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Facebook Growth Bolstered by Mix Shift to Higher Engagement Ads

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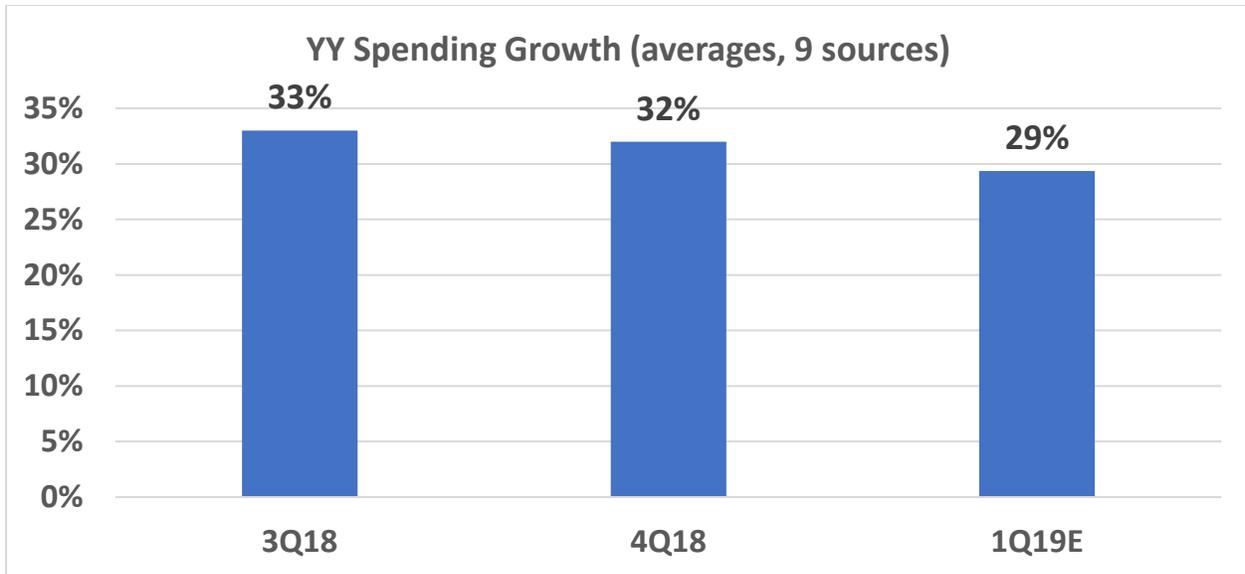
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Large advertisers see engagement improve on wider adoption of richer, dynamic ads on Facebook, Instagram and Messenger in 4Q18, helping yy growth remain strong despite a continued slowdown in legacy static newsfeed ad unit growth.

- Facebook 4Q18 yy spending growth of 32% comes roughly in-line with source expectations in VMI's October report, with only mild yy growth deceleration on average versus 3Q18.
- Larger advertisers seeing strong and improving engagement from Dynamic Product Ads (DPAs), Carousel, Instant Experience and Click to Message ads offsetting slowdown in legacy static newsfeed.
- Traction for automatic placement increasing; expansion of marketplace shoppable ads spurring direct e-commerce.
- Sources optimistic Stories ads will see far heavier ramp-up in 2019, mostly complementing rather than cannibalizing rich newsfeed ads.
- 1Q19 yy growth expected to remain close to 30%; sources believe full year 2019 baseline should remain above 25%.

Spending Growth Remains Solid

4Q18 yy ad spending growth remained roughly in-line with prior expectations, with sources reporting 32% yy growth in 4Q18 only modestly off the 35% yy growth rate published in VMI's 3Q18 report (which included data from a few sources not interviewed for this report) and only very slightly off the 33% 3Q18 yy growth pace reported by the sources interviewed for this report.



* VMI's published 3q18 average in October report was 35%, and included a few sources not interviewed for this report., The current 3Q18 yy average of 33% is compiled solely from sources interviewed in this report.

Source: Vertical Market Intelligence 2018-2019

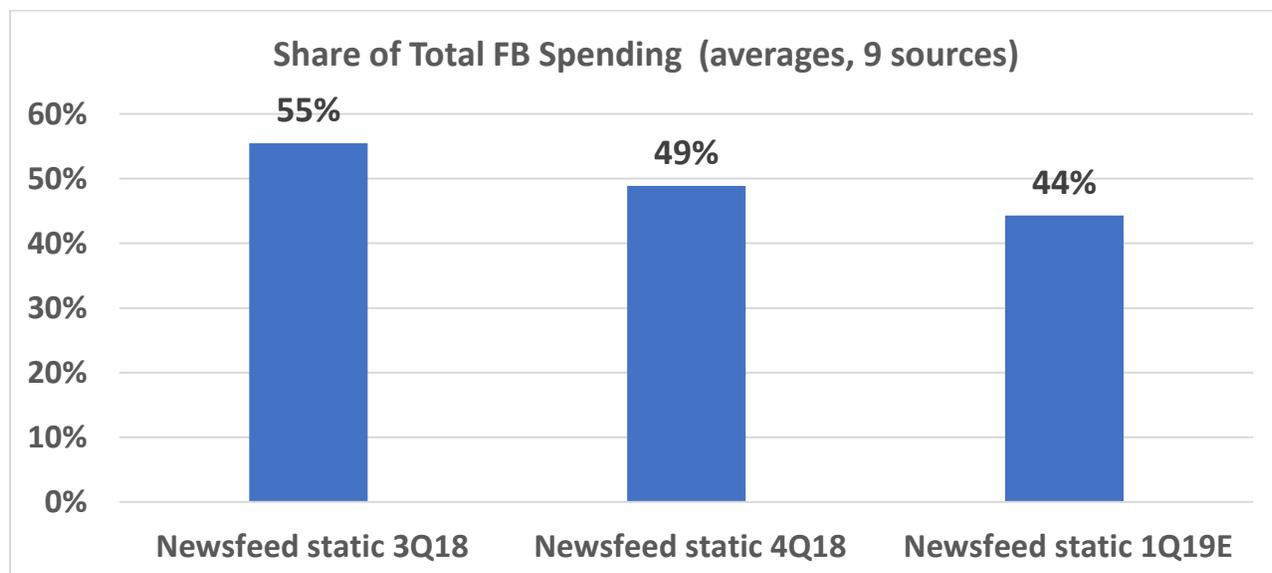
Sources widely agreed that a more sanitized and better policed platform, particularly on Facebook's core app, was helping improve user response to ads and driving improvement in overall clickthroughs and post-click conversion rates. "Facebook continues the purge the platform of bots, misinformation etc. and to lay-out more narrow parameters for targeting, but through automatic placement it is making targeting around core metrics and desirable actions far more streamlined for a wider number of advertisers," said a source.

Sources also said previous chokepoints driven by headline chaos around data use and growing privacy regulations has become forgotten by most advertisers, who instead are focusing on future ad technology improvements and better use of first-party data throughout Facebook's ecosystem. "Over the past few months some of the confusion has ebbed and a clearer set of directions is emerging. Advertisers, more savvy ones anyway, have moved through the steps of untethering themselves from reliance on less reliable and lower quality third-party data, and are getting much better at aggregating their first party and privacy compliant third-party data. There's been a tug-of-war between brands and Facebook over liability for misuse of data which has also created friction, but the worst of this transition seems to be ebbing as both Facebook and advertisers acclimate to changes."

Newsfeed Spending Driven by Engagement Gains

Thanks to continued improvement in DPAs, which have become an essential part of holiday season campaigns, especially for m-Commerce advertisers, Facebook has been able to offset a decline in inventory growth on the newsfeed with better performing newsfeed ads with higher CPMs and a higher ROAS for advertisers. "Subtly, steadily,

Facebook has been making progress in making its Dynamic Product Ads (DPAs), rich carousels and instant experience (formerly Canvas) ads more e-commerce friendly, as well as making Facebook Marketplace more of a true e-commerce hub. As that occurs consumers are interacting more regularly with brands.”



Source: Vertical Market Intelligence 2018-2019

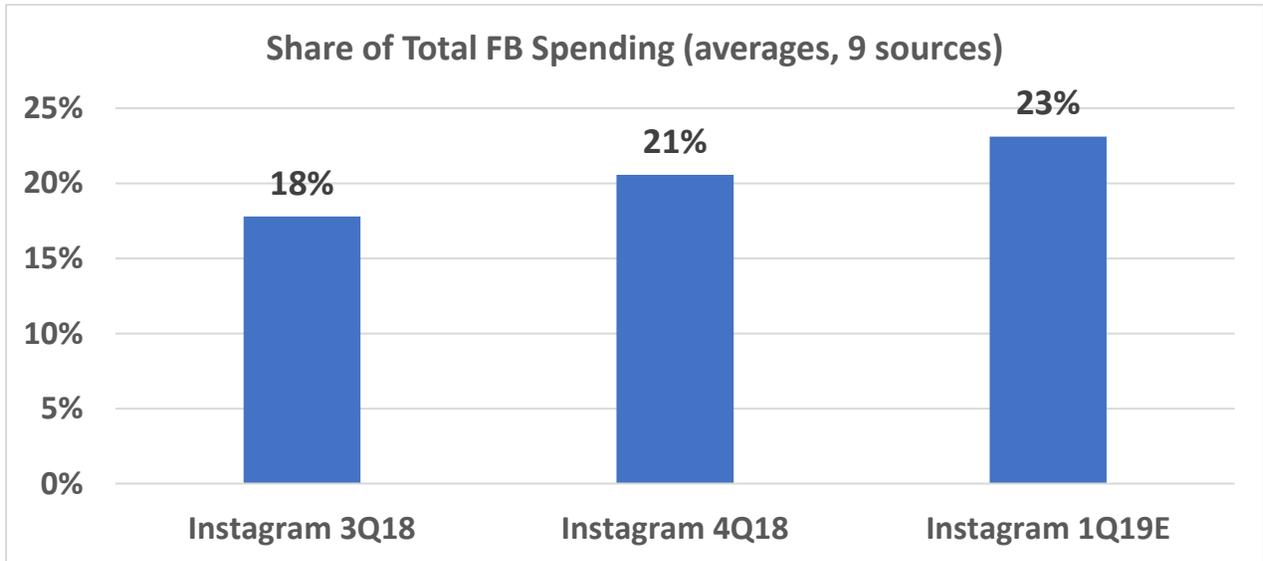
Despite these steady improvements, independent growth of ad spending on Instagram, which has led to incremental dollars coming to Facebook from alternatives as diverse as third-part video DSPs and small niche social platforms like Pinterest and Snapchat, has caused the newsfeed’s share of total Facebook spending to dip below 50% in 4Q18 for the first time ever. Sources believe the newsfeed’s portion of total ad budgets will continue to decline as Facebook attracts additional dollars from competitors, making the company less reliant on its core newsfeed ad and more dependent on improving monetization of Instagram, Messenger, and WhatsApp. “We remain very committed to the platform. It’s been kind of confusing trying to keep up with all the newer ad formats in a multi-app universe within Facebook to serve those ads, but tools such as automatic placement, campaign budget optimization, and creative compass are beginning to address that challenge,” said a source

Automatic Ad Placement, Marketplace Shoppable Ads

Sources broadly agreed that Facebook’s ability to place ads where they will get the best response continues to improve thanks to the firm’s A.I.-driven ad placement technology, while also noting that a pivot towards more m-Commerce-friendly ad formats and targeting tools, especially on Instagram, Messenger, and WhatsApp, was driving overall enthusiasm about the platform and its future. “Looking forward, I think you are going to see a lot more small ecommerce guys using Instagram as essentially a storefront, in much the way that Google Shopping ads are already utilized by SEMs. A key that many don’t understand about Instagram is that it is a really good search engine—something that Facebook never was good at. That’s an opportunity, and Facebook is already latching onto it by abandoning an aspirational brand-focused approach to the platform

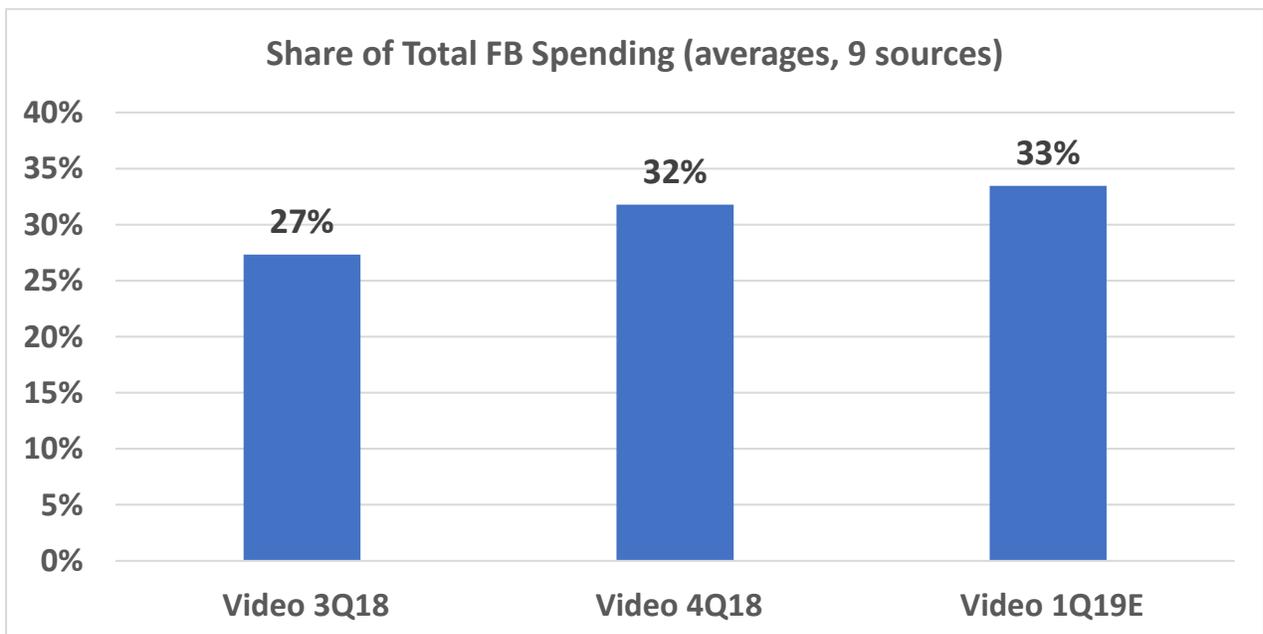
where you're a loathed ad spend to a more m-Commerce-focused approach where you're a necessary cost of goods sold and where the sky is the limit, as long as ROAS remains positive," said a source.

Instagram Gains Share; Optimism on Stories' Future



Source: Vertical Market Intelligence 2018-2019

While Instagram's share of spending continues to increase at a steady pace, Facebook video's gains have slowed slightly as a result of a greater shift towards both Instagram and Instagram Video, driving their yy CPM growth at a high pace in addition to incremental ad performance growth thanks to greater DR-friendly ad options.



Source: Vertical Market Intelligence 2018-2019

“Shopping on Instagram has been great for fashion and health and beauty just at a time when Instagram has wiped out all competition, from Snap to Pinterest, for these high-margin verticals. This has driven a lot of demand for space on the newsfeed, causing CPMs to explode,” said a source, adding that ROAS has remained high (if down slightly throughout 2018), and is superior in these verticals vis-à-vis other display alternatives.

Stories to See Independent Growth; FY19 Spend to Top 25% YY

Sources believe that the yy deceleration in spending growth due to the law of large numbers, which remains offset by a mix-shift towards more expensive ad units, could become a more pronounced trend in 2019, thanks in part to the tremendous shift towards Instagram and Stories that has already occurred. “In 2018, Stories was such a tiny portion of budgets that it had no real impact on pricing or spending, even though it’s an independent bucket that we don’t really consider social—the Stories format is much more direct-to-consumer because public backtalk isn’t really an option, unlike on Facebook. So, there’s tremendous value in the ad format that isn’t being priced in, because many advertisers don’t know how to use it, still,” said a source. “But in 2019 we’ll be doubling down on Stories experimentation last year. That changes the dynamics tremendously.” Another source noted that best practices, so far an elusive and essential element of broad Stories adoption, are just beginning to emerge. “Advertisers are beginning to get the hang of Stories. It’s not an overnight success, but a process of steadily learning how to make them [i.e., Stories] compelling for consumers and how to build engagement and take advantage of the swipe up function to sell goods. All of those elements are making significant strides forward.”

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