SNAP INC. Q4 AND FULL YEAR 2017 TRANSCRIPT

PREPARED REMARKS

ARMAN PANJWANI, INVESTOR RELATIONS

Thank you, and good afternoon, everyone. Welcome to Snap Inc's Fourth Quarter and Full Year 2017 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 fourth quarter and full year 2017, 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 fourth quarter and full-year 2017 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 prospectus dated March 1, 2017, particularly in the section titled Risk Factors. This information can also 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 SPIEGEL, CHIEF EXECUTIVE OFFICER

Hello everyone and welcome to the call.

Our business really came together towards the end of last year and I am very proud of our team for working hard to deliver these results. We executed well on our 2017 plan to improve quality, performance, and automation, which removed friction from our advertising business and improved our application for the Snapchat community. This translated into annual revenues that grew 104 percent from the prior year, and 8.9 million Daily Active Users added in the fourth quarter, the highest number of quarterly net adds since the third quarter of 2016.

All this growth came at a lower cost than the previous quarter. Cash burn decreased 49 percent from the prior quarter, and gross margin increased 1,400 points sequentially to 36 percent. These are big improvements that show how quickly Snap can scale when our products and our ad business are working well together.

In 2017, we focused on removing friction from our products, our advertising business, and our team.

Last year we talked a lot about our investments in Android and the importance of improving our Android application. Our community has benefited significantly from the changes we have made throughout 2017, and we're excited to see the impact of this hard work reflected in our Daily Active User growth. The retention rate of new Android users increased by nearly 20 percent when compared to last year, meaning that the people who try Snapchat on Android are much more likely to stick around and become Daily Active Users. Additionally, the fourth quarter saw significantly more new Android users as a percentage of net additional users than any other quarter in our history.

It wasn't just Android that grew because of our efforts. Our growth on iOS continues, and we were honored and excited to end the year with Bitmoji and Snapchat as the number one and number two most popular apps of 2017 in the Apple App Store.

Our advertising business changed profoundly over the past year as we migrated the sale of our Snap Ads to an automated auction. Over 90 percent of Snap Ads were bought programmatically during Q4, which means that the auction transition for Snap Ads is largely behind us. We are learning a lot while operating our automated advertising platform and we are constantly improving the way we sell and serve advertising. In Q4, our effective price per impression decreased by 25 percent while our total advertising revenue grew 38 percent sequentially. More importantly, we increased advertising impressions by over four times year-over-year while continuing to grow per-user engagement. This demonstrates that our platform can deliver value and efficiency at scale for our advertisers.

Over the past two years, we hired over 2,400 people—roughly 100 new team members every month. While it was critical to build our team to keep pace with the growth of our business, it has become clear that we can now unlock substantially more productivity simply by changing the way that we work and by continuing to build an inclusive and creative culture. As such, we plan to moderate the growth of our team over the next year and focus on making sure that we have the right team, leadership, and organizational practices in place to support our culture and our mission. We are determined to have a close-knit, hardworking team that is brimming with positive energy and we will continue to make the necessary changes to ensure that everyone at our company is aligned with our values.

We ended 2017 confident that we can grow our Snapchat community and monetize our products more efficiently than ever before. With our plans for user growth, augmented reality, and content in 2018, I have never been more excited about the future of our business. We're going to keep up the hard work and stay focused on the big opportunities ahead.

Improving application performance is just the beginning when it comes to removing friction so that our community can grow and enjoy Snapchat. We have recently launched partnerships with wireless carriers in over a dozen markets to begin reducing cellular bandwidth costs for Snapchatters around the world. We have seen that when data is less expensive, more people are willing to use our data-intensive products. This is important because Snapchat can be more fun to use out in the world rather than at home on WiFi.

We feel strongly that Snapchat should not be confined to our mobile application—the amazing Snaps created by our community deserve wider distribution so they can be enjoyed by everyone. We recently rolled out Stories Everywhere, so that the whole world can easily view Stories on the web. We've also started bringing Snaps to bigger screens like stadium jumbotrons at this year's Rose Bowl and Sugar Bowl. Removing friction from the way people use Snapchat and view Snaps will help us continue to grow our community over the coming year.

One of the things that makes Snapchat so unique is our Camera and how frequently it is used by our community. This is different from many other services where content is uploaded from other sources rather than created in-app. Today, 97 percent of all the Snaps sent on Snapchat are created using our Camera. With billions of Snaps created every day, we have a unique opportunity to engage our community with augmented reality experiences overlaid on our Camera. Every week, on average, more than half of the entire 13-34-year-old population of the United States plays with augmented reality Lenses in Snapchat.

We recently expanded our Lenses product with the release of Lens Studio, a set of desktop creative tools that make it easy for anyone to create their own augmented reality experiences and distribute them using Snapchat. In just six weeks from launch, over 30,000 Lenses were created by our community and viewed over one billion times. We are blown away by the ingenuity of our community and we can't wait to see what they create next. We'll be working hard to expand Lens Studio for years to come.

Our content partners continue to shine on Snapchat, and we're seeing great traction around our new Shows format. In the fourth quarter, more 13-34-year-old US viewers watched an average episode of Face Forward by E! on Snapchat than many of the most popular television shows during the same period. Our sports coverage continues to expand, and this season we entertained more than 30 million football fans in the United States with over 400 NFL Stories. We've built our content business on the belief that sustainable partnerships benefit everyone involved – our partners, our community, and our company. This year we generated over $100 million in revenue for our content partners and we're excited to deepen these relationships over the coming years.

In addition to our ongoing efforts in user growth, augmented reality, and content, we believe that the redesign of our application that we announced on our last call will provide a strong foundation for the evolution of our business. That's because our redesign separates social from media, solving many of the problems that arise when friends are commingled with professional content creators.

While we are still very early in the rollout, we are optimistic about the potential to unlock additional growth with the redesign of our application. As expected, it will take time for our community to get used to the changes, but overall, we are pleased with the initial results and will be making the redesign available to our entire community in Q1. There is a lot of work ahead as we optimize the updated application, but our early observations support the thesis behind the new architecture and the many growth opportunities that it provides.

For example, in one of our first test markets, we saw that the number of Daily Active Users watching Publisher Stories on Discover grew by over 40 percent when compared to the old design of the application. We also saw gains in ad performance, both in terms of view time and engagement, as well as an overall increase in our Average Revenue Per User when compared to the prior design.

Additionally, we believe that the redesign has also made our application simpler and easier to use, especially for older users. Compared to the old design, core metrics around content consumption and time spent in the redesigned application are disproportionately higher for users over the age of 35, which bodes well for increasing engagement among older users as we continue to grow our business.

Our design and engineering teams are constantly monitoring the rollout of the redesign and making improvements based on what we learn from our community and their usage of Snapchat. These adjustments to our products will continue over the next few quarters as we continue to optimize the application.

Our work during 2017 is proof that we aren't afraid to make big changes for the long-term success of our business. We redesigned the Snapchat application, transitioned our Snap Ad business to an auction model, and made changes to our team to improve productivity and collaboration. We enter 2018 energized by the opportunities in front of us and excited to deliver against our plan for user growth, augmented reality, and content.

I'll now hand over the call to Imran for a discussion of our business results.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Thank you, Evan, and hi everyone.

We had a great fourth quarter. Total advertising revenue for the quarter was $281 million, an increase of 74 percent year-over-year and 38 percent quarter-over-quarter. The investments we have made across our advertising business are starting to pay off, and we are pleased with the results we have seen so far. We remained focused on three key areas throughout the year, and I would like to provide an update on each area: 1) enhancing our ad product suite, 2) developing efficient tools for our advertisers, and 3) proving the effectiveness of our advertising.

First, enhancing our ad product suite. We want to offer ad products that are valuable to all advertisers. This means developing and refining solutions that solve a wide variety of business objectives. Not only does this allow us to serve more advertisers, it also helps us become a one-stop shop for those that continue to invest in our platform. Our strategy is paying off.

For example, of the Top 100 Ad Age Advertisers that started advertising with us in Q1 of 2016 or earlier, each one of them, at a parent level, also spent with us in 2017 and over 90 percent of them spent in every quarter of 2017.

In Q4, we launched a new ad format called Promoted Story. Our advertising partners have told us that they want a way to spend more time with their audiences. Promoted Story allows brands to take advantage of the familiar Stories format that we invented four years ago. It's been just over a month since launch, and we have seen some amazing Stories from advertisers such as State Farm, Dominos, T-Mobile, and American Express. More importantly, our community is embracing our new format. On average, users that chose to watch Promoted Stories viewed them for over 10 seconds. In the coming weeks, we plan to make this format available in our self-service tools, making it the first "Story Ad unit" buyable within the Snap Ads auction platform.

We have also seen strong growth in our direct-response business. In April of last year, we launched the ability to "bid for installs" in our self-service tools. This allowed advertisers to optimize campaigns for users most likely to install their app. Our ongoing investment in machine learning and our commitment to improving efficiency for advertisers is paying off. We drove 15 times more app installs in December compared to April, while continuing to drive increased return on investment. As we doubled our total revenue from app-install campaigns since the beginning of Q4, we also significantly decreased Cost per Installs for our advertisers. One great example of our progress on the direct-response front is Etermax, the creators of the mobile trivia game, Trivia Crack. Using our app-install ads, they were able to acquire high-value, highly engaged users at scale. They saw that Snapchat users were 25 percent more likely to still play the game after a week compared to users from other platforms, and overall Snapchat users played the game for twice as long as users acquired anywhere else. Importantly, they were able to achieve these results at a Cost Per Signup and Cost Per Install that was 20 percent lower than other channels.

The second area of focus is developing efficient tools for our advertisers. We know that in order to truly scale our business, advertising on Snapchat has to be really easy. As Evan mentioned, in Q4, over 90 percent of Snap Ad impressions were delivered programmatically. In Q4 of 2016, this number was under 10 percent, so we're really happy about how quickly our advertisers have embraced this transition and continue to do so. In fact, the number of advertisers spending in the auction doubled quarter-over-quarter.

We're also really excited that these self-service tools have allowed us to reach different types of advertisers, not just big brands. Revenue from small and medium-sized businesses more than doubled quarter-over-quarter. For the first time, revenue in Q4 from advertisers outside of Ad Age's Top 100 exceeded revenue from the Top 100 Advertisers.

The Penny Hoarder is a great example of an SMB that is growing their business on Snapchat. The Penny Hoarder is a website dedicated to personal finance tips. They came to Snapchat with the goal of finding a new audience that couldn't be reached on other platforms. In just a few months' time, their Snap Ads campaigns generated 40 percent higher returns than other platforms and drove a 51 percent increase in their revenue. We're thrilled by the results they have seen.

Our self-service tools have also enabled us to quickly scale in international markets. For example, in the Middle East, we made the strategic decision to rely exclusively on our self-serve tools for Snap Ads. Starting on October 1st, Snap Ads could only be purchased through Ad Manager, and this decision quickly paid off. In three months, we more than tripled the number of advertisers spending in our auction, and out of all our international offices, this region was our top contributor to overall revenue growth in Q4.

Still, we have a lot of opportunity to make it even easier for advertisers. Snap Publisher, a web tool for vertical video creation, was a great milestone on the Snap Ads front, and most recently, we took a big step in helping brands with augmented reality. As Evan mentioned, we launched Lens Studio less than two months ago to make it easier for our community and our advertisers to create Lenses. Foot Locker was our first advertiser to leverage Lens Studio to create a Sponsored Lens. They worked with our Lens Studio partner, North Kingdom, on a Lens that was incredibly successful and highly engaging. On average, users played with their Lens for 45 seconds!

Lastly, proving the effectiveness of our advertising. In Q4, we made a lot of good progress with Snap Pixel. We focused on scaling its usage as well as building out its capabilities. In just two months since its launch, some of the most visited websites have installed the Pixel across thousands of domains. Many of these advertisers were previously not spending with us until we had stronger first-party measurement solutions. One out of every three advertisers that participated in the Q4 Pixel beta spent their first dollar on Snap after they got access to the Pixel. The Pixel is helping us to unlock dollars, especially from performance budgets. We think this will continue as we build out additional capabilities, such as dynamic custom audiences, conversion optimization, and secondary objective optimization. We also rolled out Pixel Custom Audiences in December, which allows advertisers to reach audiences based on actions such as visiting their site. It is very early but we're seeing good results. We still have a lot of work to do here but we're excited about what this can do, mostly for our mid-market and SMB customers.

Our focus on online to offline measurement throughout the year helped us capitalize on the holiday season. We know Q4 is a critical time for many of our advertisers, especially retailers, and they want their campaigns to drive store visits and sales. Target partnered with us, using Snap Ads and Filters, to drive action intent and in-store visitation for holiday shopping. We drove a 16 percentage-point lift in action intent to shop at Target for the holidays as measured by Nielsen, as well as over 660,000 incremental visitors to their stores as measured by Snap to Store, which is our proprietary solution that measures foot traffic in stores.

We continue to invest in our measurement ecosystem and now have 19 third-party measurement partners. In Q4, we partnered with the National Research Group, a leading data provider in the movie industry, to understand the impact that our ad campaigns have on Opening Weekend Box Office. Our ongoing partnership demonstrates that Snapchatters represent 36 percent of moviegoers and 50 percent of ticket sales. Additionally, movies that advertise on Snapchat are 22 percent more likely to be moviegoers' "first choice" in theaters on the Opening Weekend, a metric that is highly correlated to Opening Weekend Box Office.

We're really happy with the progress we made in 2017. We still have a lot of work to do, but we're excited to keep the momentum going. Thank you for the time today, and here's Drew to discuss our financial results.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

Thanks, Imran, and good afternoon everyone.

Simply put, our fourth quarter results represented a major step forward for Snap, both financially and operationally.

Overall, we saw improvements across our business, but I will comment on four specific areas of interest for Q4:

1. First, revenues increased 72 percent year-over-year and 37 percent sequentially, anchored by growing auction traction and holiday brand sales. Revenues for the year more than doubled, up 104 percent.

2. Second, gross margin expanded substantially, which continues to validate that our business model can scale profitably. As Evan noted, gross margins were 36 percent, improving over 2,700 basis points year over year and up 1,400 basis points in just one quarter.

3. Third, headcount growth continues to moderate, thanks to productivity gains from our team. Net additions in the quarter were slightly more than one hundred, one third of the rate of recent quarters.

4. And fourth, cash burn declined 49 percent sequentially, driven by more focused capital deployment priorities and thoughtful cash management.

I will now expand on each.

First, global revenues grew to $286 million in the fourth quarter. We saw growth in every region, and international markets now represent 23 percent of our total revenue, up from 12 percent a year ago and 20 percent last quarter.

As expected, the fastest growing product in Q4 was Snap Ads, and specifically, Snap Ads sold through the auction. Many of the auction dynamics were consistent with prior quarters, although ad volumes were much higher in Q4. It was very encouraging to see some substantial daily sales volumes flowing through the auction during the quarter.

As expected, revenue gains were driven by growth in ad impressions, partially offset by Snap Ad pricing, which fell sequentially due to the mix shift from managed to programmatic and reserved to bidded ads. Let me share some numbers with you on impressions and pricing:

1. First, Snap Ad impressions, excluding Promoted Stories, were up 90 percent sequentially and up over 575 percent year–over-year.

2. Second, overall Snap Ad pricing, excluding Promoted Stories, was down more than 15 percent sequentially, and nearly 70 percent year-over-year.

3. Third, we ended the quarter with over 90 percent of our ads served programmatically, up from 80 percent in the prior quarter.

Over the medium term, we believe that increasing our advertiser count will have a positive impact on our pricing. In the quarter, we saw the percentage of contested auctions increase versus the prior quarter, and auctions that were contested continued to have higher prices than single-bidded auctions.

Now, looking at our key cost drivers, we are excited to continue to see our economic model gaining traction: growing revenues coupled with banded user expenses fueled gross-margin expansion again in Q4.

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.

The cost leverage we are seeing is particularly apparent on a per user basis. In Q4, our ARPU increased 46 percent year-over-year to $1.53, while our costs per user, or CoRPU, only increased 2 percent, to $0.98. We've been able to moderate user cost growth through the successful execution of our multi cloud strategy. Specifically, hosting costs per user dropped from $0.72 a year ago to $0.70 in the quarter. That's great progress in a year when our sales have more than doubled and engagement metrics have grown substantially.

As a result, worldwide gross margins expanded to 36 percent. Internal analyses continue to suggest our economic model can scale well as North American gross margins are well above the worldwide average, driven by their higher ARPU, which was $2.75 in the quarter. Now, moving down the income statement, the primary driver for operating expenses remains people cost. In the quarter, our hiring pace slowed substantially. Specifically, net adds were slightly more than 100, as we started to lever our significant early investments in people. Hiring mix remains a priority, and the absolute number of back-office employees declined in Q4. Overall operating expenses were up 17 percent sequentially, driven by modest hiring, increased sales commissions, legal costs, and year-end expenses.

Lastly, we focused on capital deployment priorities and thoughtfully managed our cash position this quarter. Capex remained modest at $21 million and less than $85 million for the year, driven by our capital light infrastructure strategy. Our Capex per user for the year was less than $0.50, which we believe leads the industry. M&A was modest in the quarter, and we adopted a sell-to-cover approach for vested restricted stock units for employees during the quarter, which substantially reduced our cash spend. As a result, we were able to reduce our cash burn by 49 percent sequentially. We ended 2017 with $2.0 billion in cash and marketable securities.

As of December 31, 2017, total shares outstanding were 1,222 million and 1,420 million on a fully diluted basis.

Q4 represented a significant step forward for Snap on the key financial metrics. As we move forward, we'll continue to manage our business for the long term. In 2018, there is much to do and we are focused to deliver on our key priorities.

I want to share some financial thoughts with you for the early part of the year:

First, as we think about revenue growth in Q1 2018, we start with the current momentum in the business. Specifically, we saw strong growth in Q4, and our year-over-year advertising revenue growth rate accelerated to 74 percent. In Q1, we are planning for our year-over-year revenue growth rate to moderate from the Q4 pace. The majority of our revenue is generated through brand advertising, which seasonally peaks in the fourth quarter. Additionally, we are planning for the transition of the creative tools business to the programmatic platform, which we believe will drive additional impressions at lower prices and result in more modest growth in the first half of 2018. Also note that in Q1 2017 we had $8 million of Spectacles revenue which we are planning to be substantially down year-over-year and sequentially.

On hosting expenses, we exited the fourth quarter with a slightly higher cost per DAU than the quarterly average of $0.70. The cost impact of our application redesign has yet to be fully determined. That said, we are focused on executing additional cost-saving initiatives in 2018 to continue to offset future cost increases.

With respect to operating expenses, we are planning for continued gains in team productivity and modest hiring. We are planning for operating-expense growth to moderate in the first half of 2018 and be up low double-digits versus the second half of 2017, primarily driven by more focused hiring in front-of-house functions. Please note that this does not include any potential acquisitions.

Capital expenditures were less than $85 million in 2017, and we are planning for a slight increase in 2018. We are moving many of our headquarter teams to a series of leased facilities in Santa Monica during the first half of the year, although we do expect additional moves to occur later in the year and into 2019 as well.

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

QUESTIONS AND ANSWERS

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.

Our first question is from Ross Sandler with Barclays. Please go ahead.

ROSS SANDLER, BARCLAYS

Great, thanks. Just two questions, one for Evan and one for Imran. Evan, you mentioned that Android retention is up 20% quarter-on-quarter. Can you just give us some color on what's driving that? And then you also said that engagement in the older cohorts and with Discover is up pretty big following the redesign, so how do the engagement stats compare with the younger cohorts versus the older cohorts?

And then the second question, for Imran, we saw some news out of the Upfronts that you guys had secured as much as $70 million in ad revenue for the Winter Olympics. So, can you just talk about how much of that will flow through Snap and how that kind of triangulates with the comments about first quarter? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

Thanks, Ross. Yeah, I think in my comments earlier I talked about a year-over-year increase in retention. We've been working very hard to provide more value to our users when they sign up, and one of the key ways that we do this is to try to make sure that they have a lot of great friends ready for them.

So, we rolled out a Quick Add over this year, and that's made a huge difference on making sure that folks who sign up get the friends they need quickly. I can't provide any detail on cohorts, but we're excited with the progress we've been making on Android.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

So, on the Olympic side, Ross, let me jump on that one. So, we are very excited to have a special event like the Winter Olympics, and we believe Snap, the community, will really enjoy what we have there. We're also excited to be the biggest mobile partner there. Obviously, it's an extension of a successful, strong, overall partnership we have with NBC Universal, and it builds on the success that we had with the Summer Olympics we had back in 2016.

So as our business is growing, we look at these tentpole events as engagement drivers more than we do financial drivers. And so our core business today is much bigger than it was back in the summer of 2016. Now, we have been working with advertisers and our ad packages have sold well, so we do expect modest revenue tailwind in Q1. But overall percentage revenue boost to our sales base we expect to be less than what it was a couple of years ago when we had a smaller business.

OPERATOR

Our next question is from Stephen Ju with Credit Suisse. Please go ahead.

STEPHEN JU, CREDIT SUISSE

Okay, thanks. Imran, I recall you saying, I think it was two quarters ago, that you were looking to evangelize the platform and lure in advertisers with cheaper price inventory. You touched on this to some degree on the prepared remarks around Pixel, but how are the conversations going now? Do you still feel like you have to sell the benefits of advertising with Snap, especially for the DR guys? Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yes. I think the conversation is going really well. That's evident by our Q4 result, and I think a couple of things happening. Number one, we are really offering very attractive value to our advertisers on our platform, given our size and scale. And you are seeing that more and more advertisers are coming to our platform. And the number of advertisers in auction doubled in Q4 quarter-over-quarter.

The second thing is on a direct-response side we are seeing great success on app install and lead generation and we are aggressively moving into e-commerce customers with the launch of Pixel. And our early trend looks really good and we're really excited about that.

OPERATOR

And our next question is from Justin Post with Merrill Lynch. Please go ahead.

JUSTIN POST, BANK OF AMERICA MERRILL LYNCH

Great. Nice revenue quarter. Couple questions for you, meaning Imran. The ad impressions were up 575%. Is that all just demand-generated, or did the company make a decision to open up more ad impressions this year? And do you just feel like you have tremendous room still to grow there? And then maybe a question for Drew. You touched on it a little bit, but was there any just unusual items in the fourth quarter as far as revenues that we should be thinking about that might not sustain into next year? Thank you.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yes, with 187 million daily active users who are incredibly engaged, we have a lot of inventory on our platform, and we think there is still a lot of room for us to grow.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

And, Justin, hey, it's Drew. On the revenue side of the role, we did try to call out a couple of those in my comments. We are a brand business and we do believe that the brand business seasonally peaks in the fourth quarter. So that was something we wanted to highlight as we think about the earlier part of the year.

Also, as you think about the early part of the year, our Spectacles business was $8 million last year in the first quarter of 2017. We do not expect that business to annualize or even sequentially comp to where it's been.

OPERATOR

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

MARK MAHANEY, RBC

I want to try to get at the question of the sustainability of two trends: the DAU trends and the revenue growth trends. And I guess I'd like to ask first in the DAU trends, in terms of how far along you think you are in terms of "fixing" the Android problems. Where are the crash levels versus where you had them before? I know in the past you talked about having that all finalized by Q2 of this year. Do you think you're already there? So, is there anything more you need to do with Android in order to get that experience like you want it?

And then on the revenue side, I guess the one thing I'd add there is it sounds like you're already through all of the transition to the auction process, so I would think that these kind of growth rates that we're seeing, leaving aside seasonality, is relatively sustainable, but anything else you'd want to caution us on extrapolating growth from here, other than the seasonality and the Spectacles?

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

So, on the DAU side, obviously we've talked a lot in 2017 about Android and how much we've been focused on it. And you know, today, we have some of the lowest-ever crash rates that we've seen. But we're still going to be doing a lot of work to rebuild the Android application. There are components of that in the updated Discover functionality and rolling out in the redesign. So that's great to see.

You know, the frame dropping has gone away, the scroll performance is awesome, streaming is making a huge difference for people who are watching content on our service. So, I think that's a great step in the right direction, especially with the redesign, but you'll see a lot more this year. We've been chopping a lot of wood on that for a long time, as you know.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

And Ross, excuse me, it's Drew here. Hey, a couple of thoughts for you on the overall business, Mark. So, in terms of the revenue-growth drivers, we did talk about the seasonality, we talked about Spectacles. Spectacles is a smaller piece.

Overall, the way that you should think about the business is really that the engine that drove the growth in the fourth quarter, and will continue to drive our growth really is the auction platform. That's really where things are heading.

There is a smaller piece of our business on the creative tools side. We will be transitioning that in the first half of the year. As we transition that, we do expect to see gains in impressions offset by declines in price.

But really, sort of as you're thinking about big-picture ideas and where our business is going, what the business drivers are, it really is going to be Snap Ads in the auction for the foreseeable future.

OPERATOR

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

HEATH TERRY, GOLDMAN SACHS

Great, thanks. Evan, how is the experience with the redesign impacting the way that you're planning product development? Where and how has it impacted your priorities? And then, Drew, just a quick one: given the progress on cash burn, how should we be thinking about the trajectory there going forward?

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

We decoupled the redesign from a lot of the future development that we've been working on, so that's continued and I'm very excited about the product pipeline for this year. The redesign was really focused on three things: we wanted to make the app easier to use, and we wanted to bring your friends together, and we wanted to elevate a lot of the great content that we have at Discover.

So far, I think we've accomplished all three and we've tried to be very deliberate in the rollout. We learned a lot as we rolled it out. Now, it's at about 40 million folks and we're excited on the progress there. So, we'll be working on a lot of that throughout the year for the years to come, but that's decoupled from the future development process internally.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

And Heath, on the working capital or just general cash burn of the business, obviously, big picture, cash is very important to us. Liquidity is something that we look at all the time. If you think about sort of the uses of cash for the business, we're EBITDA negative and investments in business operations continue to be our number-one capital-deployment priority.

Our second capital-deployment priority is M&A. It's opportunistic, as you know. So sometimes we do stuff, sometimes we don't. I do think we can do a better job of thinking about cash-versus-stock mix as we do that, but I think we're still in the M&A game and we'll be periodically looking at deals.

I do think the big change we made between the third and the fourth quarter was really we stopped buying back employee shares here in the fourth quarter, and that was a big piece of what the change in cash burn was. I also think we did a better job of managing our working capital within the balance sheet, and that's just a maturing business getting better at what it does. So overall, it's really going to be the investment in the business and the M&A our capital deployments and those are primary uses of cash.

OPERATOR

And our next question is from Lloyd Walmsley with Deutsche Bank. Please go ahead.

MATT DIAMOND, DEUTSCHE BANK

Hey, guys. Congrats on the solid results. This is actually Matt Diamond on Lloyd's behalf. The question, two questions, really. One, with the Android development, could you talk about where you saw the engagement increase? Was it pretty uniform across your geographies? Are there any differences to call out there?

Two, for any advertisers who might have been with you but have since left, what were the key challenges that they faced, and have those challenges been addressed? Whether that's targeting, ROAS, lack of measurability, maybe not finding the right demographic. Any color there would be helpful.

IMRAN KHAN, CHIEF STRATEGY OFFICER

So, with advertisers’ side, you know, I think we make tremendous progress delivering things that advertisers are looking for. We made tremendous progress on the app-install side, tremendous progress on lead-generation side, and we also launched Pixel. And I think, you know, a lot of advertisers, primarily who are on the e-commerce segment are looking for Pixel to really understand how we're driving growth and I think that's one big area that we continue to invest.

The other area is that we’ll continue to remain really focused to buying ads on Snapchat, absolutely easy. We did make a lot of progress with Snap publishers and we're going to continue to do so, and that will also continue to drive growth.

But overall, we are very happy with the progress we make and we're going to continue to do so. In terms of android geography, we saw improvement across all geographies. So, there's no one specific geography to point that out.

OPERATOR

Our next question is from Eric Sheridan with UBS. Please go ahead.

ERIC SHERIDAN, UBS

Thanks for taking the question. Maybe two on the advertising. The way you guys break up the business in talking about it between managed versus programmatic or reserved versus bidded, is there any chance you can give us color about the skew in terms of percentage of revenue that tilts one way or the other? And also the differences in price between the two? So we can get a better sense of where we are on the transition, on the revenue base and on the pricing mix of the business. Thanks so much.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yeah. With regards to breaking down revenue by channel, we don't do that. But I think one thing I believe Drew pointed out that programmatic was the fastest-growing segment of the business, as evidenced by the number of impression that is flowing through the programmatic business.

With regards to pricing, I think we really focus here to drive return-on-investment for advertisers. If we drive more return-on-investment for advertisers that means more advertisers will come to our platform. We are just getting started. There are 26 million small businesses out there. We want to capture a big chunk of that. So, so we're less focused on price, more focused on driving value and driving growth.

But in general, right, if an advertiser wants to reserve a date that always was higher-priced, than, you know, than bidded pricing. So that's how it usually works.

OPERATOR

And our next question is from John Blackledge with Cowen & Company. Please go ahead.

JOHN BLACKLEDGE, COWEN & COMPANY

Great, thank you. So, the user growth was better than expected. I'm just wondering if you have any color on engagement, time spent on the platform, and how you think about kind of the key engagement drivers in 2018. And then, just a quick one on total number of advertisers on the platform. Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

I don't have any material updates for you on engagement, but I did see yesterday Verizon released some numbers about their customers' usage during the Super Bowl, and I guess last year we were number three in terms of overall usage during the Super Bowl, and this year we were number one. So, we're pretty excited about that, directionally, but no specific updates for you today.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

In terms of the total number of advertisers on the platform, obviously it's a key accelerator for our business. We know, when we get more competition on the auction, we think it's a real way that we can drive pricing over the medium term. We did double the number of advertisers on the platform. We're still a young business with a lot of room to grow, but we were excited by the progress in the quarter.

OPERATOR

Our next question is from Douglas Anmuth with JP Morgan. Please go ahead.

DOUGLAS ANMUTH, J.P. MORGAN

Thanks for taking the question. I have two. First for Drew or Imran, can you just help us understand how your long-standing kind of existing advertisers are behaving in a reserved media world versus auction – just how their behavior is shifting. And then secondly, Evan, you talked a couple of times about removing friction. What are the opportunities that you're thinking about in 2018 to continue doing that? Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Thanks, Doug. You know, I think if you look at the large advertisers, they have different buckets of budgets, right? So, they have always on budgets, they have activation budgets surrounding some events like the Super Bowl, or they have new initiative budgets. And what we're trying to do is play into all of those buckets and trying to capture dollar. So, with regards to always on budget, that's good money we're getting through our auction platform and through our self-service platform.

But then, we also have this incredible ad unit, creative tools like Lenses and Filters, that are really unique and no other platform has that at scale like us. And you can see that large advertisers take advantage of those products, or take advantage of our premium products, like for shows and for Discover surrounding some events or deliver some message that they want to do that throughout as part of their premium content strategy. Like Super Bowl, I think, I don't know if you saw that we had a couple of great Lenses, and that did really, really well and we're really, really excited about that.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

On the removing friction mandate over here, you know, I think one of the key things is all of the new processes we have around quality and performance, that will continue to make a big difference for us, and were obviously a big focus of last year. But also, you know, we have some major architectural changes coming to both iOS and Android coming throughout the year and we're excited about the opportunities there.

OPERATOR

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

MARK MAY, CITI

Thanks. I had two. I think the first for Drew and then the next one for Evan. Getting back through to the question a lot of people have asked around the outlook for Q1 revenue, we can obviously kind of back-out Spectacles impact. And brand, I guess, is seasonal, like you said. So, it should be, you know, the seasonality should have reflected in the year ago. So, I guess I'm just trying to understand, coming off of a strong Q4 with accelerating trends, the auction dynamics etc. that are benefiting you. Why would you—what is sort of the driver of the "moderating growth" in Q1? It seems like you've got some nice tailwinds on a year-on-year basis, ex Spectacles going into Q1.

And then, for Evan, you know, there have been some other players, some other social apps in this space that have kind of admitted that some of the ways that their users are using their apps may not always be, you know deemed good uses of time, right? More around focusing going forward, more around quality versus quantity. I wonder if that's something that you think is, in any parts of Snapchat, an issue, and anything that you're sort of addressing from that perspective. Thanks.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

So, let me comment on the first question. So, we did comment on the underlying drivers for the spike up that we did see in the fourth quarter, and we did share how we're thinking internally about the Q1 dynamics. The largest piece of our revenue for our business in Q4 remains brand sales. And we believe brand revenue seasonally peaks in Q4.

And so, as the business now has more scale, we believe the year-over-year growth rates are probably the most relevant way to think about our business. We think it neutralizes the brand seasonality and it's, frankly, how our team thinks about managing its business. So, we're thinking about the year-over-year growth rate, and that's why I try to target that 74% so you got a sense on that.

What we did try to do is point out some of the underlying drivers, the seasonality, the change in the some of the creative tool platforms that we moved to self-serve, and then a little bit, which is a small piece of the business on the Spectacle side. So, we tried to give you some thoughts. Those are the big movers, if you think about our business in the first quarter.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

And on the product side, from the beginning we've been really thoughtful about how we approach these issues. That's one of the reasons why we never had public-facing metrics around followers or likes and why we've always tried to control and distribute content very widely on our platform. And I think if you look at the redesign, the evolution with the redesign, what we're trying to say is that there's a really big difference between talking to your friends on the telephone and broadcasting on a TV channel. And I think our society has noticed that difference for a really long time and that's why there's different regulations and rules around communicating it with your friends and broadcasting media.

And so, for us, as we evolve the product, I think this allows us to really reinforce the great things about our communications products, bring friends closer together, and at the same time, provide more distribution to really high-quality content. So, I think we're trying to stay way ahead of the curve on this stuff and it's something we care a lot about.

OPERATOR

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

JASON HELFSTEIN, OPPENHEIMER

Thanks. Two questions. You did share a good amount of learnings on the app redesign. Are you getting input from advertisers and agencies? How deep is the learning going? And then it does seem like brand will be a lower percent of the mix going forward between brand, DR and then large versus small advertisers. Just any thoughts about how to think about the mix of advertisers going forward and kind of the benefits of greater diversification. Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yes. We are taking feedback from advertisers and agencies. A perfect example are Promoted Stories. Agencies and advertisers always told us that they wanted a new way to tell their stories, and that's why we launched Promoted Stories and we are thrilled with the success that we are seeing and we are really, really excited about the opportunity.

The second question was around mix shift between brand and DR. I think for the first time in the company's history, more than 50% of our revenue came from advertisers who were outside the Ad Age

Top 100. As we said, there are 26 million or so large and small businesses out there and there's a tremendous opportunity to help those advertisers to be successful, and they are looking for ways to reach new users. And we can help them.

So, we are really dedicated to focusing on that. And as we do that, you will see that the mix will change, and that will also mute the seasonality in the business, hopefully in the long term.

OPERATOR

And your next question is from Youssef Squali with SunTrust. Please go ahead.

YOUSSEF SQUALI, SUNTRUST

All right, two questions please. Starting with Drew, on the cost side, can you shed some more light into the strength in the gross margin and components of that and more importantly, as we look into 2018, it looks like 2017 had a lot of noise to it from a gross margin side. How should we be thinking about seasonality on that line?

And then, Evan, GDPR requires changes to the consent recommendations around kids 16 and under. I know international is a relatively small percentage of the overall business. But how do you envision this effect in Snap's onboarding process, and just any other potential fallouts from GDPR, or not. Thanks.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

So, let me speak to some of the wins that are happening on gross margin. You're right. Gross margins have been expanding here and been expanding for a while. We did have a terrific quarter. Gross margins went from 21% sequentially up to 36%, and similar expansion on a year-over-year basis. Really, we have a powerful model when we can get incremental sales here, and so if you think about the marginal cost to serve here, it's not high.

And so simply put, sales have been growing a lot faster than our costs on a variable side, which has been terrific. Our cost structure, really on the variable side, is infrastructure costs and rev share, both of which have been heading in the right direction. Our infrastructure costs are down from $0.72 last year to $0.70. We're just doing an excellent job of executing on the multi-cloud strategy. We're winning there and obviously we're taking the capital out of the business as we do it. So that's really two wins that we've been executing on on the infrastructure side. On the rev share side, as we continue to open up more owned inventory, those incremental sales dollars come without a rev share.

So that's really been helping manage down the revenue share percentages. It was 14% of sales last year and now it's 10%. And we've seen good leverage on that all along. So really, it's a powerful combination of growing revenues, and we've done a pretty good job of flattening the cost in marginal costs, and so you've seen the expansion of the gross margin over the last six quarters. It's been nice progress.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

On the GDPR front, it's something that we are ready for and we've been very thoughtful about how we approach privacy in our product. Obviously, the things like the right to be forgotten are close to our hearts, and it's something that we have a very serious focus on.

OPERATOR

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

RICH GREENFIELD, BTIG

Hi. Thanks for taking the question. The first one for Evan, you know, Evan you were talking about trying to stay a step ahead of everyone else when you think about the product. I think there's been a lot of questions from investors about the kind of the rationale for the redesign and how much of it was something that you saw that you didn't like in user behavior, or was it trying to meet advertiser demand?

It seems like you're trying to portray it as this was more of nothing was wrong, we just believe we can be better, and I just want to understand. Maybe you could just set the record straight or confirm that's the rationale driving the redesign?

And then, just a question for Imran and Drew. You obviously exceeded Wall Street expectations for Q4, but as you think forward for full year 2018, I think if you look back to the IPO, expectations were for roughly $2 billion of revenue in 2018. That's now down to call it $1.3 billion, at least before today's call.

And while I know you don't give guidance, wondering how you feel about that level of consensus out there in terms of ability for the company to meet or exceed the way you did in Q4.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

Hey, Rich. We're always trying to improve the product and we're pretty relentless about it. We see a huge amount of opportunity both in the redesign, but also all of the other stuff that we're working on. And obviously, it's what we love to do. So, we're really excited about our work there.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

In terms of the overall thoughts for the year, Rich, the Snap Ads sold through the auction are going to continue to be our main revenue driver in 2018.

The auction continues to be new for us where there's lots of optimizing going behind the scenes every single day on pricing, on targeting, etc. Look, there were a series of new technologies, enablers, accelerators like the Pixel, like targeting improvements, new products. They should be accelerators for our business, but it's difficult to predict when they're going to be ready.

And so, as a result, our revenue visibility is really more in the near term. And so that's why we shared some thoughts with you as it relates to the first quarter on the underlying drivers of the business, and so that's the visibility that we have comfort with at this point, and so that's why we share those thoughts.

OPERATOR

Our next question is from Brian Fitzgerald at Jefferies. Please go ahead.

BRIAN FITZGERALD, JEFFERIES

Thanks. I think you guys got asked this before, maybe a couple of quarters ago. Thinking out loud, with the strength that you're seeing in self-serve, have you thought about opening up the auction to third-party DSPs to increase the number of advertisers to get some more pricing buoyancy there on the platform? Thanks.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yes. I think, when you open it up to third-party DSP providers, there’s always a risk that I think some of the user IDFA will leave our platform, and I think we are really, really focused on user privacy and ultimately that's a very, very important part of it. So, I don't think we are interested in doing that. I think what really makes it great is that anybody can log on to our platform and buy advertisements.

There are a lot of advertisers who are looking to acquire new customers, and with our strength in the millennials market, right, 70% of 13-34 in US, UK, France and those markets are on our platform, and so, we are really excited at what we can offer and I think that's a great way to grow our business without compromising potential privacy issues.

OPERATOR

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

JOHN EGBERT, STIFEL

Thanks. I had a couple questions on Maps. I was wondering how Maps fit into the redesign? Are you seeing increase usage of Maps and/or stories viewed in Maps for the test users that you're tracking? Is it a priority to make Maps usage more frictionless in this redesign?

And then on monetization, it seems like stories viewed from Maps on the interface are still un-monetized or at least very under-monetized. Should we expect to see that change anytime soon? What type of criteria are you evaluating there? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER

We're really excited about Maps. We have over 100 million monthly active users for Maps, and we'll be working on improving the frequency with which people use that product, mostly by trying to provide more value around using the Maps experience. Today it's hard to know where to go, it's hard to navigate to interesting things that are happening.

And so, as we improve the product, we'll make it easier for you to find the most interesting things that have happened on your Map. So, I think a lot of work to do there, of course, and we're happy that we're bubbling it up higher, obviously, in the redesign. On monetization, we're not currently monetizing Maps and nothing to share on that front.

OPERATOR

Our next question is from Ron Josey with JMP Securities. Please go ahead.

RON JOSEY, JMP SECURITIES

Great. Thanks for taking the question. I want to ask you about international expansion. I think Imran and Evan, you mentioned about working with carrier partners internationally and then also selling ads through Snap Ads, through Ad Manager and the newer markets like the Middle East. So, I was wanting to understand maybe there was a little bit of change in strategy in terms of focusing on the top ad markets globally or just looking at launching everywhere?

And then, in terms of monitoring headcount, just really quick, if you could provide any sort of insight on reducing the friction or improving productivity gains, you mentioned back office employees declined, but is there any change in the sales structure, given the strength in the auction? Thank you.

IMRAN KHAN, CHIEF STRATEGY OFFICER

Yes, well I think as our business is becoming more and more programmatic, our sales force is becoming a consultant to our clients and I think that is very important, because I think we have still a lot of work to do to educate the market and really teach the market how to create vertical video ads that really, really work in a mobile environment.

Many of our advertising partners are really winning by creating great ad content and really understanding how to take advantage of our platform. And so, we're going to continue to invest on that and then I think there's a tremendous opportunity for us to capture market share by doing so.

With regards to international markets, look, I think international is a great opportunity. More and more advertisers in the international market want to use Snapchat to reach their audience and we'll continue to be aggressive rolling out to the market that we think we can generate profitable revenue growth.

DREW VOLLERO, CHIEF FINANCIAL OFFICER

I was going to say, Ron, as we've been building up to the 3,000 here, the North Star really has been added to the front of the house and leverage the back of the house as much as we can. To your point, we saw that in the back of the house for the fourth quarter, but we have been able to move the mix front of house with engineering and sales now over 80% of the people at the company. That's by design.

And so really, those remain our strategic priorities. We're going to be focusing on hiring to your point as we move forward, but those remain high priorities for us.

OPERATOR

This concludes our question-and-answer session as well as Snap Inc.'s Fourth-Quarter and Full-Year 2017 Earnings Conference Call. Thank you for attending today's session. You may now disconnect.