

EARNINGS

Facebook Sets Aside \$3 Billion to Cover Expected FTC Fine

Agency has been investigating whether company violated consent decree when user data was shared with Cambridge Analytica



Facebook's Mark Zuckerberg testified on Capitol Hill in April 2018. PHOTO: CHIP SOMODEVILLA/GETTY IMAGES

By *Jeff Horwitz*

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Facebook [FB -0.65%](#) ▼ Inc. set aside \$3 billion for an expected fine from the Federal Trade Commission over privacy violations, cutting into the social-media giant's profit even as its underlying business remained strong.

Facebook posted \$15.08 billion in revenue, up 26% from \$11.97 billion in the year-earlier period. Its profit dropped by more than half, to \$2.43 billion in the first quarter, as the one-time reserve wiped out most of its income.

A multibillion-dollar penalty would likely be the largest ever against a major U.S. tech company by a U.S. regulator, and lands amid sharp debate on Capitol Hill about how best to hold Silicon Valley accountable for its abuses. It would also be the largest privacy-related fine in FTC history.

Facebook agreed in 2012 not to collect personal data and share it without user consent, as part of a settlement with the FTC. The agency began probing last year whether Facebook had

violated the terms of that earlier settlement when data of tens of millions of its users were transferred to Cambridge Analytica, a data firm that did work for the 2016 campaign of President Trump. The Wall Street Journal reported in February that FTC staff had discussed a fine of up to \$5 billion.

The FTC investigation has run for more than a year, prompting complaints from some lawmakers. Facebook's statements on Wednesday suggest the case could be winding up, though the FTC has not given any deadline. While Facebook estimated a settlement would range between \$3 billion and \$5 billion, it cautioned "there can be no assurance as to the timing or the terms of any final outcome."

Jessica Rich, a former head of the FTC's consumer protection bureau, said that the legal reserve wasn't necessarily proof that a settlement was forthcoming. But she credited "enormous consumer outrage" for the size of the fine Facebook anticipates paying, noting the largest privacy settlement the agency has ever reached was \$100 million. "The pressure is on the FTC to show that they can take serious action when warranted," she said.

The possible fine would be eminently manageable for Facebook. The company reported holding more than \$42 billion in cash and marketable securities.

For Facebook, a settlement would bring a degree of resolution to an episode that kicked off an intense period of scrutiny around its data-sharing and privacy practices. Those issues in part drove Facebook Chief Executive Officer Mark Zuckerberg last month to unveil a major shift to private and ephemeral messaging.

Despite the turmoil, Wednesday's results show a business that continues to hum.

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Following the company's first-quarter earnings report, Facebook stock rose about 8% in after-hours trading. Before the close of trading on Wednesday, the company's stock had risen about 35% year-to-date.

Facebook's results follow similarly strong quarterly numbers for social-media peers Twitter Inc. and Snap Inc., and bode well for fellow online-ad giant Alphabet Inc., the parent company of Google. Alphabet reports earnings on Monday.

Excluding the reserve for the FTC settlement, Facebook's operating margin fell to 42%—a stellar number for virtually any business but nonetheless a step down from the 46% it reported a year earlier, as costs rose to \$8.76 billion from \$6.52 billion. Facebook has been warning that its margins will decline as a result of its increased investment in moderating user-generated content.

Mr. Zuckerberg said on an earnings call that the company was rolling out encrypted messaging more slowly than it would have a few years ago, as “part of our new approach of trying to be more proactive about social issues.” He said he would reveal more details about Facebook’s business strategy around encrypted messaging in the coming weeks, but “I don’t think in the next couple of years this is going to be a major driver.”

Despite independent research suggesting that Facebook users are spending less time on the company’s main app, the company reported 1.56 billion daily active users globally, up 8% from 1.45 billion a year ago and continuing the company’s expansion streak. Average revenue per user also rose, to \$6.42, up from \$5.53 a year ago.

The company said around 2.7 billion people use Facebook, WhatsApp, Instagram, or Messenger each month.

Facebook reported nearly no user growth in the U.S., Canada and Europe, markets that produce about 70% of the company’s revenue but are approaching saturation. Its fastest-growing market was Asia, where users grew by nearly 4% over the first quarter.

The photo-sharing app Instagram stood out as a star of Facebook’s current results and the most likely candidate for strong growth in the near future. Instagram played a big role in rising revenue per user in the U.S. and Canada, with its Stories feature being the biggest driver of impression growth, according to Chief Financial Officer Dave Wehner. But ads within Stories ads remain significantly cheaper than Facebook’s other offerings, a gap that Mr. Wehner predicted would eventually narrow.

“We do have opportunities to increase the effective ad load on Stories,” Mr. Wehner said, in contrast to “the much more limited” potential in users’ Facebook and Instagram feeds.

An FTC settlement wouldn’t be the end of Facebook’s regulatory issues.

In the U.S., the company faces a lawsuit by the Department of Housing and Urban Development over alleged housing discrimination on its platform, which attacked basic features of the targeted digital advertising industry in the process.

In Europe, Facebook faces 10 different inquiries from its primary regulator, the Irish Data Protection Commission. And it faces growing international political pressure to take responsibility for content on its platform, with regulators in Australia and New Zealand going as far as proposing to threaten Facebook executives with personal fines of jail time if the company fails to adequately block illegal content.

Those efforts stemmed from the March 15 attack in which a white supremacist broadcast the murder of 50 people at two mosques in New Zealand on Facebook Live.

In response to a question from an analyst, Mr. Zuckerberg said he hoped to see regulators pursue a global framework around content moderation. But with few exceptions, “regulation isn’t global. It’s national,” he said, saying talks with regulators make him believe “we’ll see different countries make progress on different time frames.”

Facebook is also girding for another presidential campaign during which it will likely have to protect its own platform from foreign interference and protect its own reputation from the candidates. More than a year and a half before the next federal election, Sen. Elizabeth Warren (D., Mass.) has proposed breaking up many of tech’s biggest players, pledging to use antitrust laws to carve out Instagram and WhatsApp as separate entities from Facebook, a step she said would “improve the user experience and protect our privacy.”

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