

Facebook 1Q 2014 Earnings Call Transcript

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Deborah Crawford, Investor Relations

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

Before we get started, I would like to take this opportunity to remind you that our remarks today will include forward-looking statements, and 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 our annual report on form 10-K 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 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. The press release and an accompanying investor presentation are available on our website at investor.fb.com.

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

Mark Zuckerberg, CEO

Thanks Deborah, and thanks everyone for joining today.

This was a very busy quarter and a strong start to 2014. We continued to grow our community in size and engagement, with nearly 1.28 billion people now using Facebook each month and

almost 63% visiting daily. We also reached new milestones as a mobile company, with more than one billion monthly actives on mobile and almost 55% of our daily actives only connecting on mobile.

When you look at our business performance, we've also made some good progress. Our total revenue grew 72% year-over-year. Our advertising grew 82%, our strongest annual growth rate in nearly three years. And mobile accounted for 59% of our advertising revenue. These results show Facebook's business is strong and growing, and we're in great position to continue making progress towards our mission.

This quarter we made a number of big investments in our future. We reached agreements to acquire WhatsApp and Oculus, and we announced our new Connectivity Lab that's focused on developing technologies to expand internet access around the world. These are important efforts that we believe will help us continue making progress towards our mission over the long term. But as this quarter shows, we're also staying focused on execution, and carefully improving our core products and business. Execution gives us the strength to bet on the future, and our success over the long term depends on us serving our community today and delivering against our current strategy.

So, with that in mind, I'd like to run through our progress this quarter towards our three big company goals – connecting everyone, understanding the world and building the knowledge economy.

Connecting everyone is about making internet services available to everyone in the world, and allowing everyone to connect with the people and things that they care about.

Our strategy for connecting everyone is based on two approaches.

The first is about giving people new apps for sharing different kinds of content with different people. Today our apps are at different stages of maturity. Our core Facebook app has an audience of over one billion people, and has become an essential sharing infrastructure for the world. We're currently focused on building a great business around this, and our continuing revenue growth on mobile this quarter shows our strong momentum here.

For the next set of apps like Messenger, Instagram and hopefully soon WhatsApp, the current priority is growth. Messenger and Instagram both reached 200 million monthly actives this quarter. We believe these apps have a lot of room to grow and will start to be important businesses in the future, but monetization isn't our near-term priority here.

And for new apps that we're building as part of our Creative Labs effort, we're still in the very early stages of development. We're working hard to develop the technical foundations for these services so that we can rapidly launch new products and then refine them based on the initial feedback of our community. For Creative Labs projects that demonstrate a lot of value, our next priority will be to grow them to reach 100 million people, before we start developing them into significant businesses. We're pleased by the early reaction to Paper, our first app from Creative Labs, and expect this to be a good test case for our strategy.

The longer term part of our strategy for connecting everyone is focused on Internet.org, our effort to make affordable basic internet services available to the entire world. We recently reached 100 million monthly actives in India, and through Internet.org we're looking to build on this kind of success. We've already started to deliver results. By partnering with mobile operators in the Philippines and Paraguay, we've doubled the number of people using mobile data with our partners and brought almost three million more people onto the internet. Our early tests and research into new technologies such as drones and other infrastructure to connect people are promising. And over the long term we also expect WhatsApp to play an important part in connecting everyone by offering a simple, fast and reliable messaging system

that could be as ubiquitous as Facebook one day. We'll have more to share after the deal closes.

Next, let's talk about understanding the world. Understanding the world is about using Facebook to build up long term knowledge about the world and helping to answer questions for people that no other service can.

Next week Facebook holds our fifth f8 conference, the main event for our developer community. We do this because even with all the experiences we're building, we understand that there will always be more social experiences that we can't build. So we want to keep serving developers better, and to help them build, grow and monetize their apps.

We've made good progress here. On mobile, App Installs has been one of our best performing ad products, driving over 350 million installs to date. Over 60% of the top grossing apps on the Apple App Store and Google Play use Mobile App Ads, which is pretty impressive performance for a product that launched in January last year. On desktop, games continue to be popular on our platform and over the last twelve months desktop game developers generated more than \$3B in payments volume on Facebook.

It's worth noting that even though our mobile and desktop products seem completely different, they're both delivering the same value to developers -- the ability to reach a large, targeted audience. That's what we provide, and regardless of the format we will continue to improve this value. We see a big opportunity to continue improving the relevancy of the ads people see on and off Facebook, to help mobile developers better monetize their apps, and to help provide greater reach for marketers. I look forward to sharing more details next week at f8.

Finally, let's talk about our efforts to build the knowledge economy.

Building the knowledge economy is about building out the technology platforms the world needs for the future, so everyone can use information to do their jobs better.

Advertising and the ability to reach people more broadly is one of the most important technology platforms for achieving this, and we're investing a lot to serve four major kinds of partners: small businesses, brands, developers and e-commerce partners.

After introducing News Feed ads, which increased the supply of ads in our system, our recent efforts have primarily focused on improving the relevance and quality of these ads. To do this, we've been working to improve the tools we provide for marketers, so they have access to better targeting capabilities, simpler ad products and more useful measurement tools. Our approach is less about developing new products for marketers and more about improving our existing ones and helping businesses to use them efficiently. Our goal is to make our ads as interesting as organic content on Facebook, so that more people find ads useful and businesses can engage effectively with our community and grow.

Our most recent data shows that this approach is working well, and we continue to be really encouraged by the feedback we're seeing from people about our ads. There is still more work to be done here, but we've shown that we can continue to serve our community well while also growing a healthy business.

So that's my update on how we've been executing against our strategy over the last quarter. It's been a busy quarter and a strong one.

We're proud of our progress as a company and everything that we're accomplishing today. In large part this is due to the incredible quality of our team, and I'm very grateful for the support of everyone here at Facebook, as well as our stockholders and partners, as we continue working to achieve our mission.

In addition to thanking our employees, I'd also like to thank one person in particular: David Ebersman, who is stepping down as CFO after almost five years. David has been a great partner in building Facebook. He has set the right tone about operating efficiently. He has set us up to make the long term investments we need. And most importantly, he has built an incredibly strong team, including Dave Wehner, who will be our next CFO. I've learned a lot from David, both personally and professionally, and I'm grateful for everything he has done to help make the world more open and connected.

Thanks, and now here's Sheryl.

Sheryl Sandberg, COO

Thanks Mark and hi everyone. Before I start, I want to join Mark in thanking David for being an extraordinary partner and friend over these past 5 years. As Mark said, he has contributed so much so much to our Company and I've learned so much, personally, working with him. Great people build great teams and that's what David has done. I'm also really excited to continue working with Dave Wehner as he steps into his new role as our CFO.

We are off to an outstanding start in 2014. Our total revenues were up 72% year over year in the first quarter and our advertising revenue growth accelerated to 82%. That's our strongest year-over-year advertising growth rate in nearly three years.

We're really pleased with these results and the level of execution in our ads business. The team is staying focused on each element of our monetization strategy: capitalizing on the shift to mobile, growing the number of marketers who advertise with us, and investing in our ad products.

Mobile continues to be a big driver for us – and a big opportunity. Mobile comprised 59% of our ad revenue in the quarter, up six percentage points from Q4. We continue to believe this is because Facebook has the best mobile ad product in the market.

We also continue to grow the number of marketers using Facebook and saw growth from existing advertisers as well. Our growth is very broad-based and coming from all types of marketers, with particular strength from SMB and direct response. We saw strong performance this quarter from verticals such as mobile gaming, e-commerce, and consumer-packaged goods.

I am especially pleased with what we are seeing and hearing from clients around the world as they shift budgets to online, to mobile, and to Facebook. One recent powerful example is Sport Chek, Canada's largest sport retailer. They recently decided to pull their paper circulars – which their company has relied on as its primary advertising vehicle for the last 92 years – for two weeks and replace them completely with digital spend – a majority of which was on Facebook. During those two weeks, national in-store sales grew 12% year-over-year and in-store sales those items they promoted on Facebook grew 23%. As a result, they are going to continue with their tests and their goal is to transition more than 25% of their print spend to digital and Facebook in the next year.

And last week I was in Europe meetings with clients, agencies, SMBs and developers and what I heard from them was how FB was becoming increasingly important in driving their businesses. Investing to improve and expand our ad products remains a very important priority for us. Our goal is to continue to develop new ways to help marketers reach their customers. We've done this over the last couple of years by enhancing our targeting capabilities, simplifying our ad products, and improving our measurement tools. I'll touch on each of these three areas.

First, targeting. Along with Facebook's reach and scale, marketers value our proprietary targeting to help them reach the right customers and create more personalized – and,

therefore, more efficient and effective – ad campaigns. Ten times more marketers are now using our Custom Audiences targeting feature compared to last year. To share just one recent example, Ben & Jerry’s wanted to drive more sales from its classic flavors. They used a wide range of our targeting capabilities, including Custom Audiences and Partner Categories, to reach premium ice cream buyers. Their campaign reached 14 million people — roughly 90% on mobile — and drove an 8.1% sales lift from those consumers.

As more marketers use our targeting tools, our ads become more relevant for our users and drive even better results for marketers.

Second, we are simplifying and enhancing our ad tools for the over 1 million advertisers on Facebook. The tools that were previously available to only the biggest and most sophisticated advertisers - like Custom Audiences and Partner Categories - are now available in our self-service ad creation process. By making these tools more accessible, we believe we can grow the number of advertisers on our platform and improve their results. Additionally, for direct response marketers we’ve added more specific calls to action in our ads, including “buy now” or “install now” buttons that greatly improve the efficacy of these ads.

Finally, we’re also really pleased with the results we’re seeing from our investments in measurement tools. Our online conversion measurement tools enable our direct response advertisers to measure the impact their Facebook ad campaigns have on online sales. And, we recently launched new offline conversion tools to measure in-store sales, which have yielded positive initial results.

Our ongoing focus will continue to be on improving the quality, relevance and performance of our ads and demonstrating value to marketers. We believe we still have a lot of opportunity to generate future returns by continuing to focus in these areas.

We also have significant opportunities to develop newer products like premium video, ads on Instagram and our recently launched ad network test. Our initial efforts show a lot of promise and we've gotten good feedback from marketers in all of these areas. But, it's still very early and we don't expect meaningful contributions from these projects this year.

To summarize, our ads business is performing very well. I want to take a minute to congratulate and thank our teams all around the world and our ads engineering, product and design teams on the progress we have made. I also want to thank our clients, agencies, PMDs, and other partners, who work with us every day to use our platform to build their relationships with their customers to create personalized marketing at scale.

It's an exciting time for us as more marketers around the world gain conviction in the results they can achieve on Facebook. We have a great opportunity to build the world's first platform for personalized marketing at scale. It's early in that journey and we are going to stay focused on making the right investments in our ads business and executing against our plan.

Thanks everyone, and now here's David.

David Ebersman, CFO

Thanks Sheryl and good afternoon everyone.

Before I dive into the numbers, I wanted to say a few words about my decision to step down as CFO.

This was a hard decision for me because of how much I love Facebook and all the people I work with here. In particular, I can't thank Mark and Sheryl enough for their friendship and support and for letting me be a part of their team. I'm confident that Facebook's best days lie ahead and I'm excited about the path Mark and Sheryl are leading the company on.

My decision's a personal one based on my desire to get back into health care where I spent my entire career before Facebook. And, after ten years as a CFO, half of them here, I'm ready for a different role and challenge.

Right now feels like a good time for this change. The business is doing well, the foundation is solid, and in Dave Wehner we have a terrific successor who's up to speed and ready to go. I have complete confidence in Dave and the rest of the Finance team. Dave will formally take over me in June and he'll take my place on the next earnings call, though I plan to stay with the company through September to ensure a smooth transition.

I also want to thank our shareholders for your partnership and support.

Now to the quarter.

Q1 was a strong quarter for us across the business. We increased our revenue growth rate, expanded operating margins, delivered free cash flow of over \$900 million, and continued to make investments to position the company for near-term and long-term growth.

Let's start with some people metrics:

The number of people using Facebook on an average day in March grew to 802 million, up 137 million from a year ago. As Mark mentioned, this daily number represents almost 63% of the 1.28 billion people who used Facebook during the month. And overall engagement remains strong.

Additionally, these stats don't include Instagram, which now has more than 200 million monthly active users, showing the remarkable progress by the team. Two years ago this month, when the acquisition was announced, Instagram had fewer than 22 million monthly actives.

Turning now to the financials. Q1 total revenue was \$2.50 billion, up 72% vs Q1 last year, and total ad revenue was \$2.27 billion, up 82%. Ad revenue growth was strong around the world, with each of our 4 geographic regions growing by over 70%.

Mobile ad revenue was approximately \$1.3 billion, compared to around \$377M in Q1 last year, and notably mobile ad revenue was up 7% sequentially, despite the seasonal benefits in Q4. Desktop ad revenue in Q1 was up 8% compared to Q1 last year.

In Q1, the average effective price per ad displayed increased 118% year over year while total ad impressions declined 17%. The decrease in ad impressions was due to factors including the continued shift towards mobile use, where people are shown fewer ads compared to desktop. The increase in average price per ad was primarily driven by a mix shift with more ads being shown in News Feed. News Feed ads have significantly higher engagement, click through rates, and price per ad compared to right hand column ads, so a higher proportion of ads appearing in News Feed drives up the overall average price per ad. The price volume trends were pretty consistent across our four geographic regions.

Total Payments and Other Fees revenue was \$237 million, up 11% vs. Q1 last year. However, the more meaningful comparison, that better reflects the organic growth we saw in the Payments business, comes from looking at Payments volume from Games specifically, which was up 1% in Q1 compared to Q1 last year, down from the 8% year-over-year growth rate we saw in Q4. As we've discussed before, the shift to mobile is a significant headwind since our Games Payments revenue comes from desktop only, where usage is flat or declining, so growing this business going forward will be challenging.

Turning to expenses, our Q1 GAAP expenses were \$1.4 billion, up 32%, and our non-GAAP expenses were \$1.1 billion, up 26%. Our headcount increased 39% from a year ago.

Our Q1 GAAP operating income was \$1.1 billion, representing a 43% operating margin, and our non-GAAP operating income was \$1.4 billion, representing a 55% margin, up from 39% last year. While the margin improvement was helped by some non-recurring items that drove up costs in Q1 last year, we're pleased that the increase in margins came mostly from cost of revenue and G&A. As planned, we've created efficiencies in infrastructure and administration while continuing to aggressively grow our investment in R&D along with marketing and sales to drive future performance.

Our GAAP and non-GAAP tax rates were 40% and 36%, respectively. GAAP net income was \$642 million or \$0.25 per share, and non-GAAP net income was \$885 million or \$0.34 per share.

In Q1, we spent \$363 million on capX and generated \$922 million in free cash flow. We ended Q1 with \$12.6 billion in cash and investments.

Now, looking forward. First, I want to note that the forward-looking comments I'll share today do not reflect any impact from the recently announced acquisitions of WhatsApp and Oculus, neither of which has closed. After the deals close, we'll update our guidance as appropriate.

In terms of expenses, consistent with what we've said previously, we're planning that our total 2014 GAAP expenses, including cost of revenue and stock comp, will likely grow in the neighborhood of 35-40%, and that non-GAAP expenses, including cost of revenue but excluding stock comp, will likely grow in the neighborhood of 40-45%.

For taxes, we expect GAAP and non-GAAP rates for the rest of 2014 to be similar to or a bit higher than our Q1 rates, although this could vary widely depending on our international revenue and expense mix, and other factors including the impact from acquisitions.

We continue to anticipate our 2014 capX will be approximately \$2-\$2.5 billion.

We also continue to expect shares outstanding for calculating EPS to grow from around 2.6 billion at year-end 2013 by 2-2.5% in 2014 excluding the two large deals we've announced. Those deals once closed will add another 207M shares, as well as additional unvested RSUs that will affect our share count over the subsequent 4-5 years.

Turning last to ad revenue. As you know, our year-over-year comps will now get meaningfully more challenging because of the timing of the ramp up of News Feed ads in 2013. As the comps become more difficult, we continue to expect that over the rest of 2014 our year-over-year ad revenue growth rates will decline from the Q1 rate and be meaningfully lower by the end of the year. That being said, we believe we're still in the early stages of building our ads business, and we remain as optimistic as ever about the long-term opportunity to grow revenue impressively by improving the quality and relevance of our ads and increasing the value we bring to marketers.

In summary, Q1 was a great start to the year. We're very pleased with how well our ads performed, the strong marketer interest in our ads platform, particularly on mobile, and the investments we're making to build long-term shareholder value.

Now let's open for questions.

<Q – Heather Bellini – Goldman Sachs & Co.>: Great. Thank you very much. I was just wondering, Mark or Sheryl, if you can share with us your vision of payments for Facebook, and how the company might be able to play a role in reducing the friction that exists today when users are trying to engage in mobile e-commerce? And then the follow-up question was just going to be, kind of, if you could share with us what inning do you think we're in, in terms of improving the relevancy of the ads that you're showing? Thank you.

<A – Sheryl Sandberg – Facebook, Inc.>: On payments, our payments business has been important in supporting some of the developer activity on Facebook, primarily games, and we continue to be interested in that.

I think it's really important to know that our advertising business is very relevant for e-commerce and that doesn't depend on taking payments and it doesn't depend on a payment strategy, because we provide a really great opportunity for marketers to find customers who are then going to go ahead and buy their products, both online and offline.

In terms of relevance, I think we're in really early innings. I mean, I think people can see it from their own experience. Most people I talk to and certainly the data we have across the base of people, who use Facebook suggest that the ads are getting more relevant, but there's a long way to go.

Our goal is that every time you open News Feed, every time you look at Facebook, you see something, whether it's from consumers or whether it's from marketers, that really delights you, that you are genuinely happy to see. I think we hit that more than we used to with our ads, but I think the truth is we still have a long way to go to hit that bar and that's the bar we're striving for.

<Q – Doug Anmuth – JPMorgan Securities LLC>: Great. Thanks for taking the question. David, just wanted to ask you a little bit more about margins, in particular. If we look at this quarter, it looks like the incremental margins here are 78% or so. So, I was hoping you could drill down a little more just on the drivers within cost of revenues and how you're thinking about the sustainability of that going forward.

And is the 40% to 45% growth that you mentioned in non-GAAP OpEx, is that taking into account the acquisitions here at all? Just sort of thinking about how you can get to that level of spend, given where you're starting the year? Thanks.

<A – David Ebersman – Facebook, Inc.>: Yeah. Thanks for the question, Doug. I think Q1 is traditionally a light spending quarter for us, because we budget with an annual cycle and often it takes some time to sort of ramp up the new program, so I don't think it's surprising that Q1 year-over-year increase would come in a little lighter than we expect for the full year.

Additionally, there were some one-time things that benefited the quarter that kept expenses down, particularly in cost of revenue as we continue to exit leased data centers and sort of amend our supply chain.

I think that going forward, our expectation was and remains the 40% to 45% growth, excluding the impact from the acquisitions. So, we will update that guidance once the integration plans are clearer and we have a better sense for what those spend patterns will look like.

In general, in terms of margins, I mean, the comments I would make are that we don't have a quarter-to-quarter target margin that we're managing closely to. To do so, would require varying our spend patterns as revenue changes up and down over time. And I think that's the wrong way to focus on how you spend your money in the company. Our priority is really to try and make investments that are high quality that drive the creation of value and make the business better. And since many of those investments take a longer period to mature, we want to be able to think about our spend increases over a longer term horizon.

And as you can see, looking back at the last couple of years and then our plans for this year, there's been a pretty steady rate at which we've been growing spend, particularly in R&D and marketing and sales, where we really want to focus on making sure we're growing smartly and thoughtfully at a rate we can manage wisely and doesn't get ahead of our ability to manage it.

On cost of revenue and G&A, what you can see in the Q1 numbers is the fruits of a lot of labor, trying to manage those parts of the business really efficiently and free up resources to invest elsewhere.

So, I think we've always believed that Facebook has the opportunity to be a sustainably high margin business and we continue to believe that, noting that there were some individual items that helped us in Q1.

<Q – Carlos Kirjner – Sanford C. Bernstein & Co. LLC>: Thank you. I think for Mark, how do you think about the evolution of browser technology, HTML5 and development tools versus native apps? If you look 2 years to 3 years out, do you think native apps could finally become less important for many use cases? Or in other words, maybe you guys were not wrong when you tried HTML5, you were just too early? Thank you.

<A – Mark Zuckerberg – Facebook, Inc.>: Yeah. Well, timing matters a lot. So, I do think that there's nothing wrong with the standard of HTML5 technically. I think a lot of what we see is what the main platform providers want to push as the standard for developing on their own platforms, and what we've

seen is that both Apple and Google have really favored and made it easier to build high quality experiences in their own proprietary formats rather than the open web format.

So, while our bias for a number of reasons would have been to have really pushed on HTML5. And I don't want to sound like we've walked away from this, because a large number of people access Facebook from the mobile web. And I don't know if we break that out specifically, but it's quite a large number of people. So, we're continuing to develop that, but for the foreseeable future we see the best path to continuing to deliver great experiences be by working on the native app experiences that we have now.

<Q – Eric Sheridan – UBS Securities LLC>: Thanks for taking the questions. Congratulations, David, on your future endeavors as well. So, Mark, maybe a quick question for you about the way in which you think Facebook, and the various applications Facebook is developing also, move towards a communication ecosystem longer term. A big picture question on where the various applications go, the ones that are in the process of being acquired and the ones you're developing organically?

And then second question, to use the baseball analogy again, as you continue to take ad impressions out of the Facebook platform, wonder if we should think about where you get to longer term on a level of ad impressions that you think are the perfect mix for balancing engagement and monetization, and what inning we are in that process? Thanks.

<A – Mark Zuckerberg – Facebook, Inc.>: Sure. I think I can probably take both of those. So, in terms of building out a whole communication ecosystem, the way that we think about the new apps and products that we're building is that, people want to share all kinds of different content with all kinds of different audiences, right?

So, sometimes you want to have a one-on-one conversation or text or chat or voice call, up to having a small group conversation, to communicating – updating all your friends on something at once and sometimes there's really good public content, whether it's news or premium video or things like that. And at the intersection of each type of content and each audience, we think that there's a really compelling experience to be built.

And Facebook historically has focused on friends and public content. Now, with Messenger and WhatsApp, we're taking a couple of different approaches towards more private content as well. You're

going to see us do more things in more private content, I think. That's an ecosystem that's growing incredibly quickly. And also that speaks to why WhatsApp and Messenger are both growing independently, quickly, is because they actually serve pretty different use cases within private sharing and private content.

In terms of our investments, I think you want to look at it as, I kind of outlined this in my remarks, but I think it's important enough to say again. There are different stages of maturity for the different things that we're doing. So, the Facebook app by itself is the furthest along and more than 1 billion people use it and it's not only one of the most used apps, probably the most used app, it's also the core of our business.

Then, the second set of apps that we have are Messenger, Instagram and soon WhatsApp. And Messenger and Instagram are each now greater than 200 million active users. I think the WhatsApp folks independently announced, I think, it was yesterday that they just passed 500 million actives. So, these are apps that are now at a pretty big scale and the immediate priority is going to be getting them to 1 billion people, right? So, continuing to focus on that before focusing on monetization in the way that we have with the core Facebook app. So, that's kind of the second stage.

The third sets are the new Facebook Creative Labs apps that we're just getting started. So, things like Paper and a number of other things that we might announce at some point. Those are even further along than even Messenger, Instagram and WhatsApp, where it'll probably take a few years for those to even get to the stage that Instagram, Messenger and WhatsApp are at, which by themselves are probably a few years away from being big and important businesses for us. So, that's kind of the pipeline of things that we see and there's kind of a full ecosystem of different ways that people want to share with different people.

In terms of ads, going to your second question, I don't actually think we have a strategy to decrease ad impressions. I think what you're seeing and what David mentioned is, we have News Feed ads, which are higher quality and perform better, and then we have this legacy of right hand column ads on desktop, which generally are just shown higher volume and they perform less well per ad unit.

So, as we shift more towards News Feed, what you're seeing is the total raw number of impressions is decreasing, but actually the amount of value that we're delivering is increasing. So, that might continue to shift as we continue to shift towards mobile, but I think overall what we're trying to do is make it so that the individual load on a per-person basis isn't increasing at a dramatic rate; but instead, we're

driving most of the wins in user experience, advertiser performance and our own revenue through increasing the quality, primarily around News Feed ads. And we think that there's quite a lot to go there, as Sheryl said. We want to get to a state where the ad content is as good as the organic content and we see that we're getting pretty close to that in a few countries, but we want to get to that everywhere.

<Q – Peter Stabler – Wells Fargo Securities LLC>: Good afternoon. Thanks for taking my question. I wanted to ask a question about engagement. By one measure, DAU/MAU, it's at an all-time high. But no doubt you always have a body of last users. Wondering if you could share any color on what types of algorithm or product tweaks that you've made have yielded the most return or the greatest return in terms of re-engaging last users?

And then, secondly, just quickly, any color you could provide on your estimate of the overlap of Instagram and Facebook users, perhaps based on the linking of those accounts? Thank you very much.

<A – Mark Zuckerberg – Facebook, Inc.>: Unfortunately, I don't think I'm going to have much color on either of those. I mean, we're constantly doing things to make it so that people can share the content that they want, that they have the tools that they need, and that we're showing the most relevant content to people. That is always going to be the way that people will use the service, not through some kind of trick or something that we're using to re-engage people.

One stat that I think is pretty interesting is that you would expect naturally that as the community continues to grow, and we're getting into later and later adopters, that the percent of people who are using Facebook, who use it every day would decrease. And I've actually predicted for a long time that eventually that will flatten out, and I've thought it would decrease, but actually it continues to increase, much to our surprise and joy.

And now this quarter, I think we're at almost 63% of people who use Facebook in a month, will use it in a given day. And I think, another stat that I think is actually quite interesting is we track how many people use Facebook not just every day, so I mean one day out of – so what percent of our monthly folks used it today, but what percent of people used it 6 days out of 7 days of the week.

And that number, for the first time in the last quarter, passed 50%. So, that's pretty crazy, if you think about it, that you have this really big, engaged community and not only are almost 63% of people touching it in a given day and using the service, because it's really engaging content, but we've gone through a period where more than 50% of people have used it 6 days out of 7 days of the week, almost

every single day of a week. That just speaks to, I think, just the underlying kind of fundamental strength in the content and the work that we're doing to serve the best content to the best people.

<Q – Ben Schachter – Macquarie Capital (USA), Inc.>: First, David, let me add my congratulations on your success. And good luck with the future role. Mark, beyond games, do you see other categories of apps that are ramping? And do you need to see that or can games continue to be sort of the primary driver of app install and app engagement ads?

And then, separately, on Graph Search, do you see the potential for more partnerships for Graph Search in terms of additional data sets and distributions partners? Or is this more go-it-along?

And then, finally, maybe for Sheryl or David, can you just give us a sense on pricing trends on app install ads? Thanks.

<A – David Ebersman – Facebook, Inc.>: Yes. On app installs, I actually think we see more diversity in the customers of developers on mobile now than we saw on desktop with Canvas. So Canvas, the business, was almost entirely games. And now, we see that a lot of it is games, but a lot of it is other kinds of folks because everyone who's building apps on mobile needs installs and we have the number one products out there for delivering that. So, we see that happening and we feel pretty good about that.

<A – Sheryl Sandberg – Facebook, Inc.>: On pricing, we don't break out pricing by type of ad. But overall in the ecosystem, our prices are up. As Mark said, the effective price per ad shown is driven up by more ads in News Feed and that's because News Feed ads have significantly higher engagement and click-through rates.

<Q – Evan Wilson – Pacific Crest Securities LLC>: Hi. Thanks for the question. Just a small item, but it looks like the Asia engagement metric, the MAU, was down sequentially, slightly. Was there something there that impacted that in Q1 or was there something competitive there you think might be impacting that part of the business, like the big mobile messaging services? Thanks.

<A – David Ebersman – Facebook, Inc.>: I don't know that I would read anything into that yet. We haven't identified that as a trend that we're focused on at this point. The numbers do bounce around a little bit from quarter-to-quarter in various regions.

<Q – Anthony DiClemente – Nomura Securities International, Inc.>: Thanks. Congratulations, David. And best of luck in your new endeavors, as well. One question for David and one for Sheryl. David, I just wondered if you could talk about your mix of impressions in terms of brand versus direct response. And how has that changed this quarter versus prior quarters? And what else can be said about that split?

And then, secondly, for Sheryl, just wondered if you could give us a little more of an update on premium video ads. Specifically, I'm curious as to how those are sold. Are they sold on an impression basis or on a performance basis, or some hybrid of the two?

And then I know you don't give pricing by property, but just is there a way to think about the premium or premium multiple of price that premium video ads would go for as compared to core News Feed ads? Thanks for any color on that.

<A – David Ebersman – Facebook, Inc.>: Thanks, Anthony. I'm happy to take the first part of the question. I think in the first quarter, we delivered strong performance across all the advertiser segments that we focused on. And so, I think they're all growing nicely.

We don't have a perfect measure for what kind of demand is brand versus DR, per se, because someone doesn't have to input that into the system when they come in. We have lots of things we do to try and find surrogates for that and are happy to see that using some of that data we're seeing nice growth across the various segments.

<A – Sheryl Sandberg – Facebook, Inc.>: On video ads, video represents a really big opportunity really driven by consumer behavior. Smartphones are getting better and faster, and more people have phones that can provide a great video experience. So, you're seeing consumers do a lot more on video. There's also a lot more video going through News Feed that consumers are putting in and that creates an opportunity for us both on the consumer side and the ad side.

We have a current product in the market. It's a click to play video ad. It's a part of a page post. You can post a video. Those are sold both CPM and CPC and those are going really well and I think explains some of the growth we're seeing in our ads business.

We also have been in early conversations with some clients about what would be a CPM auto-play video ad, and in terms of the expectations for that we really want to see auto-play video ads be something that's pretty common in the News Feed experience based on consumer usage, before we push very hard in the ads business.

So, we remain long-term very excited. We do expect that product to demand a premium product. But as I said in my remarks, we won't see a material contribution from it this year.

<Q – Mark Mahaney – RBC Capital Markets LLC>: On those auto-play videos, as an average Facebook user, I've noticed them more and more in my News Feed, and I think they're really neat. I think all my friends love watching videos of my kids play basketball.

The question I'd have for you is what have you seen internally in terms of engagement. I assume that since I'm seeing more, other people are too, and that users like having them in. But is there any way you could quantify or maybe talk broadly about the impact that's having on usage? Thank you.

<A – Sheryl Sandberg – Facebook, Inc.>: Our goal is to make News Feed as engaging as possible, and I think if you look at the engagement we have on mobile, we're getting 20% of mobile time on Facebook in the U.S. and growing globally as well.

I think you'd see that, that engagement's great. I'm sure your friends love seeing your kids play basketball. I think they'd probably like to see more of those. And when and if we deliver a really great ad experience – and ads that you loved, something you're interested in, I think you're going to like that just as much. We look forward to the growth.

<Q – Justin Post – Merrill Lynch, Pierce, Fenner & Smith, Inc.>: Great. I have a couple questions. On the app installs, can you help us at all understand what – I know you gave us the number of total apps, but

maybe how that revenue as a percentage of total, how important it is to you? And then there's a lot of competitors targeting that market with new products. Maybe you could outline some of Facebook's competitive advantages in that market?

And then, one for Dave, we'll miss you. But, maybe you could talk a little bit about maybe some things Facebook could do to offset some of the dilution from the acquisitions, if anything? Thank you.

<A – Sheryl Sandberg – Facebook, Inc.>: On mobile app ads, we've seen really strong adoption and this is a very nascent, but growing market. I think people sometimes think that a lot of our mobile ad revenue is coming from this one type of ad and our mobile ad revenue is very broad-based. We know what you see in News Feed and what we see, are ads from brand marketers, direct response, SMBs and developers, and so we're pretty distributed there and pretty happy about that.

I think it's not surprising that other people are entering the space. It's obviously growing. It's one that performs well. I think we continue to be excited by the results we're seeing for marketers and developers, the results we're seeing from consumers. And we think the fact that we've already been investing and learning and growing puts us in a great position to continue to have a very strong product offering, even in a more competitive space.

<A – David Ebersman – Facebook, Inc.>: So, Justin, on the acquisition, the most important thing we'll do to really I'd say, justify the dilution will be to make those acquisition successful and over time ensure that the sort of unique assets that we're buying contribute to Facebook's success and to our cash flows over time. The business is obviously in really healthy shape right now, in terms of the cash it's generating. And we look forward at the moment to really continuing to prioritize where it's appropriate, investing that in the business to drive future growth.

<Q – Youssef Squali – Cantor Fitzgerald Securities>: Thank you very much. So first, David, can you talk a little bit about the ad load during the quarter? We saw noticeable increases here in the holidays and through Q1 versus that 5% or 6% you mentioned back on the Q3 call. Is the new ad load we are seeing sustainable, do you think, going forward?

And, second, maybe Mark or Sheryl, can you just talk a little bit about timing for monetization of Instagram? Are there any thresholds, either in terms of users, user engagement, whatnot, before you can ramp that advertising, or advertise on that platform? I think, David, you were talking earlier about maybe reaching 1 billion, but I think that was a general comment? Thanks.

<A – David Ebersman – Facebook, Inc.>: Yeah, thanks, Youssef. So, as Mark sort of alluded to earlier as it relates to ad load, what we're trying to do is optimize across multiple variables that really produce the best experience for people who used the network and help us to grow the business. And ad load is one of the variables that we look at. Of course, we also look at things like the size of the ads, the prominence of the ads, and of course the quality of the ads.

And what we're trying to do is to continually, really tweak all of those variables and then measure what impacts we're having on engagement, on feedback from people, on revenue, and trying to optimize, using that data and the changes that we've made.

And I think the story there's a really good one. Things continue to go very well. Obviously, in terms of revenue, which you see, but also in terms of engagement and in terms of feedback we get from people when we survey them, so we think we remain in a really very strong position in that way.

I actually would not validate the assertion that you gave, that the ad load increased dramatically in the timeframe you described, because that's not consistent in aggregate with our data. What I can say is that every person that uses Facebook has their own experience and the experience, including the ad experience, is personalized based on the other content we have available, based on how much they've engaged with ads we've shown in the past, et cetera.

So ideally, we'd like to personalize not just the organic content you see, but also your ad experience in a way that's really optimized for you and your interests.

<A – Sheryl Sandberg – Facebook, Inc.>: On Instagram, Instagram's a great product. I think that's why we see so much engagement from people who are using it and the growth passing 200 million. It's also a great advertising product and there's just tons of demand because the pictures themselves are so visually appealing and also there's so much consumer engagement.

We're in really early days. We've seen some great results. Just to mention one, Levi's is running an ad which is basically pictures of people wearing denim in really beautiful outdoor spaces. They targeted people 18 to 34 in the United States, reached over 7 million people, and importantly they drove a 24 point lift in ad recall which was three times the control group. So, I think that shows that just as people

engage with the consumer pictures on Instagram, they're going to engage with the right pictures for marketers.

That said, we're very focused on consumer growth and we move slowly and deliberately in monetization. So, we don't see the need or the urge to ramp this as quickly as we possibly could, but really want to grow it slowly, grow it deliberately and continue the growth on a consumer side and the great returns for marketers.

<Q – Colin Sebastian – Robert W. Baird & Co., Inc. (Broker)>: Thanks. Appreciate the chance to ask two questions. The first one is, I wonder if there's any way we can generalize or correlate around the growth in mobile monetization with the shift to 4G LTE, and whether this could be a driver, as well, of improving monetization internationally, as those higher-speed networks are deployed in new markets?

And then, secondly, regarding Nearby Friends, just wondering how you plan to tie that feature and data set into more of a commercialized local offering for businesses, whether that's geo targeting or other related services? Thank you.

<A – Mark Zuckerberg – Facebook, Inc.>: Well, a lot of what we're trying to do with Internet.org is make it so that everyone has the cellular networks that they need to be able to get on the Internet and access basic services, which we think are text-based communication services, whether it's things like social networks or messaging or e-mail or search, weather, stock prices, basic stuff like that, that people use on a day-to-day basis, but don't require a huge amount of data.

We're pretty happy with the early progress that we've made. We have a multi-year initiative to work with operators around the world to roll out a program where folks can have free basic services.

And as I mentioned before, a lot of the initial partnerships were in the Philippines and Paraguay. And what we're really pleased with, even just a few months of work we were able to help almost 3 million people get access to data for the first time. So, there's no doubt that going from having no access to data to having some access is a huge jump in terms of the activity and business that we see that's available from people.

Moving towards things like LTE later on in the funnel will be helpful as we move towards richer types of content like higher resolution photos and videos, so that will be important, especially as the mix of content that people share moves towards richer media, but we're really focused on both and we have a huge investment as well in the Internet.org, just making sure that everyone in the world gets connected.

<A – Sheryl Sandberg – Facebook, Inc.>: On Nearby Friends, it's a great new feature, it's an optional feature we just rolled out last week. I don't know if people had a chance to try it yet, but, rolling out slowly but it's a great product experience, one we're excited to be able to offer. We use information like this to enhance all the services we provide, make things more relevant, including relevant ads.

<Q – Brian Wieser – Pivotal Research Group LLC>: Oh, hi. Thanks for taking the question. First of all, I was wondering, with regard to the WhatsApp acquisition, I was wondering if you could update us on the status, if the current situation with Russia poses any issues given the development team's based there?

And then, separately, I was wondering if you could talk about Nielsen and the use of OCR with respect to advertisers' interest in using OCR tools. Do you find that, that's making a difference at the present time in terms of brands spending money with you in general?

<A – Sheryl Sandberg – Facebook, Inc.>: On the first, their development team is located in Mountain View, not in Russia...

<A – Mark Zuckerberg – Facebook, Inc.>: They're doing extremely well.

<A – Sheryl Sandberg – Facebook, Inc.>: Yeah. They're doing really well.

<A – Mark Zuckerberg – Facebook, Inc.>: The deal hasn't closed. So, we don't have anything to share, but I'll just point you to a blog post that Jan wrote, I think it was yesterday, announcing that they just helped connect 0.5 billion monthly actives. They're growing very quickly. So, I think that's up from about 460 million monthlies just a couple of months ago when we announced the deal with them in the first place.

And I think that Jan specifically called out a few countries, including Russia and Brazil and I think India as some of the fastest growing markets for WhatsApp. So, I'd just direct you to that statement and you should go read that for more information on how they're doing and we'll update you more when the deal closes.

<A – Sheryl Sandberg – Facebook, Inc.>: On Nielsen OCR, anything that helps advertisers measure their spend is really important. I've talked on the call a bunch about how measuring online and in-store sales really matters. It also matters to marketers to be able to measure their spend compared to other investments they can make.

And what OCR has done, it's given advertisers and marketers comparability between TV and digital and our spend. I think in those comparisons, we do very well. And I think that is part of the shift that's happening. And it's part of why we see growing interest from clients.

<Q – Ross Sandler – Deutsche Bank Securities, Inc.>: Good afternoon. Can you guys hear me now? Okay. Sorry. So, just two quick questions. Facebook's on pace to represent around 20% of global display advertising or non-search advertising in 2014. Do you view that as your addressable market? And, if so, what do you see as the potential market share you guys can capture relative to the – I think, Sheryl, you said it's 23% mobile consumption, ex-China, globally today.

And then the second question is, there's been some press recently that Facebook is looking at building peer-to-peer money transfer services. Is that a market that you view as an opportunity? And would that fit into Messenger or potentially a standalone app? Thanks.

<A – Sheryl Sandberg – Facebook, Inc.>: We've had a payments business for a while and we continue to have one and nothing new to announce there.

On the first question, I think our addressable market is much bigger than digital, and you see that in the trends. The big trend that's happening is the shift from consumer time. So, last year was the very first time those lines crossed and consumers spent more time in digital, which is mobile and desktop than they did on TV. That continues to grow, so where we are right now is the average U.S. consumer, as an example, spends 4.5 hours per day on TV, but 5.75 hours on digital, and that's largely being driven by mobile.

That means that as consumer time and attention shifts, we think ad budgets shift as well, particularly, if you have good mobile ad products and you can measure results. So, we definitely believe there will be and continues to be a shift happening.

I talked about a print shift happening with the example of Sport Chek in Canada, but we see this across the board that marketers are looking for the highest ROI they can find, and they should be comparing us and everyone else across and they do that not just across digital but across print, across radio, across TV, across any other vehicle they can.

I think our investments in measurement really pay off here. We say to our clients all around the world, we want to earn your business, because we want to be the best dollar and the best minute you spend, because both their dollars and their time are so valuable. And we want them to compare us to the other investments they could make to see who can drive the most value to their bottom line, and that's what we're focused on, and that goes way beyond digital.

<A – Deborah Crawford – Facebook, Inc.>: I think we have time for one last question.

<Q – John Blackledge – Cowen & Co. LLC>: Great. Thanks for the questions. Just wondered if you could discuss how Facebook's potential mobile ad network would provide additional value to advertisers than other existing mobile ad networks?

And then just a second question for David. I don't know if you could help quantify what meaningfully lower year-over-year ad revenue growth is, or just give us a sense of how to think about it for modeling purposes? Thank you.

<A – Sheryl Sandberg – Facebook, Inc.>: On the ad network, we are in very early testing for mobile ad network. We do see a big opportunity here. We think because we are people-based, we have an opportunity both to provide greater reach for marketers and developers who are working with Facebook across other platforms, but also improve the relevance of the ads people see both on and off Facebook. And I think that has been our core advantage and will continue to be. That said, it's really early days, and we're in the early testing phase.

<A – David Ebersman – Facebook, Inc.>: Yeah, so John, obviously the Q1 ad revenue growth here was 82% which is fantastic and a real tribute to the team and the platform. One of the things that contributed to that growth rate is the ramp up of News Feed ads that in Q1 of last year we were still really early in that part of the journey and so the comparison between the state of News Feed ads in the Q1 we're reporting now and a year ago is meaningfully different.

As you'll remember from last year, News Feed ads really ramped up in the second quarter and revenue growth ramped up as well, so that's just going to impact the comparisons in the subsequent quarters of the year.

Having said that, there's lots of things that we're focused on that'll continue to drive our ad revenue growth, including more users and critically more marketer demand, so bringing more marketers into the system, improving our products and tools to increase their returns and their ability to measure those returns, and generally improving the quality and relevance and value of the ads. So, those are the things that we'll stay focused on.

Deborah Crawford, Director-Investor Relations

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