SNAP INC. AT MORGAN STANLEY EUROPEAN TECHNOLOGY, MEDIA & TELECOM CONFERENCE 2023 TRANSCRIPT

SEAN DIFFLEY, MORGAN STANLEY

All righty, thanks, everyone, for joining us. My name is Sean Diffley. I'm the Internet, Media and Telecom Sector Specialist at Morgan Stanley. I'm very excited to be joined by Derek Andersen, the CFO of Snap.

Just a quick disclosure, and then we'll get right into it. Please note that all important disclosures, including personal holdings disclosures and Morgan Stanley disclosures can be found at the Morgan Stanley website. And please note that some statements by Snap today may be considered forward-looking. These involve a number of risks and uncertainties and could differ from actual results.

So no further ado, Derek, you've been at Snap for just over 5 years now. You're at Amazon before that. Lot of exciting, interesting things going on at the company right now. I wanted to kick off with the recent Amazon shopping ads on Snap announcement, which came out this week, which you confirmed. Maybe you can talk about what's involved in the announcement, where you see the opportunity and how investors should be thinking about it?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. Well, look, thanks for having me, and it's exciting to be here, and thank you all of you who have joined us, including on a live stream.

Look, I think broadly, what we're seeing is an opportunity to make the experience better for our community and generally for advertisers. And in some cases, that's involving doing more custom or bespoke types of integrations that make the flow of discovering products, learning more about them and actually completing transactions smoother for the community and smoother for the advertiser, which you'd expect will improve flow-through and the completion of funnels and whatnot. So I think there's just an example of a way that we can work with an advertiser to make the experience better for them and better for the community.

SEAN DIFFLEY, MORGAN STANLEY

Great. And I think Amazon has often been reported to be the largest advertiser in the world. I think for a little while, there were some speculation that they were not super involved on the platform. Is this -- is it fair to assume that this is kind of that relationship improving and getting better as a result of this announcement?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. I mean I think this is certainly an example of a way that we can work with large advertisers in order to help them have a great experience on the platform. And not even specific to any one advertiser, but being able to work through ways that we can cooperate and make the experience better for them. And in a way that's also better for our community. If you can discover a product on Snap and more easily complete the purchase funnel even without leaving the application, in some cases, that's going to be a better experience for the community and hopefully a better experience for the advertiser, too.

SEAN DIFFLEY, MORGAN STANLEY

Great. And another area of focus that's gotten some attention this week is kind of Evan really reengaging in the company and the business. I'd be curious, how are you thinking about the culture and how have you seen kind of Evan's time spent in areas of focus evolve over your time there at the company?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. Look, I think we're at a place in our business where we want to see performance improve and I think you started to see that over the last couple of quarters that we've made a lot of progress with the ad platform. And I think that we have an expectation of our leadership at the company to be really hands-on in the details, to be outcome-oriented. And one of the ways that we can do that and role model that as leaders is by doing that ourselves. And certainly, we see right from the top that example being set, of how to be deeply engaged with the details of the business, how to be deeply engaged with the outcomes that our advertisers are seeing and our community is experiencing in ways that help drive the business forward. And so what I'm seeing is a leadership team that's very deeply engaged in the business in driving outcomes. And you're seeing that show up in the outcomes of the business in terms of metrics and results now.

SEAN DIFFLEY, MORGAN STANLEY

Would you say priorities have changed from the top in the last few months or so?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

I think there's a really high sense of urgency to make progress. I think that the digital advertising space broadly has gone through a big transition over the last 12 or 18 months. And we've made big changes to our ad platform at the beginning of this year. We've had a lot of changes in terms of our go-to-market efforts and our ad product technology. And there's a desire to make that progress go really quick. Let's make this better for the community, let's make this better for advertisers, let's progress those results really quickly. Let's understand where we have opportunity to make things better and then deliver

really quickly. And so I'd say that the biggest change is, one, a very deep customer orientation on the ad platform side; and then two, this urgency to deliver outcomes and to deliver improvement.

SEAN DIFFLEY, MORGAN STANLEY

That's a great place to start. So over the last 12 years, the business has transformed and now has 750 million monthly active users. So starting with the core pieces of the platform, obviously, it starts with the camera and Stories and chat features. How would you describe consumer behavior evolving?

And how do you think of Snap as a utility? And what are the things you look to grow and improve over the next few years on the core app.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. Well, look, I think if you step back, the core product value all starts with communication, with your closest friends and family. And in particular, because we open to the camera and because we've been focused on communication that's visual, a lot of that communication is pictures and video and using that to communicate in a very rich way with your closest friends and family. And that leads to a lot of frequent engagement with the app. And really frequent opens and a daily habit, which is why you see we've topped 400 million daily active users even on that large MAU number. And so what you're seeing then is that gives us the opportunity to build other services around that communication utility and we started with Stories, and the ability to share friend Stories and then that evolved into the Discover platform with publishers. More recently, that's evolved into Creator stories.

We've also been able to build the Spotlight business, which is our short-term vertical scrolling business on the content side. And we've also been able to build out a map and of course, the augmented reality business that is beneficial to the camera. And so what I would expect that you're going to see over time is that we're getting better and better at creating linkages between your best friends and your community on the platform and these services, whether that's making it easier for you to share a really funny Spotlight that you think your friend might appreciate with them and then that leading more naturally into a content session for them or making the app work better on the map in terms of being relevant to you and your friendship. So the map being more oriented around where your friends are and your favorite places and more customized.

So I think what you'll see is us continue to build around that core and make these other screens that we've added to the product more and more high value and high utility for the community. And of course, that also gives way to a great advertising business, where we can give very relevant ads, both for the community and the advertiser as a result of that deep engagement that we have with the community.

SEAN DIFFLEY, MORGAN STANLEY

Great. And on the advertising point, I did want to ask you, as we think about the ad market and your guidance, you obviously grew 5% in the last quarter, you spoke to an internal forecast, kind of 2% to 6% growth, maybe walk us through puts and takes, areas of strength and weakness, how we should be thinking about the ad market. You spoke to kind of a pause in brand advertising around conflict in the Middle East? Just maybe any further detail you'd like to provide around that?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. I think the most important thing I'd focus on is the progress that we're making broadly with the ad platform. And I think what we've seen over the course of this year, as we made really significant changes to the ad platform in Q1, to really focus the DR business around more immediate in-session click-through conversions. And then all of the investments we've made in ML infrastructure after that through Q2 and Q3 in order to make the ad platform more performant, improve ranking, and improve optimization, bring more signal into our models and optimize around that and then add measurement solutions like 7/0 that allow advertisers to take advantage of those improvements to the ad platform. We've seen that translate into momentum.

So first, you saw in Q2 the improvements in purchase-related conversions that grew significantly sequentially in Q2, then you start to see the business accelerate from a quarter-over-quarter growth perspective in the Q3 and we return to top line growth on a year-over-year basis in Q3. So that's a very important part of the story is just the momentum on the build in the DR ad platform. And the more progress that we can make in terms of improving the optimizations for the advertiser, the better that platform is going to be over time. So I think the most important story there is the progress for the DR ad platform.

And then on the other side of that, there is the progress we've made with the brand platform and that we've released some new takeover products this year, and we were really pleased with the uptake we saw in those in Q3, and that's an important part of the story as well in terms of returning the business to growth in the current quarter. So products that allow people in a very short period of time to get really immense reach by reserving a First Story or First Commercial or what have you, which has been really successful for our partners.

So that's, I think, the most important element of the story is that we continue to progress that. We're pairing that with improvements to our go-to-market. And so you can see the leadership changes that we've made there, both with the region president roles and a number of country leader roles as well underneath that, bringing really deep DR experience and scaled ad platform experience into those roles. So we're in a position to help our clients get to the right ad product, get to the right optimization and grow their business on Snap.

SEAN DIFFLEY, MORGAN STANLEY

Got it. And maybe we could talk about some verticals on the ad front. On the call, you referenced CPG, restaurants and travel doing well. Obviously, there's a lot of attention on e-commerce broadly. Obviously, Temu getting a lot of attention and Meta talking about them a bit. I'm curious, anything you'd want to kind of provide in terms of what your exposure there might be or what categories you're seeing particular strength or weakness?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. I think what you're seeing right now is that there's sort of a Venn diagram of sectors that are doing reasonably well, sectors that overlap with our audience really well and the parts of our ad platform that have made the most progress. And so when you think about those things together, one, there's several sort of verticals that we've talked about that have been doing quite well this year. CPG is a good example. Obviously, a very important demo for building brand affinity. We have really a large reach there, good overlap with ad products. So that has been a category that's done well.

In addition, we've seen travel and tourism, restaurants and e-comm and retail together doing really well. And in terms of specifically the more DR side of things, we've made a lot of progress with purchase-oriented conversions. We shared some metrics about that in each of Q2 and Q3, and you're seeing the combination of purchase optimizations like Pixel Purchase, measurement solutions like 7/0, really helping to make sure -- make that perform really well for those partners. And as a result, we've made a lot of progress in those categories.

I think from here, we have a long way to go. There's more that we can do to help those advertisers, including making progress with things like value optimization and Dynamic Product Ads, which will make it possible to have the performance get even better for some of those categories. And then there's more we can do on the app side of things to make the platform even more performant for people who are focused on those optimizations.

So we've made a lot of progress this year, but there's still a lot of room to go for us, and you're going to see us continue to invest in the ad platform to make that happen.

SEAN DIFFLEY, MORGAN STANLEY

Got it. A question I've gotten from investors is media and entertainment spend has been kind of weak with streamers focusing on profitability and obviously, the Hollywood strikes and not much spend there. Is that a category -- I know historically that people thought of that as a bigger category. Is that still significant to you or not really?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. Historically, that's been a really good category for us. I think if you go back several years sort of when I first joined the business, weekend movie releases, Snap is a phenomenal platform for that because it has the demographic that is mostly only going to the theaters and we have great takeover products and AR products have been great for those releases.

We saw during the pandemic period, a lot of that demand shift more towards the streamers. And good relationships drove good business against that category, which we talked about plenty during that period. I think we're at a spot here with that category where our platform still works well for that vertical, but there's always ebbs and flows depending on where those businesses are. And coming out of the pandemic, you see some streamers being a little more rational in terms of investment and getting into more of like a sustained growth and you're also seeing the box office just starting to come back. And so I am excited about what that category could mean over time, especially if you start to see that begin to scale and get to a more long-term focus.

SEAN DIFFLEY, MORGAN STANLEY

Great. And I wanted to turn to users and engagement. Obviously, pretty high penetration in the core demo in North America, a lot more growth kind of Rest of World and Asia. Maybe walk us through puts and takes, I'd say, on the quarter, maybe a slight disappointment on the user guide. Walk us through how we should think about kind of different geos and user growth and engagement.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. Yes. right off the start, I would say that we have really deep penetration in some of the most important ad markets in the world. And so if you think, for example, North America is a primary example. 150 million MAU is the last number we shared there, 101 million DAU in the most recent quarter, really deep penetration. We've shared metrics in the past around 75% of 13- to 24-year-olds or 90% there, sorry. And 75% up to 13 to 34 in North America. So you've got, in some of these mature markets, including Western Europe, really deep penetration.

So a lot of the opportunity in those markets is around continuing to win with new smartphone owners as they enter the market and continuing to have strong retention as people age up in those categories. And certainly, there's opportunity at the margins to improve DAU-MAU ratios over time. But in general, the growth there just because of how deep the penetration is, is going to be a little slower. And we have a long way to go on improving monetization and realizing the ARPU opportunity in those markets, even absent dramatic user growth.

I think there are other markets where we're a little less mature and certainly you can see Rest of World, for example, growing at a much higher clip over the last number of years as we've focused on markets

that we think are going to be a great business for us in the future where we can be margin accretive over time as we build a business in those markets, and we've had success.

India is an example of a market that we've talked about previously, where we found good product market fit and been able to make localization investments and grow the community there. There's certainly a number of other markets, you know, where we can do that and where we're making progress.

And so you'll probably see a little bit divergent growth rates depending on the area. And because we've tried to make sure that we have a focus on growing in communities where we can see it being accretive to the business over time, you'll see the growth sort of be logically based on how we try to focus that and grow it out over time. And so not just growing for the sake of growth, but growing for the sake of growing the business.

SEAN DIFFLEY, MORGAN STANLEY

And I guess, given that we're in Barcelona, are there any interesting kind of territories or markets or countries where people might be surprised like growth is really strong or use cases are different than they are, say, in North America?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. I think there are certain markets where Android is a greater share of the market. And even though we're several years now removed from the rebuild of our Android application that occurred in say 2019, we are still growing relatively faster in some of those markets where we have more opportunity to grow relatively faster in those markets.

And so that's a big opportunity for us to continue to catch up on penetration. And that app is very performant, and so it's an opportunity for us to continue to grow. And then beyond that, all of the markets that weren't particularly an early focus in early going are opportunities for us to now grow and start to match the level of penetration that we have in our most mature markets.

SEAN DIFFLEY, MORGAN STANLEY

Great. And on the monetization point, I think a common pushback on the company and the stock is that a lot of time spent is on chat, and that's harder to monetize. I think you've made some good progress here. So maybe walk us through how you're thinking about that and what your pushback would be to that assertion?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. I think the first thing I would say about that is that chat and specifically our product, which focuses on communication with your closest friends and family is a wonderful product from a frequency of engagement and retention and how retentive that product is. So if you're on Snap and you've managed to connect with one or two of your best friends and maybe a family member, then we typically see that that's the on-ramp to a very retentive relationship. And that is bringing people into the app many times a day and many days of the week, which is why we've been able to build such a large community. And then that organic top of funnel gives you the ability to be in all kinds of other businesses. And so that's where you see we've built a really large content business. We've been able to add the Maps business, we've got a sponsored AR business.

But I do -- I think to the point of well, okay, but how do you monetize chat more directly? I mean, first of all, there's lots of ways to monetize that level of engagement, which is we've doing and growing really quickly. But I also think that we've made really important advances in the business more recently. And I would point to two in particular, one is Snapchat+, which is our subscription service. We're very early in the going there, but the last number we shared was that we'd exceeded 5 million subscribers, which is very exciting, a very significant contributor to the revenue growth now and starting to become a bigger part of the revenue story in the business.

And some of the most popular features or benefits of Snapchat+ are things that are allowing people to customize their experience with the application and customize aspects of how the communication services are within there, including things like wallpapers for your chat with your friend. And so those things are essentially allowing us to monetize that really frequent engagement and the passion that so many people have for the app through that subscription product, which is exciting.

And then I think a second similar sort of vector is around My AI. And it's very early with My AI, but it's an exciting product, where we've enabled an AI assistant within the chat of -- of each of our users. And we're seeing sort of two things there. One is that there's a lot of commercial intent or we're learning a lot about our community from the conversations that we're having with My AI, and there's an opportunity to make the experience better for the user and certainly make sure that the ads that they see on the platform over time will be more relevant as a result of that.

So that's early sort of testing, but exciting as an opportunity for what that could mean for the overall ad platform. And again, it's a chat aspect of the product.

And then the other is, we've been doing testing, there's been some reporting around us testing sponsored links within My AI. And I think that's another really exciting way for us to be monetizing directly within the chat over time. But again, it's very early for that, but I think that those are two things

between Snapchat+ and My AI that get more directly at the monetization of what is the core behavior there.

SEAN DIFFLEY, MORGAN STANLEY

Great. And you highlighted at earnings that the fundamental progress you're making on the ad platform is showing up in ARPU. Can you walk us through how we should think about additional conversions and improved ROAS for advertisers?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes, absolutely. I think I would point back to some of the progress that we've made already with the platform to get more focused on immediate click-through conversions that are much easier for advertising partners to measure and much easier to attribute. But then there's a long, long runway of improvements that we can continue to make to the ad platform.

So far this year, you've seen a big ramp in ML investment on the infrastructure side in order to make models more performant, in order to make our models bigger, to refresh models more frequently, to be able to ramp the frequency of testing of new signal into the platform to make it better.

You've also seen us make a lot of progress on different optimizations, whether that be the performance we're seeing on purchase optimizations or measurement solutions like 7/0. But as I mentioned earlier, there's a ton more on the runway to make those products more performant over time, make the models better over time and improve some of the optimizations by adding features like the ability to optimize for basket or ASP or what have you.

So there's a long way to go, but it's nice to see that we've made a significant amount of progress already this year with the ad platform.

SEAN DIFFLEY, MORGAN STANLEY

Great. So you mentioned 7/0 a couple of times, maybe for the crowd, if you could kind of explain what exactly that is? And why they're resonating so much with advertisers?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes, I think what essentially different measurement optimizations allow the advertiser to focus on the measurement window and what exactly they're measuring against. And so in the case of 7/0, that's allowing people to measure, based on click, and how many days after that, you're going to lead to a conversion. And so it's a relatively high bar measure for a DR platform.

And I think in the -- if you think of the big shift that we made in the ad platform at the beginning of this year, to focus more on click-through conversions to orient how our community interacts with that, so on the platform to be more click-based. And then to have optimizations like 7/0 on the back of that, that allow advertiser to optimize for that kind of behavior, it puts them in a much better position to feel really confident about the return that they're measuring on their results.

And we've seen people on the back of that, be able to scale their investment. And in our most recent investor letters, shared a number of case studies where people are seeing really nice lifts in their ROAS as a result of that. So it's a great product for our partners and one that they've really embraced.

SEAN DIFFLEY, MORGAN STANLEY

And how much of this is kind of post ATT IDFA? What have kind of been the learnings from that? And where do you stand in terms of data and attribution now?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes, for sure. I mean I think we've made a lot of progress. Certainly, those changes were disruptive to the ecosystem broadly that folks had been working together to build over a long period of time. But I think we've been able to rebuild to a place where in a privacy safe manner they were able to build a really performant ad platform and make progress with that.

And I think that we've always been a privacy-first platform. Our products are privacy by design in terms of how we think about them, and so that's aligned with our values. And now we've been able to make the changes to our ad platform and then make investments in ML on the back of that in order to get to a place where we have a platform that's both privacy safe and performant, which is great for our community and great for our advertising partners.

SEAN DIFFLEY, MORGAN STANLEY

Great. And I want to talk a little bit more about the direct response transition that you made earlier this year. Just how should we be thinking about how long it takes to roll out? And what are the signposts in terms of success in adoption?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. Great question. I think we've shared a little bit along the way with each step in this journey. The biggest milestone was the transition we made in Q1 to shift towards the more click-through in-session sort of conversion focus. And then on the back of that, you saw the big ramp in ML in order to build signal into the model and be able to optimize better on the back of that and rebuild models to be optimized for that as the objective. And then there's been a lot of milestones along the way. If you look

at Q2, the first quarter after we made that big change, you saw a big step-up in purchase-related conversion volumes on the platform sequentially, you saw improvements in advertiser retention and advertiser count. And so that was a sign that the changes were beginning to work and that the investments that we've made in ML were beginning to pay off in that environment. But we hadn't yet returned to growth. And part of that at the time was that we had a small number of very large advertisers in North America, in particular, who were very good at optimizing for the platform before those changes were made. And for whom the solution going forward is in some cases, going to be a more customized integration or a more customized ad solution that will allow them to scale on the platform in this new environment. And so you've seen us do a lot of work over the last 6 or 9 months with those partners to help them recover and grow.

And so -- for example, we shared in Q2 that about half of those advertisers had already returned to prior year levels one quarter after the change, which is pretty good progress. And because those folks were very concentrated in North America, you can kind of see it in the North America results. And then we get to Q3, a lot more progress with those partners. And you saw North America was the fastest-growing region, sequentially up 14% quarter-over-quarter. So a lot more progress there.

And so we're continuing to work through that with all of these partners and help them get to a place where we have different custom solutions that work for them and work for us and allow them to grow their business.

But at the same time, you can look at growth in other regions like Europe or Rest of World where this particular issue is less prevalent. and you can see that we're making really good progress in terms of top line growth there. And we've also been able to make progress with smaller and more medium-sized folks, which is why we saw the growth in the advertisers in Q2.

So you can see some of the more off-the-shelf solutions that are meant for scale working well. And so those things together are a good sign that we're making progress, that those investments in ML are paying off.

SEAN DIFFLEY, MORGAN STANLEY

Great. And I guess on the brand front, Total Takeover, you've highlighted a few times I thought the T-Mobile case study that you highlighted in the letter was cool. Do you think you're tapping into like TV budgets? Like, where do you think those dollars are coming from? And what's kind of your pitch to advertisers on that front?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. Look, I always think when we're thinking about where do the dollars come from, I think the most important thing to remember is that in the most mature markets where we're most prevalent, we're

still only 1% to 2%, typically, of the digital market share. And so we don't necessarily need to take money from another channel, we just simply need to meet ROAS targets. We need to deliver results in order to grow. And so what I'm seeing there is we've got this immense audience, right? We talked about the MAU in North America and the MAU globally, you know, are reach in the sort of 13- to 34-year-old demo in many cases, is unduplicated or incremental. And so when we can deliver a great product like some of these takeover products and First Commercial and First Story, that allow an advertiser on the launch date of a product or the launch date of a movie or at the time of specific event for them to be able to reach really large audiences that are in their -- the demo they're trying to reach and to do it all in a very short order on the same day, that can deliver great results for them. And in many cases, when they pair that with an AR product, which furthers the reach, they see even better results. And so really excited with what we're seeing there and those products, reinvigorating the brand business, and you could see that in the growth of the brand side in Q3.

SEAN DIFFLEY, MORGAN STANLEY

Great. And I wanted to go back to Snapchat+. I think I've been amazed that you have over 5 million paying subscribers a few bucks a month there. What you think the key differentiators are? What are the added functionalities that people are getting and resonating with? And then how does this kind of align with your priority to diversify revenue, move away from advertising over time?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. I mean, look, I think most importantly, what we've demonstrated in the very early going of that product, is that millions of people are willing to pay for Snapchat. And we're just getting started with that product. But certainly, we've tapped into people's passion about the product, their desire to customize aspects of it and some of the other features that will be rolled out there.

So I think it taps right into the idea of diversifying revenue. It taps into the growth in ARPU that we want to see on the platform over time, it helps in terms of giving us a way to really monetize that passion and depth of engagement on the platform. So I'm very excited with what we're seeing there so far. I think there's lots more we can do there in terms of enhancing the benefits of that product and different use cases and so on.

So, it's really early going, but pretty exciting to see, and I think it plays right into the diversification of revenue that you mentioned.

I don't necessarily see it though as a trade-off versus growing ad revenue or trying to shift mix. We have an enormous runway to grow ad revenue and to realize the ARPU potential of our business, given the depth of our engagement and some of the most important ad markets in the world. But this is yet another way that we can grow ARPU and realize the full monetization potential of the platform.

SEAN DIFFLEY, MORGAN STANLEY

Great. I wanted to hit on augmented reality. Maybe just talk about how you're thinking about the AR offerings heading into '24? How these features could drive upside? And you could tie into how you're using Gen AI and creative tools around that.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. I think Gen AI and Lenses are super exciting. There are some things that we've put out recently that are starting to show where we might be able to go in that direction. And so there's lots more that we can do there, and I think that's extremely exciting. And these products are really important to the communication use case. And making it fun to communicate and reducing barriers or friction to communicate with people, but there's also lots of entertainment use cases and other engaging fun aspects of it.

And then I would also say that it's also been a part of the advertising story for advertisers. You know, AR ad products, when combined with other campaigns, deliver great results for advertisers, in many cases, are giving them incremental reach, incremental ROAS on their campaign. And so I think the potential there is immense and you're going to see us continue to invest there and continue to have that be a big part of the story.

SEAN DIFFLEY, MORGAN STANLEY

Great. And one of the big themes of this conference has been AI. Unsurprisingly, you referenced My AI earlier. Maybe you could give us kind of a broad overview on how Snap is harnessing AI and how you're positioned overall on the theme and the tech.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. I think it's really exciting for our business. And My AI, very early, as I mentioned before, but it's one of the most used AI assistants on mobile today, which is pretty exciting. And we're just early in the going with that, but we're seeing lots of interest from the community. It's early, but like we're seeing people find ways to leverage that in their communications with friends or to be a useful utility to them. And so I think that's pretty exciting, and you'll see us continue to experiment there.

And then, of course, AI has a role to play in the AR side and the creation and also in other aspects of the business. So I think we're all learning exactly all the use cases and how it can apply to our business. But in the few areas where we have applied it already, we've had pretty exciting results, and I think what you've seen with some of the recent AR products and what you're seeing us do with My AI are great examples of how, when we can innovate on a new technology and bring it to our enormous community, we can deliver really significant results quickly.

SEAN DIFFLEY, MORGAN STANLEY

Great. I wanted to turn to expenses and margins for a second. Can you walk us through how you're driving efficiency and cloud infrastructure costs? Maybe you hit on headcount, there was a story, there were some layoffs and some kind of restructuring. So how you're thinking about the cost structure as you move into '24?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes, for sure. I think of costs in different buckets. Certainly, on the infrastructure side, you can kind of see two sides of the story there. One, us making a lot of progress on both vendor pricing and the unit economics of things that are truly variable. But at the same time, making big sort of fixed cost in nature investments in ML to drive forward the app platform.

And so we're trying to be measured with those investments, to make sure we reinvest really aggressively throughout the last couple of quarters in order to be able to progress the ad platform and depth of content engagement as quickly as we could. But I think going forward, there's an opportunity for us to get operating leverage from those investments over time. And certainly, that would be helpful to the gross margin story.

And then when you're looking at more of the fixed cost side of the business, including OpEx and SBC, look, we've tried to make sure that we're responsible with our level of investment over time. And so a year ago -- a little over a year ago, we made the really difficult decision to remove about 20% of our head count and really refocus our investments on our core priorities, in order to accelerate revenue and improve depth of engagement and continued leadership in AR and that was really important to getting the business in a place where we could generate free cash flow and positive adjusted EBITDA and even at reduced growth rates, which you could see in the results we reported in the most recent quarter.

Going forward, we continue to be really careful about the prioritization of our costs, and we've made some decisions more recently over the last 3 or 4 months that you've seen that have further optimized the cost structure, further focused our investments on helping the business to return to a level of growth. And what you can expect to see is us continue to be really, really careful about prioritizing those investments, so that we can get to a place where we talked about in our Investor Day earlier this year, which is getting to meaningful adjusted EBITDA, getting to sustained meaningful free cash flow generation.

This is a business that has historically always had very high incremental margins. And flow-through of incremental revenue to adjusted EBITDA and free cash flow. So as we begin to make this transition, as we did in the most recent quarter to top line growth again, we want to make sure that we can scale that through and drive out adjusted EBITDA and free cash flow at reasonable rates going forward.

SEAN DIFFLEY, MORGAN STANLEY

And you announced a buyback in the quarter. Just is that largely to try to offset dilution? Or you are you -- kind of walk us through the decision on allocation buyback.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. I mean, look, when we were careful when times were very good to make sure that we built a fortress balance sheet, and we were fortunate to be able to raise a lot of capital at times when the capital was much cheaper than it is today. And then on the back of that, when our shares were trading at much higher levels, we early converted more than $1 billion of our convertible notes in order to give ourselves unencumbered cash. And that put us in a position where over the last 18 months when things have been tougher in the market and multiples have been compressed, that we've been able to defend our share count, repurchase shares. We bought back $1 billion last year in the back half of the year and now more recently have announced another $500 million. And that's really about using our capital and our balance sheet responsibly, to make sure that we're defending our share count and defending dilution and making sure that we're driving returns for shareholders over the long term. And so we're fortunate to be able to be in a position to do that and do that for the benefit of our shareholders over the longer term.

SEAN DIFFLEY, MORGAN STANLEY

Great. And I want to close out with third-party partnerships. So we obviously mentioned Amazon at the start. Shopify is another one. How are you thinking about partnering across the industry? And what do you think the biggest upside drivers could be around unlocking some of those things?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. I think the biggest part of working with third parties and partners for us is things that are going to make it easier for advertisers to be successful on our platform and easier for people to do business with us. And so whether that's an integration partner that allows other advertisers to more quickly get set up and run on our platform, I think Shopify being an example of that. Those things are really important for us in terms of being able to grow advertiser count and grow demand on the platform and simply make advertisers have a lower friction experience to get up and running on the platform.

But I do think with our immense reach and our immense depth of engagement, we're in a really unique position to be able to build a full-fledged DR platform here. And so we want to make sure that those relationships with our advertising partners are as direct as possible and that they're feeding the monetization ecosystem of the platform so that we can get better and better for our ad partners and provide a better and better experience for the Snapchatter as well.

SEAN DIFFLEY, MORGAN STANLEY

Great. And I want to close out with any final remarks you have in terms of how you're thinking? What are investors missing about the Snapchat story? What do you think they should be paying more attention to?

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Sure. I mean, I think that we're at a really important point for the business. This transition period over the last 12 or 18 months as the entire industry has sorted through how direct response advertising is going to work going forward, has been a really important period, and we're making really significant progress through that.

And so the changes we've made to the ad platform this year, I think we -- one quarter does not a trend make, but it was really an important milestone for the business to be able to return to top line growth in the current quarter.

And I think then stepping back with the case studies we've been able to share and the metrics and the performance of the ad platform we've been able to share, you can start to come back to the fundamental thesis of Snap, which is a highly retentive product with massive reach on an MAU and DAU basis and a really deep engagement with really compelling ad products. And so I'm excited for folks to sort of come back to the fundamental thesis of the business and our ability to grow ARPU over time and capture share in the ad market, and then what that means for the ability to deliver incremental cash flow to the bottom line and free cash flow. And I think as people are able to see and we're able to deliver more progress on the ad platform and the top line, that will become increasingly apparent.

SEAN DIFFLEY, MORGAN STANLEY

Great. Perfect place to end.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Thank you very much. Thank you for coming.