

Facebook Q4 2014 Earnings Call Transcript

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Deborah Crawford, Investor Relations

Thank you. Good afternoon and welcome to Facebook's fourth 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, our annual report on form 10-K and our most recent 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 a great end to the year. Our community continued to grow in size and engagement, and we're very pleased with the growth of our business.

Overall, 2014 was a year of great progress for the Facebook community. 1.39 billion people now use Facebook each month and 890 million people daily, an increase of 165 million monthly actives and 133 million daily actives this year. Time spent per person per day across our services continued to rise, growing this quarter by more than 10% compared to last year and this doesn't even include WhatsApp, which joined us late last year.

These milestones show that our community continues to get stronger. But it's not just our community where we've made a lot of progress. 2014 was also a year of big investments in our future.

This year, we made big bets on the next generation of communication and computing platforms by acquiring WhatsApp and Oculus. We focused on serving our community better across all of our products, raising the quality and relevance of content in News Feed, improving our search and video products, and improving the performance and efficiency of our mobile apps. And we continued to invest in our employees and infrastructure, growing our headcount by 45% this year and opening our newest data center in November in Altoona, Iowa.

When you consider the progress of our community and our investments, 2014 was an important year for us and a good sign of how we're thinking about the future.

In the next decade, Facebook is focused on our mission to connect the entire world, welcoming billions of people to our community and connecting many more people to the internet through Internet.org.

To serve the entire world, we need to build products that serve our community and allow people to share different types of content with different audiences. We need to offer new services and infrastructure at greater scale and we need to create new tools and innovate to solve fundamental challenges in the places we want to connect.

Doing this will take a lot of effort over the coming years, and Facebook is going to have to evolve. Similar to our transition to mobile over the last couple of years, now we want to really focus on serving everyone in the world. Our mission has always been to make the world more open and connected, so this is something that we've been preparing for over the last decade. Everything we've achieved in 2014 and over the last ten years has helped us to build a foundation for a future of greater scale. I'm excited for our progress in 2015.

With that in mind, I want to talk about the things that we expect to execute over the next three, five and ten years.

Over the next three years, our main focus is to continue to serve and grow our community by delivering better services for people and businesses around the world.

One sign of our continued growth and engagement is our progress on visual and public content. Nearly 2 billion photos are now shared daily across Facebook, Instagram, Messenger and WhatsApp. Video grew significantly this year to an average of more than 3 billion video views per day on Facebook. And we now have more than 2 billion interactions every week on Facebook between public figures and their fans.

Instagram is also growing and helping people share and consume the most engaging content in different communities across the world. Instagram reached 300 million monthly actives, with more than 70% outside the US. Average time spent using the app also continues to be very strong compared to other mobile services.

Across Facebook and Instagram we've done a very good job on engagement, especially when it comes to helping people find and consume content they like. In 2015, we'll continue working on this, as well as developing more ways for people to share even more moments on Facebook. Five years ago, most of the content shared on Facebook was text and some photos. Today it's primarily photos, with some text and video. Over the next five years we want to keep developing new products and features that help people share the way they want.

When it comes to serving businesses, we've continued to help drive results for businesses of every size around the world. Last week a Deloitte report found that in 2014 Facebook created more than \$225 billion of global economic impact and 4.5 million new jobs. This is an important reminder of the big opportunity we have to create value for businesses, and why we're committed to serving them well. In 2014 we invested aggressively in improving our ad tech and measurement tools, and we're going to continue working to provide new capabilities for marketers. Sheryl will talk about this in one moment.

Next, let's talk about our efforts over the next five years to build the next generation of Facebook services.

We expect WhatsApp and Messenger to connect hundreds of millions of more people and become indispensable services for the world, as well as important contributors to our business. Messenger and

WhatsApp recently achieved impressive new milestones. In November, Messenger reached 500 million monthly actives and at the beginning of January WhatsApp reached 700 million monthly actives, with more than 30 billion messages sent each day. These numbers speak to the quality of both products, and the size of the opportunity ahead to help billions of people communicate and collaborate.

Search at Facebook is another important effort that we expect to create a lot of value over the next few years, and this quarter we launched updates to Facebook Search to make it easier to find content in posts on mobile and desktop. We're going to continue listening to feedback from our community and taking the time to build a really valuable product here. We're optimistic about our ability to deliver value that only Facebook is able to provide.

Working with developers is the other part of our strategy, and this quarter we continued to make progress with helping developers build, grow, and monetize their apps. In October we rolled out our Audience Network around the world, and since then the number of apps in the network has nearly tripled and impressions served by the network more than quadrupled. In 2015 we'll continue to build upon our long term goal of making Facebook a truly cross-platform platform that allows developers to share their work across every major mobile platform, and we look forward to sharing more details at our next F8 event in San Francisco this March.

Finally, let's talk about our plans over the next decade to connect everyone to the internet through Internet.org and to develop the next generation of computing platforms with Oculus.

Internet.org now has a lot of momentum, and we've now launched free basic internet services in Zambia, Tanzania, Ghana, Kenya and Colombia. More than 150 million people living in these countries now have the option to connect to the internet using Internet.org, and we've already connected 6 of them to the internet who didn't before have access. We're very excited by Internet.org's progress, and the level of interest we're seeing across industries, governments and our community. 2015 is going to be an important year for our long term plans and I expect us to share more updates about our progress here over the coming months.

Oculus continues to make progress towards a future of immersive VR experiences that are part of daily life for millions of people. This month the team had another good showing at CES, and developer interest in the Oculus platform continues to grow.

So that's my update for this quarter. It's been a strong quarter and a good end to an important year for us.

I want to thank everyone in the Facebook community and our employees, partners and stockholders for their support. Thanks to you, our community is growing stronger every day and we're making progress towards making the entire world more open and connected.

Thanks, and now here's Sheryl.

Sheryl Sandberg, COO

Thanks Mark and hi everyone.

Q4 was strong across the board, capping a great year. This was our first quarter with over \$3 billion in ad revenue and over \$2 billion in mobile ad revenue. Q4 ad revenue grew 53% year over year. Mobile ad revenue was 69% of total ad revenue and doubled in the past year. Our growth was strong across all

verticals and marketer segments. We also saw healthy growth around the world, although growth rates outside the US were affected by exchange rates.

Looking back at 2014, our teams made great progress on our three main priorities: capitalizing on the shift to mobile, growing the number of marketers using our ads products, and making our ads more relevant. We believe that the market increasingly understands that we have the leading mobile ad product and are the only platform that delivers people-based marketing at scale.

The shift to mobile is changing the way people consume video. As Mark said, video grew dramatically on Facebook in 2014, especially around global events like the World Cup and the ALS Ice Bucket Challenge. In just one year, the number of video posts per person on Facebook increased 75% globally and 94% in the US. Today, over 50% of people in the US who come to Facebook daily watch at least one video per day. And globally, over 65% of Facebook video views occur on mobile. Marketers have followed this trend and are using video to help people discover and learn about their brands. In Q4, we expanded auto-play video ads internationally. During the holiday season, we saw many clients telling their stories creatively through video.

2014 was also the year we began scaling Instagram ads. In Q4, we rolled out Instagram ads in Australia and Canada. Marketers are excited to have access to the 300 million people who use Instagram and the creativity it inspires. We're seeing beautiful creative and great results from brand marketers across verticals - from insurance and tech to retail and entertainment. For example, as one of our first Instagram video advertisers, Banana Republic developed a series of videos to promote its new BR clothing line. The videos showed fashion sketches from the new collection and drove a 23-point lift in ad recall. While it's still early and we're being deliberate in our roll-out, we believe that Instagram will become core to advertisers' mobile brand building efforts.

We also made progress growing the number of marketers using our ad products. Custom Audiences, our suite of proprietary targeting products, has become an essential tool for segmenting current and potential customers. Conversion tracking, a way for marketers to measure the impact of their campaigns online, is also seeing wider adoption. We've made it easier for businesses of all sizes to plan and manage their ad campaigns and for small businesses to use our targeting tools. Travel company Thomas Cook recently used Facebook in Belgium to reach a broad audience and used custom audiences to send targeted messages to existing customers based on places they'd expressed interest in. They reached 30% of the Belgian population in one day and achieved a 3.85 times return on investment. Results like these are attracting more marketers of all kinds to our platform.

Finally, we made great progress improving ad relevance and measurement. To do this we made significant investments in both our core measurement and targeting tools as well as Ad Tech. Earlier in 2014, we introduced ad buying capabilities based on reach and frequency metrics, which is similar to how brand marketers buy TV ads and therefore enables better cross-comparison. We improved our Ads Manager product to give better insights into ad campaign's audience and impact.

In the fall, we re-launched Atlas to help marketers reach real people and measure results across multiple devices. Omnicom was our first global client, and this month we announced a partnership with Havas to further expand globally. We also invested in Audience Network, which helps marketers extend their campaigns off of Facebook, and LiveRail, which provides publishers with video tools to monetize their inventory more efficiently.

Heading into 2015, we're excited to build on the progress we've made with our core ad products, as well as with newer areas like video, Instagram and ad tech. It's still early days in all of these efforts. There is a lot of hard work to do, and we plan to invest aggressively.

Our ultimate goal is to be a critical business partner to our clients – providing people-based marketing at scale to build their brands and move their products off shelves. Over the past few weeks, I have had a chance to meet with many of our largest global clients and agency partners, and talk about how we can drive real business results for them – making every impression count and every dollar they spend improve their bottom line. Our clients are excited by the opportunity to use video, Instagram, and ads on and off Facebook to reach the right people with the right message. In turn, as our ads become more relevant, we provide a better experience for the people who use Facebook.

Coming off our biggest year ever I want to say a special thank you to the Facebook teams around the world. To our global sales, engineering, product, design, and infrastructure teams, your accomplishments over this past year are the reason our business is in such a great place. To our entire company, I feel lucky to work with you as we stay focused on our priorities and work together to help connect the world. And to our clients, thank you for your partnerships and your trust in us.

Heading into 2015, we have big opportunities and a lot of work ahead.

Thanks, and now here's Dave.

Dave Wehner, CFO

Thanks Sheryl and good afternoon everyone.

Q4 wrapped up a strong year for Facebook. In 2014, our revenue grew 58% to approximately \$12.5B, and we generated over \$3.6B in free cash flow.

We are very pleased with the continuing growth of our network. In December, the number of people using Facebook on an average day increased by 18% compared to last year to 890 million. This daily number represents 64% of the 1.39 billion people who used Facebook during the month.

Mobile remains the primary driver of our growth. We ended the year with 1.19B people using Facebook on mobile in the month. We also continue to see solid growth with Instagram, Messenger and WhatsApp recently crossing 300M, 500M and 700M MAU, respectively.

Turning now to the financials.

All of our comparisons are on a year-over-year basis unless otherwise noted. In addition, as a reminder, our non-GAAP measures exclude stock-based compensation and the amortization of intangibles.

Total revenue in Q4 was \$3.9 billion, up 49%, or 53% on a constant currency basis.

Given how significantly exchange rates have continued to move, we anticipate that this currency headwind will increase in 2015. I will give more color on this later in the call.

Ad revenue was \$3.6 billion, up 53%, or 58% on a constant currency basis.

Mobile ad revenue in Q4 doubled \$2.5 billion or 69% of ad revenue, compared to approximately \$1.2 billion or 53% of ad revenue last year.

Desktop ad revenue was up approximately 1% despite the fact that overall desktop usage was down.

In Q4, the average price per ad increased 335%, while total ad impressions declined 65%. Similar to last quarter, these price-volume trends were primarily driven by the redesign of our right hand column ads which rolled out in the third quarter.

Total Payments and Other Fees revenue was \$257 million, up 7%. Note that the growth was driven by revenue from acquisitions made in the past year. On an organic basis, payments revenue from Games, which represents the substantial majority of our Payments and Other Fees revenue, declined 10% compared to last year. As previously noted, we expect this trend to continue as desktop usage declines.

Turning now to expenses.

Our Q4 total GAAP expenses were \$2.7 billion, up 87%, and non-GAAP expenses were \$1.6 billion, up 50%.

GAAP expense growth was driven primarily by significant stock-based compensation and amortization expenses related to the WhatsApp acquisition.

Non-GAAP expense growth was driven primarily by increases in headcount-related costs, cost of revenue and marketing expenses.

On a full-year basis, our 2014 GAAP expenses were \$7.4 billion, up 47%, and our non-GAAP expenses were \$5.3 billion, up 34%.

We ended the year with roughly 9,200 total employees, up 45%. Overall, we remain very pleased with our ability to attract and retain top-tier talent.

GAAP operating income was \$1.1 billion in Q4, representing a 29% operating margin, down from 44% last year, again primarily due to expenses related to our recent large acquisitions.

Non-GAAP operating income was \$2.2 billion in Q4, representing a 58% operating margin, consistent with the margin last year.

Interest and other income and expense was a net expense of \$19 million in Q4 vs. a net expense of \$3 million in Q4 last year. This increase in expense was primarily due to foreign exchange losses resulting from the periodic re-measurement of our foreign currency balances during the period.

In Q4, we benefited from the reinstatement of the R&D tax credit. Our GAAP tax rate was 37% but would have been approximately 42% excluding the benefit of the tax credit. Our Q4 non-GAAP tax rate was 31% and would have been approximately 32% excluding this benefit.

Q4 net income was \$701 million or \$0.25 per share, and non-GAAP net income was \$1.5 billion or \$0.54 per share.

In 2014, we spent \$1.8 billion on CapEx and generated over \$3.6 billion of free cash flow. We ended 2014 with \$11.2 billion in cash and investments and a net operating loss carryforward of approximately \$4.5 billion.

Turning now to the outlook.

Let me start with revenue. We are still in the early stages of building out many aspects of our ads business and remain optimistic about our long-term opportunities.

Looking at 2015, there are a couple of things I want to note.

The first involves how the recent movements in exchange rates might impact our 2015 revenue.

Assuming exchange rates were to remain constant at today's levels, we would expect that our total revenue in 2015 would be approximately 5% lower than it would be under 2014 exchange rates. Note this 5% represents the expected reduction in 2015 total revenue, not the reduction in the year-over-year growth rate.

And second, we are reporting revenue from Atlas, LiveRail and the Audience Network on a net, not a gross, basis so the growth in those products will have less of an impact on our overall reported revenue growth in 2015.

Turning now to expenses. We are tightening our ranges modestly given the better visibility into 2015 spending. We expect that our full-year 2015 total GAAP expenses will increase 55-70% compared to 2014. We expect that our 2015 total non-GAAP expenses will increase 50-65%.

A simple way of thinking about our investments is across three categories: people, product and infrastructure.

On the people side, we enter 2015 with 45% more employees than we did a year ago, and we will continue to invest in and grow the talent base throughout the year.

In terms of product, we are investing to build great experiences for people, marketers and developers, ranging from our existing products and services to newer initiatives such as ad tech, Internet.org, Oculus and WhatsApp. We'll also invest in marketing to support all of these initiatives, which, as I noted, was a driver of expense growth in Q4.

Turning to infrastructure. We continue to build out our global infrastructure to enable billions of people around the world to connect, message and share with each other. We will be investing in data centers, our network, and servers to grow our existing services and support newer initiatives such as video and our global connectivity efforts through Internet.org. We anticipate our 2015 CapEx will be in the neighborhood of \$2.7-\$3.2 billion.

We expect stock-based compensation for 2015 to be in the range of \$3-\$3.3 billion, approximately half of which is related to our prior acquisitions, most notably WhatsApp.

We expect amortization expenses for 2015 to be approximately \$700-800 million.

And finally, we anticipate our Q1 and full-year 2015 GAAP tax rates to be in the mid-to-high 40s and non-GAAP rates to be in the mid-to-high 30s.

In summary, Q4 capped off a great year for Facebook in which we executed well and also made some very important investments for our future. In 2015, we are focused on continuing to execute on the business and investing in our long-term mission and success.

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

Heather Bellini - Goldman Sachs - Analyst

I just had two quick questions. Sheryl or Mark, I was just wondering, from a brand advertising perspective, is there a way you could share with us how your conversations with these advertisers have been trending over the past 12 months, how they've been evolving, and how they are thinking about the video opportunity?

And then, Dave, I just wanted to follow up on your question about total expense guidance, because in the past you've given a 5-point range, I believe, for total expenses and this year it's 15. Granted, you did tighten it, which we appreciate. And just wondering the parameters around how we think about the low end versus the high end?

Sheryl Sandberg - Facebook, Inc. - COO

It's a great time for the brand question because over the past few weeks I've spent a lot of time kicking off 2015 with our largest agency partners and largest clients. I would say that people remain really excited about Facebook, but people are bigger believers, because we've had an opportunity to do more measurement over the past year.

So, I think there are two things about the Facebook platform that are really exciting for brand marketers. The first is the creativity and storytelling. And certainly, as you mentioned, video is a big part of that because video is a format that marketers have used for a long time to build emotional connection to brands.

The second is measurement. What clients want and what they should want is an ability to look at their ad spend and see how effective it is, not just in the brand lift metrics, even though those are important, but in moving products off shelves. Over the past year and a half, the investments we've made in building out that measurement have paid off.

So, when I sit down with clients at the beginning of this year compared to last year, we have more actual case studies of marketing we've done with them. We've been able to A-B test Facebook ads versus no Facebook ads, and what the effectiveness is on their sales. And I think across the board, we are showing very healthy, very competitive ROI.

The opportunity and the challenge, now, is to scale. Even for our largest clients globally we still represent a really small part of what they do. So, it's on us to prove to them that the results we're showing them in these smaller tests can happen in more brands, more countries with a larger part of their business.

Dave Wehner - Facebook, Inc. - CFO

Just following up on that, where we land in the range of guidance on expenses will depend on a number of different factors. It's going to depend on how successful we are at hitting our recruiting goals, how much we ramp in areas like marketing, how quickly we deploy our capital against our CapEx plan, and then how we execute against our plan of ramping investments in new areas like Oculus, WhatsApp, Internet.org, et cetera.

We feel good about where we are. We're going into 2015 on a high note. So, I feel like we're making these investments from a position of strength, and excited about the opportunities to put more capital to work in 2015.

Eric Sheridan - UBS - Analyst

Mark, I wanted to follow up on your comment around search. It's early days, but what the Company is seeing in terms of the way people are interacting with the new search functionality inside Facebook, broadly. And then maybe tying it back to advertising, what that might mean for closing the loop with some of your small- and medium-sized business advertises, and maybe even the Places initiative, long-term, thanks.

Mark Zuckerberg - Facebook, Inc. - CEO

Sure. Our view on this is that there is a lot of unique content that people have shared in Facebook, a lot of personal content, recommendations from friends that you can get, that you just wouldn't be able to get through a traditional web search service or other app. We are on this multi-year voyage to basically index all the content and make it available to people and rank it well.

We started off by launching Graph Search, which I think included more than 1 trillion different connections in the first system. The second round of the search progress that we just started rolling out at the end of last year was Post Search, which now has indexed more than I think 1 trillion posts. The sizes of these corpuses are bigger than anything in a traditional web search corpus that you'd find.

It's an interesting and fun challenge to make this work. We're seeing that people immediately understand how they can use this and find content that they've seen in newsfeeds before or that they've posted with just a few keywords. We're excited about that but there's a lot more to do.

So, I'd say we're not really thinking about advertising in it yet. On the scale that our community operates, 1 billion searches per day is actually not that big compared to what we think the opportunity here should be. And we are just continuing to keep on working on it because there's just a lot of unique value that people should be able to get from their friends on Facebook through search.

John Blackledge - Cowen and Company - Analyst

I just wondered if you could provide your view on Facebook as a video platform given that video views per day increased to 3 billion in December from 1 billion in September of 2014. And how we should think about video content mix over the next couple of years.

And same kind of topic, if you can give a sense of user and advertiser feedback on the autoplay video ads, that would be great. Thank you.

Mark Zuckerberg - Facebook, Inc. - CEO

I'll talk about the consumer products and then Sheryl can jump in about ads.

What we're seeing, and I alluded to this a bit in my opening remarks, is that there's been this evolution of content on Facebook over the last 10 years towards richer format that conveys more of the moments that people care about. So, if you go back five years ago, a lot of Facebook was primarily text and a little bit of photos.

Now, I think the primary mode that people are using to share is photos. And I wouldn't be surprised if in the future that shifted more and more towards videos.

So, we're thinking about how to enable consumption first of the content that people were sharing. And this year an increased focus on new opportunities around production. That way it's easier for people to

capture the moments that are important to them, create higher-quality moments and pieces of content out of those, and increase their experiences through that.

So, there's a lot more to do here. And I think that this is going to be one of the big trends over the next three to five years, is the growth in video and richer content in our service.

Sheryl Sandberg - Facebook, Inc. - COO

From a consumer and marketer feedback on video ads point of view, those two things really go together. It's exciting that we've gotten to 3 billion video views per day because that means consumers are using video ads and enjoying them on Facebook and in newsfeed.

The way we think about our ads product is we want them to blend in with the consumer experience. So, the fact that we have this much consumer video on Facebook, means we have an opportunity to grow our ad business, and that's exciting for marketers.

Justin Post - BofA Merrill Lynch - Analyst

It looks like you did about \$9 of revenue in the US per MAU, which is over a \$30 run rate, which is impressive.

Sheryl, maybe first question to you. How do you grow that from here? Is it usage? Is it more higher ad load? Is it the mix of ads? Or is it targeting? Maybe some thoughts on how you grow from there.

And then, Mark, as you look at your other three platforms; WhatsApp, Instagram, Messenger, and other things you probably have in mind -- can they monetize anywhere as well as Facebook if you look out to your five-year plan? Thank you.

Sheryl Sandberg - Facebook, Inc. - COO

Thanks for the question. When you think about what's happening, certainly the growth has been good. But it's still true that marketing dollars have not followed consumer time in the same percentages.

In the US, mobile gets 25% of consumer media time but only 10% of the ad budget. And to take one comparable example, that means that for every consumer hour spent on print, marketers spent \$1, and they spend \$0.07 per hour on mobile. Which means that we have an opportunity to grow.

One of the most important ways we grow is not just bringing more marketers into Facebook, having them use more of our ad products, but, as you mentioned, better targeting. A more relevant ad is a better ad experience for consumers, but also drives a much higher return for marketers. And since we're running an auction, as our ads get more relevant and we provide higher ROI, we should be able to continue to grow.

I think we've done a good job over the last year making our ads more relevant. I think most people on this call would say that you see more relevant ads than you used to a year ago. But I still think some of the Facebook ads still have room for improvement in terms of relevance. And, so, we see a lot of room for improvement there, both in the ROI we deliver and in the experience we can provide consumers.

Mark Zuckerberg - Facebook, Inc. - CEO

I'll add something to that just on the side of how we think about value through Facebook and then I will talk about the other apps. In terms of the product development that we do here, we have four major groups inside the Company. This is how our Company is organized.

We have one which is focused on growing the community; one which is focused on increasing content consumption and people's engagement; another which is focused on efficiency and helping people get the most value out of each moment that they're spending on Facebook; and then the fourth group is our core business which is focused on helping people to see the best ads and basically make the most money per moment that people are spending at the lowest cost and most efficiency in terms of serving people.

There is, I think, big upside in each of those four categories. Our community is growing. I mentioned in our comments up front that time spent across our services grew by 10% year over year per person, which is pretty meaningful. Utility and efficiency are increasing. And, of course, the ads business per person and the efficiency of our services are both increasing, as well.

So, I'm pretty excited about that and think we are organized in a way where we can continue executing against that.

That other opportunity is Instagram, Messenger and WhatsApp. I'm really excited about. And I do think that they're going to reach the level where they contribute to our business in a pretty big way.

But it's really important to get this right and not rush it. What I'd say around messaging is we're pretty early in that cycle. We are about where Facebook was in around 2006 or 2007, where, at that point, Facebook is really just a consumer product. There were no businesses in the ecosystem.

And a lot of people were telling us go put better ads in. And that felt wrong. I didn't think that that was going to be the right way to build the product or build the business.

So, instead, what we did was we built pages, which was a way for businesses to interact for free in the system and start creating organic interactions between people and businesses so we could figure out what the people using Facebook wanted from businesses within Facebook. And we built more tools for pages and businesses to engage. Our recent success with advertising is really just built on some of those organic interactions between people and businesses.

What you see in Messenger and WhatsApp now is we're still at the early end of that curve where the interaction is still primarily people to people, and businesses are starting to figure out, in the case of WhatsApp -- much less in Messenger, so far -- what the organic interaction is. But we're going to have to go through a whole cycle of figuring out how that works before it really makes sense to start monetizing them in a big way. But, yes, I'm a big fundamental believer that these are going to be very big contributors to our businesses over time, but we just have to do it right.

Ben Swinburne - Morgan Stanley - Analyst

Two questions. Sheryl, can you talk about where we are in the North American market versus your other regions in terms of advertiser maturation and acceptance of the Facebook platform? The growth rates in North America continue to be really impressive despite it being your business when you look at the ARPU trends. And compared to the other regions those seem to be moderating a bit.

And then I was wondering, Dave, if you could talk about the pricing growth which actually accelerated from Q3 to Q4? Can you give us some color there? I know there were changes to right-hand rail but anything else you would add about why there was such a huge acceleration in pricing growth. Thanks.

Sheryl Sandberg - Facebook, Inc. - COO

North America remains a really important market for us. And, as you said, we've had growth we are very happy with. It's still true that for any client, no matter how big they are for us, we represent a really tiny part of their ad spend. And we represent an under-investment in terms of where they can reach their consumers.

So we believe by continuing to make these investments we can really continue to grow. We get 20% of people's time on mobile phone in the US between Facebook and Instagram. We don't get close to that in terms of anyone's marketing spent or the time they spend.

What we say to our clients over and over again is that we want to drive their business. And that's probably the most important thing we're doing for these large North American spenders, is around the measurement work we've done.

Two years ago we were not able to measure all the way through to purchase off the shelves, and now we can. Yesterday, we rolled out a product we call Lift, which is really the next iteration of our measurement capabilities. It enables large customers to go in and set up ads with control test groups so that they can A-B test; this group of people saw a Facebook ad, this group of people didn't. And they can measure all the way through to conversion of whatever they are measuring, whether it's an online conversion to a sale.

We think the measurement out there online and digitally is not particularly accurate. People don't have real people-based measurement. Through our investments in Atlas and through our investments in the core Facebook measuring tools, we think if we can show the ROI marketers are getting, and we can increasingly do so, we can continue to penetrate the North America market.

Dave Wehner - Facebook, Inc. - CFO

Also just building on what Sheryl said, worth noting that the drop in the value of international currency is impacted by results outside the US. So, some of what you're seeing here is the result of that.

It reduced year-over-year revenue growth rates by 7% to 8% in the different international regions. That's a big reason why you see the US doing much better, as well as the fact that that's just a more advanced market in what we've done in terms of just building up the advertiser base and getting adoption of our best targeting products, as Sheryl was talking about.

Going to your question on pricing growth, I would just reiterate what I said in my comments. It's largely due to the right-hand column redesign and then also this shift to mobile where we don't show right-hand column ads. That's really what's causing the pricing shift.

Then, fundamentally, we just continue to get better at targeting. That drives better engagement. And as we get better engagement, that drives better ROI for our advertisers, which ultimately, I think as Sheryl commented on earlier, gets reflected in better pricing for our ads. And that's a big opportunity for us.

And we are seeing that we're getting better and better at driving engagement from the ad units that we have, and getting that right ad in front of the right person. So, that's a big factor, as well.

Brian Wieser - Pivotal Research Group - Analyst

Thanks for taking the question.

First, I was wondering if you could talk about the degree to which you think premium video is content, where it's not necessary to optimally capture budgets from advertiser that might otherwise have gone to TV? You have a couple of initiatives around ABC and NFL. So, I was curious to hear your thoughts on that.

Separately, among clients who are using Atlas, and especially those who are new to Atlas, do you get a sense that their spending on digital media is changing? Or, if so, how? And, alternately, are they just happier with their campaign management tools? Thanks very much.

Sheryl Sandberg - Facebook, Inc. - COO

On video ads, what really matters is that consumers are using video on Facebook because that gives us an opportunity, one, to provide a great consumer experience, but, two, to have ads match that consumer experience. If there wasn't consumer video on Facebook, video ads in your newsfeed would be very jarring. As a percentage of the videos you're seeing, video ads fit nicely into that experience.

I don't think it matters as much what the video content is. So, while we're certainly exploring some premium content -- as you said, we have an NFL Verizon test out there in the public eye -- we're already seeing pretty explosive growth without that kind of premium content in the system in large numbers. And, so, we'll continue to figure out.

We are certainly open to increasing video content either way, but we haven't quite figured out what the mix needs to be. And right now the growth is very strong.

In terms of Atlas, we just relaunched this fall and we're just seeing those deals get done in broad adoption. So, I think it's too soon for us to report that Atlas drives an increase in digital spend or an increase in any particular kind of spend.

But here's what we believe really deeply, which is that Atlas is going to revitalize marketing by making the measurement more accurate. If you look at how digital ads are being measured, they are being measured based on a cookie-based world that assumes that people have one device, largely a PC, and that's just not true.

Consumers have phones, they have tablets, they have PCs, as well. And the ability to understand that that's one person to serve an ad and measure all the way through correctly, we think it's going to massively improve the efficiency in the system as it gets adopted.

Peter Stabler - Wells Fargo Securities - Analyst

One for Sheryl. Sheryl, as you push further toward monetizing off-platform inventory, wondering if you could speak to the state of your relationships with premium publishers? There is a narrative out there we sometimes encounter that publishers are growing a bit concerned about the power you guys wheel, particularly as you push into monetizing off the platform. Thanks very much.

Sheryl Sandberg - Facebook, Inc. - COO

Our audience network efforts are still pretty new. We have a goal of serving more relevant ads to people off Facebook, which will provide greater reach for Facebook marketers and also a better opportunity to monetize for publishers.

We're seeing some nice results. Shazam reported that using Audience Network increased their revenue from Ad Networks by 37%. We believe that working with publishers, if we can increase the value of their inventory by providing more relevant and targeted ads, they are going to be really happy with that opportunity. And we are in the early stages of finding those partners.

Anthony DiClemente - Nomura Securities Intl - Analyst

First for either Mark or Sheryl on the subject of public video content and what you guys are doing to increase the amount of video in the newsfeed. Are there things in terms of actors, celebrities, public figures that you can do to economically incentivize those creators of, let's say, the higher-quality user-

generated content onto the Facebook platform, be it a revenue share, what have you, relative to the economics for those types of folks on competing online video platforms?

And then just one quick one for Dave. You mentioned -- I just had to ask -- you'd be the shifting the accounting for Facebook Audience Network and LiveRail for revenue to be net of TAC in 2015 versus gross in 2014.

I'm just wondering why do that? And is there anything you can help us with in terms of order of magnitude of that shift? Thanks.

Sheryl Sandberg - Facebook, Inc. - COO

On premium video content, we haven't figured out exactly how important this is to the ecosystem or how much we're going to invest or what kind of monetization we're going to offer. Video is growing quite nicely through the ecosystem right now.

We have made a lot of investments in public content, working with public figures to use the Facebook platform. We are by far the largest social platform and increasingly you're seeing public figures, everything from news broadcasters to journalists to public figures, do a lot on Facebook. And that's important to us because it provides the kind of sharing people want.

People come to Facebook to share with their friends and family but they also come to Facebook to connect with everyone from politicians to journalists to celebrities they want to connect with, and get news. And we've definitely seen public content grow as a percentage of what people get.

We also had some nice wins with the Golden Globes this year. Other things we're doing to go deep, we're doing some partnerships. We did In Davos at CNBC to show how we can help content creators increase their distribution and reach people directly on Facebook.

Dave Wehner - Facebook, Inc. - CFO

Just to be clear, the net revenue recognition for those products, that's how we did it in Q4, as well. Those are all small today. But there's not a change in accounting in 2015. That's how we accounted for those products in Q4.

As far as the net versus gross we just evaluated all the facts and circumstances and made the judgment that net revenue recognition was the most appropriate treatment here.

Ross Sandler - Deutsche Bank - Analyst

Just following up on the video concept, how important is it that Facebook host the videos versus sharing clips from third-party players in the feed? What percent of that 3 billion streams daily is Facebook-embedded versus from other players? And are you able to monetize videos from third-party players today or is there a way to work around that in the future? Thanks.

Mark Zuckerberg - Facebook, Inc. - CEO

The stat that we shared of 3 billion a day is all native on Facebook. There are probably other shares from other video services, as well. But the way that those look in our services are if they're links to other sites.

The reason why I think native video is so valuable for people using our service is that, when someone uploads a video to Facebook directly, we can optimize how it's delivered. We can make it autoplay. We can find the right quality and bit rate to send down to the person based on their connection over time, and optimize all kinds of different things.

So, what I think people are finding from public figures to everyday videos that people are uploading is that the best experience that you can get is by uploading content native to Facebook, which is I think, a big part of the growth that we are seeing there.

Colin Sebastian - Robert W. Baird & Co. - Analyst

I wonder if it's possible to distinguish how much of the growth in advertising revenues can be attributed to changes in organic compressions and how you balance the desire of business partners to contribute content to feeds versus monetization? Thank you.

Dave Wehner - Facebook, Inc. - CFO

I'm not sure I exactly understand the question. But let me see if I can take a crack at it, Colin.

We're seeing, obviously, great growth in DAU which is up 18%. We're seeing growth in time spent across the network, up 10% per DAU. So, you've got those underlying drivers of engagement driving growth.

We're also monetizing at higher rates because we're able to get better targeting into the ads and get better conversion for advertisers. So, that's reflected in better pricing.

So, there's a number of different factors that are coming into play. But, clearly, driving organic growth and engagement is critical in the business and we're seeing good success there.

Mark Zuckerberg - Facebook, Inc. - CEO

One theme that I'd just add to emphasize here, because I think there have been a couple of questions to this effect, is our primary strategy for growing the ad business is increasing the quality of the content, not increasing the number of ads per story that people are seeing on Facebook. There are impacts like, as people consume more content on Facebook, within the ratio of ads, the organic content that we will show, they might see more ads.

But overall, our strategy is much less about increasing the volume of ads and much more about increasing the quality of the content and the quality of the targeting to get the right content to the right people. This is a pretty controversial strategy internally and we weren't sure if that was going to work out. But for the last year it's really fueled our growth in a good way and we feel very confident that this is the right path going forward, as well.

Carlos Kirjner - Sanford C. Bernstein & Company, Inc. - Analyst

I have two quick questions.

First, when you say that time spent increased 10% year on year, is this roughly uniform across your geographic regions?

And, secondly, Mark, I think during your remarks in every earnings call, you talk to your investors for a considerable amount of time about Facebook's efforts to connect the world, and specifically about Internet.org which suggest you think this is important to investors. Can you clarify why you think this

matters to investors? And, importantly, why you think Facebook can make a significant difference at scale, given that your [ann over pupil] user in emerging markets is about \$5, and to connect any user who has no device or coverage may be at risk in terms of dollars? Thank you.

Mark Zuckerberg - Facebook, Inc. - CEO

It matters to the kind of investors that we want to have, because we are really a mission-focused company. We wake up every day and make decisions because we want to help connect the world. That's what we're doing here.

Part of the subtext of your question is that, yes, if we were only focused on making money, we might put all of our energy on just increasing ads to people in the US and the other most developed countries. But that's not the only thing that we care about here.

I do think that over the long term, that focusing on helping connect everyone will be a good business opportunity for us, as well. We may not be able to tell you exactly how many years that's going to happen in. But as these countries get more connected, the economies grow, the ad markets grow, and if Facebook and the other services in our community, or the number one, and number two, three, four, five services that people are using, then over time we will be compensated for some of the value that we've provided.

This is why we're here. We're here because our mission is to connect the world. I just think it's really important that investors know that.

Dave Wehner - Facebook, Inc. - CFO

And, Carlos, on the time spent per DAU, we're just giving the one point. We're not breaking anything out by region.

Paul Vogel - Barclays Capital - Analyst

I'm just curious, given the impact that currency had on the quarter on growth rates outside the US, is there any market you could call out, particularly, that were either better or worse that might be masked by the currency swings, number one? And, number two, I'm just curious if currency does stay where it is, does it all impact your spending plans or how and where and when you'll invest? Thanks.

Dave Wehner - Facebook, Inc. - CFO

Taking your second part first, we are really making investment decisions on short-term fluctuations in currency. So, I would say, in general, no, it's not affecting those decisions.

There are certainly big macro effects that are going on, and part of those are what's driving a lot of the currency fluctuation, as well. So, you have regions that are certainly growing more quickly and regions that are growing more slowly.

So, from a macro perspective, the United States is doing better in terms of growth versus Europe versus Latin America. You see those compounded in both currency and macroeconomic conditions in those regions. I'd say generally we've got more favorable market conditions in which to operate in the US.

Overall, I would say the business is driven by the fundamentals of us continuing to execute against our plan. Whether you're in a market that's suffering a little bit from a macroeconomic headwind, we still have the best mobile product in that market and we are growing.

So, I think, at the end of the day, it's the fundamentals of our business that are going to drive our success, and we're focused on that. But wanted to at least give some color around how the currencies might impact the 2015 results.

Robert Peck - SunTrust Robinson Humphrey - Analyst

I have two quick questions. Mark, you haven't spoken much yet today about the e-commerce opportunity in front of Facebook, particularly the buy button. Can you elaborate a little bit on plans around e-commerce and what you see that opportunity?

And then, Dave, I was wondering, for investors, could you maybe go through your view on how you look at capital efficiency and ROI, so that, whether it be acquisitions or CapEx or even OpEx, how you look and see you are getting a good return on that spend? Thanks so much.

Sheryl Sandberg - Facebook, Inc. - COO

Q4 is a really important quarter in general, but it's a particularly important quarter for e-commerce. So, it's a timely question.

When you think about buy on Facebook, it's a small task in the US we started last quarter. It enables people to buy on pages.

To be clear, you're not buying from Facebook, you're buying directly from the merchant. And it's really an SMB product to give them capability they haven't had.

We'll see what happens in terms of where people convert, whether it's on Facebook. But we think the opportunity to connect consumers with the products that they then purchase is a really big one. Where we play in that most directly is the time and attention consumers have, as well as the information to do very relevant advertising, and we're going to stay focused there.

Dave Wehner - Facebook, Inc. - CFO

Robert, I think the bulk of the investment that we're doing is really focused on the capital and the OpEx to deliver against the core mission of enabling billions of people to connect and share. So, for the most part, we're looking at what do we need to deploy to deliver against the mission to deliver against our overall financial results. There are places where we can individually take out specific projects, whether it be M&A or specific capital investments, and then we'll look at those on an IRR basis for specific projects.

But you have to recognize that we're basically one large business, and we're operating against capital deployment against delivering, against the objectives of that business. That's the bulk of the spend that we do. But certainly we look at things on an ROI basis on an individual project basis, as well.

Arvind Bhatia - Sterne, Agee & Leach - Analyst

Just quickly on WhatsApp, I know the focus will be user growth for a while. But in the future, as you do turn on the monetization engine, just curious what are some of the primary ways that you are assuming growth will come from advertising or games perhaps.

And also, on WhatsApp user growth, would you be able to call out where that's coming from? Is there any particular areas that are stronger? And curious how that's doing in the US? Thank you.

Mark Zuckerberg - Facebook, Inc. - CEO

You are right that the focus for WhatsApp is on helping to connect a lot more people. When Jan and team joined us, one of the first things that we agreed on, and why I think it made sense for them to join, is that now they can focus for a few years on getting to 1 billion more than that and continuing to scale.

Beyond that, SMS is an incredibly global and universal product. And I think WhatsApp just has a huge opportunity to serve billions of people.

In terms of what the business looks like, at the end of the day, it's a distribution business, like Facebook and Instagram. How you most effectively convert that into business opportunities for customers, whether that's through payments or ads or other different kinds of structures, we'll figure that out, what the optimal thing will be.

But the first order thing to do is to help serve billions of people here, help continue to increase engagement. And if people are spending a lot of time in WhatsApp, sending more than 30 billion messages a day, which is really crazy when you think about the volume there compared to the global SMS volume overall. And I think if we do that, there will be a number of opportunities.

People asked me this question a while ago, about how we thought about games on Facebook, as well. I always thought about our canvass business on desktop, even though it was payment, as actually the same thing as our business on mobile around app install and engagement.

What developers asked for is distribution. And whether they're doing that through payments or ads or whatever it is, it kind of is all the same. The most important thing is to help people connect, help people and businesses connect, create business opportunities. And then you get a small amount of the value that you are creating on top.

So, that will play out over the next set of years. It's one of the intellectual challenges that I'm really looking forward to tackling.

Mark Mahaney - RBC Capital Markets - Analyst

Sheryl, the size of the ad revenue that Facebook is generating and the growth, these are large budgets that are shifting over to Facebook. Any commentary on where you think those budgets are coming from? What are the source of funds?

And then I know, David, the engagement levels seem to be rising. This seemed to be a little slip in the engagement levels, that DAU over MAU ratio in Asia and the rest of world, at least sequentially. Is that just noise or is that a reason to panic? Thanks.

Sheryl Sandberg - Facebook, Inc. - COO

I don't think there's any single source of where the dollars are coming from. Certainly as consumer time and attention is shifting to mobile, the marketer time and attention, we pay a lot of attention to the marketer segments we work with. So, we're seeing strong growth from brand, from direct response like e-commerce, from SMBs and developers.

We stay pretty focused, not really on the source of where the money is coming from but what are the objectives people are spending against on Facebook so that we can meet all the different objectives. We understand that in order to continue to grow -- and we want to continue to grow -- we're going to have to serve multiple objectives on the Facebook platform, and that's what we're focused on.

Dave Wehner - Facebook, Inc. - CFO

Mark, I think the simple story is we're really pleased with how we're executing on the engagement front. 64% of people coming to Facebook monthly, coming on an average day, is, we think, a great stat. I think small changes are pretty much noise. We're really happy with it.

We talked about things like the video engagement. Mark shared some stats like how much photo sharing is going on across our properties. Overall, I think engagement is a great story for us and we are really happy with it.

Deborah Crawford - Facebook, Inc. - VP of IR

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