SNAP INC. Q1 2019 TRANSCRIPT

OPERATOR

Good afternoon, everyone, and welcome to Snap Inc's First Quarter 2019 Earnings Conference Call. At this time, participants will be in a listen-only mode. After the prepared remarks, there will be a question-and-answer session. If you would like to ask a question during that time please press star, then the number one on your telephone keypad. This call is being recorded. Thank you very much.

Mr. David Ometer of Investor Relations, you may now begin your conference.

DAVID OMETER, INVESTOR RELATIONS

Thank you, and good afternoon, everyone. Welcome to Snap's First Quarter 2019 Earnings Conference Call. With us today are Evan Spiegel, Chief Executive Officer and Co-Founder, Jeremi Gorman, Chief Business Officer, and Lara Sweet, Interim Chief Financial Officer.

Earlier today we made a slide presentation available that provides an overview of our user and financial metrics for the first quarter 2019, which can be found on our Investor Relations website at investor.snap.com. Now I will cover the Safe Harbor. Today's call is to provide you with information regarding our first quarter 2019 performance in addition to our financial outlook. This conference call includes forward-looking statements. Any statement that refers to expectations, projections, guidance, or other characterizations of future events, including financial projections or future market conditions, is a forward-looking statement based on assumptions today.

Actual results may differ materially from those expressed in these forward-looking statements, and we make no obligation to update our disclosures. For more information about factors that may cause actual results to differ materially from forward-looking statements, please refer to the press release we issued today, as well as risks described in our annual report on Form 10-K for the year ended December 31, 2018, particularly in the section titled Risk Factors. Additional information can be found in our other filings with the SEC, when available. Our commentary today will also include non-GAAP financial measures and 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 Investor Relations website. Please note that when we discuss all of our expense figures they will exclude stock-based compensation and related

payroll taxes as well as depreciation and amortization and non-recurring charges. At times in our prepared remarks, or in response to questions, we may offer additional metrics to provide greater insight into our business or our quarterly and annual results. This additional detail may be one-time in nature, and we may or may not provide an update in the future on these metrics. Please refer to our filings with the SEC to understand how we calculate our metrics.

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

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Hi everyone and welcome to our call.

We began the year with a solid first quarter, delivering strong results across our business with growth in daily active users, user engagement, and revenue. Our early momentum in the fiscal year is driven by our ability to innovate and execute on our mission to empower people to express themselves, live in the moment, learn about the world, and have fun together. We are excited to see the early results of some of the investments we made in 2018 and prior years.

We added four million net additional users in the first quarter, growing our community to 190 million daily active users. We have achieved significant reach with Millennials and Gen Z in key markets like the United States, where we now reach 75 percent of all 13-34 year-olds. As of March, our ads can now reach more 13-34 year-olds than Instagram in the United States. Our business generated revenues of $320 million in Q1, an increase of 39 percent year-over-year, and our year-over-year revenue growth increased by 3 percentage points versus the prior quarter. Our adjusted EBITDA loss in Q1 was $123 million, representing a 43 percent improvement year-over-year. This is the second consecutive quarter where more than 100 percent of our incremental year-over-year revenue flowed through to our bottom line.

As of the end of Q1, our new Android application is available to everyone. Compared to the prior version, it is 25 percent smaller, opens 20 percent faster on average, and is modularized to allow for efficient ongoing innovation. On some of the lowest-performing devices, this resulted in a 6 percent increase in the number of people sending Snaps within the first week of upgrading to the new Android build. While these early results are promising, improvements in performance and new user retention will take time to compound and meaningfully impact our top-line metrics. There are billions of Android devices in the world that now have access to an improved Snapchat experience, and we look forward to being able to grow our Snapchat community in new markets.

Following the expansion of our Discover platform with last year's redesign, we have been focused on broadening our content offerings and growing engagement. We now offer more than 450 premium content channels worldwide. We doubled the number of non-US partners we work with in the past six

months, and launched over 50 new Shows and Publisher Stories in international markets in Q1 alone. After seeing incredible engagement with Snap Originals, we will be launching 10 new original shows while also renewing some of last season's hit shows.

The number of people watching Discover and their time spent watching content continue to grow as Discover becomes part of their daily routine. In Q1, nearly half of our daily Discover viewers watched Discover every day of the week. This growth in engagement is benefitting our content partners who have been able to reach a new audience on Snapchat. ESPN's Emmy-nominated Discover content added an incremental 13 percent to the total viewership across ESPN's U.S. mobile presence among people 13 and older in January, as measured by ComScore. In March, our partners increased their total mobile monthly reach in the U.S. by an average of more than 30 percent just by publishing to Discover, as measured by ComScore.

Our augmented reality platform continues to evolve, with our community now spending more than 250 million minutes playing with AR experiences every day on average in the Snapchat camera. This represents a 10 percent increase in play time per DAU compared to last year. With this growing engagement, we are also focusing on our growing community of Lens creators as well as extending the capabilities of our AR platform.

When we launched Lens Studio just over one year ago, a talented community of creators began creating and sharing AR experiences. Creators are now submitting thousands of new Lenses on a daily basis, and Lenses from our community are viewed hundreds of millions of times every day. We are constantly adding new functionality to Lens Studio, while also investing directly in our creator community. For example, we recently launched Creator Profiles, where creators can showcase their portfolios and build a following among our 190 million daily active users, more than three quarters of whom are engaging with AR on Snapchat every day.

Augmented reality allows our Snapchat community to overlay their creativity on the world. We started by building augmented reality for selfies and then surfaces, and are currently working on powering an even broader range of real-world interactions. With our new Landmarkers product, our camera can now interact directly with iconic buildings around the world, making it possible to land an Ice Dragon on top of the Flatiron building in New York for the Game of Thrones premiere. With Scan, our camera can also recognize what it's looking at and deliver a contextually-relevant experience. For example, our camera might surface pet-friendly Lenses when you're scanning your dog, or help you identify a particular product you are scanning to help you buy on Amazon.

We recently launched Snap Games, which allows our community to play high-quality mobile games with their friends in real-time through our chat service. This was the result of more than two years of investment to create a new way to have fun with your close friends. We worked with some amazing partners to build a platform focused on unique gaming experiences designed specifically for our

platform and community, with communication between friends and thoughtfully integrated monetization. We've been so excited to see the response from our community and we can't wait to continue developing games.

Our advertising business is continuing to scale following our transition to self-serve monetization, with nearly all of our products, including Lenses, now available via our Ads Manager. We invested heavily in this platform over the past year, including launching dozens of new capabilities to deliver scalable ROI for an increasing variety of advertisers, including bid optimization for conversion events. This has helped us scale our direct response revenue, which more than doubled when compared to Q1 last year.

Brand buyers are also seeing great results from our improvements over the past year. We now allow advertisers to optimize against important brand goals like efficient reach and targeting, which helps our vertical video and camera marketing products work together to deliver a brand narrative. We have also seen that our growing reach and engagement among Millennials and Gen Z is an important differentiator in the marketplace. These generations are unprecedented in size and spending power, are still in the process of developing their brand loyalties, and are difficult to engage on other platforms or with traditional advertising formats.

For example, Nestle recently ran a multi-product campaign for DiGiorno Pizza across Snap Ads and Filters, enabling them to deliver a comprehensive narrative across the different parts of our platform and allowing them to reach new buyers. One third of incremental sales were driven by new buyers to the DiGiorno portfolio, as measured by Nielsen Catalina Solutions. This resulted in a 3.3 percent sales lift driven almost entirely by increased penetration, and a 3.6x return on ad spend, as measured by Nielsen Catalina Solutions. We are so excited to see advertisers achieve great results on Snapchat and we are looking forward to continuing to improve our advertising products and platform.

We have worked hard to thoughtfully balance our long-term investments in product innovation with operating cost discipline. The improvements we have made to our cost structure over the past year were largely due to efficiencies we found in our products and operations that outpaced our growing investments across our content, gaming, augmented reality, and advertising platforms. As we look towards the future, we see many opportunities to increase our investments, and we will continue to manage our business for long-term growth.

Our team is energized by our progress and the many opportunities in front of us. We will continue to drive product innovation, enhance our advertising platform, and strengthen our team and business. With that, I'll turn the call over to Jeremi to talk more about our advertising business.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks, Evan.

It's been a pleasure to be a part of Snap for the past six months, and I'm thrilled to continue to work together with the rest of our leadership to build upon our strong foundation.

We continue to see significant upside and opportunity in the future of our business. There are three primary drivers of our optimism: the first is our opportunity to scale the learnings from our successful brand partnerships across a wider variety of partners and industries, the second is our rapid progress with performance advertisers, and the third is the health of our advertising ecosystem given the strength of our ad products and growing user engagement.

First, we have been working closely with many large brand advertisers as we build out our ad platform and products, learning and iterating with them, and we've made major strides following our switch to a self-service platform. Over the past year, we've been building some of the best tools for brand marketers into Snap Ads Manager to enable them to achieve business results. For example, advertisers can now buy our core ad products based on Reach & Frequency which allows brand marketers the flexibility and customization of self-service tools with the transparency and predictability of reserved pricing. It has only been less than a year since we launched Reach & Frequency for Lenses, and it is now the dominant way marketers are buying AR advertising on Snap.

We see a significant opportunity to scale the learnings from this group of successful brand advertisers to a broader set of customers. For example, while we've seen success with a number of key QSR brands, there are remaining advertisers in the category with whom we can do more, and now, with the teams organized by vertical, these advertisers can be serviced by our team members with relevant categorical expertise. Like in this example, in order to fully realize these opportunities, we needed to set up a more scalable structure for our sales teams. As of April 1st, the reorganization has taken effect in the US, and the International reorganization is underway as we speak. We have split the team into three segments to organize around advertiser needs. A significant portion of our US revenue is transitioning between sales team members, and while we expect some disruption to our near-term business, we are confident that this is the right long-term structure. Our Enterprise sales team is focused on large brand advertisers with complex buying structures, and is now structured by vertical rather than by region. This allows our teams to share learnings across categories and gain expertise in the industries in which our advertisers operate, especially as these relationships and campaigns become increasingly sophisticated.

Alongside this Enterprise team is an Emerging Advertiser team focused primarily on Direct Response advertisers, such as app install and direct-to-consumer brands. This is a category seeing growing success on our platform. Lastly, our newly-formed Scaled Services organization is focused on one-to-many marketing and sales tactics to continue to bring more and more advertisers to our platform. Overlaying this structure is a newly developed Agency team, to focus specifically on deepening our

relationships with our Agency partners. We are excited about these changes and the opportunities that come with them.

This new structure will allow us to better drive adoption of some of the most engaging and innovative ad units in the industry. As Millennials and Gen Z are increasingly favoring short-form video and other rich mobile experiences over desktop and television, we are creating mobile ad units so that brands can reach our audience using these formats. Earlier this month, we announced a new slate of Snap Originals and our new Snap Games platform. Both of these products are monetized by Commercials, our six-second non-skippable mobile video product. We designed this specifically to work well for both our users and our advertising partners. Brayden Ainzuain, Head of Digital and Innovation at Publicis in MENA told us, "The launch of commercials on Snapchat answers the growing desire amongst brands to reach a mobile audience with compelling branded video content. Being the launch partner of this new format with our forward-thinking clients gave us a first view of its impact. We saw incredible results for BMW, MINI, Nestlé, and Samsung locally achieving really efficient CPMs, CPCVs and view-through rates."

We continue to build on our industry-leading AR technology. Brands can now leverage our image recognition technology and location-enabled AR to immerse our community in an impactful content experience. For example, Nike and Foot Locker recently brought the House of Hoops to life by having LeBron James emerge from the wall to dunk, all inside our camera. On average, three quarters of our daily active users engage with AR experiences every day, and we are excited to partner with brands to bring even more AR experiences to our camera.

We see an interesting opportunity at the intersection of our self serve tools, our video ads, and our AR ads. Our Ads Manager empowers advertisers to run sophisticated campaigns that leverage multiple formats, helping brands tell a cohesive story across our service. Combining our optimization and delivery capabilities with formats native to the Snapchat Generation allows our products to work better together and delivers compelling storytelling at scale.

For example, Toyota ran a sophisticated campaign across our various video and AR products to promote the Corolla Hatchback amongst Millennials. Snapchatters engaged with the ads, watching more than 90 percent of their Commercials on average, and playing with their Lens for more than 10 seconds each on average. By combining different video and AR experiences in an optimized and efficient way, Toyota was able to deliver a rich narrative that lead Snapchatters 25 and older who saw the ads to be 40 percent more likely to identify the car as having the particular brand attributes the ads were designed to promote, as measured by Kantar.

Second, we've made remarkable progress with performance advertisers and our direct response platform generally. In less than two years, we built a self-service ad platform from scratch that is nearly at feature parity with industry leaders on things like targeting and delivery capabilities. That's why

Wish—one of the most sophisticated e-commerce advertisers—is seeing success with our newest formats, such as a 75 percent lower cost per install when leveraging our new app-install optimization capabilities, and an even lower cost per install when using our new Shoppable Catalog Ad format.

Additionally, our progress in this area allowed us to increase the volume of "always on" performance advertisers that are not as affected by seasonal brand advertising trends, with our total direct response revenue more than doubling year-over-year. Advanced DR advertisers such as Pocket Gems, makers of the popular mobile game "Episode," have seen improved return on ad spend on our platform over time. For instance, in Q1, our app-install ads drove 300 percent more purchase volume inside Episode as compared to Q1 2018. We continue to learn alongside close partners like Pocket Gems, improving measurement, optimization, and relevance to drive stronger downstream results for performance-oriented campaigns.

Lastly, while our advertising business is still young, it is powered by very strong underlying fundamentals, including a hard-to-reach audience with high-quality engagement, and auction dynamics to drive better results as we scale our business.

We have high penetration among a valuable and growing audience, who engages heavily with both premium mobile video and interactive AR every day in Snapchat. With demographic and behavioral trends pointing in our favor, we are increasing inventory within our ad products, such as high-quality Shows and Games, which have the potential to attract incremental online video budgets into our hand-curated, brand-safe environment.

We also have a lot of opportunities to improve and expand our business. Our advertising products and self-serve platform have proven to deliver ROI at scale, with a lot of headroom for continued improvement. In the past year alone, we introduced several new capabilities, from lower-funnel bidding optimizations for downstream events like website and in-app purchases, to innovative new ad formats like Story Ads, Commercials, and AR Lenses with Direct Response Attachments. We are also expanding existing self-serve products for camera advertising to bring the benefits of optimization and scale to even more of our ad products. As these improvements have given advertisers of all types and sizes the capacity to win on Snap, we also have opportunities to not only deepen our relationships with the world's largest companies, but also expand into new industries, geographies, and advertiser types to increase the overall advertiser breadth and depth on the platform.

Furthermore, trends in our business also point to auction dynamics that can drive both growth and performance. This past year has demonstrated that we're able to grow our advertiser base and revenue while simultaneously decreasing average costs per conversion for our advertisers, showing how our ongoing improvements in our efficiency and optimization have plenty of room to flow through to deliver better results at a larger scale.

We also recently announced the upcoming Snap Audience Network, which will allow us to help our publisher and advertiser partners reach their customers in a variety of environments in a privacy-safe way. This will be a long-term investment and we are getting started with a few select partners.

We are committed to our advertisers' success in every way possible, and the results of the past few quarters show this. I feel so fortunate to be here at this fantastic moment in Snap's history and I am confident that there is an incredible amount of opportunity ahead of us.

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

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

Thanks, Jeremi.

Our Q1 2019 financial results reflect our continued focus on driving growth, revenue, and long-term operational efficiencies.

Our Q1 2019 operating cash flow improved $166 million to negative $66 million compared with Q1 2018 and improved $60 million compared with Q4 2018. The year-over-year change in operating cash flow is driven by a $94 million improvement in adjusted EBITDA, offset by changes in the timing of working capital. Similarly, the sequential change in operating cash flow is driven by changes in the timing of working capital, reflecting the seasonality of our business between Q4 and Q1, partially offset by a $73 million decline in adjusted EBITDA.

Our capital expenditures, which are nominal, are mainly associated with the build out of our office facilities. Q1 2019 capital expenditures were $12 million, compared to $36 million in Q1 2018 and $23 million in the prior quarter.

Our Q1 2019 free cash flow improved $190 million to negative $78 million compared with Q1 2018 and improved $71 million compared with Q4 2018.

Common shares outstanding plus shares underlying stock-based awards outstanding, totaled 1,544 million on March 31, 2019, compared with 1,457 million a year ago.

We ended the quarter with $1.2 billion of cash and marketable securities. Our change in cash for the quarter was negative $70 million. The change in cash was $151 million better than the prior year and improved $65 million versus the prior quarter as we continue to make progress towards generating free cash flow.

For the quarter, we generated record Q1 revenue of $320 million, an increase of 39 percent year-over-year, and a decrease of 18 percent sequentially, reflecting the expected seasonality in our business from Q4 to Q1.

Daily active users were 190 million in Q1 2019 compared to 191 million in Q1 2018 and 186 million in Q4 2018. Our results in Q1 benefitted from positive momentum at the beginning of the quarter due to seasonality that we observed as a result of the holiday season.

Average revenue per user was $1.68, an increase of 39 percent year-over-year and a decrease of 19 percent sequentially, again reflecting seasonality in our business. In Q1 2019, North America ARPU increased 34 percent year-over-year, compared to a 23 percent year-over year increase in Q4 2018 and a 16 percent year-over-year increase in Q1 2018.

In terms of our advertising business, total impressions were up 155 percent year-over-year and 6 percent sequentially, while pricing was down 42 percent year-over-year and was down 22 percent sequentially. The price decrease was driven primarily by an increase in available supply.

Infrastructure costs per daily active user were $0.72 in Q1 2019, down from $0.73 in Q1 2018 and flat sequentially. We have maintained our focus on unit cost efficiencies while growing daily active users by 4 million quarter-over-quarter.

Our cloud infrastructure costs moving forward are expected to be driven by three primary factors. The first is the size of our community and the depth of engagement per user of our application. If engagement trends continue in a positive direction, we expect to observe higher infrastructure costs despite improving unit costs for the underlying cloud services and user actions. The second factor is the cost structure of our cloud partners, where we continue to benefit from their growing economies of scale, which are passed on to us in the form of lower rates. The third factor is how efficiently we utilize our cloud infrastructure. On this last front, we are seeing continuous improvements in the unit cost of delivering various services to our users, including, for example, the cost to serve an advertising impression and the cost to deliver a Snap.

In addition to infrastructure costs, the remainder of cost of revenue is primarily made up of content costs and payments to third party ad sellers, which declined 11 percent sequentially and increased 10 percent year-over-year, primarily due to seasonality in our business.

Gross margin expanded substantially year-over-year, which continues to demonstrate that our business model is scaling profitably. Gross margin was 39 percent, improving over 2,100 basis points year-over-year, although gross margin declined by 900 basis points sequentially, again reflecting the seasonal nature of our business.

Operating expenses in the quarter were $248 million, down 4 percent year-over-year, and up 4 percent sequentially. We continue to focus on driving operating-cost productivity across our business. Our operating expenses are primarily driven by employee-related costs, which represent about two-thirds of our operating expenses. We continue to see fixed cost leverage in employee-related costs, which declined 2 percent year-over-year and were up 4 percent sequentially. Operating expenses as a percentage of revenue were 77 percent compared with 112 percent in Q1 2018, and 61 percent in Q4 2018.

Q1 2019 adjusted EBITDA was negative $123 million, an improvement of $94 million over the prior year and a decline of $73 million over the prior quarter. This was the fourth consecutive quarter that we had an improvement in year-over-year adjusted EBITDA. Adjusted EBITDA margin for Q1 2019 improved significantly year-over-year to negative 39 percent compared with negative 94 percent in Q1 2018. Adjusted EBITDA leverage was 105 percent in the quarter, compared to 104 percent in the prior quarter.

Finally, Q1 operating loss improved $76 million over the prior year to negative $316 million. Our Q1 operating loss increased $121 million over the prior quarter.

With respect to the second quarter of 2019, the positive trends we are observing in per-user engagement may increase our infrastructure costs overall. Additionally, as Evan mentioned earlier, we plan to make additional investments in marketing, content, engineering, and sales to support our long term strategic objectives, and to build on the momentum we see in our business today. We believe that these investments will create value over the long term, but in the immediate term they will put downward pressure on the very high operating leverage we have observed in recent quarters.

These forward-looking statements reflect our expectations as of April 23, 2019, and are subject to substantial uncertainty. As mentioned at the start of the call, our results are inherently unpredictable and may be materially affected by many factors.

Now I'll share our Q2 2019 outlook:

Revenue is expected to be between $335 million and $360 million, or to grow between 28 percent and 37 percent year-over-year, compared to $262 million in Q2 2018.

Adjusted EBITDA is expected to be between negative $150 million and negative $125 million compared to negative $169 million in Q2 2018.

This guidance assumes, among other things, that no business acquisitions, investments, restructurings, or legal settlements are concluded in the quarter.

While we are not going to give specific guidance on daily active users, we have previously seen stronger daily active user growth rates in Q1 when compared to Q2.

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

OPERATOR

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

And today's first questioner will be Ross Sandler with Barclays. Please go ahead.

ROSS SANDLER, BARCLAYS

Great, thanks. Evan, just a question on the DAU commentary for Q2. So, you just mentioned in the prepared remarks that the growth rate will be lower than Q1. I assume you guys are referring to the 2 percent sequential growth that you just realized in the first quarter in terms of it being lower than that, but just a clarification would be helpful. And then big picture, when do you see Snap getting back to the cadence of DAU growth that you had pre-redesign now that Android is fully rolled out, and is Android at this point growing month-over-month? Any color would be helpful on that. Thank you.

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

Hey, Ross, this is Lara, and thanks for the question. I think, to be clear, as you pointed out, we were talking about our sequential growth rates. So we've previously seen stronger quarter-over-quarter daily active user growth rates in Q1 when compared with Q2. Additionally, we don't provide guidance outside of what we've reflected in Q2 and our assumptions on DAU are reflected in our guidance on revenue and adjusted EBITDA. And we think that while the early results on Android are promising, improvements in performance and new user retention take time to compound and meaningfully impact our top line metrics.

OPERATOR

And our next questioner today will be Heath Terry with Goldman Sachs. Please go ahead.

HEATH TERRY, GOLDMAN SACHS

Great, thanks. Evan, I know you touched on it a little bit in the remarks, but any deeper discussion you want to have around the initial returns you're seeing on the Android app, levels of engagement, geographies, in terms of where that's showing the most benefit? And then from an advertising revenue side of things, as you think about benchmarking yourself versus your peers, when you look at the mix

that you've got, whether it's brand versus direct response or self-serve versus direct sales, is there a particular opportunity or gap there that you're more focused on in terms of closing? Maybe that's a better question for Jeremi, but appreciate any thoughts you have.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Hey Heath, thanks for the questions. I'll let Jeremi handle the second one. As it pertains to Android, we're definitely excited by what we're seeing. We talked about the improvements especially on resource-constrained devices, which is really exciting for us because that opens up a new market opportunity for folks who really weren't able to use Snapchat as effectively in the past. So, excited by what we're seeing, I can't provide any specifics beyond what we shared earlier, but it's early, and I think really for us this is the price of admission to international markets. So, I think the next chapter is really going to be about localizing our content experiences, our augmented reality experiences, things like that, as we look to grow internationally.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

And thanks, I'll take the second part of the question. Parts of what have driven the strong results for this quarter have been performance advertisers who have more than doubled their spend year-over-year in Q1. This followed the launch of our lower-funnel tools in the past year, such as goal-based bidding for in-app conversions and pixel events.

We're very pleased that we've also seen growth from brand advertisers as we continue to iterate on the ad product ecosystem specific to Reach & Frequency Lenses that are available, our Commercial format which is the full-screen unskippable video format that's in brand safe environments, which are really strong for brand advertisers. So, we are seeing strong growth in both segments and expect that to continue.

OPERATOR

And the next questioner today will be Rich Greenfield with BTIG. Please go ahead.

RICH GREENFIELD, BTIG

Hi. Thanks for taking the questions. I've got a few. First, Evan, at the Partner Summit you talked about gaming being what you thought was the most exciting part of the series of announcements. I was hoping you could elaborate for everyone listening why gaming is so important to Snapchat. Is it more about engagement, revenues or both?

Two, Ad Kit. I think Jeremi mentioned this. I know it was a new announcement at the Partner Summit. Any partners yet or any third-party platforms or any third-party mobile apps using Ad Kit and actually using your ads anywhere yet and how should we think about the timing of that?

And then just lastly on the Android rollout. Obviously, you've had a lot of people for the last few years that have been frustrated with Snapchat on Android, which is why you rebuilt it. Well, in markets like India where you're a new launch, I don't assume you need a win-back campaign, but in markets like Europe where people may have been frustrated, what's your plan for helping tell people that there is a new rebuilt app and a much better experience? What's that marketing strategy look like over the next several months? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks, Rich, for the questions. As it pertains to gaming, I think what's great about the gaming platform is that it really leverages the unique attributes of Snapchat to bring friends together. So, I think what we're excited about over the long-term is that it may create more monetization opportunities around the communication side of our business, but it's very early and we're excited by the enthusiasm around that platform. So, that will be great.

And I think as it pertains to Android and the win-back, it's going to take time to rebuild that trust. I think the best way for us to do that is really to deliver on the product, continue our pace of innovation on Android, and deliver those improvements over time. We're of course supplementing that with marketing and other in-market activities. But I think it's going to be a process.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

And I'll jump in on the Ad Kit question, Rich. Thank you for the question. The Ad Kit has not launched yet for the Snap Audience Network. It's a long-term strategy and still obviously very early days, we just announced it a couple of weeks ago, but we're really excited by the response from publishers who want to work with us and our ad partners on connecting with our hard to reach audience while they spend time outside of Snapchat.

We're growing the list of partners deliberately and we're going to have more to share in the months to come. But we don't expect it to have a material impact on revenue in 2019 as we're making this a very deliberate long-term strategy for the business.

OPERATOR

And our next questioner today will be Justin Post with Merrill Lynch. Please go ahead.

JUSTIN POST, BANK OF AMERICA MERRILL LYNCH

Great. In the prepared remarks you talked about engagement being up. I was wondering if you could talk about what people are really growing on Snapchat. Is it Discover, is it other areas? And any impact on total time spent? And then secondly, related to that, impressions were up 155 percent, where are you serving the majority of those new ad impressions? And are the yields to advertisers as good with those new impressions? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

So, on engagement growth, we're really seeing it across the board. We've shared that time spent remains over 30 minutes per user per day. So, really excited about that. And I think there is lots of opportunity to grow on the content side of the business, but also with our augmented reality products and communication.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

And then as far as the diversification of where we run our advertising, we're very fortunate to continue to have these innovative areas such as Games and the forthcoming Audience Network of course. As we continue to grow DAU, there are more opportunities to show more ads, more Story Ads, for instance. And then with the Commercial format that runs in Discover and across Games, as we start to see increased engagement in those two areas, we have more opportunities to show more ads to our Snapchat community without impacting their experience.

OPERATOR

And our next questioner today will be Lloyd Walmsley with Deutsche Bank. Please go ahead.

LLOYD WALMSLEY, DEUTSCHE BANK

Great. I have two if I can. First, Jeremi, lot of changes to the sales force with some verticalization, some Emerging ad team, Agency team. Can you rank order the most interesting opportunity to drive revenue in the next year or two and talk about maybe how conversations with advertisers have been changing?

And then second one, related to this. It seems like most of the focus right now is around performance advertisers. You said performance ad revenue has doubled, and assuming that is the majority of ad spend, it implies a flattish or decline in brand spend. I don't know if that's right if you are really over half on performance. But if you can give us a sense of mix and then how that brand spend has trended and where the focus is there? Thanks.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks for the questions, Lloyd. I will answer them generally in reverse order. We just started our performance advertising business about a year ago, so the growth trends do not imply a decline in brand spend. It's just newer, so it's growing more quickly.

As it pertains to the sales reorganization in particular, I'm actually really excited about the split, because if you look at it in segment, specifically to the enterprise customers, what our sales team used to have was a list of somewhere between 60 to 100 advertisers on whom they were calling, and we've shrunk that list in the enterprise world, allowing them to go much more deep with the advertisers they service and that's consistent across industries as well.

So everyone who calls on QSR for instance across the whole country rolls up into the same manager. In terms of the emerging pieces, because we were seeing such high growth specific to app install as well as direct to consumer, for example, we grouped those together so that we have optimization experts that are focused on those kinds of clients that require a different level of service.

So really what we've done is organized the team against advertiser needs, very specific to how they like to be serviced. Some want to have more optimization specialists, some want to have more white-glove service as their advertising mix becomes more sophisticated. So I'm excited about all of that. It would be hard to rank order them in terms of the most interesting, but making the business both horizontal and vertical, we expect to yield dividends for years to come. We feel it's a very durable structure.

OPERATOR

And our next questioner today will be Mark Mahaney with RBC Capital Markets. Please go ahead.

MARK MAHANEY, RBC CAPITAL MARKETS

Hey, thanks. Just some color please on the DAU growth in the March quarter. I think last quarter you provided a little bit of color on how much of the growth came from iOS versus Android. Could you do that for the March quarter?

Secondly, could you talk a little bit about the success you've had in expanding the demographic appeal above the 34-year-old age cut off? I know there's a few of us above there. And then third, in these investments that you're making in the June quarter, is it just an increase in magnitude of investments in these areas marketing, engineering, content, and sales or are there new areas that you've not invested before that you plan to invest in now? Just talk about whether it's qualitative or quantitative increase. Thank you.

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

Thanks. I'll take two of those questions. One, we're not breaking out our iOS versus Android expectations as it relates to DAU. And then, similarly, as we look at our investments, these are things that we are continuing to invest in. We always have a focus on driving growth and innovation in our business and our Q2 guidance reflects our continuation of that.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Mark, I think as we look at expanding our audience, we are most focused today on the international audience that's 13 to 34. We know that our product really resonates with our core demo. We're going to focus our efforts there, and I think the age-up strategy is a longer-term strategy for us and will require more investments in terms of content and augmented reality experiences that appeal to that demographic. But that's something that we're certainly working on.

OPERATOR

The next questioner today will be John Egbert with Stifel. Please go ahead.

JOHN EGBERT, STIFEL

Thanks. I know it's extremely early, but I'm wondering if you can share any early learnings from user behavior on the Games platform, whether it's behavior you observe directly or feedback you've gotten from your developer partners? And I'm sure it will differ by game and you might have a very, very broad group of different types of games eventually, but in general, is there a meaningful difference in infrastructure costs for real-time games relative to other forms of content consumption on Snapchat?

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

We don't provide the breakout of how we look at the cost per engagement across our various forms of content. As we look forward into Q2, we do see that the positive trends that we're observing overall and per user engagement may increase our infrastructure costs overall.

OPERATOR

And the next questioner today will be Eric Sheridan with UBS. Please go ahead.

ERIC SHERIDAN, UBS

Thanks for taking the question. Maybe a little bit of color on the increased success you've had on the direct response side. Can you give us a little bit of color about how direct response advertisers might be trending year-on-year from a budget standpoint, or what's driving more success on the direct response side? Is it depth of advertisers in the auction as you continue to widen out depth or is it upward price

from the auction dynamic? Just wanted a little bit more color on what's driving the growth both in terms of mix and on the advertiser side and direct response? Thanks so much guys.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks for the question, Eric. And there are a couple of reasons that we're seeing so much success it is most of those things it's an increased number of active ad accounts. In fact, the number of active ad accounts is higher than it has ever been in our history.

We are seeing increased budgets, we're seeing success in app-install, and we are seeing success in commerce as we continue to iterate on the ad products such as Catalogs that allow advertisers like Wish to find success in their direct response advertising. And at the end of the day, we believe that our innovative mobile-first ad formats provide both brand and DR advertisers an opportunity to reach their customers at scale in an engaging way and still believe there's significant upside.

OPERATOR

And our next questioner today will be Mark May with Citi. Please go ahead.

MARK MAY, CITI

Hi. In terms of your philosophy around balancing growth and profitability and this just ties into your prepared remarks regarding operating leverage going forward. How are you thinking about delivering on your stretch goal of EBITDA breakeven this year and just in general around delivering on improvements in margins and EBITDA, say, over the next year or so? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks for the question. Yes, I think, as we look at our progress over the last year or so, we've really been able to hold our cost structure roughly flat for more than a year. And I think as we look forward, it is our second quarter of more than 100 percent incremental flow through on year-over-year incremental revenue. And so I think as we're looking at the growth opportunities in front of us, not only will increasing engagement translate to higher infrastructure costs but we also see more opportunities to invest in our content business, our augmented reality business and more. So, I think, just as we look to the future, we're of course going to do our best to balance our operating efficiency along with our long-term investments, but we see a lot of opportunities right now and we want to make sure we're doing the right thing for the long-term.

OPERATOR

And the next questioner today will be John Blackledge with Cowen. Please go ahead.

JOHN BLACKLEDGE, COWEN

Thank you. With the sales re-org, you mentioned, some disruption to the near-term business. Could you discuss that a little bit more broadly, how long it might persist and also perhaps quantify or give a range of the impact?

The second question is on user engagement, definitely appears strong despite rising ad loads over the past year or so. How do you feel about your ability to continue to raise ad load over the near and intermediate term? Thank you.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Hey, John, thanks for the question. This is Jeremi. I'll answer the first part and then turn it over to Lara. Regarding the sales re-org, Snap, like any other organization has some potential disruption when you do a reorganization. Nothing particularly acute to us, but just general sentiment when you do a reorganization. That is reflected in our guidance. Thus far we've mitigated as many risks as we possibly can with revenue changing hands or clients changing hands.

An example of that would be that if an account was turning over from account executive to a different account executive with whom that client hadn't worked, we had a month overlap with that advertiser in March between the two teams to ensure continuity of service and we put another number of other mitigating risk factors in there as well.

So, nothing specific to us but just general disruption as things change hands and that is again reflected in our guidance. I'll turn it to Lara for the second part.

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

Great. Thanks, Jeremi. And I think as it relates to that as well as Jeremi mentioned we did factor that into our guidance as these are inherently disruptive events. When we look at our ad load broadly, when we looked at Q1, we consistently increased supply while monitoring the effect on users. This allowed more and more brand and performance advertisers to achieve return on investment and see success with our growing suite of ad products. We expect this result will increase demand going forward.

Additionally, our monetization efforts always keep the user experience top of mind, which is why we're focused on optimization and providing the most relevant adds to our users. Healthy engagement from our community is important as increased engagement opens up available ad inventory as do features like new Originals and Games.

OPERATOR

The next questioner today will be Doug Anmuth with JP Morgan. Please go ahead.

DOUG ANMUTH, JP MORGAN

Thanks for taking the questions. Jeremi, I was hoping you could just talk a little bit about your efforts to improve the on-boarding of advertisers, how you might be doing that faster now. And then, Lara, you talked a little bit about some of those investment areas where you're going to pick up the spend here. The cloud part was pretty clear, just hoping you could talk more on marketing, content, sales, if there's anything else to call out in those areas. Thanks.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Sure thing, Doug. Thanks for the question. We're making a couple of different changes on both the product side as well as on the sales side to onboard new advertisers. Right now the sophisticated advertisers, those who have been buying advertising for a long time have a really easy time utilizing our Ads Manager as the features are nearly at parity with the rest of the industry.

However, for smaller businesses we know that we need to change the tools a bit to make them a little bit easier, a little bit more automated and simple for smaller advertisers to use. We're in the process of evaluating those changes and making some of those to activate more advertisers in the tail.

To coincide with that, we've also formed the Scaled Services team whose job is to focus on one-to-many marketing and sales tactics such as email marketing and a proper CRM system to guide them through the process to get them on-boarded and to ensure that their churn rate stays low, so that we can get more and more advertisers into the ecosystem, ultimately impacting our auction dynamics in a favorable way.

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

Great, and I'll take the next part. If you look at over time the improvements we've made in our cost structure over the past year were largely due to efficiencies we found in our product and operations. These outpaced our growing investments across content, gaming, augmented reality, and our ad platform.

So as we're looking forward and building on the momentum of the business, that's where we're really focusing on areas to be able to invest in such as marketing, content, engineering, and sales, so that we're providing more opportunities for our community to deeply engage with our app, as well as factors that Jeremi mentioned, the creation of the Emerging sales team, which allows us to reach new advertisers at scale. We plan to do this through things like targeted investments in people that will really support our long-term strategic objectives.

OPERATOR

And the next questioner today will be Brian Nowak with Morgan Stanley. Please go ahead.

BRIAN NOWAK, MORGAN STANLEY

Thanks for taking my question. You've made a series of improvements to the overall ad process, the self-serve tools, the re-orged salesforce, video ads et cetera. Could you maybe talk about the one or two biggest hurdles you're still encountering with branded advertisers to really get them to spend more on the platform? It seems like performance is coming. What's the one or two biggest improvements you have to make to really start to crack the brands more?

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks for the question, Brian. I would say the number one hurdle is that our ad formats are different than you would traditionally see on desktop, television or even other digital. So that's not assets that everybody necessarily has at their disposal when you think of a six-second, unskippable, vertical video, for instance, that's not something that everybody just has on hand.

The good news is that we are working very closely with the product team, who has been working very hard to help our advertisers create these assets in an automated and simple and scalable way so that more advertisers can advertise on our platform.

Additionally as these formats, vertical video, vertical still images, become more and more common across the overall advertising ecosystem outside of Snap, we suspect that will mean that other people have these assets at their disposal and that becomes less of a hurdle for us.

But we remain focused on improving the ad product suite. We're investing in relevance, optimization and measurement and these innovative ad formats to continue, but I would say that is probably our number one hurdle for on-boarding.

OPERATOR

The next questioner today will be Michael Nathanson with MoffettNathanson. Please go ahead.

MICHAEL NATHANSON, MOFFETTNATHANSON

Thanks. I have one for Jeremi, one for Lara. Jeremi, answering that question of Brian's, one of the bull case ideas is perhaps the category of digital ads on Snap is going to grow because of Instagram's push into Stories. So, is there any way you can help us understand if, has Instagram Stories push maybe made it easier for you to transition people to a different type of format? Is there anything you can share on that?

JEREMI GORMAN, CHIEF BUSINESS OFFICER

I'd say unspecific to Instagram, but the adoption of the vertical Stories format generally across the app ecosystem will help us. Again referring to my previous answer, the more advertisers that have that asset, the easier it is for us to onboard those advertisers into Snap. So we view that as a success for the entirety of the industry and how people naturally hold their phones native to this generation.

OPERATOR

And the next questioner today will be Anthony DiClemente with Evercore. Please go ahead.

ANTHONY DICLEMENTE, EVERCORE

Thanks. Maybe for Jeremi. One thing I'm curious about on premium publisher revenue. So a number of points in the prepared remarks about how well Discover is doing in terms of growing engagement and viewership with Discover.

Assuming a lot of that is premium publisher content it seems like, at the same time, you've done a great job controlling revenue share cost. If you just look at the slide that shows the composition of cost of revenue, I think those are up 9 percent, so staying relatively in check. So can you just help me think about how do those content agreements and revenue share costs work, like why shouldn't we expect premium publisher costs related to Discover, expect those to start to pick up or am I thinking about that the right way? In other words, how do those flow through the income statement, those agreements and how do you see them trending going forward?

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

Thanks. This is Lara. I'll actually take that one. I think that the health of our relationships with our content partners and our content ecosystem is very important to us. And as we talked about one of the areas that we're focusing on investing in is our content area and these expectations are factored into our guidance for Q2. And I think, additionally, as we look at the P&L, we don't go into details on how we structure these arrangements. But as you know from an actual income statement standpoint, our cost of revenue includes our rev share as well as our infrastructure costs.

OPERATOR

And the next questioner today will be Brent Thill with Jefferies. Please go ahead.

BRENT THILL, JEFFERIES

Lara, on pricing, it's gotten better but you were down 42 percent in Q1, down 65 percent in Q1 last year. At what point do you start to see improvements, is that back half of the year from your perspective?

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

Price is not an outcome we seek to drive in the short-term. Our focus has always been on building a healthy marketplace that ensures advertisers continue to achieve the best outcomes while maximizing ROI.

In Q1 on the supply side, we steadily rolled out new ad products and placements and this captured the growing engagement on our service while monitoring the effect on users. More and more advertisers are then able to come in, achieve return on investment, see success with our ad products, and we think this is actually going to increase demand going forward.

So while we believe this is healthy for our business in the long-term, it caused downward pressure on our pricing. And also as a reminder, for the demand side, our self-serve tools are less than two years old, so demand is still early and we continue to see meaningful growth.

OPERATOR

And the next questioner today will be Ron Josey with JMP Securities. Please go ahead.

RON JOSEY, JMP SECURITIES

Great. Thanks for taking the question. Jeremi, just wanted to follow-up on something you talked about an interesting opportunity at the intersection of self-serve video and AR and just maybe understand that a little bit more just given how the market has really been adopting video and AR together. Thank you.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Sure. Thanks for the question, Ron. I think that it's a fascinating intersection because we see that when advertisers use the entirety of our product suite or at least more than just one particular piece that their outcomes are better as specific to their KPIs.

So when we see people utilize Lenses, Stories and Snap Ads together in a campaign, those results come out better and that's what I was referring to when I was talking about the intersection. In addition, we've moved things like our Lens product into the auction, into the self-service format where advertisers can now bid via things like Reach & Frequency, for instance.

So, where Lenses used to be available only on a per day basis, now they can be bought on an audience basis, allowing more advertisers of all types to use our Creative Tools to drive performance.

OPERATOR

Our next questioner today will be Youssef Squali with SunTrust. Please go ahead.

YOUSSEF SQUALI, SUNTRUST

Great. Thank you very much. Two quick questions, please. Can you speak to your performance across geos? It looks like North America did it really well. Europe and rest of world did a little less well; anything to call out there? And then from your early observations, how do you think monetization on Android will compare to that of iOS? Is there anything structural that should actually justify a delta between the two? Thank you.

LARA SWEET, INTERIM CHIEF FINANCIAL OFFICER

This is Lara and thanks for the question. North America, growth accelerated 34 percent year-over-year versus 23 percent last quarter. We think a lot of the reason for this acceleration was strong advertiser trends in North America and increased spend from those brand and performance advertisers despite seasonality. We believe there's still a large opportunity with both brand and performance businesses in the US and internationally.

So as you look at that Europe mixed in that bucket really lagged North America in the shift to self-serve. So the impacts are more pronounced in our year-over-year revenue and ARPU trends, whereas rest of world started on the auction, and so we're able to begin monetizing those markets quickly. And you see results of that in our rest of world including areas like the Middle East.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

I think as it pertains to the monetization opportunity on Android versus iOS, we don't break out the difference there, but I would say that as Android engagement increases, we believe the revenue opportunity will increase as well.

OPERATOR

And our last questioner for today will be Ray Stochel with Consumer Edge Research. Please go ahead.

RAY STOCHEL, CONSUMER EDGE

Great. Thanks so much for taking my question. All related to gaming, but could involve things that are non-gaming related.

What does rewarded advertising add to your capabilities and what feedback are you getting from advertisers so far? And then how important would in-app purchases be over time to success in rewarded advertising? And then big picture across gaming and non-gaming, how big could in-app purchases be as a portion of sales in let's say, three years to five years? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks for the question. Yes, our rewarded video products built on top of Commercials and that product is seeing, I think, a lot of uptake in the marketplace. It's a six-second non-skippable unit premium video and that's been really well-received by advertisers. So, we're expanding that inventory with our rewarded video units in gaming. I can't speak to the broader in-app purchase opportunity, but it's certainly something we're looking at.

OPERATOR

And this will conclude our question-and-answer session as well as Snap Inc's First Quarter 2019 Earnings Conference Call. I just want to thank you all for attending today's presentation and you may now disconnect your lines.