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Snap, Inc. (SNAP)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, everyone, and welcome to Snap Inc.'s First Quarter 2018 Earnings Call. At this time, participants are in a listen-only mode. After the prepared remarks, there will be a question-and-answer session. [Operator Instructions] . This call will be recorded.

Thank you very much. Mr. Arman Panjwani, Investor Relations, you may begin.

Arman Panjwani

Corporate Finance and Investor Relations

Thank you, and good afternoon, everyone. Welcome to Snap Inc.'s First Quarter 2018 Earnings Conference Call. With us today are Evan Spiegel, CEO; Imran Khan, Chief Strategy Officer; and Drew Vollero, CFO.

Earlier today, we made a slide presentation available reviewing our key engagement and financial metrics for the first quarter of 2018, which can be found on our Investor Relations website.

Now I will quickly cover the Safe Harbor. Today's call is to provide you with information regarding our first quarter 2018 performance in addition to our financial outlook. This conference call includes forward-looking statements. Any statement that refers to expectations, projections or other characterizations of future events, including financial projections or future market conditions, is a forward-looking statement based on assumptions today. Actual results may differ materially from those expressed in these forward-looking statements, and we make no obligation to update our disclosures.

For more information about factors that may cause actual results to differ materially from forward-looking statements, please refer to the press release we issued today as well as risks described in our Annual report on Form-10K for the year ended December 31, 2017, particularly in the section titled Risk Factors. This information can be found in our other filings with the SEC when available.

Our commentary today will also include non-GAAP financial measures. We believe that the use of these non-GAAP financial measures provides an additional tool for investors to use in evaluating ongoing operating results and trends. These measures should not be considered in isolation from or as a substitute for financial information prepared in accordance with GAAP.

Reconciliations between GAAP and non-GAAP metrics for our reported results can be found in our press release issued today, a copy of which can be found on our website at investor.snap.com.

At times in our prepared comments or in response to questions, we may offer additional metrics to provide greater insight to our business or our quarterly and annual results. This additional detail may be one-time in nature, and we may or may not provide an update in the future on these metrics. Please refer to our filings with the SEC to understand how we calculate our metrics.

With that, I'd like to turn the call over to Evan.

Evan Thomas Spiegel

Co-Founder and Chief Executive Officer

Hi, everyone, and thanks for joining us today. We began 2018 with several major Snapchat updates and we continue to make progress in growing our advertising business and building tools for advertisers. This quarter we rolled out the redesign of our application. This new design is driven by our fundamental belief that separating friends from professional content creators is important to both our mission and the long-term growth of our business. For example, we have known for a long time that creating public facing content is a very different behavior from interacting with close friends, which makes it challenging for both to exist successfully in the same ecosystem.

Before the redesign, Stories were sorted by recency, meaning that people who post most frequently were usually at the top of the list. Naturally, the most frequently posting users tended to be people who create content as part of their job compared to users who are just sharing their day with friends. As our community continue to grow keeping friends and creators in the same feed make Snapchat feel less personal because close friends were constantly buried below creators.

We addressed these issues by separating friends from creators and by making it easier to find Stories from the people closest to you. Now personal friends no longer have to compete with creators and people can find Stories based on the depth of their relationships rather than who is posting most often. We also built a new home for creators in a newly expanded Discover section. This enables us to properly invest in products discovery and monetization for our creators while also supporting a larger variety of content on Snapchat.

The redesign lays the foundation for the future of both our communication products and our media platform and we look forward to doubling down on both. As we have mentioned on our past two earnings calls, a change this big to existing behavior comes with some disruption, especially given the high frequency of daily engagement of our community.

While we had an average of 191 million daily actives users in Q1, our March average was lower but still above our Q4 average. We are already starting to see early signs of stabilization among our iOS users as people get used to the changes but still have a lot of work to do to optimize the new design especially for our Android users.

Our time spent remain more than 30 minutes per day on average following the redesign and we have also started to realize some of the positive benefits including increased new user retention for older users.

We are now focused on optimizing the redesign based on our ongoing experimentation and learning. For example, when we separated friends Stories from creator Stories, we also moved them to the left side of the camera and merged them into the Chat feed. We learned that combining watching Stories and communicating with friends into the same place made it harder to optimize for both competing behaviors. We are currently rolling out an update to address this by sorting communication by recency and moving Stories from friends to the right side of the application while maintaining the structural changes we have made around separating friends from creators and sorting friends Stories by relationships.

The redesign create a lot of new opportunities and we look forward to continuing our efforts to refine and improve Snapchat. This overall process is indicative of how we approach product development at Snap. We start with a core belief that builds on our mission of empowering people to express themselves live in the moment, learn about the world and have fun together.

In this case it is our long standing belief that separating social interactions from media content encourages people to create and share snaps with each other while also providing better opportunities and incentives for media partners. We then build and optimize our products around these underlying values prioritizing them over short term growth.

While doing so can often lead our company to take bigger risks and endure the accompanying volatility, we do this for two reasons. First, we firmly believe that it's the right thing to do for our community because it ensures that our various products maintain a cohesive vision and stay true to our mission.

Second, starting from first principles often lead us to create novel and unexpected experiences, which naturally tend to be longer term opportunities that are difficult to optimize based on short term results.

For example, our focus on self expression and living in the moment from the very beginning took a long time for people to understand and get used to but over the years has helped Snapchat become one of the most used cameras in the world with more than 60% of our daily active users creating snaps with our camera even as we doubled our user base over the past 2.5 years.

Furthermore, one of the great things about our software products is that we can modify and update them any time. This makes it easier for us to take these risks knowing that we are constantly learning and optimizing our products to better achieve our mission over the long term.

Android performance is still a weakness for us but we are making significant progress. Given the volume of changes we made with the redesign, a number of performance regressions contributed to a disproportionately negative impact among Android users and we are currently working on addressing them.

While the investments we made in our performance automation systems have significantly improved the speed and scale at which we are able to identify and fix these kinds of issues our legacy code base remains a problem. I'm really excited about the new version of the Android application that I talked about last year which has been completely rebuilt from the ground up to be lightweight performant and modular, which we hope will alleviate many of the performance related issues we see with new product launches and updates.

We've been testing the rebuilt application internally and we have quite a bit more work to do before our expected launch in Q3 of this year. In the meantime, we are incorporating some of the new modular components like Discover and the FriendFeed into the existing application, which we hope will improve performance in the near term.

We continue to lead in mobile content and augmented reality, with a lot of progress in both this quarter. During the Winter Olympics, more than 81 million people watched our coverage on Discover in nine different languages, quickly surpassing the reach of our Rio Summer Olympics coverage. In the United States alone, over 10 million people on average tuned in every day of the Games. The redesign also enabled us to experiment with our first live streaming experience so that our users could watch key moments of the Olympics in real time wherever they were.

Additionally, our content is starting to find its way outside of our application and into the world. During March Madness, Snaps submitted to Our Story appeared on stadium jumbotrons at each of the 67 games, as well as on local and national broadcast television coverage of the tournament. Over 200 media organizations have featured Snaps or embedded the Snap Map in their online, social, and broadcast television channels since we enabled the functionality just a few months ago. We believe that broadening the distribution of the unique Snaps created by our community will inspire more people to download Snapchat and create Snaps using our camera.

We expanded our augmented reality platform and offerings significantly this quarter. Lens Studio has seen incredible adoption. Over 200 of the Lenses created by our community were viewed over a million times in the few months since launch. Our community has used these tools in ways we would have never imagined, and they have inspired us to invest more in empowering their creativity. We recently upgraded Lens Studio to now support the creation of new experiences like soundboards, interactive paths, and face Lenses. We're also expanding the underlying architecture of Lenses with Snappables, our latest Lens format that helps our community collaborate and interact with their friends through augmented reality experiences.

Despite some headwinds from our redesign, our advertising business has continued to grow. While our decision to migrate our Snap Ads business to our programmatic auction led to a short-term slowdown in our revenue growth last year, we made the transition quickly and the company is far better for it. We are now better able to manage and optimize our overall advertising business and auction dynamics, which has accelerated the pace with which we can improve ROI for our advertisers.

In Q1, both the average cost per app install and the average cost per swipe in the United States were well under half of what they were the year before, and we are continuing to make improvements. Our self-serve products helped us increase the number of advertisers actively spending on our platform by twenty times over the past year, and we still have a lot of opportunity to expand from here.

With a growing advertiser base, we are now also introducing both paid and organic tools and experiences for companies of all sizes. Snapcodes unlock experiences like creative tools and sticker packs, and we are seeing brands experimenting with Lens Studio to create unique campaigns. Additionally, our product roadmap for empowering creators will also benefit small and large businesses alike and give them a better organic presence on our service.

Our total revenue for the quarter was $230.7 million, up 54% from last year. Our redesign created some headwinds in our revenue this quarter by disrupting user behavior and creating some apprehension among our advertising partners. We believe that our current path forward will address both issues, and that our advertising business has benefited and will continue to benefit from the tough decisions we make in order to create and maintain a positive and healthy environment for our community over the long term.

Thanks again for joining the call, and I will now turn it over to Imran to talk about our business.

Imran T. Khan

Chief Strategy Officer

Thank you, Evan, and hi, everyone. Total advertising revenue for the quarter was $229 million, an increase of 62% year-over-year. Evan talked about the philosophy behind the redesign, which is ongoing and a learning process. In Q1, we learned a lot based on how our users reacted to the redesign. But because of that, we also experienced some short-term disruptions to the business.

The rapid pace at which we changed the core product introduced increased volatility into our ads marketplace. While we did not grow as quickly as we wanted, our Snap Ad revenue grew 102% year-over-year and was down only 6% sequentially in a seasonally tough quarter. Additionally, during the quarter we had many conversations with our advertisers about the redesign. These have been challenging conversations as we made the proactive and deliberate decision to prioritize our long term consumer product goals over our short term monetization goals.

The impact was primarily felt in our sponsored creative tools business. On top of the expected seasonally weaker demand our Lens and Filters product which generally have a higher average selling price were challenged by a negative market narrative. We are also in the middle of transitioning these products to a programmatic audience based buy model which has negatively impacted the Average Order Value or AOV for the products.

For example, in Q1, the total number of Lenses sold was up 16% year-over-year but AOV was down 37%. This is similar to what we experienced during our Snap Ad transition. As we transition all products to our self service tool, we believe, we can drive broader advertiser adoption and ultimately a long term sustainable business.

While we anticipate that some of these factors may continue to impact our business in Q2, I'm very excited about the second half of this year. This is because of the progress we are making in our three focus areas: Number one, enhancing our ad product suite; two, developing efficient tools for our advertisers; and three, proving the effectiveness of our advertising.

First enhancing our ad product suite. In December, we launched a new ad format called Promoted Stories, which allows advertisers to leverage the familiar Stories format that our community knows and loves. But to better reflect the storytelling capabilities of this format we are now calling them Story Ads.

We recently brought Story Ads to our self service tool so that advertisers can use the same advanced targeting that they use for Snap Ads. Since launching this format in the auction users that choose to watch Story Ads viewed them for an average of over 20 seconds. We believe this is a strong indication that our community is continuing to embrace this format.

On the direct response side we continue to make great progress. We believe that when we show the right ad to the right user it creates a win-win situation. Swipe rates are one indication of whether or not we are creating this win-win situation.

Quarter-over-quarter for campaigns optimize for swipes, we increased our swipe rates by 8 percentage points while also increasing total swipes by nearly 14 percentage points. This is a testament to the great work that our ad ranking team is doing to show the right ad to the right person.

We're also continuing to evolve our formats and I'm really excited about our recent launch of Shoppable augmented reality. Since bringing Lenses to market in 2015, we have seen this product drive tons of engagement and even create pop culture moments but we wanted to bring the power of creative tools to our direct response advertisers. While users are playing with the lens in the camera, advertisers can now include a button that will redirect them to a long form video website or the App Store.

The first brands to try this new format include sports company Adidas, maker of the Candy Crush video games King and makeup brand Clairol. As we scale adoption of this product, we are confident that it will help accelerate the growth of our lens business as well.

Our second area of focus is developing efficient tools for advertisers. As we have outlined before, one of our key priorities is to grow our SMB or Online Sales business. The vast majority of businesses are SMBs, and they are increasingly adopting digital marketing platforms to grow their businesses. In order to onboard these advertisers, we have been rolling out our self-serve tools and investing to create a frictionless ad buying experience.

We made good progress this quarter as evidenced by 30% quarter-over-quarter revenue growth for our SMB business. We're also launching sophisticated tools for our large advertisers. For example, we recently launched our reach and frequency tool for Snap Ads to a handful of select advertisers in the U.S. and U.K. This has been a key request from advertisers looking to plan and buy in advance on Snapchat. Only a few other scaled platforms have brought this tool to market, and it offers predictable delivery and pricing something that is very valuable for large brand focused campaigns.

We launched Reach and Frequency within our self-service platform and are partnering closely with Unilever, U.K., P&G, U.S., Google, U.S., and U. K. and Microsoft, U.K. There's still a lot of work to do to fully bring this tool to market, but we're excited that this new buying method will empower advertisers to efficiently share their stories on our platform.

One of the products I'm most excited about is Snap Pro for Business and Creators. This product will be made for public entities from public figures to local businesses to charitable causes that want to use our platform to organically reach an audience beyond friends and family. With Snap Pro, it will be easier to manage a public profile, create and distribute content, understand audience insights, and ultimately, advertise with us. We're still extremely early in our roll-out plan and just recently onboarded a select group of brands and creators.

For our third area of focus, we remain strongly committed to proving the effectiveness of our advertising. ROI is the best incentive that we can offer our advertisers, and we have been working tirelessly to show it across multiple products and verticals. This quarter, we made great progress scaling adoption and usage of Snap Pixel. We nearly tripled the number of advertisers using the pixel quarter-over-quarter. We're seeing that this capability drives strong results, primarily for our SMB and commerce advertisers.

One great example is the Ridge, a wallet brand that used Snap Pixel to create both custom and lookalike audiences based on people who made a purchase on their eCommerce site. This strategy delivered. They drove a 4.1 times Return on Ad Spend. It also delivered a 55% decrease in Cost per Action, or CPA, allowing the company to achieve an overall CPA that was more than 20% lower than on other ad platforms.

We are excited for the future of Snap Pixel as we continue investing in improvements such as the ability to optimize delivery based on lower-funnel events. We also understand how important it is for advertisers to measure impact across platforms. From television to social platforms, we want to demonstrate that advertising on Snapchat increases value to an advertiser's overall strategy.

We recently collaborated with Nielsen, using their Total Ad Ratings, which allow advertisers to measure the incremental reach of their Snapchat campaigns relative to TV campaigns. Despite being outspent 25:1 by television, Snapchat campaigns were able to deliver 8% incremental reach on top of TV campaigns for the same set of brands.

Finally, we are continuing to work with our third-party ecosystem to demonstrate ROI for all verticals. We conducted a series of custom marketing mix model studies with Nielsen to measure the effectiveness of Snapchat advertising within the beer category. The studies showed that Snapchat was more efficient than both traditional channels and other forms of digital media.

Snap Ads outperformed the category media average Return on Ad Spend by 4.7 times, while Lenses and Filters outperformed the media average Return on Ad Spend by 4.3 times. Overall, I'm really pleased with the progress we're making and I'm optimistic about the future of our business.

Thank you for your time. I will now hand it off to Drew for a financial update.

Andrew Vollero

Chief Financial Officer

Thanks, Imran, and good afternoon, everyone. In the quarter, we made continued progress against our three financial goals. First, grow users and sales; second, leverage our cost structure; and third, soundly manage cash. As Imran mentioned, sales grew meaningfully year-over-year. Equally important, sales growth continues to well outpace our cost growth year-over-year.

Over the past few years, we've worked hard to make the right long-term decisions for our business. One of our core financial strategies was to invest early ahead of the sales curve to build the right cost structure that we could both scale with our growth and leverage over time.

In the first quarter, we successfully leveraged our cost structure. Year-over-year sales growth was over one and a half times our cost growth, and sequential costs were up only 1% in the quarter. On a per-user basis, ARPU increased 34% year-over-year, twice as fast as our CoRPU growth. Cost of revenue grew modestly, and operating expenses were sequentially down for the second time in three quarters, excluding restructuring charges.

An efficient cost structure is a central part of our financial roadmap. We will continue to invest in strategic areas like innovation, new products, and people to fuel future growth. That said we believe many of these opportunities can be funded by running our business more effectively, in areas like the back of house and hosting infrastructure.

As we continue to successfully manage our cost structure, it should continue to yield two key benefits. First, we see strong incremental flow-through on revenue growth; and second, we can continue to moderate our cash burn, which we did again in Q1, as cash burn was less than half the rate from a few quarters ago.

Let me now expand on the results from the quarter. First, global revenues were $231 million in the first quarter, and we saw growth in every region. International markets now represent 26% of our total revenue, up from 14% a year ago and 23% in Q4.

Consistent with prior quarters, the fastest growing product in Q1 was Snap Ads, and specifically, Snap Ads sold programmatically. Strength in Snap Ads more than offset softness in Creative Tools sales, which were down in the quarter.

As expected, auction revenue gains were driven by growth in ad impressions, partially offset by Snap Ad pricing. Let me share some numbers with you. First, Snap Ad impressions, excluding Story Ads, were up over 450% year-over-year and over 15% sequentially. Second, overall Snap Ad pricing, excluding Story Ads, was down nearly 65% year-over-year and nearly 20% sequentially.

Third, we ended the quarter with 95% of our Snaps Ad impressions, excluding Story Ads, served programmatically, up from 90% in the prior quarter. In the quarter, we added many new programs to the Discover page. In February, we partnered with NBC to bring the Winter Olympics to Snapchat users. We offered a series of creative ad products and packages to our advertisers, which drove incremental revenues for the business. Financially, the Olympics were a nice revenue boost, but comprised less than 10% of total revenues for the quarter.

Now, let me talk about expenses. Please note that when I discuss all of our expense figures, including gross margins, they will exclude stock based compensation and related payroll taxes as well as depreciation and amortization and non-recurring charges.

Cost of revenue expenses grew 7 million in the quarter, driven by three factors: first, higher revenue share on Olympic content; second, incremental infrastructure costs related to the launch of the app redesign; and third, the addition of 4.2 million new DAUs.

Hosting costs per user increased from $0.70 in Q4 to $0.73 in Q1, but hosting cost increases moderated during the quarter as our engineering team continued to optimize new code to reduce infrastructure expenses.

On operating expenses, the primary driver remains people cost. Over the last few years, we have consistently invested to build an organization with the scale to compete. We hired over 2,400 people in the last two years and we're now digesting that rapid growth in an evolving world.

As a result, during Q1 we had a 7% reduction in force, in order to better align resources around our top strategic priorities and reflect structural changes in our business. Consistent with earlier disclosures, the company recorded a charge of 9.9 million in the first quarter, but those charges have been adjusted out of EBITDA.

We expect to realize $7 million to $8 million in ongoing savings per quarter. In the first quarter, OpEx costs were 257 million, down 1% sequentially, and overall head count declined 3% for the period.

Let me briefly touch on our capital deployment priorities, which remain reinvesting in strategic areas of our business like product, content, AR, automation, and international expansion as well as opportunistic M&A.

Q1 CapEx remained modest at 36 million and we ended the first quarter with 1.8 billion in cash and marketable securities. As of March 31, 2018, total shares outstanding were 1.254 billion and 1.457 billion on a fully diluted basis.

Let me now share some near-term observations on our business; first, as we think about our year-over-year revenue growth rates, we are planning for our Q2 growth rate to decelerate substantially from Q1 levels, with growth in auction impressions, partially offset by pricing for both Snap Ads and Creative Tools.

We are planning for infrastructure costs to increase modestly in the short-term as we continue to test and rollout further changes to the application, partially offset by hosting cost efficiency programs. Revenue share expenses should moderate without Olympic content.

We continue to plan for modest operating expense growth in the near-term. Consistent with last quarter, we are planning for the first half of 2018 to grow by low double-digits versus the back half of 2017, excluding one-time charges. Please note operating expenses exclude cost of revenue, stock-based compensation, and our move to Santa Monica.

Consistent with prior disclosures on the Venice exit, we expect to incur $25 million to $45 million in charges throughout 2018, primarily in the second and third quarters, to reflect the exit cost of these Venice buildings. The majority of these charges are cash payments due on remaining lease terms. We are planning for CapEx to be slightly elevated in the nearterm, as we continue our build-out of leased Santa Monica facilities and execute our move facilities and execute our move throughout 2018.

With respect to stock-based compensation and related payroll tax expense, our Q1 expense was $143.2 million. Please note that this number included a one-time benefit of $32 million, as a result of the reduction in force plan we implemented during the quarter. We believe that the stock-based compensation rate in the second half of 2017 is a good proxy for the short-term. Future acquisitions will likely be additive to this amount.

With that, I will now turn the line back over to the operator to open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: That concludes the prepared remarks for today's earnings call and we will now begin the question-and-answer session. [Operator Instructions] And our first question will come from Ross Sandler with Barclays. Please go ahead.

Ross Sandler

Q

Great. Two questions guys, one for Evan and then one for Drew. Evan on the DAU it seems like any time you guys are making changes to the Android app you're running into some performance issues and DAUs tend to drop off. So I guess what gives you the confidence that as you shift this new Android code in the second half of this year that we'll see a stabilization? And when do you expect Android use to start kind of consistently picking up?

And then Drew you mentioned that 2Q revenue growth will be substantially lower. So is that just the Olympics impact coming out? Or can you talk a little bit more specifically about the deceleration in ad revenue versus the 61% in the first quarter? Thank you.

Evan Spiegel

A

Ross we should have made a lot of changes faster in our engineering organization and really put Android first. Now and starting last year, we started rearchitecting the entire application and rebuilding it from scratch. And we now have a bunch of those components and we're testing some already in the application. But ultimately it's the rearchitecture that will make a big difference.

And I think beyond just the performance improvements that we're going to see it will also enable our entire team to move a lot faster as we build new features. Right now if we build a new feature the code base is so complex. We tend to break other things. And I think reducing the complexity through modularization will make a huge difference in our ability to execute quickly on the product road map.

Andrew Vollero
Chief Financial Officer

A

So Ross as it relates to the second quarter we remain focused on the strategic activities of the business not necessarily the near term financial targets. We're really focused on improving the redesign, improving Android, driving new users to the platform, driving our advertisers' ROI. If you look at the platform itself at the product level we have strength in Snap Ads the direct response business is doing quite well. International has been growing for us as well.

But look at the end of the day we are transitioning right now to the creative tool business with Imran talked about in his opening remarks. And we really are focused on being the value leader in the advertising platform. And so what we're not doing is playing the pricing game to maximize short term revenues. We're really more focused on bringing advertisers to the platform and making sure advertisers have solid ROIs. There was a modest boost in the quarter as you mentioned to Olympic revenue which we don't expect to continue in Q2 but that's not a big piece of the story here.

Operator: And our next question comes from Mark Mahaney with RBC Capital Markets.

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Operator: And our next question comes from Mark Mahaney with RBC Capital Markets. Please go ahead.

Mark Mahaney

Q

Okay. Thanks. In the past I think you talked about crash levels on the Android app. Any sort of update there as to how they're trending? And then you talked about the disruption to users. What have you seen in the quarter so far in terms of those disruptions to users? Any impact on engagement? Does it seem to you like you're back to normal with your user's use of the app? Is there still a lot of experimentation? Just how would you address the volatility of the overall user base in response to the redesign? Thanks.

A

Thanks Mark. No specific updates on the crash levels. I do want to talk about one of the big changes that we're making to Snap which I think will make a big difference. When we redesigned the application we combined the Stories and Chats from your friends onto the same page. And we like having all the stuff from your friends in one place, because it was a lot easier to find. But we didn't realize how hard it would be to optimize for those two different behaviors talking with friends and watching their Stories. And it turns out it's really hard to optimize for both at the same time.

So one of the biggest changes that we're making is moving Stories from your friends over to Discover page and putting them at the top of the page. So they'll still be separate from all the other content on our service. But that way your friends come first no matter where you are in the application but we can still optimize for watching content on one side of service and communicating with friends on the other. So that's a big change coming and we think it'll make a difference.

Operator: And our next question is from Justin Post with Bank of America Merrill Lynch. Please go ahead.

Justin Post

Q

Great. Two things. I think in your prepared remarks you said users were stabilizing in April. Maybe you could revisit that a little bit. And then Imran how much of the 2Q deceleration is related to the redesign? And how are you thinking you mentioned you expected a big back half. How would you think about an improvement in the back half on advertising? Thank you.

Imran Khan

A

Yes. Hi. So let's take the second question first. So I think one of the things that we have done we listened to our advertisers very closely and what are the products that they want. And I think in my prepared remarks we talked about how we are – we have launched reach and frequency with few advertisers. We're also launching Snap Pro which will let people to create content. And then ultimately promote those content. We are also launching lower funnel optimization for our performance advertising product. All of those things I think will significantly help our advertisers to take leverage of our platform. And then on top of that what we're doing in terms of on ad ranking side by improving swipe rate and showing the right ad to the right users. And as our mission gets better and better I think there's a lot of opportunities on that. So I'm really optimistic that I think we're doing the right thing and building the right thing. In terms of Evan's comment on, I think we said we are seeing early sign of stabilization on iOS.

Operator: And our next question comes from Stephen Ju with Credit Suisse. Please go ahead.

Stephen Ju

Q

Okay. Thanks. So Evan I think at the time of the IPO one of the concerns was the need for your ad ops team to essentially vet the creative so that it fits in with the surrounding content and does not work against the consumer experience. But now that you are going more self service you have certain instances, which I guess result in the negative market creative you touched on earlier. So it seems like there's a need to police the ad creatives as well. So is there a technology base or some other type of solution that can look for that type of ad content to take that down? And Imran, a question on the Story Ads. Is the need to reformat the ad content to vertical presentation still a headwind for you? And if so what are you doing to help advertisers either from a technology or product perspective? Thanks.

A

Stephen yes, we had a lot of empathy for the ad reviewers who work on our business. It's a tough job. We really consider them digital first responders in a sense. And so we're definitely building out a lot of programs to try and help them do their jobs more effectively and we always feel terrible when mistakes are made. But we're making progress there. And really we want to do our best to support the team doing their job.

A

With regards to Story Ad I think what we're seeing that market is more and more embracing our format. I think three 3.5 years ago when we started the ad business I think this full screen vertical video was very foreign to many advertisers and we had a lot of pushback.

But I think, over the years we have seen that advertisers are seeing the value of the full screen ad and the storytelling ad. And we are seeing that other advertisers – other publishers also are embracing this format.

So I think it is – the headwind is getting better and I think we're also building a lot of creatives. And I think one of our mission is creating frictionless ad creation experience. And I think we're making a lot of progress there and we continue to invest on the technology.

Operator: Our next question comes from Heath Terry with Goldman Sachs. Please go ahead.

Heath Terry

Q

Great. Thanks. We've seen some of the changes that you're talking about in terms of separating out Stories and – from Snaps and sort of the next evolution of this redesign. Realize it's extremely early but any sort of indication in terms of how users are reacting to that? I know you're not going to go into specific metrics but just even qualitatively what you're hearing from them.

And then to the extent that we're sort of seeing pricing fluctuation the way we are in the early innings of your moves into programmatic any sense sort of where pricing on any sort of like-for-like basis is shaking out between where Snap and other major digital platforms would be?

I know it's not always easy to compare apples and oranges but whether it's an ROI metric or a price per engagement would be curious in any benchmarking you might be able to share insight into.

A

When we build products we're not just thinking about what our community is going to like to use right away. We're thinking a lot about how our products that we build will help us accomplish our mission. So we build things that we believe that will help us empower people to express themselves live in the moment, learn about the world and have fun together.

And so I think it's really important to understand that people think about self expression on Snapchat in different ways. So some people would rather create content with just a small audience and their friends and other people want to create content if they have a much bigger audience because they want to reach more people.

And so our job is to make Snap work well for all different types of people so that we can empower people to express themselves. And with the redesign in particular, we tried to make Snapchat feel more personal for people who want to use is exclusively with their friends and also more valuable for people who want to use that large audience because we want to do both really well. So we believe the redesign brings us closer to accomplishing our mission and we're continuing to iterate very quickly on the things that we don't like.

A

With regards to pricing we are really focused on driving advertisers' ROI and bringing more and more advertisers on our platform. Because when you have a lot more users we have more choices to show right ad to the right users. And I think we're also a new platform so we want advertisers to learn our platform and how to win on our platform. And so fundamentally, we're not really focused on pricing right now. We're more focused on bringing more advertisers on the platform and helping them understand our platform.

Operator: And our next question comes from Mark May with Citi. Please go ahead.

Mark May

Q

Thank you. I think you mentioned earlier that the pricing is down 65% year-on-year and then when talking about the substantial decel in Q2 I think you noted that pricing is the primary driver there. I guess the question is where are we in that adjustment period? And at what point do you expect that pricing will begin to stabilize? And then in terms of the redesign with putting friend Stories above Discover content, what impact do you think that that'll have on engagement with commercial content and ultimately with some of the ad revenues that flow through that part of the channel? Thanks.

A

So as it relates to pricing the 65% decline year-over-year really represents the change in selling method. We use to have a direct sales force that sold the ads top of funnel. Now we've gone to programmatic and so that's really led to the year-over-year decline. I'll echo Imran's sentiments. Right now, the key activities that we're focused on are really bringing advertisers to the platform. We need a broader base of advertisers using our product. And then similarly, we're very focused on ROI. We do think that will be the number one metric for us in the long-term success. So that's where we're focused on far more than sort of where pricing bottoms out. We don't have a near term plan for that.

A

In terms of the Discover product, we believe that making Snapchat the best place to express yourself within the moment, learn about the world and have fun together will build a larger audience for creators and ultimately benefit them. And we're also introducing a lot of new tools this year for creators which we believe will inspire them to continue creating great content for Snaps. So ultimately, we're taking a long view here. And we believe that as users experience, our products we'll be able to build our audience and that will benefit creators.

Operator: And our next question comes from Lloyd Walmsley with Deutsche Bank. Please go ahead.

Lloyd Walmsley

Q

Hi, thanks. See if I can. First Imran, I think you said March average DAU was lower than 1Q average, but still up from the 4Q average. It seems to imply that may be March ended lower than where you were in December kind of on a period end basis. Can you kind of talk about if April is down from March and then do you think the early results from moving friend Stories back to the right side of the camera that does suggest that alone can help stabilize the DAU?

And then secondly, can you give us a sense for what percent of ad revenue now is coming from performance advertisers and maybe a sense of how the more sophisticated performance advertisers who have adopted the best most sophisticated tools, how they're scaling budgets close those adoption rates and maybe give us an update on the percentage of Ad Age 100 that are still spending from the kind of 1Q 2016 period [indiscernible] give us that would be great?

A

Yes. I'll take from the like last questions first. Look I think we're seeing great success with a lot of the large advertisers. We strengthened our relationship with several brands like take McDonald's as an example. They have pushed a multi-product approach for nearly every campaign. All is looking to test optimize and learn with us. In fact, they were one of the first advertisers to test audience Filters and auction creating seven different filters and targeting each one of -- each one to a niche audience.

But most importantly, over the years Snapchat has gone from being a platform that McDonald's would leverage periodically to an always on long-term partners. Year-over-year McDonald's grew their investment triple-digit with us, so we're really pleased, we have a lot of success stories like that. We are becoming true business partner for lot of large advertisers. But at the same time, we're seeing healthy growth in our performance advertising campaign. And I think we've got great feedback from them, and based on that we're trying to bring creative tools also to the DR customers. And that business is growing very healthy rate and we're very, very excited about it.

With regards to DAU, I think we gave you the average for the quarter was 191 million. Q4 average was 187 million. I believe what Evan talked about in his prepared remarks that March was lower than our Q1 average of 191 million, but higher than the Q4 average of 187 million. So that should give you a pretty good guidance where the numbers were in March.

Operator: And then our next question is from Jason Helfstein with Oppenheimer. Please go ahead.

Jason Helfstein

Q

Thanks. Want to dig a bit more, I give a following to what you just said. So for all the examples of McDonald's up triple-digits, I guess, how much of the weakness or relative to what we were all expecting was from advertisers who pulled back because of call it a misunderstanding or questions or publicity? And to the point is like what does it take to get those advertisers back? And is that the point being you expect those advertisers to be back in the third quarter? Just go a little bit deeper into that. What caused the advertisers who were spending to pull back? And what makes you -- and what gives you confidence they come back?

A

Look, I think, thanks for asking the question. At the end of the day advertisers are rational. They want to advertise and they want to drive return on their ad spend. But at the same time they're human. When there's a lot of negative news on the press every day, it does give people pause. It does influence people buying decisions. It's very hard to handicap what percentage, but that does come out on the conversation and become a disruption on the selling process. But I think the way to win is by improving ROI right? The examples like McDonald's or some of the examples that I shared on the call.

When we go improve advertisers that the money that they spend and we drive value for them, it's really, really important. I think one of the things that's really important to understand that the Snapchat's position in the millennial audience, right? There are over 90 million millennials in the U.S. today and they represent the single largest generation ever defined. Millennials are expected to become a huge economic force in the coming years. They're already dominating a lot of buying decisions. And we have a very strong position in that demographic. And some of the investment that our product team and engineering team did to showing the right ad to the right audience, I think that we and we just need to prove those ROIs and educate the market. And that's ultimately drive value for everybody.

Operator: Our next question comes from John Blackledge with Cowen. Please go ahead.

John Blackledge

Q

Great. Thank you. So ad impression growth has been significant the past several quarters. Just wondering how you feel about ad loads and ability to raise ad loads. And then just any update on engagement. I'm not sure if you mentioned that on time spent on the platform anything there would be helpful? Thank you.

A

Yeah. I think, again, when I think about the problem is ad is a piece of content. And when it's a piece of content you have to show the most relevant content to the most relevant person. And that really drive the engagement, right? If I show you one content that you don't care about it, if you're sure you one piece of content, you will be annoyed. If I show you three great piece of content that you really, really like and you want to engage with it that you will like it. So I think rather than thinking about the ad load what we have been challenging our product team and our engineering team are we doing the best job showing the most relevant content to our users. When you do that everybody wins. And I think one of the things I talked about in the call that how we saw 8 percentage point increase in swipe rate. And I think that's really, really exciting and that's something I think there's a lot more work to be done. And we continue to push our team to do that. In terms of time spent, I think Evan mentioned in the call that more than over 30 minutes people are continue to spend on the platform over 30 minutes.

Operator: Our next question comes from Douglas Anmuth with JPMorgan. Please go ahead.

Douglas Anmuth

Q

Thanks for taking the question. Just first you talked about self serve helping increase advertising number 20x over the past year. I'm just curious, if you can quantify that number? And then Imran can you just talk more about the content moving to always on spending and how much that's actually happening across the platform at this point? And then just quickly do you think you're seeing an impact to users from competitive entertainment like Fortnite and PUBG? Thanks.

Imran T. Khan
Chief Strategy Officer

A

So with regards to – look I think in terms of number of advertisers we launched our self serve platform in Q2 of last year. So it's a very new platform. So we have lot of other room to grow our number of advertisers on our platform. And I think and so we have a lot of work to do and we're very pleased with the growth. But we want to grow faster and there's a lot of room to grow. With regards to competitive pressure from games like Fortnite my son who is eight years old loves playing that game. I played with him over the weekend. But I think it's really hard for me to see here and predict how that spending impacting time on our platform at this point.

Operator: Our next question comes from Brian Nowak with Morgan Stanley. Please go ahead.

Brian Nowak

Q

Thanks for taking my questions. I have two. The first one appreciate the color around the Snap Ad versus their creative tools the Lenses growth in the quarter. Wondered if could you talk us through how we should think about the growth trajectory of those two businesses over the course of the year maybe the relative size sort of think about the puts and takes on revenue growth and seeing those two buckets this year. And the second one you talked a lot about the focus to bring more advertisers onto the platform. Maybe talk through philosophically how has your advertiser on-boarding process changed between large advertisers and SMBs? And what are the keys to success going forward?

A

Good. As it relates to the product mix we've never really quantified the difference between the Snap Ads and the creative tools. To give you sort of sense maybe a couple of years ago about the size of a business we described in the sort of a good one two combination in both very meaningful to our business. I would say with a move to programmatic over the last 6 to 12 months the Snap Ads business has become a much bigger piece of our business than the creative tools. And so the Snap Ads business continues to grow. We have good traction internationally. We have good traction on the DR side of the world. So we're definitely seeing that being the engine that's fueling our growth right now. I think the creative business will continue – the creative tool business will create continue to transition that as we commented on in the second quarter here those are – that's what we're seeing in the near-term. So right now the bulk of the revenue is being driven by the Snap Ads business. And that's really the engine that's going to fuel our growth in the near-term.

A

Yeah. I think to add on Drew's color I think our creative tool business also have a lot of opportunities. Like more recently we launched Lens Studio for example. It's really democratized who can create Lenses. I think one of the big challenge for a lot of small businesses to create creative tools is that they have to work with us directly but as the Lens Studios and those they have opportunity for a lot of advertisers to embrace this creative tools business that's also opened up new revenue opportunity for us.

So I think we feel very excited about that how we are monetizing camera and at the same time we are monetizing content on our platform and how there are a lot more opportunities to do that.

With regards to your second question, how we are addressing the market, we break up ourselves as I mentioned in two different groups. One is DSO, our Direct Sales Organization who focus on the large advertisers and they are really a sales consultant for those. The second bucket is our global online sales team. So that has combination of inside sales and our channel partners. So we partner with other channels who actually sell on behalf of us as well. So that's how we're trying to cover across the market and educate them about the platform and help onboard more and more advertisers on the platform.

Operator: And our next question comes from Rich Greenfield with BTIG. Please go ahead.

Rich Greenfield

Q

Hi. Few questions. First just housekeeping, I wanted to follow-up on the question before regarding Evan's commentary on DAUs. If you look at kind of March 2018 quarter end, should we infer basically is the inference essentially that March quarter end for 2018 was actually below December 2017 quarter end?

And then two on product Evan you mentioned shifting friend's content over to the right, which I certainly understand. But part of the new right side redesign not only was it algorithmic but it was also kind of everything. So it was like one solid flowing experience where it almost felt like you got lost and you were just clicking – you'd have this kind of infinite array of content.

Now as you start to separate out friends from everything else kind of brand/influencers, how does that impact time spent in the Discover/influencer content on the right side relative to friends? And then just a part of that could that actually cause a disruption as you kind of shift the stories back to the right? Are we looking at another potential disruption in user behavior as people get used to that type of a change back that would be really helpful. Thanks.

A

So overall as we look at the redesign – the thing that we're most excited about is creating this infinite scroll of content. As you mentioned in the past the right side of the application really only had your friends stories and a very small select group of publishers without a lot of personalization. And so I think one of the really great things that we've been able to accomplish with the redesign is putting your friends at the top, making them most important, but also still opening up into this world of personalized content below.

So I think we're going to get the best of both worlds in that sense and still create an environment where people feel empowered to express themselves. And I don't think we can give you any specifics on the earlier DAU question but we're excited about the progress we're making.

Operator: Your next question comes from Anthony DiClemente with Evercore. Please go ahad.

Anthony DiClemente

Q

Hi. I just wanted to follow-up on that question about content. In terms of – it just sounds based on what you said Evan that there could be a transition in emphasis to user generated content given the changes in the Discover tab. And I guess if not maybe just what is your forward strategy with respect to licensed professional content from here?

And then a question for Drew. You stated in your prepared remarks that future acquisitions will likely be additive to stock based compensation. So I'm curious what areas is Snap actively pursuing in terms of M&A? And how do you think about balancing the potential M&A with your priorities around cash management from here? Thanks.

Andrew Vollero
Chief Financial Officer

A

Let me take the second one first and then I'll turn it over to Evan. Look we've had a lot of success managing our cash burn rate over the last couple of quarters. We've reduced it by over the 50%. How we've done that is we've really focused the strategic capital deployment priorities here at the company. We're really focused on investing in our business. The M&A here will be very opportunistic. If we see the right thing at the right time at the right price we'll go ahead and make that happen.

But right now, we're focused on really the key strategic activities growing our business around the app we design, around Android, new advertisers' ROI. Those are the strategic priorities in the business. If we have a chance to be opportunistic with an acquisition we'll go ahead and do that.

Historically the acquisitions have been pretty tuck-in in nature. They've been focused more on technologies and talent that they have been sort of robust acquisitions, big companies, big business models et cetera. So that's where we've been focused to-date. And I'd love for again our strategy priority for cash related investment in the business.

Evan Spiegel

A

Ultimately user generated content has obviously been a strong suit for us for a very long time because we're so focused on powering creativity, opening to the camera and building all these creative tools and inspire people to create. I think as we look at the redesign the opportunity for publishers and creators, we're definitely excited about the progress we'll be able to make for both.

Last year we delivered $100 million in revenue to our partners and we're excited to build on that. So I think publishers will pay -- play a very important role in the future and also create more opportunities for creators and influencers to be successful on Snap.

Operator: And our next question comes from Youssef Squali with SunTrust. Please go ahead.

Youssef Squali

Q

All right, thank you very much. Two quick questions for me. First maybe Evan, you referenced changes in market narrative as a reason for the softness. Just trying to understand kind of the other side of that is for the market narrative to change again. I'm assuming this is on the advertiser side. If there's really no control necessarily in terms of timing. So you talked about how Q3 is going to be an inflection point for that just trying to get a sense of if advertisers have now so to speak put you guys in the penalty box what kind of gives you the confidence that you can get out of it within a quarter?

And then on the profitability side there were some news reports talking about how maybe you gave directives internally to accelerate dramatically accelerate the profitability of the business. First is there any truth to that? And second how do you look at and maybe this is a question for Drew party as well balance out the profitability versus the doubling down of the investments as you suggest in your prepared remarks? Thank you.

Evan Spiegel

A

So in terms of profitability obviously building a sustainable business is what's going to allow us to pursue our mission for a really long time so it's something we think about. And I think we've made great progress over the last few years towards being able to fund our own growth. I think if we look at the big transition we made last year to our programmatic advertising business I think the really great benefit of that is we've gotten a lot better at showing advertisers' ROI. So the market narrative I think will matter less over time as we continue to improve our measurement capabilities and to really deliver that for advertisers, so excited about the progress that we're making there. And you're right that it's important to focus on performance business.

Andrew Vollero
Chief Financial Officer

A

So at a high level just to build on Evan's comments I mean it makes sense for us to go built toward a breakeven. It's the logical next step for our business. But let's be clear we don't manage against that. There's no time line to arrive at that at a certain date. The key thing to remember is that that's going to for us begin with growth. We need to continue to grow our user base. We need to grow revenues. We're going to keep investing in areas like product innovation, AR and content to name a few.

That said, Snap for breakeven also is going to revolve around carrying water on both shoulders. We have to be sensible about our cost structure. We have to moderate cost growth where it makes sense. We have a large infrastructure company, our size. We're built for growth and you saw that in Q1. We're able to leverage the cost structure. Our cost growth was only up 1% sequentially. So there are opportunities for us to do things better and that should allow us to continue to make investments that will fuel our growth.

Operator: And this concludes our question-and-answer session as well as Snap Inc.'s First Quarter 2018 Earnings Conference Call. We thank you for attending today's session and you may now disconnect.