SNAP INC. Q2 2019 TRANSCRIPT

OPERATOR

Good afternoon, everyone, and welcome to Snap Inc's Second Quarter 2019 Earnings Conference Call. At this time, participants are 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 will be recorded. Thank you very much.

Mr. David Ometer of Investor Relations, you may begin.

DAVID OMETER, INVESTOR RELATIONS

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

Earlier today we made a slide presentation available that provides an overview of our user and financial metrics for the second 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 second 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 quarterly report on Form 10-Q for the quarter ended March 31, 2019, 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 are proud of the results that our team delivered this quarter. We added 13 million daily active users, our highest net adds since the second quarter of 2016, bringing our daily active users to 203 million. The average number of Snaps created every day grew to more than 3.5 billion this quarter and average time spent per user was over 30 minutes per day. Our revenue growth rate accelerated both quarter-over-quarter and year-over-year to 48 percent, yielding $388 million in total revenue for the quarter.

This growth in our community, engagement, and revenue is the result of several transitions we completed over the past 18 months. Early last year we redesigned our application to emphasize the importance of communicating with real friends and create a space for premium content. We rebuilt our Android application to reach a broader audience, built a self-serve advertising platform to reach more advertisers, and transitioned our leadership to support our growing team. In addition to delivering improved business results, we have built a company culture that reflects our long-held values of being kind, smart, and creative.

Completing these transitions has established a strong foundation for growing our community, increasing engagement, and growing advertiser demand. Our team is hard at work making significant progress against each of these areas.

We have driven the growth of our community by making Snapchat a fast and fun way to communicate with real friends. Following last year's substantial product evolution, we believe that we are now better positioned for long-term success. Today, more than 75 percent of the 13-34 year-old population in the United States is active on Snapchat, making us larger than services like Facebook and Instagram among this audience, and demonstrating the broad-based appeal of our service.

We have also observed that communicating visually with real friends on Snapchat provides long-term value for our community. For example, Snapchatters in the United States who joined five years ago and were active at the end of their first year have retained at more than a 95 percent annualized rate. We believe this high retention rate underscores the important role Snapchat plays in the lives of the people who use our products.

We've built a strong base with high penetration and retention in core markets like the United States, and we're hard at work bringing the Snapchat experience to a broader community around the world.

We are seeing early positive results following the rollout of our new Android application, with more than a 10 percent increase in the retention rate of people who open Snapchat for the first time. Furthermore, on the majority of Android devices used by new users, Snapchatters are now sending 7 percent more Snaps when compared to the old version, which we believe is an important leading indicator of their long-term retention.

We have also partnered with global telcos that serve more than one billion customers to help our community better manage the costs of Snapchat usage, and we launched eight new languages so far in 2019 that are spoken by over 750 million people worldwide.

We have never been more excited about our opportunity to build a global community. Our redesigned application helps new Snapchatters adopt retentive behaviors like talking with their real friends, our rebuilt Android application provides a vastly improved experience across billions of devices, and our self-serve advertising business has driven accelerating revenue growth that can support a growing community around the world.

Meanwhile, we are also working to deepen engagement across Snapchat. Now that we have built a strong underlying foundation for our service, we are well-positioned to continue investing in key areas like our content platform, our augmented reality platform, and our gaming platform. These efforts support our mission of empowering people to express themselves, live in the moment, learn about the world, and have fun together, which in turn will help drive the long-term growth of our business.

We are working hard to grow a made-for-mobile content platform that serves our community, content creators, and advertisers. Our content partners are growing in both number and quality as our platform matures, and as their experience on Snapchat has helped them become more effective mobile storytellers. For example, ESPN started out as a text-heavy Publisher Story when we first launched Discover. They have since transitioned to full-screen vertical video with SportsCenter, and are now expanding their sports coverage on Discover to four different Shows.

We are also continuing to evolve the product experience for this expanding slate of content. For example, we improved content discovery through better ranking to help our community find content that appeals to them, and facilitated loyalty through products like Show Profiles where people can browse past seasons and manage their subscriptions. We are focused on building loyalty and repeat engagement with our Shows, and we saw more than 90 percent of Snapchatters who completed the first season of Endless Summer, a Snap Original produced by Bunim/Murray Productions, go on to watch season two in its first month.

As a result of our investments in our content platform, total daily time spent by Snapchatters watching Discover increased by over 60 percent year-over-year, while the number of daily viewers has grown by 35 percent year-over-year. This was driven by the additional content we added to our platform over the past year, as well as changes we made to our platform to prioritize depth of engagement. By investing in premium content, we are seeing the quality of our content platform improve in addition to increasing engagement with longer-form content. We believe this is best for the overall health of our content business.

We are also improving our advertising offering to better support our content platform. Building upon the success of our Shows format, we recently announced the launch of Snap Select, a new way for advertisers to run Commercials within a curated set of our Shows programming. This is an example of a product evolution that serves both our advertisers and our content partners, while strengthening our overall platform by generating revenue that we can reinvest into better serving our community.

Augmented reality has become a daily behavior for the vast majority of our community because Snapchat opens into the camera. Our strategy is to continue driving innovation in fundamental AR technology, while building a platform for creators and partners to power augmented reality experiences for our community. We recently launched the next generation of AR Lenses, which leverage our experience with the mobile camera as well as our ongoing investment in research and innovation. These new Lenses use deep neural networks to modify a person's appearance in real-time, and were well-received by our community, with over 200 million people playing with these new Lenses in the first two weeks.

We continue to invest in Lens Studio, our desktop application for creating augmented reality experiences. With Lens Studio, we're making the AR creation process easier, while simultaneously providing more sophisticated tools in order to unlock the creativity of our community. We launched Lens Studio 2.0 at the beginning of the quarter to introduce Landmarkers, a new tool for overlaying augmented reality on the world, and a variety of other capabilities. The number of people submitting new Lenses every month grew by more than 20 percent from the prior quarter, and we love seeing the new experiences created by our community as we continue to add new templates and capabilities.

We're also supporting our creator community with new in-app features like creator profiles, so that people can follow their favorite Lens creators, view their portfolio of Lenses, and get notified about their latest creations. We saw more engagement with Lenses created by our community in Q2 2019 than the entirety of 2018, and we are continuing to invest in improving both the creation process and the discovery of these community Lenses. We believe that investing in fundamental long-term innovation and supporting a vibrant creator platform will help us continue to lead the way in augmented reality.

Our newly launched gaming platform is off to a great start. In the past four months, we have worked with our partners to release seven new premium games for our community, including three games that allow Snapchatters to play as their Bitmoji. We designed our gaming platform to support gameplay with real friends, and are excited to see early results showing the value of these social interactions. For example, we see a direct correlation between the number of friends playing a game together and their time spent playing games. While we are just getting started building out our new gaming platform, we are learning a lot and can't wait to continue evolving the platform to serve our partners and community.

Our advertising business is gaining momentum following the transitions we have made in our business. Over the past few years, we have built a large and unique audience, created effective and engaging mobile ad units, and migrated to a self-serve monetization platform. We're now working on scaling demand on our platform by helping advertisers of all types and sizes generate returns on their ad spend.

On the front end, we are developing services and partnerships to make it easier for advertisers to create and buy ads, and we are seeing positive momentum with vertical video and Stories as the broader industry moves to adopt the mobile ad formats that we have pioneered. On the back end, we have dramatically improved our optimization engine in order to better meet a variety of campaign goals, whether advertisers are trying to efficiently reach a large audience or drive high-quality conversions.

These changes have broadened the types of advertisers and campaigns that find success on our platform and have led to increased budgets. For example, with the launch of conversion optimization less than one year ago, we are now accessing uncapped performance budgets from some of our largest advertisers that are limited only by the return on investment that we are able to deliver. As we see advertisers increase their budgets in response to these improved returns, we are also putting effort into scaling the number of advertisers on our platform.

I want to briefly step back and highlight how our different efforts across Snap work together to drive our long-term growth strategy. This quarter offers a great example: our significant investments in innovation have helped us build a scaled augmented reality platform and deliver cutting-edge technology like the new Lenses powered by deep neural networks that we launched in May. The popularity of these Lenses drew millions of people into our rebuilt Android application, where they experienced the new and improved Snapchat that led to increased engagement. The enhancements we have made to our advertising business and self-serve platform meant that we were better able to monetize this increased engagement, leading to accelerating revenue growth.

Our team is at our best when we combine creativity, technical innovation, and operational excellence to deliver new experiences for our community and make those experiences available as widely as possible. This quarter demonstrated our ability to work together as a team across many disciplines to deliver great results.

Our accelerating top-line growth in daily active users, engagement, and revenue is translating into significant improvements in our financial performance. Our total cost structure per daily active user grew less than 1 percent year-over-year, meaning that nearly all of our revenue growth flowed through to the bottom line and resulted in a 53 percent year-over-year improvement in adjusted EBITDA. As we approach our stretch goal of adjusted EBITDA breakeven, we are excited about dedicating more resources toward investing in innovation while maintaining a high degree of operational rigor.

We are so excited about our opportunity to reinvent the camera and achieve our vision of overlaying computing on the world, and our rapidly improving business results will allow us to move faster to better serve our community in the future. Our team is collaborating well together, supporting one another, and we are all committed to making a positive difference in the lives of the people who use our products.

Before I hand things over to Jeremi and Derek, I want to welcome Kenny Mitchell, who joined us recently as our first Chief Marketing Officer. We look forward to bringing his deep experience with McDonald's and Gatorade to build our marketing strategy moving forward. In addition, I want to welcome Derek into his new role as our Chief Financial Officer and Lara as our new Chief People Officer—both Derek and Lara have been strong leaders at Snap for some time, and I look forward to the continued positive impact they will bring to our team and business.

With that, I'll turn the call over to Jeremi to share more about our advertising business.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks, Evan. We're pleased with our results for this quarter and continue to see significant upside and opportunity for our advertising business. In Q2, we generated total revenue of $388 million, and delivered a second straight quarter of revenue growth acceleration. Average revenue per user was $1.91 in Q2, an increase of 37 percent year-over-year and 14 percent sequentially.

We believe the single biggest driver for our revenue in the short to medium term will be increasing the number of active advertisers using Snapchat. We have significant headroom in our business given high levels of user engagement and ample supply of available impressions. We are making consistent improvements and investments across our products, tools, and sales teams to grow advertiser demand and help advertisers on Snapchat achieve business outcomes at scale.

We have a strong, straightforward value proposition to offer new and existing advertisers. As Evan noted, Snapchat plays a central role in the lives of the 13-34 year old demographic. In fact, in the U.S. advertisers can reach more of this audience on Snapchat than on other platforms like Instagram, Facebook, and Twitter, creating an obvious and exciting opportunity for incremental reach. In addition to Millennials, Gen Z has become a growing focus for brands, as this generation begins to develop life-

long habits and brand affinity. Gen Z already commands $44 billion in buying power and influences up to $600 billion in household spending, particularly in categories in which Gen Z family members are more native to the product, such as in tech and gaming. As we look to the future, we have many opportunities to highlight the ways that Millennials and Gen Z use Snapchat with their friends, and to enable brands to reach them in creative and impactful ways.

To engage the Snapchat audience, advertisers need effective ads, easy buying, and consistent, positive campaign results. To that end, we are focused on two fundamental priorities in our ad business: the first is to develop powerful ad formats that are both innovative and easy to create. The second is to show consistent, predictable results for our advertisers, driving measurable ROI and enabling them to optimize for the outcomes most relevant to them.

Just this month we started testing our new Instant Create onboarding flow, which generates ads for businesses in three simple steps from their existing assets, be it their app or their ecommerce storefront. Additionally, our Product Catalog formats, typically used for ecommerce, have had an immediate impact, allowing our partners to easily showcase multiple products, and for our community to shop without leaving Snapchat. Thousands of advertisers have already uploaded their product catalogs to Snapchat, and we expect that these ecommerce ads will drive incremental revenue growth in the second-half of the year.

Q2 was a big quarter for Snap's broadly-adopted, state-of-the-art augmented reality platform. On the revenue side, we believe that augmented reality is the future of experiential, immersive advertising, and that the industry is just beginning to leverage our technology to connect with Snapchatters. Our users opt in to over 10 seconds of play time on average with our Sponsored Lenses. Our self-serve AR buying tool has been scaling quickly since its launch in Q2 2018, and we anticipate advertisers will grow their investment in our ad platform as we continue driving new AR ad products, market education, and robust measurement.

Let's dive into a recent AR example. Of course, the world stopped for Game of Thrones, and we were thrilled to be a part of the zeitgeist. But the most incredible aspect of this execution was how the remarkable ability to land a dragon on the Flatiron building and turn New York into King's Landing led to performance outcomes for HBO in the form of HBO Now user acquisition. HBO 'augmented' the iconic dragon with a National Lens that was played with by our users for 23 seconds on average and led to a 10 point lift in both brand favorability and recommendation intent according to Millward Brown. A concurrent HBO Now campaign implemented our Snap Pixel to help drive high quality conversions, making us one of HBO's most performant acquisition channels of 2019. This deep partnership was made possible by our recent sales team verticalization.

As Evan mentioned, this quarter we also announced Snap Select for premium video ads. Snap Select combines four things brands love: our 6 second, full-screen, non-skippable video product; running

adjacent to a set of premium Shows; bought via a simple, one-click buy flow; at a predictable, fixed price. It's designed for both Social Video and Online Video buyers and has the potential to attract incremental Online Video and TV budgets into our hand-curated, brand safe environment. Brand safety is vitally important to us, and Snap Select highlights our continued focus on premium content from verified publishers.

Now let's talk about an example of an advertiser using a portfolio approach. Subway recently took advantage of our Commercials premium video offering to reach an incremental audience on Snapchat. We ran two campaigns, both measured via Nielsen Total Audience Ratings. In a campaign that compared the reach and efficiency of Commercials, we were able to offer 8 percent incremental reach versus TV. When the campaign was expanded beyond Commercials to include Snap Ads, we were able to add 26 percent incremental reach. In both campaigns, over three-quarters of those reached on Snapchat were reached only on our platform. We believe this demonstrates the opportunity for our video offering to augment other TV and online-video budgets.

Snapchat advertising drives measurable and repeatable ROI. Over the last quarter, our engineering team successfully migrated our primary monetization machine learning models to use deep learning. Deep learning provides greater predictive power, and we expect this to improve our ability to serve the right ad to the right user, driving better advertising outcomes and improving the user experience. For example, when we launched the new deep learning model for App Installs, we were able to drive 20 percent more installs, at a greater impression efficiency.

Now let's talk about a performance based example. Direct-to-consumer advertisers like Quip, a growing oral care brand, will benefit from these improvements to our ad technology. In their first ever Conversion Lift test with us, we proved out a 7 percent incremental lift in purchases driven by Snap Ads and Story Ads. Certain audience cohorts generated greater than 8 percent incremental lift, providing fuel for optimization of future campaigns. Our large audience, creative formats, and advanced measurement toolset provide a significant opportunity for direct-to-consumer brands like Quip to expand beyond the saturated marketplaces of our peers.

Our number of active advertisers continues to grow. There were more ad accounts active on Snap this quarter than ever before, yet we remain constrained by demand, not by supply. Our advertisers retain well and generally increase their spend as we continue to demonstrate consistent, meaningful ROI for them. As we add more advertisers, we see the health of our marketplace growing with increasing diversity, relevance, and engagement, which subsequently improves advertiser efficiency and user experience. We expect that increasing the number of advertisers will be the largest contributor to revenue growth and we are aggressively pursuing the opportunity.

We believe that driving ROI is the best advertiser retention tool, and following our investments in our ad products and self-serve platform, we have demonstrated our ability to deliver strong results at scale

for our advertisers. While there is still a lot of opportunity to further improve ROI, we are focused on bringing in more demand into our platform, starting with three major opportunities. First, we are building integrations with third-party channels like Shopify to make buying, measurement, and campaign management significantly easier for a large set of customers. Secondly, we are removing friction from our self-serve tools with products like Instant Create that decrease the time and creative investment required for smaller, resource-constrained advertisers. Finally, as we continue to launch products and partnerships that are designed to help scale our demand to more advertisers, we are also putting sales and marketing functions in place to help on-board and support this broader base of advertisers. Our product is evolving from a power-user tool for advanced, professional marketers to one that serves businesses of all types and sizes and we are excited to scale our platform to more advertisers.

As a closing note, we have completed our sales reorganization in the US. We are pleased with the results thus far and are cautiously optimistic that we will see limited disruption to momentum as we extend the reorganization to our International teams in Q3. In Q2, our North America year-over-year ARPU growth rate was 42 percent, our highest growth rate since the second quarter of 2017. Importantly, we remain confident that the changes we have made to our team will lead to growing and building deep relationships with advertisers over the longer term.

And now I'd like to turn the call over to Derek to discuss our Q2 financials.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Thanks Jeremi. Our Q2 financial results reflect our priorities of making focused investments in the future of our business, and scaling our business efficiently, in order to drive towards profitability and positive free cash flow.

As Evan mentioned earlier, daily active users increased to 203 million in Q2 2019, which represents an increase of 13 million or 7 percent growth sequentially, and 15 million or 8 percent growth year-over-year. We were particularly pleased to see that the growth of our community was broad based, with year-over-year and sequential growth on both iOS and Android platforms. In addition, we observed both year-over-year and sequential growth across each of North America, Europe, and Rest of World.

We estimate that approximately 7 to 9 million of the 13 million in sequential DAU growth is attributable to an improvement in user engagement that we observed after launching our new augmented reality Lenses, which brought in new users and re-engaged lapsed users. We estimate that the remaining 4 to 6 million of sequential growth in DAU was driven by underlying growth trends in our community, which are the result of the improvements we have made to our application over the past year. Importantly, the impact of our augmented reality innovation was higher because of these improvements, including

the rebuild of Android, as these improvements have better positioned us to capture the upside of our innovation.

Average revenue per user was $1.91 in Q2, an increase of 37 percent year-over-year and 14 percent sequentially. We saw improvement in ARPU across all regions both year-over-year and sequentially. Impressions per DAU were up 122 percent year-over-year driven by growth in user engagement, in particular growing engagement with Premium content, and improvements in sell through rate.

For the quarter, we generated total revenue of $388 million, an increase of 48 percent year-over-year. Our year-over-year revenue growth rate accelerated by 9 percentage points versus the prior quarter. We were particularly pleased that immediately following our sales reorganization in North America, we saw revenue growth in that region accelerate by 14 percentage points to 47 percent. We view this as an early sign that the changes we have made are working for our business and our advertisers.

On the yield side, we saw cost per impression continue to level off in Q2, down 34 percent year-over-year but just 3 percent sequentially. Given our ample supply of available impressions we view yield as an output at this stage and not an input. As a result, we are focused on optimizing our overall revenue growth. We expect that demand will continue to fill in for our newest ad products over time. As an example, revenue from Commercials grew more than 60 percent sequentially, which illustrates that demand is building quickly for our latest ad products. We view the launch of Snap Select in the final weeks of Q2 as an additional catalyst for growth of our Commercials ad product going forward. We are still very early in the growth cycle for our newest ad units, and believe we have significant runway to grow revenue with our existing supply. In the interim, we are pleased with the high ROI being achieved by our early adopter advertisers as this will allow them to continue to expand their budgets with us over time.

Gross margins were 46 percent in Q2 2019, up 17 percentage points year-over-year, and 7 percentage points sequentially, as we continue to focus on scaling our operations efficiently. Infrastructure costs per DAU were $0.72 in Q2 2019, flat both year-over-year and sequentially. We continue to make significant progress in driving down our underlying unit costs over time, including the cost to deliver a Snap, the cost to deliver an impression, and other key drivers of infrastructure costs. In Q2, improvements in user activity were fully offset by these infrastructure efficiency efforts as we continue to prioritize scaling the business efficiently in order to drive positive operating leverage.

Operating expenses were $259 million in Q2 2019, up 5 percent year-over-year and 4 percent sequentially. The growth in operating expenses in Q2 was driven primarily by investments in support of our sales organization, partnership development efforts, and marketing to support advertiser and community growth.

We expect to make additional investments to grow our business going forward, including to build new products for our community, and improve our advertising platform. As a result, we plan to grow our talent base in the second half of 2019, in addition to making targeted investments in marketing and content to support the growth of our community and advertiser base. We will continue to be disciplined in our approach to investments and focused on scaling our business efficiently to drive operating leverage. We see the investments that we have made in recent quarters, and that we will make in the quarters ahead, as a key part of our path to becoming sustainably profitable.

Adjusted EBITDA losses were $79 million in Q2 2019, an improvement of $90 million over the prior year, and $45 million over the prior quarter. This was the fifth consecutive quarter that we reported a year-over-year improvement in Adjusted EBITDA. In the second quarter we delivered Adjusted EBITDA leverage of 72 percent, which is down from 105 percent in the prior quarter, but up significantly from 31 percent in the prior year, as we continue to invest in the future of our business while making progress towards profitability and positive free cash flow.

Free Cash Flow for Q2 was negative $103 million, a decline of $25 million quarter-over-quarter, which reflects the relatively higher collections in Q1 following seasonally higher revenue in Q4. Free Cash Flow improved by $131 million year-over-year driven by the significant improvements in Adjusted EBITDA.

We ended the quarter with $1.2 billion in cash and marketable securities, nearly flat versus the prior quarter, and are pleased with the progress we have made in reducing our cash burn as we scale our business efficiently.

Forward Looking Guidance

As we look forward to Q3 we expect to continue to invest in the future of our business, to scale our business efficiently, and to make additional progress towards profitability and positive free cash flow. To begin, I will share with you some of the directional thinking regarding DAU growth that we have used internally to set our financial guidance. Q3 has historically been a relatively difficult quarter for us seasonality wise and this will be a headwind in Q3 relative to Q2. We expect that the underlying growth we've experienced year to date will continue in Q3, and therefore offset these seasonal headwinds. As a result, our financial guidance assumes DAU of 205 to 207 million in Q3, representing 10 to 11 percent year-over-year growth, which would be a sequential acceleration from 8 percent in Q2. We are cautiously optimistic that the underlying growth trend in user engagement will continue into Q4 and next year.

In terms of our financial guidance, we expect to maintain strong momentum on the top line and to continue to make solid progress toward profitability. For Q3, we are guiding to a range of between $410 million and $435 million for revenue. For Adjusted EBITDA in Q3 we are guiding to a range of between

negative $85 million and negative $60 million, which would mark our sixth consecutive quarter of year over year improvement in Adjusted EBITDA.

Thank you for joining our call today and we will now take your questions.

OPERATOR

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

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

Our first question today will come from Ross Sandler of Barclays. Please go ahead.

ROSS SANDLER, BARCLAYS

Hey, guys, one question related to the DAU trajectory, and then a quick one on Discover. So, Evan, I guess how has the retention on the 7 to 9 million DAUs that you added in Q2, from the new filters been trending as of late? Is the guidance for Q3 reflecting some drop-off in that user cohort, or is that just some conservatism baked in? Any color there would be helpful.

And then you guys gave a couple new stats on engagement from new Discover users and existing Discover users. So, it looks like it's going up a lot. So, what are the primary drivers of the accelerating growth and engagement you're seeing in Discover, and do you think this can continue for the foreseeable future? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks, Ross. Yes, we're really excited about the momentum we're seeing in our content business -- a lot of demand for our content. I think that's a function of the improving content quality, and also the personalization that we've really been investing in over the past couple of quarters.

We're also currently testing a bunch of new ways of merchandizing content, and specifically our Shows and premium content. We're excited about that too. And I'll let Derek speak to the guidance question.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Hey, Ross, thanks for the question. We were pleased with the growth that we saw in Q2, particularly that it was broad-based. We saw growth both across platforms and regions, which is really nice.

Looking forward into Q3, we're coming from a higher base in Q2 and really pleased that we're able to share that we expect to have sequential growth again into the next quarter. This time around, we wanted to share with you guys a little bit of guidance on that front, in terms of what we've assumed for DAU growth in our own financial forecasting. Hopefully that gives you a little bit of color about what we can expect going forward, and really pleased to see that we've got strength in the underlying momentum of the business and that that's going to carry forward and allow us to grow off of our now higher base number.

OPERATOR

The next question will come from Heath Terry of Goldman Sachs. Please go ahead.

HEATH TERRY, GOLDMAN SACHS

Wonder if we could dig a bit into the monetization side of things. As we look at the improvement here, can you give us a sense of what the profile of that growth is? How much of it is brands versus direct response? You mentioned growing advertisers -- is that to say that the majority of this is coming from existing advertisers increasing their spend? And then as we think about the channels within that spend, is there a way to disaggregate between professional content, Creative Tools, UGC, messaging, and then of course the impact of self-serve? Just trying to get a little bit deeper into that number, please.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks for the question, Heath. We don't break out specific brand versus DR, but I can give you some examples. As you heard in the call just a bit ago, we have great examples from Subway, HBO, and Quip, which are really reflective of our overall ecosystem growing from all different types of advertisers.

We are also really focused on how those two objectives are starting to converge. So, we don't really consider there to be a specific brand advertiser and a specific DR advertiser anymore. What we really are focused on is making sure that the outcomes are best for the advertiser, and those are starting to converge.

In order to do this, we are creating a powerful, easy to use format. We moved to the auction, as everybody has heard us talk about, and that really helped our DR advertisers grow. But we also have just absolutely incredible augmented reality formats, Creative Tools, and as we talked about before, with the increased engagement in Discover, we also have the opportunity to run our unskippable six-second Commercials format, and now even further refined into Snap Select, which is running those in a brand safe environment. So, we continue to see acceleration across both brand and DR types of advertisers, and we saw that this past quarter.

OPERATOR

The next question will come from Mark Mahaney of RBC. Please go ahead.

MARK MAHANEY, RBC CAPITAL MARKETS

Okay, let me try two questions. I just want to follow up on Ross's question, and I just want to try to get at the issue of this extra color you gave on the DAU growth in the quarter. Should we be reading that some of the DAUs that came in, because of maybe some of the lens filters, may be less sustainable, that they may not stick with the company as long as the other DAUs? Just address that, what you're seeing in that. I know it's early, but is there a particular reason why you would call that group of DAUs out?

And then when you talk about talent, investing in talent in the back half of the year, any more color on what sort of talent you're looking for? Is that on the sales side, R&D side? Any color there would be appreciated. Thank you.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Hey, Mark, thanks for the question. I think on the first one there, around the drivers around the DAU growth, really pleased to see the overall growth in Q2. And we thought with the big number there it made sense to share a little bit of color about some of the drivers, and obviously, pleased to see we've had innovation on the augmented reality lens side. That's been a driver for us, and that's not only brought in some new users to the platform, but it's increased engagement with existing users as well, which contributed to the overall growth.

But in addition to that, we're pleased that we've got an underlying momentum of growth with our user base, which is really coming from all of the improvements that we've made to the app over the last year, which are paying off in terms of us being able to capture the benefit of our own innovation driving into the platform. And so, the benefit that we saw off of the augmented reality lens innovation was higher because of those improvements we made.

So, hopefully that gives you a little bit more color in terms of what drove the growth in Q2. And again, as I said earlier, we're super pleased that we can now build on top of that higher base going into the next quarter.

I believe your second question was around the growing of the talent base in the latter half of the year, and yes, definitely making targeted investments in the business. We see a lot of opportunity in the business, and we want to make sure that we're investing in the long-term future of the business.

We think we've been pretty disciplined about those investments so far and expect to be going forward, so that we're balancing operating leverage, and pushing towards our goals of profitability and positive

free cash flow while still making big investments in the future of the business. We've made a lot of investments recently and expect to make more going forward, and we see that as part of us building towards a sustainably profitable business, so these things go hand-in-hand. Hopefully that helps give a little more context.

OPERATOR

The next question will come from Stephen Ju of Credit Suisse. Please go ahead.

STEPHEN JU, CREDIT SUISSE

Okay. Thank you. So, Evan, it seems like in the past the potential ARPU over CoRPU had to make sense for you guys to think about entering any regions. But how does the current Android app, or even the iOS app for that matter, change that ratio? You've launched eight new languages, per your prepared remarks, so should we be thinking about a more expansive addressable market for Snapchat?

And Jeremi, you understandably called out brand safety as an important consideration for premium video ads. So, it sounds like right now that inventory is corralled around Shows where you know the context and the content. So, can you talk about what you will look to do to scale this stream of revenue in the future? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks, Stephen. Yes, there's a confluence of factors that are making us excited about our international growth opportunity. One of them is the success we're seeing on the self-serve advertising platform, and you can see that in the rest of world ARPU numbers.

So, we're getting more and more confident about our ability to really scale the business, and generate revenue there over the longer-term. And additionally, the improvements we've made on Android have now made our product available to a much larger subset of the smartphone population globally. So, really excited about the progress there.

What we're going to do now is invest a lot more in content, augmented reality experiences, and of course localizing the service in terms of the languages that we discussed. And so, we're investing heavily there, and we're excited about that long-term opportunity. And given the way we've been able to manage costs on the infrastructure side, we think that can be a really valuable revenue generator for the business over the long-term.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

And thanks. I'll take the second part regarding safety. It is not centered specifically on Discover or on Commercials. From the outset, Snapchat has been designed to create the feeling of a natural conversation. It's a private conversation and communication that deletes by default and it's not preserved for eternity, which makes it brand safe across the board.

And all-in, we are really comfortable with our position because of the regulatory notions and privacy concerns like discussed in GDPR. Those have been embedded in our principles since the beginning as a company. And our content isn't random, it's hand curated with select community members, as well as publishers participating in Discover.

So what I was speaking to, is that that's further curated in Snap Select so that it is from our hand curated publisher content, as well as our own Shows to ensure brand safety. But it's something that is truly embedded in our values, in everything we do across all of our platforms, including our augmented reality, our Snap ads, as well as our Story ads.

OPERATOR

The next question will come from John Egbert of Stifel. Please go ahead.

JOHN EGBERT, STIFEL

Great, thanks. Over the last couple weeks, we've seen growing concerns around the usage of third-party apps, like FaceApp, in terms of how they obtain, store, and claim ownership of the users' personal photos. I was wondering if you could talk about some of the ways that Snap protects users' photos and videos when they use Snap's own AR lenses, as well as those built by creators in the Lens Studio.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yes, that's a great question. Obviously, we've invested a lot in privacy and we care a lot about the safety of our community. And from the beginning, we've always embraced this idea of deletion by default, meaning that the content that you create and send to your friends is deleted after they've viewed it.

And so, I think the way that we have constructed our service really helps preserve user privacy. And as we look forward and empower more creativity on our platform, that's always something that what we're going to keep in mind.

OPERATOR

The next question will come from Lloyd Walmsley of Deutsche Bank. Please go ahead.

LLOYD WALMSLEY, DEUTSCHE BANK

Thanks. So, you talked about seeing an immediate impact from product catalogs, and what sounds like healthy adoption from businesses there. So, wondering if you can just give us a sense of what kind of conversion rates or conversion rate uplifts the advertisers are seeing from integrating that format with the new ad unit, relative to a traditional ad that would require a click-out.

And then related to that, what are you seeing in terms of ad pricing in this, as people integrate product catalogs? Does this drive a premium pricing to these ad units? Anything you can share there would be great.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks for the question, Lloyd. Regarding the ROI that advertisers are seeing, we really believe that our advertising partners are voting with their wallets. They're retaining well. They're continuing to grow their spend and we are keeping them within the ecosystem. We do believe that driving that ROI is the best retention tool for us, and we continue to make investments in the ad products and self-service platform.

You mentioned catalogs specifically, which is built, of course, for e-commerce advertisers. And we are committed to helping these e-commerce businesses achieve their objectives by creating these rich experiences. We have launched, as you know probably, the Amazon visual search product. We have digital recognition tech. And we recently launched our Shopify integration as well, which will allow our advertising partners, who have Shopify stores to link quickly, to build ads just right from the Shopify experience. And then, we've also dipped our toes into launching stores for influencers. So, it's very clear that we're committed to the e-commerce space.

And again, with the retention that we see from these advertisers in particular and their continued spend growth, we know that we're continuing to perform on an ROI basis for them.

OPERATOR

The next question will come from Brian Nowak of Morgan Stanley. Please go ahead.

BRIAN NOWAK, MORGAN STANLEY

I have two. The first one, your innovation around AR continues to really stand out with what you have with Baby Face and Gender Swap this quarter. Could you just talk to us a little bit about how you think about pipeline, the visibility on forward pipeline for other big AR innovations to come, to continue to drive the user growth as we go into the back half and into 2020?

And then the second one, in the letter you talked about the importance of advertiser count growth. Can you just give us an update on how many advertisers you have now on the platform and how quickly that's growing? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Well, on the AR front, we really believe we're barely scratching the surface. We're investing heavily in that area, and I think most importantly, building tools for creators. So, what we're seeing in Lens Studio is that people are creating more and more lenses for our community, and really creating an ecosystem around augmented reality.

So, beyond even the fundamental investment and fundamental innovation in augmented reality at Snap, I think the way that our community is embracing the tools that we're creating is really exciting. So, a lot of work to do there. This is a three, five, ten year journey for us, and we're just at the beginning, so we're really excited about that.

And unfortunately, we don't break out the number of advertisers, but we're making good progress there. And I think what's exciting is spend per advertiser and advertisers are both growing together, and I think that bodes well for the long term.

OPERATOR

The next question will come from Justin Post of Merrill Lynch. Please go ahead.

JUSTIN POST, BANK OF AMERICA MERRILL LYNCH

Great. Thanks for taking the question. Obviously, you have a very strong reach among younger demographics, and just wondering if you could talk about the challenges and opportunities for advertisers in reaching that demographic. Are there additional concerns that you think about? And then longer term, how do you think, with all your engagement, your ARPU will look when you compare it to other sites, such as Twitter and Instagram, given how much engagement you have? Thank you.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks. Yes, I think the biggest hurdle for advertisers historically has been the creative format, but I think fortunately, what we're seeing is that formats like our six second nonskippable video ads have a really high impact with our community. And so, advertisers are increasingly willing to make vertical creative or cut their creative, so I think we've overcome that barrier.

And we're seeing advertisers get really excited about augmented reality -- this idea of experiential advertising that our community opts into. So, I think really those creative formats two, three years ago

maybe were a hindrance for our business, but now have become a real asset for us. And so, that's really an exciting shift to see there.

And then in terms of the ARPU question, I think if we take the U.S. for example, I think we're monetizing at like roughly a fifth of Twitter ARPU, or something like that in the U.S. And not that we want to use that as a comp, but I think there's a huge amount of upside relative to the time spent and engagement we're seeing on our platform.

So, I think as Jeremi pointed out, that's why we're so focused on advertiser growth. We've got a lot of supply and we really have to onboard advertisers and fortunately, with our new self-serve platform, people are seeing great ROI, great results, and they're able to scale.

OPERATOR

The next question will come from Jason Helfstein of Oppenheimer. Please go ahead.

JASON HELFSTEIN, OPPENHEIMER

Thanks. Two questions. One, the metrics that you started out with, the 3.8 billion Snaps per day and 30 minutes per day in time spent -- is that a regular metric you plan to give? And can you tell us perhaps how that trended either sequentially or year-over-year?

And then just second, maybe just to dig deeper, I know you don't want to give out the number of advertisers. But can you comment in the growth perhaps in advertisers quarterly or year-over-year? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Yes, we shared the Snaps per day metric in the past, as well as time spent, both as spot metrics. That 3.5 billion Snaps a day is up from 3 billion. And I'm afraid we can't break out advertiser growth for you, but we'll try to share more in the future.

OPERATOR

The next question will come from John Blackledge of Cowen. Please go ahead.

JOHN BLACKLEDGE, COWEN

Great. Thank you. Evan, on the gaming opportunity, could you just discuss it a little bit further, and how you would expect it to impact the user base, whether it be engagement or retention, etc.?

And then on user growth, as it relates to the Q3 guide and going into Q4 and 2020, you expect to add more users. Would you expect the majority of the user additions to be driven by Rest of World, or would it perhaps be a little bit more broad-based? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

On the gaming front, I think the best way to think about it is really, when we first started out building our content business, we really took time to get the user experience right before we scaled it out. And so, today we're working with a very small number of publishers really focusing on user engagement and retention.

And I think the exciting thing that we're seeing is that people who are playing games with more friends are playing longer, which means that the Snap platform can really provide unique value to gaming publishers because we're able to bring this group of real friends that like hanging out together. So, I think we've been correct so far on our thesis around socializing and social gaming, so we're excited to continue building on that.

And I think I'll let Derek take the question on the guide for DAU.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Yes. Hey, John, thanks for the question. Really pleased with the growth we saw in Q2 and pleased that we can share that we do expect to grow again into the next quarter sequentially.

And in terms of sources of growth, we really are pleased with the underlying growth trends and momentum that we're seeing in the business. Those have come from the improvements we've made to the app over the last year, including the rebuild of Android, but also improvements across all platforms. And so, you saw that we had fairly broad-based growth in Q2, all regions, all platforms, which we were pleased with. We do expect to grow into the next quarter.

We're not going to break out our thoughts going forward by platform or by region. But we are pleased to see that we've got fairly broad-based momentum in the most recent quarters, and we expect that that will continue forward into the next quarter and be able to grow again sequentially on our new higher base. Thanks for the question.

OPERATOR

The next question will come from Mark May of Citi. Please go ahead.

MARK MAY, CITI

Thank you. Two if I could. First, I know advertisers on Snap can execute against many different objectives like app installs, website visits, video views, etc. I'm sure they're all growing nicely. I just was hoping that you could comment on the ones where you're seeing particularly strong growth right now.

And then on Snap Maps, other companies in the space have been able to create a lot of value off their map assets. Snapchat uses the map in a very different way than all of these other companies. Just curious what sort of opportunities, if any, that there may be to further leverage Snap Maps going forward from an engagement and monetization standpoint.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks for the question, Mark. I'll answer the first part and then turn it over. Regarding where advertisers are seeing success, I think it's on goal-based bidding across the board. So, whether that goal is number of app installs, number of views, number of impressions, whether it means that they want to sell product on ecommerce, whatever it may be, they have the opportunity to choose that goal-based bidding in our ads manager platform that was well designed to have an algorithm that optimizes to those outcomes. And we're seeing success across the board given the strength of the algorithm and it's learning over time.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

On the Snap Maps front, we really set out to explore this opportunity of creating a personal map. We noticed that so many people, when they open their phone, they have the exact same map, even though their personal experiences of the world are so different -- they live in different places, they hang out with different friends, they have different favorite places to go.

And so, I think as we've been on this journey, the first place we really started was bringing your friends into the map and allowing you to interact with them. And that's really gone well so far, so we're super excited with the engagement that we are seeing there.

But this is a long product journey for us before we think about monetization. And so, for now, we're just focused on the product experience. We've got a big long roadmap here to keep developing that product, but so far great engagement and exciting to build on that thesis.

OPERATOR

The next question will come from Doug Anmuth of J.P. Morgan. Please go ahead.

DOUG ANMUTH, J.P. MORGAN

Thanks for taking the questions, one for Evan and one for Jeremi. First, Evan, you talked about 75% of the 13 to 34-year-old population in the U.S. active on Snapchat. Can you just talk about whether you think it's important to go beyond 34-year-olds? Is that a material part of the strategy still?

And then Jeremi, record advertisers in Q2 and still demand constrained. What's the gating factor, in your view, to getting more advertisers on board? Thanks.

EVAN SPIEGEL, CHIEF EXECUTIVE OFFICER AND CO-FOUNDER

Thanks. Yes, I definitely think it's important for us to grow with our user base over time, especially as we look towards the long-term of the business. That's why we shared the retention stat that we're really excited about, that I think shows that this communication with real friends, and this idea of visual communication is really powerful and something that people grow with over time as it becomes a part of their life.

So, definitely think that that's an important opportunity, and one of the areas where we're investing there is around content and augmented reality experiences to meet the needs of different demographics, so that no matter what age you are when you come into Snapchat, you feel like there's something for you to play with or to watch. We think that's really important.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

And thanks. Regarding how we increase the number of advertisers, we're very fortunate to be in a position where engagement continues to be broad across the entirety of the app from Discover, to the camera, to chat. And we have an opportunity from the supply side to really just add more advertisers, as we've talked about. So, can't overemphasize enough how our biggest opportunity is getting more advertisers into the system, and in order to do that we're focused on three fundamental priorities.

One is to develop ad formats that are both innovative and easy to create, to take down any barriers that advertisers may have regardless of their level of sophistication. The second is to show consistent and predictable results for our advertisers, driving ROI and enabling them to optimize for whatever outcome it is that they want. And then also, as we've been continuing to do over the last three quarters, aligning our sales teams around the advertiser needs and objectives.

And both segmentation and verticalization have led to really positive momentum across all cohorts and verticals, and we're really thrilled about that. So, we will continue to focus on those to get even more than the record number of advertisers that we had this quarter, and we know that the opportunity in front of us is tremendous.

OPERATOR

Our next question will come from Victor Anthony of Aegis Capital. Please go ahead.

VICTOR ANTHONY, AEGIS CAPITAL

Hey, guys, thanks for putting me on. Maybe you could just talk about your path to free cash flow generation, if you'd give somewhat of a timeframe on that. And second, you touched upon I guess the ecommerce efforts, whether it be product catalog format, or Instant Create. Maybe you could just discuss how big of an opportunity do you think ecommerce will be for you guys. Thanks.

DEREK ANDERSEN, CHIEF FINANCIAL OFFICER

Hey, Victor, thanks for the question. I'll take the first one and the second one for Jeremi. On the path to free cash flow, I think you've seen pretty consistent progress quarter to quarter to quarter. Pretty pleased this was our fifth consecutive quarter of year-over-year adjusted EBITDA improvement. We're guiding for next quarter that we expect that we would make it a sixth. So, we're just trying to be super disciplined here in terms of making progress down that road, getting to free cash flow.

I'm not going to give you a timeline here, but certainly you can see that we've been making significant progress. It's been fairly consistent quarter to quarter for a couple of years now, and looking forward to being able to get to that milestone at some point, not a specific date, but pleased with our progress and it is a priority for us for sure.

JEREMI GORMAN, CHIEF BUSINESS OFFICER

And thanks. As it comes to ecommerce advertisers, it's definitely an area of focus for us. We are doubling down on our sales efforts, on our product efforts, continuing to innovate not only on the bid side of the platform, but also on the outcome side of the platform to ensure that the people who are looking to sell products from Snap, are staying within the confines of Snap and able to execute that transaction really easily.

If you think about the opportunity ahead, I'll just speak to the partnership that we have with Shopify specifically. If you just look at that one opportunity, there are hundreds of thousands of Shopify vendors that have storefronts that they can create in just a few clicks directly into Snap, create a store and our customers can shop directly from that store. And that is just Shopify. So, if you extrapolate that out into the litany of other ecommerce players that there are in the ecosystem, the opportunity is tremendous, and we will continue to double down both in product and sales to ensure that we capture that.

OPERATOR

Our last question comes from Michael Levine of Pivotal. Please go ahead.

MICHAEL LEVINE, PIVOTAL

Congratulations on a great quarter, guys. To your comment, Jeremi, about verticalization of the sales force, what inning would you say you view the business at in terms of generating returns from that restructuring?

JEREMI GORMAN, CHIEF BUSINESS OFFICER

Thanks for the question, Michael. It's early days. We have completed the reorganization in the U.S., and that has been behind us for one quarter now. We are cautiously optimistic that we'll see a lot of the same positive momentum in the international reorg which we're undergoing right now.

I can tell you that advertiser sentiment has been extremely positive as our teams start to grow and learn, and have depth of experience by category, particularly when you consider that each different category has different levels of pressure, different types of investor pressures, different types of tariff pressures. The better that we can understand their particular industries, the better we can help solve their problem.

So, we are seeing a huge groundswell of support from our advertiser and agency community on the verticalization, but it's still early days. But I am thrilled to see that most of the verticals at the company right now are growing.

OPERATOR

This concludes our question and answer session as well as Snap, Inc.'s Second Quarter 2019 Earnings Conference Call. Thank you for attending today's session. You may now disconnect.