Facebook 3Q 2014 Earnings Call Transcript

October 28, 2014 – 2:00pm PT

Deborah Crawford, Investor Relations

Thank you. Good afternoon and welcome to Facebook's third quarter earnings conference call.

Joining me today to talk about our results are Mark Zuckerberg, CEO, Sheryl Sandberg, COO and Dave Wehner, CFO.

Before we get started, I would like to take this opportunity to remind you that our remarks today will include forward-looking statements, 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 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 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 has been a good quarter for Facebook and we've achieved strong results across the board. We've continued to grow our community in both size and engagement, with 1.35 billion people now using Facebook each month and 64% using Facebook daily. On mobile, 1.12 billion people now use Facebook each month, and 703 million people each day – nearly 40% growth from this time last year.

Looking at our business, we continue to do well. This quarter, total revenue reached $3.2 billion and advertising revenue grew 64% year-over-year. Mobile now accounts for 66% of our advertising revenue.

These results show that Facebook is getting stronger every day as a community, a partner for developers and marketers, and as a business. One thing that I'm particularly pleased about is that while we're investing aggressively and making progress towards our big long-term goals, we also continue to execute well against our near-term priorities.

On previous calls you've heard me talk about our big company goals: of connecting everyone, understanding the world and building the next generation of platforms. These goals are important for us and are the foundation of our strategy for the next decade. But achieving these will involve many different efforts and steps along the way, some that will be achieved rapidly and others that will take longer.

With that in mind, I'd like to run through our progress this quarter on the different efforts that we expect to deliver a lot of impact over the next three, five and ten years.

Let's begin with our three year goals.

Over the next three years, our main goals are around continuing to grow and serve our existing communities and businesses, and help them reach their full potential.

When you look at the size and engagement of our community, our progress remains very strong. 864 million people use Facebook every day, and across our core products we continue to see huge engagement. For example, around 700 million people now use Facebook Groups every month. Achieving this scale shows that we're delivering experiences for the way that people want to share and connect.

Another example is our progress on public content. Last quarter, I talked about how we're working to connect people around important public moments and personalities on Facebook. This quarter, we've continued to build on our results and there are now more than 1 billion interactions every week between public figures and their fans on Facebook.

The investments we've made in video have also played a big part here. This quarter we announced a new milestone for video on Facebook, achieving 1 billion daily views of native videos. During this summer's Ice Bucket Challenge, there were more than 10 billion video views by 440 million people, which is a good sign of how far our video product has come.

Instagram has also made a lot of progress this quarter. In August, the Instagram team launched Hyperlapse, a standalone app for time lapse videos on iOS. The team has also invested heavily in improving the speed and performance of Instagram on Android. This has helped drive Instagram's strong international growth, which in some countries has achieved more than 100% year-over-year growth. Globally, people using it now spend around 21 minutes a day on average using the app. This is a strong figure compared to the industry, and a good sign that Instagram's strategy is on the right path.

Our other big focus over the next three years is to continue serving businesses well and creating a lot of value for marketers.

As our results show, our approach here is working. We continue delivering value for businesses as we work to improve the quality of ads in News Feed by reducing low-quality content and improving our targeting to show more timely and relevant content.

We've also made some big advances in our ad tech, most importantly, the launch of our new Atlas platform. Atlas offers marketers a lot of new capabilities to help reach people across devices, platforms and publishers, as well as improving measurement of online campaigns. We're very excited for the future of Atlas, and Sheryl will talk more about this in a moment.

Next, let's talk about our strategy over the next five years.

Over the next five years our goals are around taking our next generation of services – Instagram, Messenger, WhatsApp and search – and helping them connect billions of people and become important businesses in their own right.

One big priority for us here is messaging, and continuing to build and grow Messenger and now WhatsApp as well, as great services.

This quarter we made an important change to our mobile messaging efforts by transitioning people to Messenger on iOS, Android and Windows Phone. We believe this change allows us to offer a better and faster messaging experience on mobile, and our data shows that people who use Messenger usually respond about 20% faster.

This month we also completed our acquisition of WhatsApp. I'm excited to be working with the team and for Jan to join the board. WhatsApp continues to be on a path to connect more than a billion people around the world, and we're going to be working to accelerate their efforts here.

Another key part of our strategy is helping developers to build more great social experiences on our platform. Over the next few years our goal is to make Facebook the cross-platform platform that allows developers to build, grow and monetize their apps across every major mobile platform.

We've continued to make good progress here. This quarter we opened our Audience Network to all developers and publishers, allowing over 1.5 million advertisers on Facebook to extend their campaigns across mobile and for developers to begin monetizing their apps. We're also excited by the continued adoption of App Links, our deep-linking technology for mobile apps. App Links is now used by hundreds of apps across iOS, Android and Windows Phone, and in just the past six months, developers have created links to more than 3 billion individual destinations in these apps.

Now let's talk about how we're approaching our goals over the next ten years. Over the next ten years our focus is on driving the fundamental changes in the world that we need to achieve our mission – connecting the whole world, understanding the world with big leaps in AI, and developing the next generation of platforms especially in computing.

This was a very busy period for our efforts with Internet.org. In July we worked with Airtel to launch the Internet.org app in Zambia. This provides free data access to a set of basic internet services for health, education, employment and communication. The results from this are very encouraging, and we've already heard a lot of amazing stories about how people are using the internet to add value to their lives. We hope to bring the Internet.org app to many more countries soon.

Over the last few months I've also traveled to several countries and met with policy-makers, industry leaders and people in communities that are coming online for the first time. Increasingly, industry and governments are seeing expanding internet access as one of their core priorities. This is a positive development for our work with Internet.org and our long-term goal of connecting everyone in the world.

Finally, let's talk for a minute about our progress on Oculus.

As I've said before, with Oculus we're making a long-term bet on the future of computing. Every 10-15 years a new major computing platform arrives, and we think virtual and augmented reality are important parts of this upcoming next platform.

This quarter Oculus continued to make progress towards this vision. In September, the first Oculus developer conference took place where we announced a new prototype VR headset on the path to the consumer version of the Rift. We continue to see a lot of excitement in the developer community, and we've now shipped more than 100,000 Rift developer kits to over 130 countries. It's still early days for Oculus, but we're encouraged to see the variety of apps and games being developed for the platform.

Internet.org and Oculus are just two of the huge opportunities ahead. Our efforts here will take longer to achieve their full impact, but we're going to continue preparing for the future by investing aggressively.

So that's how we're approaching our strategy over the next 3, 5 and 10 years while focusing on our big goals of connecting everyone, understanding the world and building the next generation of platforms.

This has been a quarter with strong results.

I want to thank the entire Facebook community, our employees, partners and stockholders for their continued support. Because of your contributions, Facebook continues to grow in strength and to create greater value in the world for people, partners and businesses. We have a long journey ahead of us, but we're on the right path and I'm excited about the progress that we're making.

Thanks, and now here's Sheryl.

Sheryl Sandberg, COO

Thanks Mark and hi everyone.

We had another strong quarter and we're continuing to execute well on our priorities: capitalizing on the shift to mobile, growing the number of Facebook marketers, and building products to make our ads more relevant.

Our growth this quarter was again broad-based – we saw strong performance around the world as well as across verticals and our four marketer segments –brand, direct marketers, developers, and small and medium businesses.

I'd like to briefly highlight some of our progress on the product front and then focus on important new investments we're making in ad tech.

One of our main ad product goals is to make ads more relevant. Just like content in NewsFeed, when ads are more relevant they provide a better experience for people using Facebook – and a better return for marketers. One of the best ways to improve relevance is to help advertisers reach the right audience with their messages. Facebook's age and gender targeting is 45% more accurate than the digital industry average. Working with Facebook, advertisers can also target based on people's interests.

In addition, we are continuing to build out Custom Audiences – which enable marketers to use their own data to segment current and prospective customers. We are pleased with the response from clients and we are focused on driving deeper penetration with both existing and new clients. We also offer Lookalike Audiences, which help marketers find new potential customers who are similar to their current customers.

To share one recent example, earlier this year global financial services company MetLife wanted to find new customers for life insurance policies. Working with its agency Merkle, they used Lookalike Audiences to find more people like their existing customers. MetLife ran ads that led people to its "Get a Quote" website page. Over the six-month campaign, the leads that came from Facebook resulted in new policies at a 2.4X higher rate than MetLife's next best-performing channel – and at half the cost of display ads.

We're also making steady progress with newer ads initiatives. Throughout this quarter, we continued to enable autoplay for more video ads. We're also continuing to roll out ads on Instagram. We think there's good opportunity with both video and Instagram ads but we're going to remain deliberate and slow in our approach to scaling both businesses.

We are also making longer term investments that we believe will be important for Facebook and the ad industry. In Q3, we re-launched Atlas, closed our acquisition of LiveRail, and rolled out our Audience Network, so I want to spend a few minutes discussing our longer-term ad tech strategy.

We're investing in ad tech for a simple reason: consumers are shifting quickly to mobile and the advertising industry is not keeping up. 2013 was the first year the average American adult spent more time on digital media than watching TV and that gap has continued to grow. Today, the average adult in the US spends nearly 25% of their media time on mobile, but advertisers spend only about 11% of their budgets there.

One of the main reasons budgets haven't moved as quickly as consumers is that advertisers haven't yet had an effective way to serve ads and measure their returns on mobile. Current solutions work well for one person with one device, especially a PC, and for sales that happen online. But today, people often have multiple devices and still make many purchases in physical stores. Nielsen OCR data shows that the digital industry is less than 60% accurate in demographic targeting of ads, which means that 4 in 10 people are seeing the wrong ads. Similarly, marketers are not confident that they can measure mobile ad performance. Many of the most commonly-used measurement systems overemphasize the value of the last click. This does not make sense given that studies of Facebook campaigns show that over 90% of ad driven in-store sales come from people who saw an ad but didn't click on it.

It's clear that marketers and publishers need better tools for the mobile world. This is an industry problem that we believe we are well-placed to solve. Our relaunch of Atlas last month during AdWeek was an important early step that builds on the advancements in measurement we have made over the past two years. The new Atlas is an ad-serving and measurement platform we completely rebuilt. By using Facebook data, Atlas can deliver highly relevant ads, regardless of device. Atlas is also able to provide accurate measurement by connecting online marketing to in-store sales. Importantly, Atlas does all of this in a privacy protective way; neither Atlas nor Facebook tells marketers who you are.

At Ad Week we had productive conversations about Atlas with many marketers and agencies. We are pleased with their interest.

We're also investing in additional pieces of our ad tech platform. Our Audience Network improves the relevance of ads inside mobile apps. LiveRail provides tools for publishers to enable personalized marketing at scale via their apps and websites. We believe LiveRail can build on their success in desktop video to become a great solution for mobile publishers.

I want to emphasize that the investments we're making in Ad Tech are long-term. These are large and strategic investments. The payoffs will take time, but we think they provide a necessary foundation for the advertising industry to make the shift to mobile and for Facebook's long-term growth. We recognize that by staffing engineers in these strategic ad-tech areas, we forgo shorter-term product improvements which would generate revenue more quickly. We believe these are the right decisions.

As we look toward 2015 we're going to stay focused on the areas I've talked about today: capitalizing on the shift to mobile, growing the number of Facebook marketers, and building products that make ads more relevant. Our investments in Ad Tech will be an increasingly important part of all of these efforts.

Thanks everyone, and now here's Dave.

Dave Wehner, CFO

Thanks Sheryl and good afternoon everyone.

Q3 was a solid quarter across the board. We had strong revenue growth, generated $766 million in free cash flow and continued to make investments to position us for long-term growth.

864 million people used Facebook on an average day in September, up 136 million from last year. This represents 64% of the 1.35 billion people that used Facebook during the month of September.

Mobile continues to be the core driver of our growth. Over 1.1 billion people used Facebook on mobile during the month of September, up 250 million from last year. In addition, we have hundreds of millions of people on mobile using Instagram, Messenger and WhatsApp.

Turning now to the financials.

Total revenue in Q3 was $3.2 billion, up 59% compared to last year or 58% on a constant currency basis. Total ad revenue was nearly $3 billion, up 64% compared to last year or 63% on a constant currency basis.

Ad revenue growth was strong around the world, with each of our four reported geographic regions growing by 50% or more compared to last year.

Mobile ad revenue was approximately $1.9 billion or 66% of ad revenue, compared to approximately $881 million or 49% of ad revenue last year. Desktop ad revenue was up 11% compared to last year but was flat sequentially.

In Q3, the average price per ad increased 274% compared to last year, while total ad impressions declined 56%. The increase in the average effective price per ad was driven primarily by the redesign of our right hand column ads, which resulted in larger, more engaging ads that delivered more value to marketers and thus had higher effective prices. These right-hand column ads were also fewer in number, which drove the decrease of impressions in the quarter.

To a lesser degree the shift of usage to mobile, where we don't have right-hand column ads, also continued to contribute to the reported price-volume trends. The price/volume trends were largely consistent across our four geographic regions.

Total Payments and Other Fees revenue was $246 million, up 13% vs. last year. However, Payments volume from Games, which represents the substantial majority of our Payments and Other Fees revenue, declined 2% compared to last year, notably for the first time, and we expect this trend to continue as desktop usage continues to decline.

Turning now to expenses.

Note that beginning in Q3, our definition of non-GAAP also excludes the amortization of intangible assets and historical non-GAAP measures discussed today have been updated accordingly. You can find our GAAP to non-GAAP reconciliations on page 10 of our Q3 press release.

Our Q3 total GAAP expenses were $1.8 billion, up 41% from last year, and non-GAAP expenses were $1.4 billion, up 39% from last year.

Cost of revenue grew 11% on a GAAP basis and 7% on a Non-GAAP basis. We incurred expenses in the third quarter of 2013 related to the transition out of certain leased datacenters. This mitigated our Cost of Revenue growth rate in Q3'2014 as it has done in the last two quarters.

Operating expenses, excluding cost of revenue, were up 61% on a GAAP basis and 72% on a Non-GAAP basis vs. last year, primarily due to an increase in headcount-related costs.

We ended Q3 with 8,348 employees, up 44% from last year. Of the nearly 1,200 people we added sequentially about a quarter were from acquisitions. Organic growth was high as the third quarter is our seasonally strongest new hire start period. Overall, we are pleased with our ability to attract and retain talented people who enable us to make strong progress on our mission.

Q3 operating income was $1.4 billion, representing a 44% operating margin up from 37% last year, and our non-GAAP operating income was $1.8 billion, representing a 57% operating margin up from 51% last year.

Interest and other income and expense was a net expense of $61M in the quarter vs. a net expense of $10M last year. This increase in expense was primarily due to foreign exchange losses resulting from the periodic re-measurement of our foreign currency balances and largely resulted from the substantial reduction in the value of the euro relative to the dollar experienced from the beginning to the end of the quarter.

Our GAAP and non-GAAP tax rates for the quarter were 40% and 35%, respectively.

GAAP net income was $806 million or $0.30 per share and our non-GAAP net income was $1.1 billion or $0.43 per share.

In Q3, we spent $482 million on CapEx and generated $766 million of free cash flow.

We ended Q3 with approximately $14.3 billion in cash and investments. This does not reflect the approximately $4.6 billion cash payment that we made in conjunction with the WhatsApp acquisition, which closed earlier this month.

Turning now to the outlook.

I'd like to start by noting that my forward-looking statements include the impact of both Oculus and WhatsApp. In addition, as part of the WhatsApp deal, we agreed to file a registration statement to register for re-sale the approximately 178 million shares issued to the WhatsApp stockholders. Nearly all of those shares will be fully registered and tradable during open trading windows in Q4 2014 and Q1 2015 under the registration statement we plan to file later this week.

In light of our recent acquisitions and our plans to file this registration statement, we are providing some additional guidance this quarter including a more specific outlook on the current quarter revenue and a preliminary view on 2015 expenses. This is a more detailed outlook than we have historically provided or plan to provide on future earnings calls.

Let me start with 2014 expenses. We expect that our full-year 2014 total GAAP expenses, including cost of revenue, stock compensation, and the amortization of intangibles, will grow approximately 45% to

50% vs. the full year 2013. This increase from our prior range of 30-35% is primarily due to the impact of the WhatsApp acquisition on stock-based compensation charges in the fourth quarter.

We continue to expect that our full year 2014 total non-GAAP expenses, including cost of revenue but excluding stock compensation and amortization of intangibles, will likely grow in the neighborhood of 30% to 35% vs. the full year 2013.

Turning now to revenue. We expect that total revenue in the fourth quarter will grow in the range of 40% to 47% vs. the same quarter of last year. Please keep in mind that Q4 of 2013 was our first holiday season with the roll out of News Feed ads at scale, which makes for a more difficult comparison.

For taxes, we anticipate the GAAP tax rate in the fourth quarter will be approximately 45% to 50%, which is higher than the current rate due to large non-deductible stock-based compensation charges related to the closing of the WhatsApp transaction. Our Q4 non-GAAP tax rate should be similar to our Q3 rate.

For share count, we expect that our fourth quarter fully-diluted share count will be approximately 2.8 billion shares taking into account the shares that we issued upon the closing of the WhatsApp deal.

We expect that our 2014 CapEx will be at the low end of our prior $2-2.5B capex guidance.

And lastly, while it is relatively early, I wanted to provide some preliminary color on our expense outlook for 2015. As Mark discussed in his remarks, we believe that we have very substantial growth opportunities in front of us, and we plan to invest aggressively to capitalize on those opportunities. As such, we plan on 2015 being a significant investment year.

Our current expectation is that total costs and expenses on a GAAP basis, inclusive of stock-based compensation charges related to the recent transactions, are likely to increase 55% to75% compared to the full-year 2014. On a non-GAAP basis, we expect total costs to increase approximately 50% to 70% compared to 2014. Tax rates for 2015 should be similar to our fourth quarter rates on both a GAAP and non-GAAP basis.

In summary, we're very pleased with the growth of our network, the great momentum we continue to see in our ads business, and the significant investments we're making to drive near-term and long-term growth. We have large opportunities ahead of us, and we're focused on capitalizing on those to achieve our mission and drive long-term shareholder value.

With that, operator, let's open up the call for questions.

QUESTION AND ANSWER

Douglas Anmuth - JPMorgan - Analyst

Thanks for taking the questions. Dave, just a follow-up on the comments that you just made on the outlook on expenses for '15, could you help us understand more on the non-GAAP expenses, the 50% to 70% and where we should be thinking about the incremental dollars being spent there, primarily?

And then secondly, can you talk, Sheryl, perhaps about what you're seeing in terms of branded advertising, whether you're seeing more of an inflection there as more bigger brands, CPG companies, auto OEMs are coming on board and how you're positioned there for the holidays? Thanks

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Dave Wehner - Facebook, Inc. - CFO

Sure, Doug. I'll take the first part. We're investing where we think there's a great opportunity for long-term growth. That's going to be really investing and continuing to grow the talent base at the Company, so we're investing in the people, and that's a big part of it. And we're also investing on the product side to grow the existing products, but also to invest in new areas like Oculus, WhatsApp, and then the ad-tech initiatives that Sheryl was talking about.

From an infrastructure side, we plan to invest to support the growth of the core business. That includes things like video; it also includes things like our global growth efforts with Internet.org, so we're really investing across the board on that. And in summary, we've got -- the strength of the business today is really putting us in a strong position to invest smartly for the future, and we're doing that.

Sheryl Sandberg - Facebook, Inc. - COO

On brands, we're seeing very strong growth among our brand marketer segment. We're really excited about the engagement we're having right now with brand marketers and agencies. We think we're the first technology platform to offer the ability to do creativity and storytelling at scale in a personal way, and we talk a lot with our clients and partners about personal marketing at scale.

You'll find with our clients that they're in different parts of the adoption curve. We have clients who are very early on, and they don't want any products or think about their ongoing messages about including Facebook. And there are some for whom we're not your core, and we're working on that.

With all of this, we know we need to go client by client, and we're especially focused on measurement, because measurement is so key for this segment. A lot of the products the brand marketers are selling are bought in-store, and so showing that online and mobile ads lead to in-store purchases is a hugely important part of our strategy going forward, as I talked about, and video is really exciting as well.

When you think about the holiday season, Q4 is a really important time for our clients, and that makes it a really important time for us. And I think people are increasingly recognizing that mobile is important; 65% of people use their phones while they are out shopping and people are recognizing that opportunity.

From an earnings perspective, last Q4 was a great quarter, both because our business was growing but also because that was when we rolled out ads fully into news feed. And so, it's worth keeping that in mind when you think about how you think about our business going forward.

Ben Schachter - Macquarie Research - Analyst

A few questions: David, there was no mention of a '15 revenue range, but I was wondering if you could give us any thoughts on how much margins should compresses in '15 versus '14?

Then, a couple for Mark. Mark, now that you've spent more time with the Oculus team, can you update us on how your plans for Oculus have evolved since you first tried the device on? And then you mentioned it when you talked about your 10-year outlook. Does that mean we shouldn't expect any consumer Oculus product in the next one or two years?

And then similarly, on search, you mentioned that in your five-year plan, so does that mean we shouldn't expect anything on search for the next five years? Thanks.

Dave Wehner - Facebook, Inc. - CFO

We're not really giving any guidance on 2015 revenue. We gave the growth range that we are expecting on Q4, which was 40% to 47% and that's down from 59% in Q3. But we're not providing any specific guidance on 2015 revenue.

Sort of outlined the expense growth that we expect because of the substantial investments that we're making, also driven off some of the acquisitions that we've made. Hope that that is helpful for everybody.

Mark Zuckerberg - Facebook, Inc. - CEO

Sure, and on your questions around Oculus and search and some of the other things that we're doing, the strategy for Oculus is to help accelerate their growth. They have these two products around Rift on PC, and they are supporting Gear VR and the Samsung team in building the mobile version. And I'm really excited about both of them.

I don't think that this is going to be -- it needs to reach a very large scale, 50 million units to 100 million units before it will really be a very meaningful thing as a computing platform. So I do think it's going to take a bunch of years to get there.

I don't know, it's hard to predict exactly, but I don't think it's going to get to 50 million or 100 million units in the next few years. That will take a few cycles of the device to get there, and that's what I'm talking about.

When you get to that scale, that's when it starts to be interesting as a business in terms of developing out the ecosystems. So when I'm talking about that as a 10-year thing, it's building the first set of devices and building the audience and the ecosystem around that until it eventually becomes a business.

Some of the things like search and some of these other products, this may sound a little ridiculous to say, but for us, products don't really get that interesting to turn into businesses until they have about 1 billion people using them. So for Facebook, we're there with news feed, and that's why in the near term our priority is really around continuing to grow and serve that community and making sure that the business around news feed and those mobile ads fully reach their potential.

Over a five-year time frame, we have a number of services which we think are well on their way to reaching 1 billion people: WhatsApp Instagram, and search are a number of them. And once we get to that scale, then we think that they will start to become meaningful businesses in their own right. And I think that the right way to think about that, as I've tried to say repeatedly on these calls, is not that we're going to try to monetize them very aggressively in the next year or two, because I really think for each of those categories, the right strategy is to first focus on connecting 1 billion plus people in reaching the full potential before very aggressively turning them into businesses.

But I do think that this is such a big opportunity ahead of us. I can't think of that many other companies or products that have multiple lines of products that are on track to reach and connect 1 billion people that have a clear path at how we can turn them into a business. So that will be a very fun and exciting challenge to work on over the next five years.

Heather Bellini - Goldman Sachs - Analyst

Great, thank you for taking the question. I just had two: one for Sheryl. If you could just talk about the comments you made about giving advertisers a better feel for attribution, I was wondering, what percent of attribution do you find today is given to the left-click and how overstated do you think that is right now?

And then just a follow-up question for Dave,, given your total expense range of 50% to 70% wider than what we've seen in the past, I'm wondering how should we think about the low-end versus the high-end? Under what scenarios are you thinking about those ranges? Thank you.

Sheryl Sandberg - Facebook, Inc. - COO

Heather, to your first question, we think measurement is really -- really needs to evolve for the world we're in today in many ways. One of those is overemphasizing the last click. And the percentages by which that's done really vary, but we think substantially across the industry are overemphasized.

But there are also other problems: the current measurement systems don't work on mobile, because they are largely cookie-based. They are not accurate; we think they are only 59% accurate in even the most basic demographic targeting. They don't go off-line to online.

They really work well for one person with one device, usually a PC, that's making online purchases. The world we live in today, I bet you everyone on this phone call has multiple devices, and people look at ads online and then purchase off-line, as well as deserve more relevant ads and better targeting.

So as we relaunch Atlas, as we think about investing in ad tech, we're looking to solve all these problems and we think our relaunch is the first step in doing that.

Dave Wehner - Facebook, Inc. - CFO

Heather, yes, on the range of guidance, it is wider. It is obviously an early view into 2015, and so consequently, it is a wide range. It's giving you the best view that we have on it at this time, and we'll be updating that in the future, on terms of the expense guidance range as we have in the past on an annual basis each quarter.

The big drivers will be things like the pace of hiring and the success we have in building the great teams that we want to build at Facebook, but we will be updating that on an ongoing basis.

Eric Sheridan - UBS - Analyst

Great, thanks for taking the questions. Mark, you made comments about public content and the way that's evolved on Facebook. Would love to get deeper thoughts there about the way you think content distribution develops on Facebook over the longer term.

And then one for Sheryl. The ad-tech acquisitions and moves you've made over the last year to two, wanted to know when you think we should be looking at ad tech being fully deployed in the marketplace, and what sort of returns that might generate for Facebook? Thanks.

Mark Zuckerberg - Facebook, Inc. - CEO

Sure, well, I can start off by talking about public content. So historically, a lot of people use Facebook for sharing moments in their lives with their friends and smaller sets of people, right? So we have Messenger for one-to-one communication; groups that just reach 700 million monthly actives this quarter; and then news feed, which is kind of the primary thing that people are using to share with all of their friends at once.

One of the big things that we, looking at this ecosystem thought that there was a big opportunity in was public content, where it's content that people are either comfortable sharing with everyone or want to consume that is public and shared with everyone. So we're looking at a few different areas.

Video is a very big priority. News is a very big priority, because a lot of people want to share that on Facebook already, and enabling public figures, whether they are celebrities or athletes or actors or politicians or leaders in different kind of communities, to get on Facebook and use the platform to distribute the content that they want. So those are the three areas that we're -- that you'll probably see us investing the most in over the next year or so. And we're making a lot of progress. I shared some of the stats before, but we're very proud of what we're doing, and we will have more to report soon.

Sheryl Sandberg - Facebook, Inc. - COO

On ad tech, I think we're in the middle of what is a very fundamental shift from marketing that is cookie-based on a PC, one desktop, to people-based marketing on multiple devices, to marketing that is primarily for online sales, to marketing that affects both online and off-line sales on mobile. So I think we're right now in a pretty big shift and we're not close to fully deployed there. We have a lot of pieces to do.

Our Atlas relaunch is new. We're first growing our client base, and we're pleased with our progress there. And we're putting these other pieces in place on Audience Network or LiveRail. So I think we're pretty far from being fully deployed on even this big shift.

But I think in our industry, nothing is ever fully deployed. That as soon as we catch up here, there's going to be another movement and something else that happens that we have to react to and build the technology for. And so, we remain -- we're a long-term Company, run by a founder with a very long-run vision, and we want to keep our eyes ahead on these changes in technology and keep deploying against them.

Ross Sandler - Deutsche Bank - Analyst

Thanks, I just had two questions, one for Mark and then a quick one for Dave. Mark, I don't think I heard you mention payments in the 3-, 5-, 10-year plan. There's been some speculation of payment offerings within Messenger. Can you give us a sense at a high level of what you'd envision Facebook potentially doing in the payment space longer-term across merchant payments, consumer products, like savings and lending or peer to peer?

And then, how do you see social interaction tied in with payments evolving? Does Messenger make payments better than what's out there on the market?

And then Dave, just a clarification. So the high-end of the 4Q revenue guidance assumes a pretty sharp drop-off, even normalizing for some extra currency hit. So are you seeing anything out there that makes you concerned about pacing into the quarter? Or is that largely business as usual, and it's just a tougher law of large numbers type situation? Thanks

Mark Zuckerberg - Facebook, Inc. - CEO

I'll start on payments. So payments is an important part of the online business ecosystem. But we've traditionally thought about this as something that we're going to partner with other companies on to enable great solutions, rather than trying to compete and do it as a business ourselves.

And the reason why we've taken this approach is it's very important for all online businesses and our customers and partners that there's a good online payment system. People run ads to get customers and sell products, and at the end of that conversion, if there's a good payment system that is smooth, then people will buy more things, which ultimately makes the ads and all of the whole online flow more valuable for those partners, and therefore, more revenue and profit for our business as well.

We view the ad part of the business as a more efficient part of the business than payments itself. Payments tends to be fixed fee, whereas in ads because of the option model, there's really good price discrimination built in, right? So a partner or business who is willing to pay us 30% of their revenue can bid that, and someone who's willing to only pay 5% of their revenue can bid that. And the auction model inherently takes care of that.

We think that focusing on the ads part is going to be the more effective thing for us to do. But we realize that it's important for the ad system over time and for all of our partners for there to be a payment system, which is why we're excited about partnering with credit card companies and partnering with PayPal and all of the different folks in online payments to make their solutions as good as possible as well.

Dave Wehner - Facebook, Inc. - CFO

Our view now is that Q4 revenue will come in that 40% to 47% year-over-year growth range. As I mentioned, Q4 of '13 was an absolutely fantastic quarter for us. We had news feed rolled out at scale. It was our first $1-billion mobile quarter. So we're comping against a really outstanding quarter last year; that's really the largest issue.

You asked about currency; we did see the euro drop about 7% in value over the course of Q3. And that really didn't pick up, as you saw, it didn't pick up in an impact in Q3 at all, because it happened at the end of the quarter. So that will be a headwind that we see and that's factored into the guidance.

Mark Mahaney - RBC Capital Markets - Analyst

Great, Sheryl, you talked about being careful about and slow about rolling out video ads, autoplay video ads and Instagram monetization. Have you seen any pushback in terms of user experiences to date on videos or on video ads? Is that overall caution, or is there anything you've seen in the data that suggests you want to keep it at a really slow pace? Thank you.

Sheryl Sandberg - Facebook, Inc. - COO

We're pleased with the consumer response we've had on both fronts, and we remain really optimistic over the long run about Instagram and video, because there's a lot of interest. I spoke before about creative storytelling; images video can be such a bit part of that and create a really resonant experience for brands and companies.

We really believe in going slow. That as we grow products, we pay attention to the consumer experience. We want the consumer experience always to come first. So although we are very optimistic about the opportunity here, we continue to grow slowly and pay a lot of attention to the quality of the advertising we see.

To share one example, we are seeing people using both Facebook and Instagram and also video and other ad products in combination. Mercedes-Benz launched the GLA, which was their first compact SUV, on Facebook and Instagram. They found that by doing Facebook and Instagram together, they got a 54% increase in their website visits.

So a lot of our products as you do one, you also do more Facebook ads as well, and that's something we're paying a lot of attention to.

Paul Vogel - Barclays Capital - Analyst

Great, thanks so much. I was wondering if you could talk a little bit about on the engagement side. Your DAUs to MAUs continued to be very strong. If you could talk a little about your older cohorts versus your newer cohorts and how they are behaving. And then also geographically. And on top of that on the frequency side, obviously DAUs doesn't measure how often people come back more than once per day, so is there any update on increasing frequency of visits? Thanks

Dave Wehner - Facebook, Inc. - CFO

I don't think anything to update on the latter front, Paul, but the DAU to MAU ratio, which we focus on on engagement, was strong across all geographic regions. So North America remains at the high-end, and we're really pleased with what we're seeing there.

Nothing to update on cohorts. Obviously, we're really pleased overall what the mobile impact has on the DAU to MAU ratio, and really encourage what were seeing across the board on engagement. So I don't think anything other than that specifically to call out.

Mark May - Citigroup - Analyst

Thanks. For the last couple of years you've -- back on the OpEx for next year guidance, for the last couple of years, you've grown your cash OpEx by around $1 billion a year with some consistency. And I think that seems to be continuing into the second half of the year. But obviously, your midpoint of OpEx guidance for next year represents a very significant, I think it's like 2.5% -- $2.5 billion increase at the midpoint. You obviously plan to change the level of investment in something quite significantly.

So I'm just wondering if you could talk a little bit more specifically about what are a couple of the projects of the capital-intensive projects that you're planning for next year? And is it physically possible to accelerate your hiring by that much next year?

Dave Wehner - Facebook, Inc. - CFO

Yes, thanks, Mark. The projects really that Mark and Sheryl both outlined, in terms of continuing to invest in the core Facebook experiences, growth engagement, and monetization there, building up the ad-tech side and the investments that we want to make there, as well as the recent -- continuing to invest against the recent acquisitions that we made in terms of WhatsApp and Oculus. So it's really the investments we're making there. We're also going to be supporting global growth with our Internet.org initiative, investing there. So it's a number of the key initiatives that Mark outlined in his comments that we're investing against. And again, we're giving a range on what we think is a reasonable range of guidance on that.

You saw headcount, we had a good growth headcount this quarter. And we're going to be continuing to invest, as we think that these will be good investments over the long run in terms of being able to drive our long-term growth.

John Blackledge - Cowen and Company - Analyst

Great thanks, just a couple questions on video. How should we think about Facebook as a video platform? And how does the mix of video between user-generated versus public content versus professionally produced content evolve over time? For example, as the upcoming short film content produced by Lions Gate around the Twilight franchise that will be shown exclusively on Facebook, will that increasingly be the type of content Facebook users will see in the future?

And then if you could give an update on the Instagram monthly active user comp, that would be great. Thank you.

Mark Zuckerberg - Facebook, Inc. - CEO

I can speak to the video point. I think it's going to be all of the above, in terms of what you said. Most of the content on Facebook is things that people are sharing with their friends and the people around them. So I think we'll continue to see that in video as well.

There's definitely this trend over the last few years where, if you go back five years, most of the content was text. Now a lot of it is photos, and if you look in the future as networks get better and the ability to capture good video and share it in a good way improves, then I think that going forward, a lot of the content that people share will be video. It's just very compelling.

There's also a lot of great public content that's video, especially the shorter-form content that you were mentioning I think will fit very well into the feed form factor that people consume on Facebook. So I think we're going to see a lot of both of these things, and it's going to be an evolution over the next few years, but I think you can expect to see a ramp of all of this.

Dave Wehner - Facebook, Inc. - CFO

And on Instagram MAU, we haven't updated the number; they continue to grow nicely, but we haven't announced a new public number on Instagram.

Justin Post - BofA Merrill Lynch - Analyst

Thanks. Mark, it seems like you're taking a portfolio approach to apps, and you've got several different experiences for people on mobile devices and other devices. Can you give us your philosophy around that? And as people use things like WhatsApp and Instagram, is it actually maybe possibly hurting Facebook's reported metrics? And how do you think about putting this all together and helping every app work?

Mark Zuckerberg - Facebook, Inc. - CEO

Sure. One of the things that's happening on mobile is that there's an increased focus for apps to do one thing really well. So on desktop, a lot of the things that might have fit well into a single Facebook website, now in order to best serve people, you need to build multiple standalone different apps. So we are seeing that with Facebook and Messenger, and the work that we did to kind of split out Messenger from the Facebook app to give a dedicated experience around that, that we think is a better experience. And we're going to do more of that in the future, as well with the Facebook Creative Labs products that we are releasing.

Part of what we've seen is that the use cases for products like Instagram and WhatsApp are actually more different and nuanced from -- than the products that people compare them to that Facebook had already built. So for example, on the WhatsApp and Messenger side, Messenger is primarily used today for people to chat with their Facebook friends, within this context of maybe it's not a real-time text like

you would send an SMS on your phone, but it's something that you're sending to one of your Facebook friends. Then if they happen to be there, and you can text back-and-forth or maybe they respond later.

SMS and WhatsApp are more for real-time activity. People have contacts on WhatsApp who they wouldn't want to make friends on Facebook. The graphs are somewhat different.

So one of the things that we found interestingly, to us as well, was that Messenger and WhatsApp are actually growing quickly in a lot of the same countries. There's countries that they are growing in that are different, and there mare countries that they are growing in that are the same, which to me suggests that they actually are in more different of markets then you probably intuitively would've thought. And that was definitely our understanding as we dug more into this.

Same with Instagram, and the type of sharing that happens on Instagram versus news feed. We've recently started doing more to help promote and accelerate the growth of Instagram from the Facebook app itself, because what we've found is that by doing that, we're net overall increasing the amount of sharing that people can doing and connecting that they can do within our whole family of apps.

We're definitely seeing that this is all accretive and positive, and we think that in the future, there will probably be room for more apps for sharing as well.

Anthony DiClemente - Nomura Securities Intl - Analyst

Thanks a lot. First for Sheryl, I want to come back to the theme of media measurement. You gave us some good perspective. Can you help me with first-party data versus third-party data? Can you get where you need to go with brand marketers using your in-house tools like Atlas, or do you think you need the validity and integrity of a third-party measurement source i.e., Nielsen, in order to get there?

And then second question for Mark, Mark I was just wondering where do you see Facebook at this point, in terms of its place in the hardware ecosystem? And given so much time is spent on your apps, do you think it's possible that you could get more aggressive in devices in hardware in order to achieve some of your longer-term or 10-year goals that you laid out?

Sheryl Sandberg - Facebook, Inc. - COO

To your first question, data is really important for both measurement and targeting. And when you think about first-party and third-party data, you have to think about both of those usage.

Certainly with measurement, third-party verification of that data can be very important. A lot of our largest clients and agencies also build their own data systems, which are a very important part of measuring and certifying everything we do with them. So we're using a combination of first-party and third-party.

I think where this really gets interesting is around relevance, and as I spoke about, that's a major theme for us, because we think one of the best things we can do to drive more value for marketers and improve the consumer experience on Facebook is improve relevance. And data is a great way of doing that.

So for example with Custom Audiences, Custom Audiences is a combination of our clients using the data they have on their client base, combined with the data we have that we can target. Let's say target one ad to existing customers to get them to engage more and buy more, and one ad to brand new

customers. And you can see how having a different ad to people who have never bought your products and a different ad to people who are currently buying your product would make a lot of sense.

Then you look at something like look-alike audiences, where we're looking to map customers who share characteristics; age, demos, likes, interest with current customers, and all of this takes a combination of first-party and third-party data, all of which we do in a very privacy-protected way.

Stephen Ju - Credit Suisse - Analyst

Thanks. Sheryl, from a product-development perspective, it feels like from the outside looking in that you have accelerated the rollout and delivery of various products. So wondering how you were thinking about how your product delivery cadence will change, especially given the investments you have guided to for 2015? Thanks.

Mark Zuckerberg - Facebook, Inc. - CEO

Before we go to that, I'll just quickly and so it the hardware question that we didn't get a chance to answer on the last question. We actually probably do more with hardware already than is apparent, because we design and work with folks to build up all of our own data centers and the servers there. I do think that if that ever became the right thing for us to focus on from a product perspective, we have some of the skills there already.

And when we were thinking about working with Oculus, that's actually one of the areas where we think we can help out, because we've built up a supply chain team, and we've been I think pretty effective at delivering what we've needed to run Facebook as this large system at scale.

But that said, I think that there's a huge amount of value in delivering these network and software services, and that's where you should expect us to focus on the things that we have talked about.

Sheryl Sandberg - Facebook, Inc. - COO

To the question about the rollout of products, I think the usual way we do things is that we roll out products slowly and then we iterate. So one example is Custom Audiences; we roll out Custom Audiences. Then we add on that website Custom Audiences to target ads to people visiting websites, and then mobile apps Custom Audiences adds to people who have visited mobile app. And one is building on the next, building on the next.

Similarly, this month -- earlier this month we launched local awareness targeting. It's a new option that allows local businesses to reach nearby customers, and what you saw that, it was in a massive launch; it was a small launch, fully enabled as targeting, get people to use it, and we will develop it.

Then there were the exceptions, such as Atlas. Atlas was one big launch that we're still in the process of doing, and that's really because it's a product we bought and needed to rebuild. But for the most part, our product development tends to be very iterative, and that's what you can expect from us going forward.

Youssef Squali - Cantor Fitzgerald - Analyst

Thank you very much. First question for Mark, Mark you recently came back from China. How do you think about that opportunity and what gives you the confidence that you can actually be successful where so many have failed?

And then second, on Instagram, we've seen some very complementary data that shows that Instagram is actually becoming more popular than ever with some brand marketers. Just wondering, what are the best-performing ads formats on the platform right now, and where is the ad load versus where Facebook is? Thank you.

Mark Zuckerberg - Facebook, Inc. - CEO

Sure. On China, we're already doing more in China on the business side than I think a lot of folks think about. A lot of Chinese businesses use Facebook to grow their export businesses and to help find customers around the rest of the world and grow the Chinese economy there. So that's actually a pretty meaningful thing for us already, and we always are looking to find ways to help businesses around the world to grow. And that will be just a long-term thing.

Our approach to China and every country is very long-term. We're going to be here for decades, and we want to create good relationships with these countries and businesses around the world that will help and grow over the long term.

On the Instagram side, I think we're pretty early. There have been a number of good ads, both video and images that I think have been pretty effective, but it's fairly early in the growth phase at this point. The top priority for Instagram is to grow from 200 to more and eventually connect 1 billion or more people, and I think that's something that should be possible. That's what I'm really focused on and excited about now, while we also start building out some of the parts of the business as well.

Scott Davis - Stifel Nicolaus - Analyst

Thanks I think this question is for Sheryl; the app download business seems to have grown quickly and become a big contributor of the ad revenue total for Facebook, and just wondering how you think about app re-engagement relative to app downloads, and which of those you think is the larger long-term opportunity for the Company? Thanks.

Sheryl Sandberg - Facebook, Inc. - COO

I'm glad you asked the question, because I think there has been some confusion around our mobile apps and mobile app ads and our mobile app engagement ads.

On the engagement ads, it's still pretty early and we have rolled those out. We rolled those out after mobile app ads, so we definitely see less of them, but we do think there's an opportunity.

I think the broader point is that our growth in mobile ads is very broad-based. It's across all marketer segments, and it's across all of our different ad formats. We talk about our mobile ad business growing, mobile app ads are a small part of that, that's growing in line with our total business.

The other thing that I think people get a little confused about is who is using mobile app ads. I think commonly when you think about mobile app, people often think about developers, and developers are using them and we're pleased we're able to help them grow.

But they are also being used by some of the largest branders and marketers in the world. So for example Burger King. Burger King just used our mobile app ads to do app installs for their apps. Excuse me, I'm about to sneeze. And the app, was to find Burger Kings, look at their menu and nutritional options, use mobile coupons, and use virtual gift cards. That was one use of our mobile app ads, which is not what people typically think of.

Deborah Crawford - Facebook, Inc. - VP of IR

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