: We lost you there, Dan, but I think I got the two questions. So, yeah, I think we expect that we're going to see an impact from those headwinds beyond 2020.

This -- you know, there's things that we would anticipate probably being more impactful later in the year, around whatever changes that the mobile OS and browser companies make. Those could be more impactful later in the year and into 2021.

There's obviously a variety of different things in terms of the adoption of things like OFA that could affect it. So I do think that it's not just a 2020 impact. It's a longer-term impact potentially.

As it relates to search ads, it's still very small and early days. And things like Marketplace are a place where search is effective.

Operator: Your next question comes from Ross Walthall from Cleveland Research. Your line is open. Please go ahead.

Ross Walthall: Yeah, thanks for the question. I know in the last call you characterized the 2020 outlook, saying much less pronounced decel versus the Q4 growth rate. Where do we stand on that today? And I guess how would you characterize the outlook after the Q4 performance?

Dave Wehner: Yeah, I mean, I would sort of characterize the outlook as kind of unchanged for 2020. We continue to expect deceleration going forward. I gave fairly explicit guidance on low- to mid-single-digit decel compared to the Q4 rate in Q1. So I don't think there's any -- you know, any big change in outlook on 2020 in Q4 or coming out of the Q4 results.

Operator: Your next question comes from Rohit Kulkarni from MKM Partners. Your line is open. Please go ahead.

Rohit Kulkarni: Great, thank you. Two questions, please. On the Facebook branding that was launched, I think in November, wondering whether you had any noticeable impact on engagement, particularly on those users who don't use core Facebook, but use one of the other three apps? Have they started seeing WhatsApp by Facebook on the app?

And secondly, as -- on the blog that Mark put out yesterday on upcoming privacy changes and tying all your comments – around the headwinds associated with various different external and internal factors, I was wondering, like, with what -- with, the privacy changes that you are going to roll out over the next call it few weeks, have you done any -- I'm sure you have done kind of small use cases and test cases.

Wondering if you have any feedback to share as to what feedback you have received from users who have been exposed to kind of push-based privacy compared to changes that people would be asked to make over the next call it few months?

Dave Wehner: Thanks Rohit. On -- let me see if I can tackle both these questions. I probably don't have a ton to share. I am not aware of anything on your first question in terms of impacts on user growth and the like from rolling out Facebook brands. I'm not aware of anything there that's been flagged to me.

On the -- Mark's post and just other -- other changes, nothing specific to share on that. I think we've certainly gotten favorable reaction to providing the -- providing things like OFA for people who are interested in being able to have more control over things like data from third-party websites and apps. But nothing specific to share there.

Operator: Your next question comes from Stephen Ju from Credit Suisse. Your line is open. Please go ahead.

Stephen Ju: OK, thank you. So, Dave, I guess sort of a multi-part structural question. So I think you indicated in prior, I guess, post-earnings calls like this that you're kind of at the limit of the ad load increases you can push through to the users aside from Stories. So, wondering if you still feel like that is still the case?

Second it seems like in terms of the underlying pieces of your revenue growth between impressions and pricing growth, it seems like pricing has to contribute more, especially if you're going to be constrained on the volume side.

So with the regulatory environment being what it is, it seems like realizing higher pricing will become also more difficult. So what do you think you can do to provide I guess advertisers with more value?

And -- or do you think it's a scenario in which like Sheryl said before, it's going to be a relative game versus the other places advertisers can go and they will probably have to suffer through some compression of ROI? Thanks.

Dave Wehner: Great. On the first question, I think we've talked about things like just broad brush, things like the maturity of the business and the like.

So I think there are -- we're lapping periods in Q4 where we saw higher ad load growth in places like Instagram and Stories a year ago, so I think we're seeing -- you know, we're already seeing some impact from not pushing on areas like ad load as much.

There's opportunities there, but they're more limited. We see places like Stories and Explore where we can improve things. There's always opportunities to optimize and the like. But I think in terms of broad brush Instagram feed and Facebook feed, those opportunities are lower than they were a year or two years ago.

In terms of what that means in terms of getting more revenue growth from pricing, we've seen a really good growth in supply. We've seen that driven by a variety of factors, including growth in users and engagement, and new surfaces like Stories and Explore. And so that's provided a good backdrop for growth.

And when supply grows more slowly, we'll undoubtedly see more of an impact and more strength in pricing. That's typically what we've seen in the auction environment.

You know, obviously, being able to maintain good signals and optimizing is critical to that. And being able to replace any loss of third-party signals from the headwinds that I've talked about with first-party signals, which is how people are interacting with our own services – it's going to be important.

And that's obviously an effort that we're working on. We've got the benefit of a lot of first-party activity on our services. So, we think there's opportunities there.

Deborah Crawford: Operator, we can take one last question.

Operator: Thank you. Your last question comes from Alan Gould from Loop Capital. Your line is open. Please go ahead.

Alan Gould: Thanks for taking the question. I've got two. You mentioned WhatsApp payments has been tested in India. When does that go live? Will you be taking a small transaction fee on that?

And with respect to capital allocation, you now have north of $50 billion in cash. Share repurchases dropped from almost $13 billion to $4 billion last year. What's driving your repurchase strategy?

Dave Wehner: Thanks, Alan. So, yes, WhatsApp payments has been in a test mode in India for most of 2019. And we've gotten good feedback on that product from users who have used it. And we're working towards getting that unblocked for a larger expansion in India. And we're also looking to bring payments to a number of other countries that are significant for WhatsApp.

The potential revenue and fees from that are quite small. So we're not really doing this as a revenue opportunity. It's really about giving people and businesses the ability to send and receive money to one another as easier and securely as they send a message.

And so we think this is just an important part of empowering people and businesses with the tools they need to enable commerce.

In terms of capital allocation, we are -- you know, investing in the business remains our top priority, but our share repurchase program has been active. We have two components of that, offsetting dilutions, and opportunistic repurchases.

We are -- we have a $4.9 billion of our -- initial -- our last authorization. And we just authorized an additional $10 billion authorization, and we intend to have an active share repurchase program going forward.

Deborah Crawford: Great. Thanks, Dave. Thank you for joining us today, everybody. 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.