

Price and Performance (Values in USD)	
Price	209.88
52 Week High	224.20
52 Week Low	137.10
YTD	2.3%
Average Daily Volume (mn)	19,409,956
Market Cap (mn)	597,970
Beta	0.94
EPS	6.48

Source: BiG Research; US

Facebook Inc	
Ticker BiGlobal Trade	FB
Ticker BiGTrader24	FB
Ticker BiG Power Trade	FB
P/E Ratio 2020E	28.07
P/BV Ratio	5.68
EV/EBITDA	5.81

Source: BiG Research;

Consensus	
Buy	45
Hold	5
Sell	3

Source: BiG Research;

Financial Information	
Sales (USD mn)	70,697
EBITDA (USD mn)	30,866
Nº of Employees	44,942
ROA	16.9%
ROE	21.9%
D/E	0.0%
Dividend Yield	-

Source: BiG Research;

**Notes:**

All quotes were updated in Bloomberg at 17h20 of May 6th, 2020.

**Relevant Information:**

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Francisco Fonseca

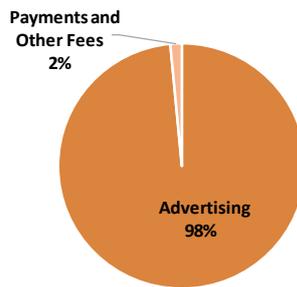
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**Facebook (Ticker: FB US)**

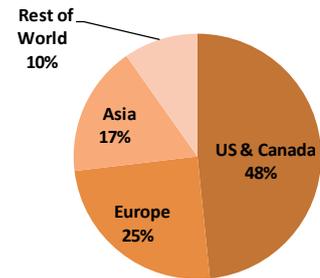
▲ **Description**

Facebook is much more than its namesake social network. **Facebook’s portfolio** of social networks also includes the photo and video sharing social network **Instagram** and the message app **WhatsApp**. This portfolio of social networks is market leader all over the world, apart from some countries where the apps are banned (such as China). More than 2 billion people use at least one of Facebook’s services every day, and around 2.6 bn use at least one of the services each month. In 2014 Facebook acquired the virtual reality company **Oculus VR** for USD 2.3 bn.

**Revenue per Segment (FY2019)**



**Revenue Per Geography (FY2019)**



Source: BiG Research

Note: Payments revenue is comprised of the net fee received from developers using Facebook’s Payments infrastructure. Other fees revenue consists of revenue from the delivery of consumer hardware devices and revenue from other sources.

▲ **Coronavirus Impact**

- **Engagement** – Community metrics, including **Facebook DAUs** (daily active users) and **MAUs** (monthly active users), reflect **increased engagement** as people around the world sheltered in place and used the company’s network to connect with each other. Yet, Facebook expects to lose at least some of this increased engagement when various social distancing restrictions are relaxed in the future.
- **Revenue** – The company experienced a **significant reduction** in the demand for **advertising**, over the last three weeks of the **first quarter of 2020**. Nevertheless, in **April** there were **signs of stability** where advertising revenue has been approximately flat compared to the same period a year ago. Due to the increasing uncertainty regarding the business outlook, Facebook **withdrew** the revenue **guidance** for the rest of the year.
- **Total expenses** – Facebook will implement **operational expense savings** in certain areas such as **travel, events, and marketing**. However, the company will continue to invest in product development and to recruit technical talent. As a result, this year total expenses are expected to come between USD 52-56 billion, down from the prior range of USD 54-59 billion (**5% reduction**). While this reflects a moderate reduction in the planned growth rate of total expenses, Facebook considered that their overall expense growth in the face of expected revenue weakness will have a negative impact on 2020 operating margins.
- **Capital expenditures** – In 2020, **capex** is expected to be approximately USD 14-16 bn, down from the prior range of USD 17-19 bn (**15% reduction**). Given the strong engagement growth and related demands on Facebook infrastructure, this year's capex reduction should be viewed as a **deferral into 2021** rather than savings.

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**Investment Thesis**

**Instagram:** Facebook (the social network) is reaching a mature stage, having expanded to all the markets that are available (i.e. that it is not blocked). Thus, the increase in the number of users of Facebook is expected to slow down. However, the social network Instagram is increasingly positioned to become the next growth vector of Facebook, being popular with the younger generations and successfully annihilating Snapchat. The current challenge of Facebook is to increase the monetization of Instagram, as the social network Facebook still accounts for most of the revenues generated. Facebook has recently introduced a shopping tab on Instagram, which could prove to be the steppingstone of Facebook in the e-commerce space.



**Oculus:** On the company's April earnings call, Zuckerberg said these products exceed expectations and that the company wishes it "could make more." It was also mentioned that Other Revenues segment grew 80% last quarter, driven primarily by sales of Oculus products. Facebook was the second largest seller of VR headsets last year with about 28% of shipments, trailing Sony Corp. Oculus is building a new version of its Quest standalone virtual reality headset, but the device is facing potential delays due to the impact of Covid-19 on product development and the global supply chain.

**Facebook Gaming App:** In order to diversify its portfolio and to explore the increasing demand within the streaming community, Facebook on April 20th will launch a new dedicated mobile gaming app. At first, it will only be available on Android devices, yet the company already has plans to release the app for iOS devices once Apple approves it. "Investing in gaming in general has become a priority for us because. We see gaming as a form of entertainment that really connects people" said Fidji Simo, head of the Facebook app. Despite Facebook's large user base — more than 2.6 bn people use Facebook every month — it still lags behind Twitch and YouTube when it comes to hours of gameplay watched. Twitch (Amazon) and YouTube (Alphabet) dominate the industry, with the first accounting for 61 % of the total hours watched in December 2019, and the latter with 28% of the market. Facebook comes in third place (6%), followed Microsoft's Mixer, which saw just under 3% of all hours spent watching livestreams.

**Jio Platforms partnership:** Facebook invested USD 5.7 bn for a 10% stake in **India's largest mobile telecom provider** (388 mi clients) - the largest transaction since WhatsApp acquisition (USD 19 bn) in 2014. Jio Platforms has also expanded into areas like digital currencies and education. The major push behind Jio's new partnership with Facebook, seems to be the company's planned launch of a nationwide **JioMart e-commerce platform**. Currently, Amazon and the Walmart-owned e-commerce firm Flipkart control over 60% of India's e-commerce market, yet these firms have been hit by recent regulations that favor domestic players like JioMart over foreign competitors. In December, Jio Platforms conducted a soft launch of JioMart in three neighborhoods near Mumbai, offering more than 50 thousand grocery products. The online retailer had plans to aggressively expand in the early months of 2020, which have likely been put on hold because of the country's lockdown amid the coronavirus pandemic. India is the largest market for the Facebook-owned WhatsApp, with over 400 million users as of July 2019, and the companies hope to use the platforms as a tool to connect small businesses with online retail.



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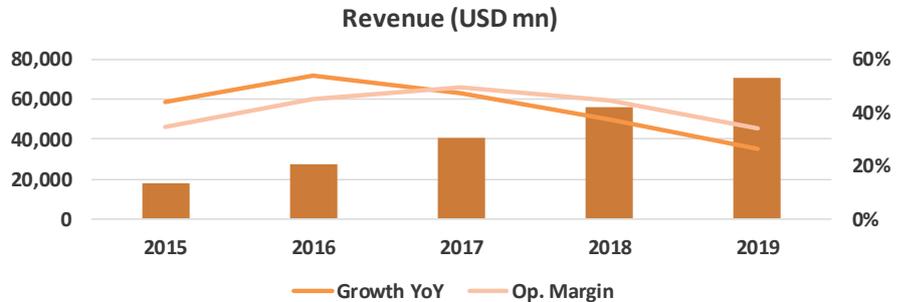
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Income Statement (USD mn)	2017	2018	2019
Revenues	40,653	55,838	70,697
Cost of revenues	5,454	9,355	12,770
Research and development	7,754	10,273	13,600
Marketing and Sales	4,725	7,846	9,876
General and administrative	2,517	3,451	10,465
Total costs and expenses	20,450	30,925	46,711
Operational income	20,203	24,913	23,986
Interest and other income (expense)	391	448	826
Provision for income taxes	4,660	3,249	6,327
Net income	15,920	22,111	16,833
EPS (basic)	5.49	7.65	6.48

Source: Company's data

## Income Statement

In 2019, revenue was USD 70.7 bn, up 27% y/y, and advertising revenue was USD 69.7 bn, up 27% y/y, as well. Excluding the USD 5 bn FTC settlement expense included within General and administrative expenses, total operating expenses were 58% of revenues (vs 55% in 2018). Officially, cost of revenue accounted for 18% of revenues (vs 17% in 2018), R&D 19% (vs 18%), Marketing 14% and G&A 15% (vs 5%). Thus, Net Income margin decreased to 26% (vs 40% in 2018) and EPS decreased -15% y/y to USD 6.48.



Source: BiG Research; Company's data

Free Cash Flow (USD mn)	2017	2018	2019
Operational Cash Flow	24,216	29,274	36,314
Net Income	15,920	22,111	18,485
D&A	3,025	4,315	5,741
Changes in WC	- 1,354	- 787	7,250
Others	6,625	3,635	4,838
Investment Cash Flow	- 20,118	- 11,603	- 19,864
Change in Fixed & Int. Assets	- 6,733	- 13,915	- 15,102
Change from Acq. & Div.	- 122	- 137	- 508
Other	- 13,263	2,449	- 4,254
Financial Cash Flow	- 5,235	- 15,572	- 7,309
Share buyback	- 1,976	- 12,879	- 4,202
Other Financing Activities	- 3,259	- 2,693	- 3,097
Effect of FX	232	- 179	4
Change in free cash flow	- 905	1,920	9,141
Total cash & cash equivalents	8,204	10,124	19,265

Source: Company's data

## Free Cash Flow

Last year, the company was able to generate an operational cash flow of USD 36 bn, which represents a 24% growth y/y. It is also important to note that the operating cash flows generated are always enough to cover both capex and share buyback – signals a strong capacity of generating operational cash flows that sustain both investing and financial activities.

- Capital expenditures are allocated to data centers, servers, office buildings, and network infrastructure. Due to the covid-19 impact, in 2020, **capital expenditures** budget will be **reduced 15%** (vs initially expected) to approximately USD 15 bn. This year's capex reduction should be viewed as a deferral into 2021 rather than savings, due to the company's strong engagement growth.
- Facebook pays **no dividend**.
- In January 2020, an additional USD 10 bn of repurchases was authorized, and now the company has USD 15 bn available under its program (no maturity).

Balance Sheet (USD mn)	2018	2019	1Q20
Cash & Equivalents	10,019	19,079	23,618
Marketable securities	31,095	35,776	36,671
Accounts Receivables	7,587	9,518	7,289
Operating Leases	-	9,460	9,359
Property and equipment, net	24,683	35,323	37,127
Intangible assets, net	1,294	894	838
Goodwill	18,301	18,715	18,811
Other Assets	4,355	4,611	4,658
Total Assets	97,334	133,376	138,371
Accounts payable	820	1,363	829
Partners Payable	541	886	712
Accrued expenses	5,509	11,735	12,446
Operating Leases	-	10,324	10,344
Other Liabilities	6,337	8,014	8,736
Total Liabilities	13,207	32,322	33,067
Total Equity	84,127	101,054	105,304
Equity + Liabilities	97,334	133,376	138,371

Source: Company's data

## Balance Sheet

- Since 2018, total assets increased by around 40% for two main reasons. On one hand, since 2019 the operating leases started to be included on the balance sheet due to the IFRS16 accounting implementation. In addition, as mentioned before property and equipment also increased due to the strong investment data centers, servers, etc.
- As of the last filling (March 31<sup>st</sup>), Facebook had **USD 60.3 bn** available in **cash and cash equivalents**, and **no debt**.

## Last Earnings (1Q20):

- **Revenues: +18%** y/y to USD 17.7 bn (vs est. USD 17.3 bn); Advertising accounted for 98% of revenues
- **Operating Income: +78%** y/y to USD 5.9 bn, which can be translated to an operating margin of 33% (vs 22% 1Q19).
- **Net Income: USD 4.9 bn**, and thus Eps were USD 1.71 (vs est. USD 1.74)
- **Community Metrics: DAU** increased 11% to 1.73 bn and MAU 10% to 2.6 bn
- **Capex:** similar to the previous quarters – USD 3.7 bn -, however
- **Operational CF: +18%** y/y to USD 11 bn.
- **Investment in Jio Platforms Limited**, a subsidiary of Reliance Industries Limited, for approximately **USD 5.7 bn**

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## Management Team

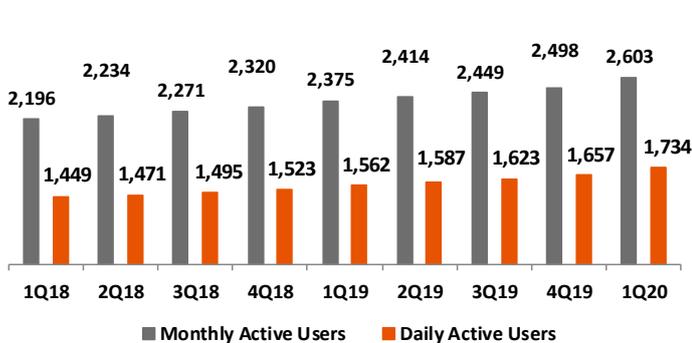
- Facebook's **CEO** and chairman is Mark Zuckerberg, which founded the company in 2004, along with 4 friends. Facebook has a dual class share structure – class A, with one vote per share, and class B, with 10 voting rights per share. Mark Zuckerberg owns 88.8% of class B shares, which represent 59.9% of the total voting power.
- In order to self-regulate his decisions, Facebook created the **Oversight Board**, which include 20 lawyers, former politicians, human rights advocates and journalists. Their function is to hear user appeals on content decisions and make binding judgment calls that could go against earlier decisions made by the company. The board will focus on cases from Facebook and Instagram that affect a large number of people or involve a particularly thorny area of Facebook's policy, so that one decision has a higher impact (all decisions will be made public). The board said it won't be addressing problems on WhatsApp, since that app is encrypted so board members can't see what users are saying. The board decisions will be binding and will not be overturned by Facebook, unless they violate the law. The board is funded by a USD 130 mn irrevocable trust, paid for by Facebook, but the company cannot fire any of the board members.

## Main Segments

### Advertising:

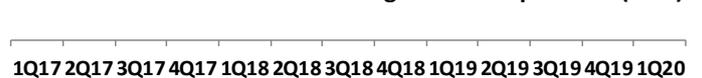
- The company generates substantially **all revenue** from advertising, and is generated by **displaying ad** products on **Facebook, Instagram, Messenger**, and third-party affiliated **websites or mobile applications**.
- Marketers pay for ad products either directly or through their relationships with advertising agencies or resellers, based on the number of impressions delivered or the number of actions (ex. clicks).
- Facebook recognizes revenue from the display of impression-based ads in the contracted period in which the impressions are delivered - displayed to a user.
- The price per ad is calculated as total ad revenue divided by the number of ads delivered, representing the effective price paid per impression by a marketer regardless of their desired objective such as impression or action.
- **Advertising spending** is traditionally **seasonally strong in the fourth quarter** of each year, which generally reflects **significant growth** in advertising revenue **between the 3Q and 4Q** vs decline in advertising spending between the fourth and subsequent first quarters. For instance, advertising revenue increased 19% and 23%, between 3Q and 4Q of 2019 and 2018, respectively, while advertising revenue for both 1Q of 2019 and 2018 declined 10% and 8% compared to the 4Q of 2018 and 2017, respectively.

Facebook's Active Users (mn)



Source: Company's Data; BiG Research

Facebook's Average Revenue per User (USD)



Source: Company's Data; BiG Research

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**Other revenue:** consists mainly of revenue generated from the delivery of consumer hardware devices and net fees Facebook receives from developers using their payments infrastructure

## Relative Valuation

Name	Market Cap	P/E 5 Yr. Average	P/E 2020E	P/E 2021E	P/BV	YTD	ROE	ROA	Div. Liq./ EBITDA	EBIT Margin
TWITTER INC	21,856	160.0	87.6	43.1	2.5	-13%	16%	10%	-4.1	7.6
ALPHABET INC-CLA	931,744	29.9	26.9	21.0	4.6	2%	18%	13%	-2.0	21.4
WEIBO CORP-SPON ADR	8,191	81.5	16.1	13.4	3.6	-22%	25%	12%	-1.1	33.8
FACEBOOK INC-CLASS A	597,970	54.5	28.1	21.4	5.7	2%	22%	17%	-1.5	36.2
Average exc. Facebook		90.5	43.5	25.8	3.5	-11%	19%	12%	-2.4	20.9

Source: Bloomberg; BiG Research

Facebook currently trades below P/E average multiples, both on a historical and current basis in comparison to its peers, notwithstanding the leadership position it has on the market. The company has a return on equity and assets above most peers (excluding Weibo) and an EBIT margin of 36%, well above the values reported by the peers.

## Risks

**Regulation:** The Russian meddling in 2016’s election and the Cambridge Analytica brought to attention the lack of regulation in which companies such as Facebook and Alphabet operate. Regulators have increased their scrutiny of these companies and the headcount of Facebook has ballooned to avoid replicas of the 2016 elections in the ones that followed (it has been relatively successful). While a more regulatory adverse environment is a risk for Facebook, we see the higher dimension (and profitability) of the social network as an advantage to face this risk (vs. smaller competitors like Snapchat).

**Data Privacy Concerns:** Facebook’s value is in the data analytics that its users provide. Each post, like and photo shared allows the company to gather information and profile the user. That data is then of great value to advertisers, which have their ads targeted to the right consumers. While the data collected by Facebook should only be provided to outside companies as analytics, providing privacy to the users, there have been circumstances where that privacy has not been upheld, which hurts the company reputation with its users, decreasing their engagement and consequently Facebook’s ability to profile its users and increase ad revenues.

**Federal Trade Commission Settlement:** In 2012, the FTC charged Facebook with eight separate privacy-related violations, including that the company made deceptive claims about consumers’ ability to control the privacy of their personal data. One specific count alleged that Facebook allowed users to choose settings that supposedly limited access to their information just to “friends” without adequate disclosures that another setting allowed that same information to be shared with the developers of apps those friends used. To settle that case, Facebook must implement a stringent program to monitor third-party developers and terminate access to any developer that doesn’t follow the rules. In addition, Facebook can’t use for advertising purposes the phone numbers it obtained specifically for security. When it comes to facial recognition technology, the order requires Facebook to give clear notice of how it uses that information and it must get consumers’ express consent before putting that data to a materially different use. Facebook also will have to encrypt passwords and can’t ask people for their passwords to other services and must report any privacy incident to the FTC within 30 days. Finally, in 2019, FTC imposed a USD 5 bn penalty - the largest ever regarding consumers’ privacy.

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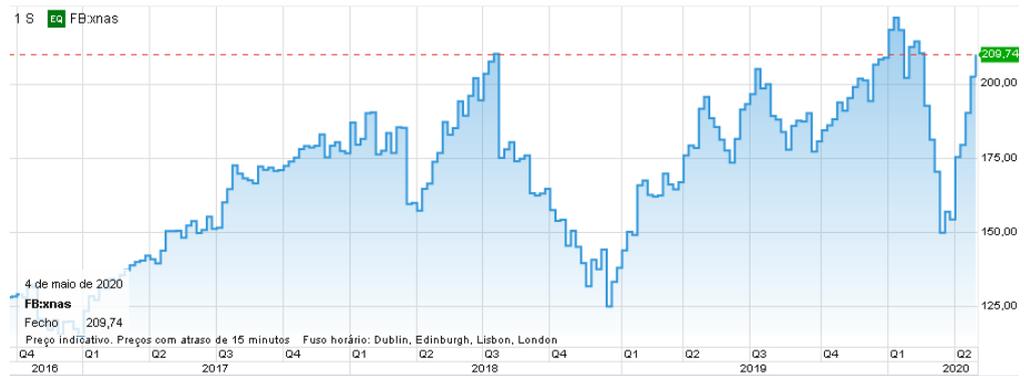
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**Social Changes:** Facebook’s operations are reliant on the users’ engagement with the social networks and messaging apps it holds. While social networks have facilitated people’s connections, there are some negative factors, such as emotional and productivity issues. These issues can lead to social changes that reduce user engagement with social networks.

## ▲ Graph



Source: BiGGlobalTrade; BiG Research

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