SNAP INC. Q2 2018 TRANSCRIPT

ARMAN PANJWANI, INVESTOR RELATIONS

Thank you, and good afternoon, everyone. Welcome to Snap Inc's Second Quarter 2018 Earnings Conference Call. With us today are Evan Spiegel, CEO and Co-Founder; Imran Khan, Chief Strategy Officer; Tim Stone, CFO; and Kristin Southey, our new VP of Investor Relations.

Please note that the format of this call will be slightly different than the calls we have hosted previously. To allow more time for questions, Evan will provide a brief strategic update and Tim will provide a brief business overview and financial outlook for Q3 2018 before we open the line for Q&A. We have also included additional supplemental financial information and business metrics for reference in our press release.

Earlier today we made a slide presentation available that provides an overview of our user and financial metrics for the second 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 second quarter 2018 performance in addition to our financial outlook. This conference call includes forward-looking statements. Any statement that refers to expectations, projections, guidance, 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 quarterly report on Form 10-Q for the quarter ended March 31, 2018, 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. Please note that when we discuss all of our expense figures they will exclude Stock Based Compensation and related payroll taxes as well as Depreciation and Amortization and non-recurring charges. At times in our prepared remarks, or in response to questions, we may offer additional metrics to provide greater insight into 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 SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Hi everyone and welcome to our Q2 earnings call. I'm really excited by the progress we have been making at Snap, and I am optimistic about the opportunities ahead as we continue to improve our team, reinforce our culture, and invest in innovation.

We have focused a lot of our time and effort this past year on developing our team, culture, and leadership that we need to rapidly scale our business. Our team is passionate about our mission to contribute to human progress by empowering people to express themselves, live in the moment, learn about the world, and have fun together and we've redesigned our performance management processes to incorporate our values of being kind, smart, and creative. For us, it's not just about the work that we do – it's about the way that we do it – and we've worked hard to make sure that this positive attitude is reflected across our company. It has been so exciting to watch our team rise to the challenge of building a public company while continuing to innovate and drive long-term value. Our team is much stronger today than it has ever been before.

While our Monthly Active Users continued to grow this quarter, we saw a 2 percent decline in our Daily Active Users. This was primarily driven by a slightly lower frequency of use among our user base due to the disruption caused by our redesign. It has been approximately six months since we broadly rolled out the redesign of our application, and we have been working hard to iterate and improve Snapchat based on the feedback from our community. We feel that we have now addressed the biggest frustrations we've heard and are eager to make more progress on the tremendous opportunity we now have to show more of the right content to the right people. For example, the number of people that watch Publisher Stories and Shows on iOS every day has grown by more than 15 percent this year, and we are excited to bring the learnings from our iterations on iOS to our Android application. Additionally, more Snaps from Publisher Stories and Shows were viewed in July than any other month in our history.

With the updated redesign, we've been able to combine the strength of our close-friend network that brings people to Snapchat every day with an infinite scroll of personalized content. We're working hard to expand the long-tail of our content offering and we are making steady progress on improving personalization. Despite our DAU results this quarter, we believe that this is an important evolution of our product that will help drive future growth in engagement. Our users continue to spend an average of over 30 minutes on Snapchat on a daily basis, and we are already starting to see meaningful improvements in leading growth indicators like new user retention. For example, new user retention for people older than 35 has increased more than 8 percent since we launched the redesign.

We want Snapchat to work well everywhere for everyone, no matter the device or network, and we've been focused on improving the quality of our application on lower-end devices and partnering with carriers to make Snapchat more accessible for everyone. New Snapchat users are predominantly using Android, and we've been working for over a year to completely rewrite our Android application. Even though our iterative efforts to improve the existing application have helped increase new user retention on Android by nearly 20 percent since Q4 of 2016, we believe that rewriting the application presents a big opportunity because it takes advantage of the latest Android capabilities and has a modularized structure that will make it easier for us to innovate in the future. Our internal tests in our device lab show substantial improvements in important application performance metrics, like the time it takes to open Snapchat and create a Snap, and we are beginning to test a limited version with beta users in select countries.

Augmented reality continues to be a massive long-term opportunity for us and we recently started rolling out Lens Explorer that allows users to browse thousands of Lenses built by our community using Lens Studio. Lens Explorer celebrates the ingenuity of our community and increases the creative power of the Snapchat camera. We also released Snappables, new augmented reality experiences that can be shared with friends. Snappables help reduce the friction from self-expression and they're a ton of fun to use together. For example, Selfie Mix, one of our first Snappables, was used to create over 300 million Snaps.

We're really excited about the progress we are making with Spectacles, our sunglasses that Snap. We released a new version of Spectacles this quarter and we are learning a lot as we continue to iterate based on customer feedback. When combined with our efforts in augmented reality, we believe Spectacles represent an exciting opportunity as we build towards a future where computing is overlaid on the world.

It has been almost two years since we began the transition to programmatic advertising, and our team has moved quickly to build out advanced targeting, measurement, goal-based bidding, near real-time analytics and insights, and so much more. All of this has resulted in lower cost-per-impression, cost-per-swipe, and cost-per-install for advertisers, while simultaneously growing our advertising revenue 48 percent year-over-year. Our advertising is now cost-effective, easy to buy, and easy to measure. This has removed friction from our advertising business and allowed us to scale to many more advertisers than we could have reached with our direct sales force. Even though this transition wasn't easy, it was the right thing to do for our business over the long-term, even at the expense of short-term revenue growth. These are the types of opportunities that inspire our team and play to our strengths because they require strong conviction and a belief in the long-term.

I'm really proud of the progress we're making towards building a sustainable business and generating free cash flow. We feel good about our cash position as we move forward and scale our business.

I'd also like to take this opportunity to introduce Tim Stone. He has brought a wealth of operational experience and a new perspective to our business and we are grateful to have him on our team. I'm going to turn the call over to Tim to share more about the progress that we are making.

TIM STONE, CHIEF FINANCIAL OFFICER

Thanks, Evan.

Our second quarter financial results reflect our focus on growth and operational efficiencies.

Q2 2018 operating cash flow was ($199) million, an improvement of $10 million compared with Q2 2017 and an improvement of $33 million compared with Q1 2018. The year-over-year change in operating cash flow is driven by a $25 million improvement in Adjusted EBITDA, offset by changes in the timing of working capital. Similarly, the sequential change in operating cash flow is driven by a $49 million improvement in Adjusted EBITDA, again offset by changes in the timing of working capital.

Q2 2018 capital expenditures were $35 million, up from $19 million in Q2 2017 and down from $36 million in Q1 2018. As a reminder, the substantial majority of our capital expenditures are associated with office facilities. The additional capital expenditures this year are related to the build-out of our leased Santa Monica office facilities, which we expect to moderate over the next several quarters.

Q2 2018 free cash flow was ($234) million, a decline of $5 million compared with Q2 2017 and an improvement of $34 million compared with Q1 2018. As a result of our relatively low capital expenditures, we should see strong Adjusted EBITDA to free cash flow conversion over time.

Common shares outstanding plus shares underlying stock-based awards outstanding totaled roughly 1.5 billion on June 30, 2018, compared with 1.4 billion a year ago.

Q2 2018 DAUs were 188 million, up 8 percent from 173 million in Q2 2017 and down from 191 million in Q1 2018; North America DAU were 80 million, up 7 percent from 75 million in Q2 2017 and down from 81 million in Q1 2018.

Total revenue for the quarter was $262 million, an increase of 44 percent year-over-year and 14 percent sequentially, and our trailing twelve month revenue was $987 million, up 58 percent year-over-year.

International countries represented 32 percent of total revenue, up from 19 percent in Q2 2017 and 26 percent in Q1 2018. As a reminder, we define international as revenue apportioned to countries outside of North America.

ARPU increased to $1.40, an improvement of 34 percent year-over-year and 16 percent sequentially.

Advertising revenue for the quarter was $260 million, an increase of 48 percent year-over-year and 14 percent sequentially, driven by traction in our Global Online Sales business, which includes SMBs and Sales Partners, and strong growth in international countries. Impressions were up 191 percent year-over-year and 26 percent sequentially. Pricing was down 52 percent year-over-year and 9 percent sequentially. It’s also interesting to look back two years, before our shift to programmatic—advertising revenue has increased more than 2.5x from $72 million in Q2 2016 and pricing is down over 90 percent.

Approximately 75 percent of our advertising revenue was transacted programmatically this quarter, compared to 18 percent in Q2 2017. Programmatic advertising revenue grew 485 percent year-over-year and 34 percent sequentially, driven by the transition of all ad formats to our programmatic marketplace, traction in our Global Online Sales business, and strength in international countries. Programmatic impressions were up 722 percent year-over-year and 47 percent sequentially, while pricing was down 29 percent year-over-year and down 9 percent sequentially. These results exclude our On-Demand Geofilters product and minimum guarantees. We will continue to transition our Creative Tools business to the programmatic platform throughout 2018.

Cost of revenue was $184 million, an increase of 26 percent year-over-year, and a decrease of 4 percent sequentially. Infrastructure costs were $136 million, an increase of 28 percent year-over-year, and a decrease of 2 percent sequentially. We are focused on driving operational efficiencies and improving the unit economics of our multi-cloud environment as we scale over time. Additionally, our model benefits from our cloud partners' continuous investments in technology innovation and cost efficiencies, which are typically passed along to customers over time. The costs of our infrastructure model are included in EBITDA as opposed to capital expenditures, which should result in higher EBITDA to free cash flow conversion over time. This year, we have seen several million dollars in cloud unit cost reductions and tens of millions of dollars in engineering operating efficiency. These improvements in our cost structure resulted in leverage in our infrastructure in Q2 2018 and we will remain focused on operating efficiencies and unit-cost economics over the long-term.

Operating expenses were $247 million, up 8 percent year-over-year, and down 4 percent sequentially. We continue to focus on driving operating-cost productivity across our business. Our operating expenses are primarily driven by labor costs, which represent about 60 percent of operating expenses excluding stock-based compensation and related payroll taxes. We saw fixed-cost leverage in people costs, which grew 9 percent year-over-year, and were down 7 percent sequentially, compared to revenue growth of 44 percent year-over-year and 14 percent sequentially.

Our cost structure, which includes cost of revenue and operating expenses, was $431 million, an increase of 15 percent year-over-year, and a decrease of 4 percent sequentially.

Q2 2018 Adjusted EBITDA was ($169) million, an improvement of 13 percent year-over-year and 22 percent sequentially. Adjusted EBITDA margin for Q2 2018 improved to (64%), compared with (107%) in Q2 2017 and (94%) in Q1 2018.

We are focused on creating long-term shareholder value and are optimistic about the long-term potential for scale and leverage in our business. We are investing in many innovation initiatives for our users, which we believe will enhance user experience and engagement as well as drive revenue growth. At the same time, we are executing on operating-cost efficiency initiatives as we drive toward free cash flow generation and operating profitability over time.

For the first time, we are providing quarterly financial guidance for revenue and Adjusted EBITDA. We believe that sharing our thoughts on our near-term financial outputs will be helpful to investors and inform external expectations.

The following forward-looking statements reflect our expectations as of August 7, 2018, and are subject to substantial uncertainty. As mentioned at the start of the call, our results are inherently unpredictable and may be materially affected by many factors.

Now I will share our Q3 2018 Outlook

- Revenue is expected to be between $265 million and $290 million, or to grow between 27 percent and 39 percent year-over-year.
- Adjusted EBITDA is expected to be between ($185) million and ($160) million, compared to ($179) million in Q3 2017
- While we are not going to give DAU guidance, as a reminder, historically Q3 DAU growth rates have trended down both year-over-year and sequentially compared with Q2.
- This guidance assumes, among other things, that no business acquisitions, investments, restructurings, or legal settlements are concluded in the quarter.

And finally, I thought I'd also mention how glad I am that I joined Snap—it's a great fit for me to be partnering with a leadership team that is so focused on the long-term. There are many opportunities for us to drive growth initiatives and operational excellence over time.

One learning since joining Snap that enhanced my enthusiasm for our long-term opportunity is the reach of our global audience, which continued to grow and was higher than ever. In the US and Canada, for example, we have over 100 million Monthly Active Users—a noteworthy achievement for a company that is less than seven years old.

I am happy to introduce Kristin Southey who recently joined Snap as VP of Investor Relations. Some of you may already know her from her prior technology finance roles. I would also like to thank Arman for leading Investor Relations for the last year.

KRISTIN SOUTHEY, VP OF INVESTOR RELATIONS

Thanks Tim. It's great to be here and I look forward to working with everyone.

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

OPERATOR

That concludes the prepared remarks for today's earnings call, and we will now begin the question and answer session. To ask a question, you may press star, then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then two.

In the interest of time, we ask that you please limit yourself to one question. After your initial question is asked, your line will be muted. At this time, we will pause momentarily to assemble our roster.

And our first question comes from Justin Post with Merrill Lynch. Please go ahead.

JUSTIN POST, BANK OF AMERICA MERRILL LYNCH

Great. Thank you for taking my questions. Tim, first, since you've taken over, one of the big questions for Snap is monetizing that large audience and you mentioned you're pretty positive on what you see as the reach. Since you've been there, what's your enthusiasm for improving monetization of the audience? Do you think there's a ton of room there?

And then secondly, just on the financials, it looks like pricing really is down significantly over the last two years. Do you think there is a bottom and could that help reaccelerate revenue growth when you get there? Thank you.

TIM STONE, CHIEF FINANCIAL OFFICER

Hey, Justin. Yeah, as it relates to the monetization, I think we see a lot of opportunities over time to monetize. Right now, we're focused on driving innovation initiatives for our users, which will enhance both the user experience and engagement, and we think that will result in more monetization opportunities for us over time as well.

As we think about monetization, we're looking at monetizing all aspects of the app as well, whether it be the communication, the camera, as well as Discover. So I think that presents a lot of opportunity for us over time, and as I said on the call, the size and reach of our global audience further reinforces that opportunity. As it relates to revenue growth and pricing, Imran, you want to take the pricing question?

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah. I think the way we think about the business is showing our audience the right ad, because when you show the most relevant ad to a consumer, it drives a better experience for our users, as well as better ROI for our advertisers.

So we are continuously focused on delivering that, and when you do that and you're bringing more advertisers, pricing takes care of it. But we're maniacally focused on continuing to improve the experience for both advertisers and our audience.

OPERATOR

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

STEPHEN JU, CREDIT SUISSE

Thanks. Evan, can you talk about the timeline of when you think your rebuilt Android app will be deployed more globally, and any views at this point in terms of how many Android users globally may have signed up and subsequently churned because the experience was suboptimal? And I guess Tim or Imran, your rest of world revenue was up 65 percent sequentially, so I'm wondering which country and/or product you lit up to drive the growth there. Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Hey, Stephen, that's a great question. We're thinking a lot about how to reengage the Android community and let them know about the changes that we're making to the Android application. Right now, we've been testing a lot internally. We're beginning to roll it out in select markets, in beta, and we're going to continue to learn and test.

We want to make sure that as we roll it out, that it's a really great experience for people no matter what handset they're on.

IMRAN KHAN, CHIEF STRATEGY OFFICER

With regards to 65 percent growth in the international market, we are very pleased with that growth rate. I think one of the key things we were able to achieve through programmatic advertising is to roll out that self-service advertising buying experience to many countries; in addition we have a strong audience in countries like Australia. So we are very pleased with our growth rate.

OPERATOR

And our next question comes from Ross Sandler with Barclays. Please go ahead.

ROSS SANDLER, BARCLAYS

Hey, guys. Two quick questions on the guidance comments, if I can. So first on the DAUs. You say that the growth rates for both year-over-year and quarter-over-quarter should decelerate. So I guess that we'd tee off on the quarter-over-quarter comment. That would get us something in the low 180s; is that the right way to think about it?

And then second, on the revenue, $290 million at the high end implies a slight decel from the 14 percent quarter-over-quarter that you just posted in Q2. So is there anything you would call out in 3Q that would cause a deceleration given that you just had the Olympics comp and given the momentum you're seeing in programmatic? Why wouldn't that lift us to higher growth rates at some point? Anything you can flesh out on that would be great.

TIM STONE, CHIEF FINANCIAL OFFICER

Sure, thanks, Ross. On the DAU comments in the guidance, I did say we're not going to be giving any DAU guidance, so there's not much more that I can add there. I did point out historically we've seen a decline both year-over-year and sequentially in the rate of growth, but our expectations for DAU and MAU, for that matter, are incorporated in our financial outlook and the guidance we gave for revenue and EBITDA.

As it relates to the revenue guidance, we would think the range of guidance we gave is appropriate, and 27 percent to 39 percent year-over-year growth is strong revenue growth. Some things to be mindful of as it relates to the revenue growth guidance, pricing in the second quarter, we saw a 52 percent decline year-over-year in pricing, 9 percent quarter-over-quarter. And in particular, providing great value for our advertisers or ROI, pricing decline and the overall experience, and we're investing a lot in that area.

But again, we think the range of guidance is appropriate and reflects strong growth.

OPERATOR

And our next question comes from Heath Terry with Goldman Sachs. Please go ahead.

HEATH TERRY, GOLDMAN SACHS

Great, thanks. Tim, I guess you've talked about the revenue side of things. Curious how, as you've gotten settled in at Snap, how you're thinking about the company's cost structure, particularly given your prior experience, the cloud costs and the costs of serving the existing user base relative to what you think might be optimal.

And then Evan or Imran, realize you're not giving guidance on DAUs, but to the extent that we're roughly halfway through the quarter, almost halfway through the quarter, any color you can give us on sort of what you're seeing in July and early August.

TIM STONE, CHIEF FINANCIAL OFFICER

Heath, this is Tim. I'll take the second question as well. We're not providing any further commentary on DAU expectations for the third quarter; it’s reflected in the guidance. As it relates to the cost structure, I’m optimistic on the opportunities on the cost structure front as well as driving growth. If you look at our infrastructure costs in the second quarter, we saw an improvement in infrastructure costs per DAU that's reflecting, as I mentioned on the call, the unit cost economic improvements as well as engineering operating efficiencies that we're seeing.

That's something we're going to keep driving, as you can imagine, not only in the second quarter, but persistently going forward. I think there's a great deal of opportunity there, again, not only to drive growth but also to drive operating cost efficiency in the infrastructure side as well as in the operating expenses.

We saw leverage in operating expenses this quarter as well, and that certainly reflects the headcount reduction we saw, 100 head reduction from Q1 to Q2 and we're down about 200 so far this year, but for the back half of this year, we're going to be continuing to invest in innovation opportunities ahead of us, augmented reality and other areas, and expect our headcount to actually be relatively consistent with the end of 2017 as we invest in growth initiative opportunities.

On EBITDA, happy to see the first time in our history an improvement year-over-year in EBITDA loss and for us to be talking about leverage. So I'm happy to be talking about 31 percent leverage that we saw in EBITDA with EBITDA improving at a greater rate than the change in revenue so, I guess overall, I'm optimistic for the opportunities ahead.

OPERATOR

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

MARK MAHANEY, RBC CAPITAL MARKETS

Okay. Let me try this. Evan, you talked about, and somebody already asked you about Android. Let me try to draw you out a little bit more on that. How about this? When do you think the Android user experience—when would you like the Android user experience to match the iOS user experience in terms of the beta testing? Is this like months, is it quarters, is it a year or two? And then is there a drag in terms of the Android experience for advertisers versus the iOS experience for advertisers? Is that something that needs to be fixed, too, or do they kind of fix whatever it is contemporaneously or at the same time? Thanks, Evan.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah sure, Mark. So I think in terms of accessibility of Snap worldwide and in particular with our Android product, there are sort of three components. I think the first one is obviously the application experience itself. That's something we're working really hard on and we're excited to be testing that more widely and the early results, internally, have been very exciting.

I think another important piece to that is really the network speed and also the affordability of the network in these different countries. So I think hopefully as we tackle all three of those, through the end of this year and next year, we'll see a better Android experience overall.

IMRAN KHAN, CHIEF STRATEGY OFFICER

With regards to advertising, as we improve the advertising work, we're going to continue to work on the client side to improve the Android ad experience as well, and that is obviously a big opportunity to help revenue growth going forward.

OPERATOR

Our next question is from John Egbert with Stifel. Please go ahead.

JOHN EGBERT, STIFEL

Thanks. I had a few questions regarding the Snap Kit tools rolling out to developers. What are some of the biggest benefits you hope to see from allowing outside developers access to your audience? How do you think you approached these tools differently than some of your peers? And would love to hear some of the innovative ways you're seeing developers leverage these tools early on.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

I think the thing we're most excited about is the way that it is empowering people to express themselves across a wide variety of applications. So I think, for example, with Pandora being able to share stickers of songs on Snaps is really exciting and then drives people to check out the music. I think another thing we've seen is really the expressive power of Bitmoji, which people are linking to applications and using in the form of stickers as a way to communicate, not just in Snapchat, but in other applications and services.

Lastly, I think as we approach Snap Kit, I think one of the things we are really excited about is that the trust we've built with our community in terms of the way that we respect privacy I think is being appreciated, and that makes people more likely to want to use Snap Kit because they trust that we'll protect their information, and I think we've worked really hard to make sure that if you use Snap Kit to log in with other services, that we'll do a good job safeguarding your identity and information.

OPERATOR

And our next question comes from Eric Sheridan with UBS. Please go ahead.

ERIC SHERIDAN, UBS

Thanks for taking the question. Maybe two, if I can, around the advertising business. With 75 percent of revenue now going programmatic, is there a mix we think we should be thinking about you trying to get to over the medium to long-term with how much of the business is programmatic versus direct, and what some of the impacts might be for the cost structure of the business, as that evolves?

And then one follow-up: as you move the Creative Tools to programmatic, is there any way to frame whether that creates headwinds on pricing as we go through 2018 and 2019? Thanks, everyone.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah, with regards to percentage of programmatic, I think long-term our vision is everybody should be able to buy advertising on our platform through the self-service platform, and that is the most frictionless way for people to enjoy the ad-buying experience.

With regards to how it impacts costs, even with the self-service platform and the programmatic advertising platform, you need to have a sales organization who are consultative, who educate the market what are the best practices, and we're going to continue to innovate on our advertising product and our platform so that the advertising world can understand this product. So we will continue to invest in our sales organization despite the automated ad-buying process and ad delivery process.

With regards to the Creative Tools transition, Creative Tools are a smaller percentage of our revenue, as opposed to our Snap Ad revenue, and we have been very thoughtful on how we are transitioning the Creative Tools business to programmatic. You saw some impact of that, that negatively impacted the growth of this quarter, and it's already baked into Tim's guidance as well.

OPERATOR

Our next question comes from Lloyd Walmsley with Deutsche Bank. Please go ahead.

LLOYD WALMSLEY, DEUTSCHE BANK

Thanks. One for Evan and maybe one for Imran. Evan, at just a high level aside from fixing the Android app, what do you think you guys need to do to reignite user growth, and I guess do you even need strong user growth to build a large and profitable ad business? And then for Imran, can you give us a sense of the mix of ad revenue between big brand advertisers and DR advertisers?

You talked a lot about improving some of the ad tech side, so I'm wondering what are some of the key challenges for scaling the DR side, you know, is it more features, more sales, and what are you doing to drive that ship? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Hi, Lloyd. Yeah, so I think as we look forward at user growth and our opportunity, I think we talked a little bit today about over 100 million monthly active users in the US and Canada, which is very significant scale, obviously, for a business as young as ours. So that's something we're really excited about.

I think what we're seeing on the engagement side, over 30 minutes a day, also represents a significant opportunity for us. So I think as we go forward, obviously DAU is something we're very focused on over the past year, 18 months, we've primarily focused on the core product, obviously improving the user experience by allowing people to explore a lot more content. So we think that there's a lot of upside there with the redesigned Discover platform.

And as we work through some of these issues we saw, especially with the communications side of the product, we think there's a lot of opportunity to help people understand the value of Snap. So, I think given the progress we've made in a pretty short amount of time, we're really excited about the opportunity and really the widespread appeal of Snap.

IMRAN KHAN, CHIEF STRATEGY OFFICER

I'll maybe add a little bit to Evan's and then answer your second question. I think when I talk to advertisers, they really appreciate our large audience in the developed market, where purchasing power is big and the advertising market is big, and also our millennial audience and the penetration we have among the millennial audience, which is very, very difficult to reach in traditional media. So we think that is very, very appreciated.

With regards to our DR business, our direct response business is doing incredibly well, and I couldn't be more happy with it. Primarily, when you put things into perspective that we launched our Ad Manager in June of last year, the kind of progress we're seeing, I'm very pleased with it, and we're making a lot of improvements. So for example, several new updates on objective-based buying, where we want to help solve business objectives and we'll continue to make progress in our transition from product-based buying to objective-based buying.

We now have nine different objectives to choose from, including driving and optimizing web conversion. So let me give you an example. There's this e-commerce company named YoShop. YoShop, they wanted to leverage our unique appeal to the millennial audience, and they found great success. They drove 40 percent of YoShop's total installs from Snapchat, and at a 50 percent higher return on investment than what they were getting from other digital channels.

So we couldn't be more pleased to help all these small businesses succeed on our platform and help them grow their business.

OPERATOR

Our next question is from Mark May with Citi. Please go ahead.

Mark, your line is live. You may proceed with your question.

MARK MAY, CITI

Thanks. A couple more on the ad business, please. With the significant increase in ad impressions recently, can you talk about where you are from an ad load perspective and if we should think of impression growth, going forward, being driven more by user and time spent growth, or do you still have headroom with load and sell-through? And then maybe separately, can you just talk about trends in user engagement with ads, maybe including view-time trends and click-through rates? Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah, I think, Mark, we really focus on showing the most relevant ad to the most relevant users, because even if I show you one ad that is completely annoying, that reduces your user experience. And if I show you five really good, great ads, and you are engaging with them, that drives a better user experience. So I think the best way to think about the ad load is are we doing the right work on the ranking side. Are we doing the right work by bringing lots more advertisers on the platform so that we can show you the most relevant ad all the time, and that's what we're working on and I think we're making good progress and delivering better ROI. I'll give you an example. Dominos has been a great partner with us, and they recently enabled conversion lift studies with us, and they were one of the initial partners. They have run three successful lift studies to date, achieving higher purchase lift in each subsequent test of the Snap Ad campaign. Because, you know, we're trying to deliver the right ad to the right people.

In terms of ad engagement, again, going back to the right point, it's a ranking problem and we are working really, really hard to improve on that, and the team is doing a really good job on that.

OPERATOR

Our next question comes from Jason Helfstein with Oppenheimer. Please go ahead.

JASON HELFSTEIN, OPPENHEIMER

I think one of the things we focused on last quarter that came out was that ad agencies had kind of gotten frustrated with the platform and some of the headlines around the platform. Obviously, the numbers speak for themselves, but can you give us just some more color on how you're working with the agencies and do you feel like, in your opinion, we've kind of crossed over? At this point, now, you're getting less product questions from them and it's really more about kind of the whole ROI discussion and what you can bring to the table there, thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah, I think with our attractive pricing and low density and auction compared to other platforms gives an incredible opportunity for advertisers to come and win on our platform. One of the trends we have seen with the headline risk with some advertisers who were looking for flashy things, yes, they were not necessarily engaged in Q1, but the advertisers who stayed with us, they have been very, very engaged and had some very good success and increased their budget with us.

So, we're really excited about that, and in fact, today, in my monetization staff meeting, we were talking about how we were seeing success with a CPG customer. One CPG customer increased their budget significantly because they're seeing good ROI. So I couldn't be more happy with it, engaging with advertisers and focusing on ROI and driving value for them.

OPERATOR

Our next question comes from Doug Anmuth with J.P. Morgan. Please go ahead.

DOUG ANMUTH, J.P. MORGAN

Thanks for taking the question. Just, one, advertising. Could you just talk a little bit more about the improvements in the ad targeting and measurement side, some of the things you're doing well and then also where you think you still have challenges? And then, two, if you could, any comments on the linearity of DAUs during Q2 or any quantification on the World Cup ad dollars that you guys received during the quarter? Thanks.

TIM STONE, CHIEF FINANCIAL OFFICER

Yeah, as it relates to DAUs during the quarter, we're not going to be commenting on intra-quarter behavior on the DAU front, beyond the comments we made on DAUs up 8 percent year-over-year and monthly actives up to our highest rate ever.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah, with regard to targeting, we continue to make pretty significant progress, from custom audiences to building targeting capabilities based on users' interest. One recent example is we extended our partnership with Nielsen, and we are now offering advertisers the ability to reach audiences based on actual purchase data. Advertisers can currently leverage over 1,000 different segments for targeting, with thousands more coming.

So we are really, really excited. One good example is advertisers can target their Snapchat campaign to people who purchased lipstick at a retail store. So we can get to that kind of level of granularity, and we are very, very excited about it. One of the challenges that you talked about, look, I'll put it as an opportunity, is the Pixel. You know, we rolled out Pixel recently and we continue to make good progress. For example, we saw over 85 percent growth quarter-over-quarter in the number of advertisers actively spending ad accounts using the Pixel, and they're getting good traction.

So one of the direct-to-consumer grooming and lifestyle companies, called Manscaped, they wanted to drive new customer acquisitions at scale, and they leveraged our Pixel to provide real-time performance results, which allowed them to easily see which ads were driving the most conversion at or below its cost per acquisition target. We thought they saw very good results. For example, the addition of Snapchat to their media mix model allowed the company to grow revenue by 17 percentage points in just two months.

And Snapchatters also proved to be high-value customers, with an average order value that is 20 percent higher than users acquired on other platforms. So we are very excited. Again, our goal is to drive ROI, drive value to the advertisers at a very attractive price so that they can win on the platform, creating a win-win situation.

TIM STONE, CHIEF FINANCIAL OFFICER

Thanks. And following up on your question on World Cup, major events like World Cup and the Olympics last quarter are more engagement drivers for us, primarily on the communication front. You had 80 million people watching World Cup content on Snap, for example, but as far as the revenue is concerned, the major events provide a modest revenue impact that's less impactful as we scale over time and at our current scale as well.

And also, be mindful of the fact that as we have evolved to be much more programmatic, it's always on versus less of an event-based as it was with direct response, historically, but as related to the second-quarter impact for World Cup again, that would also be reflected not only in our results, but in our guidance expectations for Q3.

OPERATOR

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

ALEX WANG, MORGAN STANLEY

Hi, it's actually Alex Wang on for Brian. Thanks for taking the question. In the prepared remarks, you highlighted drivers of ad revenue, including SMBs and international. I think you touched on self-serve in Australia as helping international. But wondering if you can parse out some of the trends you're seeing for SMBs and anything incremental on the international front?

And then second, as the company continues to focus on operational efficiencies, how do you think about balancing growth versus investment and incremental margin trends as we head into 2019? Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

So with regards to SMB, our SMB business, also known as Global Online Solutions business, has done really, really well and we are super-excited about it. That business is growing at a very healthy pace. They're onboarding a lot more advertisers to the platform, so we're excited, and the trend we're seeing across the world in that group, and they're run by a strong leadership team. So we're super-excited, and I think, nothing beyond to say at this point.

TIM STONE, CHIEF FINANCIAL OFFICER

As it relates to your second question, we're optimistic about the long-term potential for scale in the business. When we think about--it's not an either/or. It's growth and operating efficiencies. And that's not just now, but over the long term as well, and, for example, we talked about in the second quarter driving operating efficiencies in infrastructure as well as operating cost structure, and additionally saw 48 percent year-over-year growth in revenue.

So this is a focus on both growth and operational efficiency improvements as it drives toward free cash flow generation and operating profitability over time. That's the focus for us not just today, but over the long-term.

OPERATOR

Our next question comes from Anthony DiClemente with Evercore. Please go ahead.

ANTHONY DICLEMENTE, EVERCORE

Thanks very much for taking my questions. Tim, in your remarks, you talked about operating cost efficiencies. I wanted to ask in the Snap filings, there are minimum hosting cost commitments that are disclosed, that go out over the next several years. Do your comments suggest that there is a way or a chance that Snap wouldn't ultimately, perhaps, spend at the minimum levels disclosed in those filings on the minimum hosting costs?

And then also, I guess related to your filings, I think you normally give Snaps per day. That was disclosed in the first quarter. Can you give that to us? What were Snaps per day in the Q2, please? Thank you very much.

TIM STONE, CHIEF FINANCIAL OFFICER

As it relates to the— I'll take the cloud part of the comment first. We're constantly in dialogue with our cloud partners on optimizing our utilization of their services over time, and as I said on the call, we're driving not only unit costs and economic improvements as well as engineering and operating efficiency improvements, but we're comfortable with the current agreements with our cloud partners and comfortable with our current cloud strategy.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

In terms of Snaps per day, we saw over 3 billion Snaps per day in the quarter.

OPERATOR

Our next question comes from Rich Greenfield with BTIG. Please go ahead.

RICH GREENFIELD, BTIG

Hi. Thanks for taking the question. I wanted to follow up. In the prepared remarks, Evan, I think you talked about the fact that Publisher Stories or Shows that basically daily viewership of those products was up about 15 percent year-over-year. I was wondering, could you give us some color on what's actually happening with friend Stories, which I think is a much bigger use case, is that— is the daily usage of friend Stories, both creation and consumption, is that up or down year-over-year? How does that track, and how does that look?

And then kind of just curious intellectually, as you look across the whole platform, what percentage of your DAUs, if you look at global DAUs, what percentage of people are actually using anything on the right side? Whether it be a friend Story, a Publisher Story or a Show, how many people actually touch one of those things on a daily basis? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Hey, Rich, those are great questions. I'm not sure we disclose the exact numbers. You're right to point out the importance of friend Stories, and that's why we're so focused on keeping that close friend network so that people feel comfortable expressing themselves, and we've really seen a lot of success with our Creative Tools, which really empower that expression.

So we're very focused on friend Stories, and I think one of the great things we've seen with Discover is separating out friend Stories rather than mixing them in with all sorts of other content makes them easier to find, and so having them at the top of the Discover page, we think, is a really important thing for the long term of the business.

OPERATOR

Our next question comes from Youssef Squali with SunTrust. Please go ahead.

YOUSSEF SQUALI, SUNTRUST

Thank you very much. First of all, Tim, thanks for the guidance. That's very helpful. And then Evan, maybe these are two questions for you. You spoke about users' engagement on the platform, I think 30 minutes per day on a daily basis. How has that metric trend over the last couple years, and just how important is it for you guys to keep hitting your numbers and maybe hopefully continue to grow very fast, without necessarily seeing the growth in that metric?

And lastly, in terms of new user retention for people older than 35, I think you guys talked about plus 8 percent, what about younger audiences? What are you seeing there? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah, so in terms of time spent, I think we've pretty consistently been disclosing over 30 minutes per day. One of the things we think about a lot when we look at Discover in particular, is really trying to make sure that people can find the right content. And so I think one of the most important things about the redesign is that we're surfacing the right content to the right people as quickly as possible.

So that when they go over that page, they can dive right into content. So that's sort of how we were thinking about time spent there. Then, Tim, do you want to—.

TIM STONE, CHIEF FINANCIAL OFFICER

—I don’t have anything else to add.

OPERATOR

And our next question comes from Peter Stabler with Wells Fargo Securities. Please go ahead.

PETER STABLER, WELLS FARGO SECURITIES

Thanks very much. A couple on ARPU if I could. Is it right to assume that the transition to programmatic started first and was most aggressive in North America? And related to that, as we start lapping the fast adoption of programmatic, could investors expect ARPU in the US to reaccelerate, and if so, would that be faster than we see internationally? I guess that's it for me. Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah, I think with regards to ARPU, I think many of the international markets, we started the business programmatic directly. I think in the US, our advertising business is more mature and we had this insertion order-based buying process.

With regards to ARPU, we don't give ARPU guidance, but I think one of the key things is that we are really excited about the potential for our domestic US business. We have more than 100 million monthly users in US and Canada, which is a very large audience base. You know, one of the largest ad markets in the world, and there is a lot of opportunities to onboard a lot more advertisers. There's a lot of opportunities to go deep into a lot of advertisers, and so I think I'm really, really excited about our US business and the domestic business, our North America business. But beyond that, I cannot give you a specific ARPU guidance.

OPERATOR

And again, if you would like to ask a question, please press star, then one.

Our next question comes from Brian Fitzgerald with Jefferies. Please go ahead.

BRIAN FITZGERALD, JEFFERIES

Thanks guys, maybe as a follow-up to Eric's question, as you have the rollout of the self-serve platform, can you talk a bit about what you're seeing with respect to the auction dynamics, are the majority of these auctions competitive at this point, and what does pricing look like there? Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah, I think more and more auctions are becoming competitive, and I think we're bringing a lot more advertisers onto the platform. So I think beyond that, we're not at this point breaking down what that is doing to the pricing. Again, I think it's really important, we are really focused on delivering great ROI to advertisers and showing the most relevant ad to our consumer, because we think if we do that in the long-term that takes care of the business.

OPERATOR

Our next question comes from Brian Wieser with Pivotal Research. Please go ahead.

BRIAN WIESER, PIVOTAL RESEARCH

Thanks for taking the question. I was wondering if you could talk about what Twitter has described as the China export market and what that might be contributing? Also, did you see any impact from GDPR one way or the other? Thank you.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah. I think that with regards to GDPR, we are very happy with our international growth—international revenue growth of the business. It grew at a very healthy clip and couldn't be more happier. In terms of GDPR impact, we have not seen any material impact that I can discuss during this call for Q2. However it's still early, and we are monitoring the situation very closely.

With regards to China, you know, I think China is a very interesting market. There's a lot of companies who are looking for global traffic, and Snap offers a very attractive audience in a developed market that could be very valuable to help those businesses grow. I was recently in China meeting with advertisers last week. However, we're not breaking down the revenue contribution from that market at this point.

OPERATOR

And our next question comes from James Lee with Mizuho Securities. Please go ahead.

JAMES LEE, MIZUHO SECURITIES

Thanks for taking my questions. Follow-up question on ARPU. I realize that your rest-of-world ARPU is actually higher than Europe. I was wondering, is this sustainable? And when I look at Facebook's APAC and the rest-of-world ARPU, only 25 percent in Europe. Help us understand why that you're able to monetize so well.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah, I think, again, we're not going to give ARPU guidance, but a couple of things to keep in mind. If you look at our audience in the rest of the world, it is coming from a market that is more monetizable, like Australia or Middle East, and I think also our audience is a more millennial audience, which is also very attractive to a lot of advertisers.

And so I think in terms of guidance, we cannot provide, but you know, I think we are very, very excited about the demographic audience we have, and as the audience grows from various markets, we'll see how the ARPU trends. But we are really focused on driving overall revenue growth rather than any specific region's ARPU.

OPERATOR

And this concludes our question and answer session as well as Snap Inc's second quarter 2018 earnings conference call. Thank you for attending today's session and you may now disconnect your lines.