

SNAP INC. Q4 2023 TRANSCRIPT

OPERATOR

Good afternoon, everyone, and welcome to Snap Incorporated's Fourth Quarter 2023 Earnings Conference Call. At this time, participants are in a listen-only mode. I would now like to turn the call over to David Ometer, Head of Investor Relations.

DAVID OMETER, HEAD OF INVESTOR RELATIONS

Thank you and good afternoon, everyone. Welcome to Snap's fourth quarter 2023 earnings conference call. With us today are Evan Spiegel, Chief Executive Officer and Co-Founder; and Derek Andersen, Chief Financial Officer. Please refer to our Investor Relations website at investor.snap.com to find today's press release, slides, investor letter and investor presentation.

This conference call includes forward-looking statements which are based on our assumptions as of 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 these forward-looking statements, please refer to the press release we issued today, as well as risks described in our most recent Form 10-Q, particularly in the section titled Risk Factors.

Today's call will include both GAAP and non-GAAP measures. Reconciliations between the two can be found in today's press release. Please note that when we discuss all of our expense figures, they will exclude stock-based compensation and related payroll taxes, as well as depreciation and amortization and certain other items. Please refer to our filings with the SEC to understand how we calculate any of the metrics discussed on today's call. With that, I'd like to turn the call over to Evan.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Hi, everyone, and thank you all for joining us. In Q4, we continued to make progress on our core priorities of growing our community and improving depth of engagement, driving top line growth and diversifying our revenue sources, and carving a path to adjusted EBITDA profitability and positive free cash flow. Monthly active users increased more than 8% year-over-year and surpassed the 800 million milestone in Q4, demonstrating progress towards our goal of 1 billion monthly active users. Daily active users reached 414 million in Q4, an increase of 10% year-over-year, and we continue to deepen engagement with our content platform, with the number of viewers and total time spent watching content growing year-over-year. Revenue grew 5% year-over-year in Q4 to reach \$1.361 billion, as we remain focused on investing in our direct response business to deliver increased return on ad spend for our advertising partners. Adjusted gross margins expanded 1 percentage point quarter-over-quarter, adjusted operating expenses declined by 2% year-over-year, and we delivered adjusted EBITDA of \$159 million and free cash flow of \$111 million in Q4.

2023 was a pivotal year for Snap, as we focused relentlessly on adding value to our communities while evolving our business for long-term growth. Last year, we made transformative changes to our business by shifting to a more customer-centric approach, investing heavily in our ML platform to drive improved performance for our advertising partners, and better leveraging privacy safe signals for ranking and optimization. We also transformed our go-to-market efforts with new regional leadership and a renewed focus on customer-oriented advertising solutions.

We began 2024 with a focus on three initiatives that we believe are essential for Snapchat's long-term success. First, we are continuing to evolve our machine learning models to drive more ad interactions across our platform. Second, we are working to unify the content experience across Spotlight and Stories to improve the user experience and deepen engagement. Lastly, we are shifting more of our focus towards user growth and deepening engagement in our most highly monetizable geographies, including North America and Europe. We believe that focusing on these initiatives will help us to increase daily active usage of Snapchat, deepen content engagement, improve performance for advertisers, and ultimately accelerate revenue growth and drive increased free cash flow.

In order to best position our business to execute on these priorities and to ensure we have the capacity to invest incrementally to support our growth over time, we have made the difficult decision to restructure our team while continuing our investments in our highest priorities, including improved top line growth. We will reduce layers of management and concentrate our team members in major hub locations to support in-person collaboration, resulting in a reduction in our full-time workforce of approximately 10% in Q1 of 2024. The team members impacted by these changes are kind, smart and creative colleagues who have been important contributors to our business during this challenging time, and we are committed to supporting them in their transition. Thank you. And with that, we will begin our Q&A session.

OPERATOR

Thank you. We will now begin the Q&A session. The first question comes from Ross Sandler with Barclays. Please proceed.

ROSS SANDLER, BARCLAYS

Great. Evan, question on the DR side of the ad business. So growth was comparable at 3% for the fourth quarter about the same as the third quarter. So I guess why aren't we seeing more progress in getting that growth rate up to the levels of the broader digital ad industry? Like what's holding us back right now?

And then, your guidance for 1Q assumes that the trends accelerate upwards to low-double digits to mid-teens, depending on the range. So what kind of acceleration are you seeing in DR thus far in 1Q, and what does that mean for the rest of 2024? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks, Ross. We're really excited about the progress we're seeing, especially in our lower funnel business and with small and medium-sized advertisers. Purchase-related conversions grew 90% year-over-year in Q4. And we saw small and medium-sized – a number of small and medium-sized advertisers grow 20% year-over-year. We really think this reflects more resilient revenue as well, because as we've navigated some of these external challenges over the last couple of years, we found that those lower funnel dollars are just more resilient.

I think looking ahead at Q1, the top end of the guidance range reflects a 10-point acceleration. So, we are making progress here. Obviously, we wish we were moving faster, but we're working as hard as we can and pleased by what we're seeing in the direct response business.

OPERATOR

Our next question comes from Doug Anmuth with JPMorgan. Please proceed.

DOUG ANMUTH, JP MORGAN

Thanks for taking the question. Evan, you've talked a little bit about introducing a universal feed on the platform, perhaps unifying Stories and Spotlight content. Can you just talk about the opportunity here and how you could do this in a privacy and brand safe manner, and then what it would mean for ad inventory, and perhaps, revenue? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah. When we set out to build Spotlight, we actually built it on a totally separate stack, so meaning the ranking was separate stack, the inventory was separate from our Stories inventory, and the user experience itself as well was different. We've really seen a lot of opportunity in bringing some of those improvements to Stories. Our Stories inventory is more constrained than Spotlight, for example. It doesn't leverage some of the ranking improvements and model improvements we've made on Spotlight. And so, we think unifying the Stories and Spotlight experience will bring a lot of the benefits we've seen on the Spotlight side in terms of personalization and the user experience to Stories as well. So, we're definitely excited about that. A lot of the sort of under-the-hood work is well underway, and we have some tests rolling out throughout the year that should get us closer to that unified experience.

In terms of brand safety, we just completed a third-party audit on brand safety. I think we're about close to 99% of brand safe content on Spotlight. And close to 100% actually in terms of creator content, Snap Stars and the like. So, I think one of the really unique things about Snapchat is that advertisers can get a brand safe experience without paying a premium for it like they have to do on other platforms to avoid harmful content. So, I do think we'll be able to continue to extend those benefits to advertisers in this unified experience. And our very high levels of brand safety, I think, are a real differentiator for us.

OPERATOR

Our next question comes from Eric Sheridan with Goldman Sachs. Please proceed.

ERIC SHERIDAN, GOLDMAN SACHS

Thanks for taking the question. Evan, maybe if I could stick with the big picture themes that you introduced in your introductory remarks when you look across the competitive landscape of sort of social media, media consumption and the potential for rising utility around apps like yourself, how do you identify what you see as sort of the opportunity set and the potential challenges you're trying to navigate around to sort of reposition the business for growth in users, engagement and monetization over the long term? Thanks so much.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah. Thanks for the question. As we've designed Snapchat and really architected the product, we thought about building it around some of the core ways that people use their smartphones. So things like talking with friends, taking pictures, watching content, these are the things that people do most often and really engage with the most on their phones. And I think as we look at Snapchat, one of our biggest opportunities is actually the way the relationship between these different services. That's been a strategic advantage for us.

If you think about the growth of our content business, what we've seen is we can grow the top of funnel as

friends share content with each other. That brings more people into our content experience. So when we launched Spotlight, we leveraged the fact that so many people use our camera every day to create videos, that we could generate a lot of inventory for our Spotlight product very, very quickly. So I think this relationship between our camera, our messaging service, and of course, our content platform is really a key strategic advantage for us. And as we continue to focus on helping close friends and family stay in touch and communicate visually with one another, I think there's a lot more opportunity for us ahead.

OPERATOR

Our next question comes from Mark Shmulik with Bernstein. Please proceed.

MARK SHMULIK, BERNSTEIN

Yes. Hi. Thanks for taking the question. I noticed in the investor letter that there's – one of the priorities is to focus on North America and Europe, growing users and deepening engagement. We saw a little bit of softness in North America DAU. Can you just share a little color as to why, and perhaps, below the surface, kind of some of the changes you're doing as you think about focusing on growing engagement in these markets? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah. Thanks for the question. As we look at North America, in the fourth quarter, that decline was mostly an artifact of rounding. We're not expecting a further decline in North America in Q1. I do think overall, though, there is an opportunity for us to invest more in growth in North America and Europe. Over the past five to seven years, we've really focused on our Android product and growth in emerging markets. That's really about attracting a large volume of new users.

I think in places like North America and Europe, we can do a better job on iOS and really on resurrecting people who tried Snapchat or who aren't coming into the service as often or when they come back to receive a message from their friends, helping them onboard to our other different features. So, that's going to be an increasing focus for us and we'll be investing more there over the coming years. We're kind of currently just really sizing that opportunity and really understanding it. We, obviously, reached a very large number, I think, more than 75% of 13 to 34-year olds in over 20 countries. But I do think there is some headroom to continue to grow our business in Europe and North America in terms of users.

OPERATOR

Our next question comes from Rich Greenfield with LightShed Partners. Please proceed.

RICHARD GREENFIELD, LIGHTSHED PARTNERS

Hi. Thanks for taking the question. Evan, I guess this all kind of come down to the investor questions are tied to scale. And the Snap's smaller scale relative to Meta, is that just sort of a fundamental long-term issue? Because I think people are looking at Meta growing 30% at a tremendous underlying scale and certainly spending very, very aggressively on AI and ML. And is that the limiting factor on your growth? I mean, 10% to 15%, as you noted, is obviously a pretty nice acceleration from where you were this quarter at 5%. But backing out subscription, you're probably – you could, at the bottom end, still grow below 10% ad only. So just as we think about sort of 2024, is Q1 the low point, meaning is there a dramatic acceleration that you see possible throughout the whole year as you lean into DR and the ML investments pay off, or are you just sort of

fundamentally disadvantaged? I think that's what investors who are obviously seeing what's happened to the stock overnight or trying to struggle with to understand. Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah. Thanks, Rich. I think as a platform that serves over 800 million people around the world, we're certainly one of the largest Internet services. We aren't as large as some players, but I think there's enormous opportunity for us to continue to grow our business. I think as you look at sort of the overall revenue resilience, one of the things we've really focused on in the last couple of years is pivoting to lower funnel objectives for advertising partners and especially small and medium-sized businesses. We historically had had more of a brand-focused advertising business. And it's taken quite a lot of work and investment. We're certainly trying to play catch up here on the direct response side, but we are seeing evidence that that's working. So I think as we look at our 7/0 product, for example, in the way that that's really driving purchases for advertisers, that tells me that as we apply those learnings to other categories like apps, for example, that we'll be able to see more momentum and progress there.

So it certainly has been a difficult transition from a more brand-oriented business to direct response, but we are making a lot of progress. And when I look at the work we've done just on the modeling side and the scale of our models now and our ability to utilize, pressure more real-time signals in a privacy safe way across our platform, I do think we're making significant progress and we're optimistic that we can continue to accelerate.

OPERATOR

Our next question comes from James Heaney with Jefferies. Please proceed.

JAMES HEANEY, JEFFERIES

Great. Thanks for the question. Derek, can you just give a little bit more detail about what you're seeing so far in Q1, whether that's January or early February? The guide implies a pretty decent acceleration in revenue growth. So, just curious what's specifically giving you that confidence to get back into the mid-teens at the high point? Thank you.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Hey, it's Derek. Thanks for the question. I think at a very high level, we're off to a good start. It's early in the quarter. We're only about a month in. But we're off to a good start. And as Evan said, we've made a lot of progress with the ad platform in the trailing year.

I think what we're really looking for here is sort of four high-level things. One is significant improvement to the ad platform fundamentally, then improvements to our go-to-market, then delivering better rollout to advertisers, and then that translating into budgets moving over and advertisers growing, and then we made a lot of fundamental improvements to the ad platform and our go-to-market last year. Evan touched on a lot of that and how that started showing up and improve in Q4, whether that was the more than 90% growth in purchase-related conversions in Q4, and also early input signs in advertiser growth with the more than 20% growth in small and medium-sized customers in Q4. So, you're seeing that those fundamental improvements to the platform and our go-to-market efforts starting to translate into results for advertisers, and then us seeing that in some of our outputs with a good start here and then reflected in the guide that we've provided.

So, we're definitely seeing progress there and pleased with the start that we're off to. And that's reflected in the guide. And as you noted, at the high end of the guide, we'd be looking at a 10-percentage point acceleration in the year-over-year growth rate, which would certainly be good progress in a single quarter, and we look to build from there. So look, thanks for the question, and hopefully, you're seeing the progress that we are.

OPERATOR

Our next question today comes from Justin Post with Bank of America. Please proceed.

JUSTIN POST, BANK OF AMERICA

Great. Thanks. Maybe one for Evan, just on the cost side, pretty big change you made in January or planned in January but made recently. Can you talk about the motivation for that?

And then, Derek, maybe explain when the benefit of that will hit, I'm assuming 2Q, but maybe you could outline how much cost savings and when we'll see it hit the model? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah. Thanks for the question. It's always painful and difficult to make these sorts of changes with our team. We're really motivated by trying to move faster. Last year, towards the end of the year, we made a rather large change to our product team and restructured the team to just drive a lot more accountability and focus, and in doing so, we removed a number of layers of management. We saw the impact that that had just in terms of the clarity and focus and the ability for people to collaborate and work together.

And I think as well, we're seeing a lot of benefits from getting folks together in the office and the sort of problem solving and creativity that comes out of that. So, I think putting a real focus on reducing hierarchy and really an emphasis on bringing people together to solve problems has made a big difference for the business recently, and I think these changes will allow us to do more of that.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Hey. On the cost structure side, I think a few things to walk through here, just looking at the cost structure generally. One, we're trying to make sure that we've got a really clear path to be generating meaningful adjusted EBITDA and positive free cash flow. And that's really defining our investment levels and then we're prioritizing within that.

As I look forward to Q1, number one, we've seen a big increase in infrastructure costs in 2023, on the order of magnitude of about \$100 million of quarterly run rate of higher infrastructure costs, and that's led to the rather significant increases in per DAU. You saw that start to slow down as we went through the back half of 2023 and into Q4 of 2023 in terms of the sequential increase in the infrastructure for DAU, and really look for that to continue to slow down or level off here as we move into Q1, and that's going to give us the opportunity to make progress against our medium and long-term margin targets, given infrastructure is the biggest element of the cost of revenue side of things.

As I look down to the OpEx side, just a couple of things to note. One, we had a really good outcome on Q4 adjusted EBITDA. Part of that was being at the higher end of our internal range we shared with you on revenue, but part of that was about better flow-through. And we had lower than expected marketing costs,

for example, in Q4. And timing-wise, you're going the – some of those marketing costs in Q1 this year with the campaign that we've kicked off. And so, you're seeing a little bit of that as a one-time item flowing through the Q1 costs that, of course, are impacting the adjusted EBITDA guide in Q1.

From an ongoing cost structure perspective, though, to your question, yes, we made a very difficult decision earlier this week to restructure our team that impacted about 10% of the team. So, about 60% to two-thirds of our OpEx is people or people-related. So, we would expect to see that help us on the OpEx side. But you probably will not expect to see that really fully reflected in the cost structure until Q2 and beyond. In Q2, we'll be going through that transition and we'll actually be incurring between \$55 million and \$75 million of restructuring costs in – largely in Q1 that'll put downward pressure on net income in the quarter. So, a lot of the cost structure benefits that you would expect to see there will show up in Q2 from an adjusted EBITDA perspective.

So if you're sort of following through each of those pieces then, you've got a path here to a structure change in how to think about infrastructure and cost of revenue, where the lion's share of the increase in infrastructure costs in 2023 are best thought of as fixed. And therefore, that gives us the ability to flow through at a really good rate as we have incremental revenue growth. You saw that in Q3 and Q4, where we flowed through more than two-thirds of incremental revenue to the adjusted EBITDA line. So, that's sort of an indication of how we can scale well on the gross margin line.

And then from here, after restructuring on the OpEx side and getting to a good size on our overall fixed cost, cash cost structure, it's about being disciplined from here, which we expect to be able to do, and the changes we made give us room to invest to support our growth, as if we – if and when we accelerate revenue.

The last thing I'd just touch on here, below the adjusted EBITDA line, SBC has been a real focus for us in trying to get to a sustainable level of SBC. The restructuring changes that we made earlier this week are going to help us significantly with making progress on that.

The other is that we've been talking a lot throughout 2023 about SBC being elevated as a result of refresh grants to the team and how that flows through GAAP measurement of SBC. We saw that impact begin to dissipate in Q4 of 2023. 24% year-over-year decline or \$110 million year-over-year decline in SBC, largely driven by that impact rolling off, we'll see that further dissipate into Q1 and later this year. So, really getting the cost structure in a much better place here to carve a path to profitability, sustain free cash flow and sustainable rates of SBC and dilution. So hopefully, that helps.

And look, I know this is a long answer to a short question, but the last thing I'd add is just on managing the SBC, it's been a real focus to get the share count right. We bought back nearly \$1.2 billion of our shares over the last 18 months at prices below \$10. That's really helped us here to get through this period of transition with the business with the level of share count growth that's more sustainable. Since IPO, we've kept that number at around 3.6% CAGR. So hopefully, you can see the discipline in the cost structure with the changes we've made, and you'll see us level out at a cost structure that scales well to produce profitability and free cash flow. So, thanks for the question and bearing with the long answer.

OPERATOR

Our next question today comes from Stephen Ju with UBS. Please proceed.

STEPHEN JU, UBS

Aside from what sounds like benefit to engagement, I think you've previously talked about how My AI has been helping you gather more intent data. So, we're wondering if you can help draw the line from that as a concept to revenue benefit as you continue to underwrite the incremental cost to serve. Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah. Thanks for the question. We certainly do think that that signal can be another input into our model to help deliver more relevant and engaging advertising. We made a lot of progress on the cost-to-serve side in terms of My AI, and we've been testing routing queries to different models and whatnot to help reduce cost, depending on the complexity of the query.

I'd say overall, our generative AI efforts have been much more focused on image and video models and helping people edit their Snaps or generate Snaps in new and entertaining ways and really using that as an on-ramp to Snapchat+. We're really excited that we reached more than 7 million Snapchat+ subscribers in Q4. And I do think that Snapchat+ will be a way to monetize some of these more intensive image and video offerings that we're rolling out.

OPERATOR

Our last question comes from Mark Mahaney with Evercore. Please proceed.

MARK MAHANEY, EVERCORE

Thanks. Evan, you talked about unifying the content experience across Stories and Spotlight. Could you talk about the degree of difficulty in doing that? Do you find use cases are such that people just pick one – users pick two or two – one of those and silo off there and it's going to be hard to unify that experience? And if it is hard, how do you plan to do that? Just any more color on how you unify the content experience. Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yeah. Thanks Mark. I'd say overall, anytime you're asking people to change their behavior, that can be difficult. That's why we're really trying to be thoughtful about it. I think one of the most frustrating things from a user experience perspective is that the UI and navigation for Spotlight is different than the UI navigation for Stories. So, the initial steps here are really trying to unify the UI and then unify the navigation, and make sure there aren't any negative secondary impacts to various parts of our business.

But I think overall, as we look at the way that Spotlight has been able to drive some really significant engagement growth and really the opportunity to broaden out our inventory pool and do our ranking models in a holistic way, I think those benefits will outweigh whatever disruptions we have to navigate as we unify that user interface in navigation.

OPERATOR

This concludes our Q&A session, as well as Snap Incorporated Fourth Quarter 2023 Earnings Conference Call. Thank you all for attending today's session. You may now disconnect.