

Facebook, Inc. (FB)

Updated July 31st, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$252	5 Year CAGR Estimate:	3.9%	Market Cap:	\$724 B
Fair Value Price:	\$198	5 Year Growth Estimate:	9.0%	Ex-Dividend Date:	N/A
% Fair Value:	127%	5 Year Valuation Multiple Estimate:	-4.7%	Dividend Payment Date:	N/A
Dividend Yield:	0.0%	5 Year Price Target	\$305	Years Of Dividend Growth:	N/A
Dividend Risk Score:	N/A	Retirement Suitability Score:	N/A	Last Dividend Increase:	N/A

Overview & Current Events

Founded in 2004 by Mark Zuckerberg and fellow students at Harvard University, today Facebook operates as the world's leading social network through its namesake website. At the end of Q2 2020 the site had 1.79 billion active daily users and 2.70 billion active monthly users. The company's "family" of offerings also includes Instagram, WhatsApp and Messenger, with Facebook estimating that 3.14 billion people use at least one of their services. The Menlo Park, CA headquartered firm has a market cap of \$724 billion and employs over 52,000 people.

On July 30th, 2020 Facebook released Q2 2020 results for the period ending June 30th, 2020. For the quarter total revenue came in at \$18.69 billion, a 10.7% increase compared to the \$16.89 billion posted in Q2 2019. Net income totaled \$5.18 billion (\$1.80 per share), compared to \$2.62 billion (\$0.91 per share) in the prior year quarter. However, Q2 2019 results were skewed by special legal and tax items.

Cash, equivalents and marketable securities totaled \$58.24 billion (down from \$60.29 billion last quarter), as Facebook paid \$5.8 billion for its investment in Jio Platforms.

Facebook also provided an update related to the COVID-19 pandemic and business expectations. The company anticipates flat or slightly down daily and monthly active users as restrictions around the world ease. Revenue was growing at approximately 10% in the first three weeks of July, and this trend is expected to continue for the quarter. Total expenses are expected to be \$52 billion to \$55 billion, with \$16 billion in capital expenditures.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	---	---	\$0.02	\$0.60	\$1.10	\$1.29	\$3.49	\$6.16	\$7.57	\$8.56	\$7.50	\$13.85
DPS	---	---	---	---	---	---	---	---	---	---	---	---
Shares¹	---	---	2,372	2,547	2,797	2,845	2,892	2,906	2,854	2,876	2,880	2,880

Since the company's IPO, Facebook has put together a tremendous record – becoming one of the world's most profitable firms. This terrific record has been great for past investors, but it does become harder and harder to grow as the company builds off a larger and larger base. Still, Facebook's powerful network effect gets stronger over time, providing a stickier platform for customers and advertisers alike. In addition, the general trend toward online advertising is a long-term tailwind. Moreover, Facebook's substantial balance sheet strength allows the company to acquire new, faster growing firms or repurchase shares down the line to enhance growth.

That being said, while the current COVID-19 pandemic has increased user engagement around the world, advertising revenue is being pressured as demand declines across nearly all industries. As a result, we are expecting a down year for 2020 earnings. For valuation purposes we are using \$9 in underlying earnings power and a 9% growth rate.

Risks to this thesis include the possibility of new technology being introduced (despite Facebook's lead, the industry is finicky), data security, privacy concerns and the current crisis as it relates to advertiser demand. Still, we believe Facebook is more than able to tackle these challenges head on.

¹ In millions.

Disclosure: This analyst has no position in the security discussed in this research report and no plans to initiate one in the next 72 hours

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	---	---	---	59.2	62.7	68.6	33.5	25.3	22.6	21.3	28.0	22.0
Avg. Yld.	---	---	---	---	---	---	---	---	---	---	---	---

Facebook's terrific but short trading history does not lend itself to "fair" earnings multiple. We have assigned a P/E of 22 as a reasonable baseline, taking into consideration two items. First, the continued above average growth rate deserves a premium valuation. Second, the company's cash and security hoard – sitting at ~\$20 per share against total liabilities of ~\$10 per share – deserves premium consideration as well. This position provides excellent flexibility for Facebook to either acquire firms down the line or start repurchasing meaningful amounts of stock; both of which can aid future growth. Shares are currently trading at 28 times estimated earnings power, implying a potential valuation headwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	---	---	---	---	---	---	---	---	---	---	---

As the world's leading social media website, Facebook has a tremendous competitive advantage with its massive user base along with all of the data that is collected that can be used to effectively advertise. Moreover, this advantage grows over time as the network effect creates both a barrier to entry for would-be competitors and a stickier relationship for users thinking about alternatives. The time spent on both the company's website and app demonstrate these points.

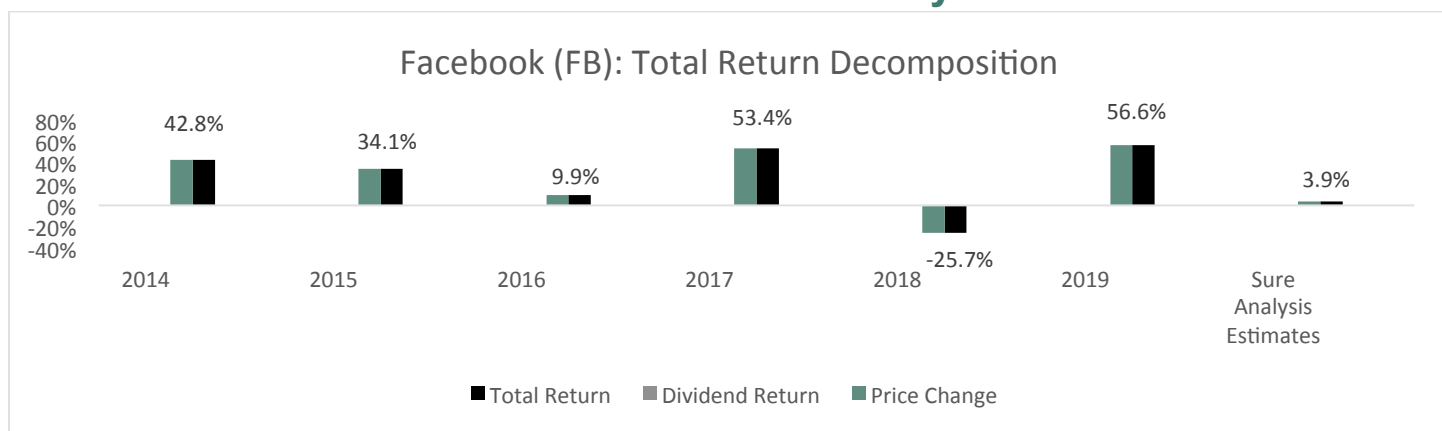
In addition, Facebook has a fortress balance sheet. As of the most recent report the company held \$58.2 billion in cash and securities, \$68.1 billion in current assets and \$139.7 billion in total assets against \$11.3 billion in current liabilities and \$29.2 billion in total liabilities, including no long-term debt. The company's net cash and security position alone, ignoring \$80+ billion in property, goodwill and other assets, outweighs all liabilities by ~\$29 billion.

While Facebook is not guaranteed to dominate the space in the decades to come, we believe this financial flexibility will at the very least allow the company to participate via buying its way into the growth avenues of the future.

Final Thoughts & Recommendation

Shares are up 25% since our last report. Facebook has put together a terrific record and it doesn't appear to be over quite yet, despite the ongoing COVID-19 pandemic. The network effect is strong and the company's balance sheet adds an additional layer of comfort with the business. We are forecasting returns of 3.9% per annum over the intermediate term as 9% annual growth could see a moderate valuation headwind. We are reiterating our hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	---	3711	5089	7872	12466	17928	27638	40653	55838	70697
Gross Profit	---	2851	3725	5997	10313	15061	23849	35199	46483	57927
Gross Margin	---	76.8%	73.2%	76.2%	82.7%	84.0%	86.3%	86.6%	83.2%	81.9%
SG&A Exp.	---	707	1788	1778	2653	4020	5503	7242	11297	20341
D&A Exp.	---	323	649	1011	1243	1945	2342	3025	4315	5741
Operating Profit	---	1756	538	2804	4994	6225	12427	20203	24913	23986
Operating Margin	---	47.3%	10.6%	35.6%	40.1%	34.7%	45.0%	49.7%	44.6%	33.9%
Net Profit	---	1000	53	1500	2940	3688	10217	15934	22112	18485
Net Margin	---	26.9%	1.0%	19.1%	23.6%	20.6%	37.0%	39.2%	39.6%	26.1%
Free Cash Flow	---	943	377	2860	5495	7797	11617	17483	15359	21212
Income Tax	---	695	441	1254	1970	2506	2301	4660	3249	6327

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	---	6331	15103	17895	39966	49407	64961	84524	97334	133376
Cash & Equivalents	---	1512	2384	3323	4315	4907	8903	8079	10019	19079
Accounts Receivable	---	547	719	1109	1678	2559	3993	5832	7587	9518
Goodwill & Int. Ass.	---	162	1388	1722	21910	21272	20657	20105	19595	---
Total Liabilities	---	1432	3348	2425	3870	5189	5767	10177	13207	19609
Accounts Payable	---	63	65	87	176	196	302	380	820	32322
Long-Term Debt	---	0	1500	0	0	201	0	340	991	1363
Shareholder's Equity	---	4284	11755	15470	36096	44218	59194	74347	84127	901
D/E Ratio	---	0.00	0.13	0.00	0.00	0.00	0.00	0.00	0.01	0.01

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	---	21.5%	0.5%	9.1%	10.2%	8.3%	17.9%	21.3%	24.3%	16.0%
Return on Equity	---	34.3%	0.7%	11.0%	11.4%	9.2%	19.8%	23.9%	27.9%	20.0%
ROIC	---	27.4%	0.6%	10.4%	11.4%	9.2%	19.7%	23.8%	27.7%	19.8%
Shares Out.	---	---	2,372	2,547	2,797	2,845	2,892	2,906	2,854	2,876
Revenue/Share	---	2.46	2.35	3.13	4.68	6.28	9.45	13.75	19.12	24.58
FCF/Share	---	0.63	0.17	1.14	2.06	2.73	3.97	5.91	5.26	7.38

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

Disclaimer

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