

Facebook, Inc.

2020 Q2 Earnings Forecast

Industry: Software **1Q20 Diluted EPS:** \$1.71 **Research Analyst:** Kyle Smith
Ticker: FB **2Q20E Diluted EPS:** \$1.45 **Mkt Cap:** \$700bn

The image shows the Facebook logo, which consists of the word "facebook" in a white, lowercase, sans-serif font centered on a dark blue rectangular background.

Company Overview

Description: Founded in 2004 by Mark Zuckerberg and classmates Eduardo Saverin, Andrew McCollum, Dustin Moskovitz, and Chris Hughes, Facebook, Inc. (FB) is a social media giant that offers products and services such as Facebook Messenger and Facebook Watch, in addition to its main offering, the Facebook platform. In addition, the company has acquired several other platforms including Instagram and Oculus.

COMPANY STATS

Founded: 2004
Market Cap: \$700bn
Revenue: \$70.7bn
Mkt Share: 74%

Business Model: Facebook's business model relies on advertising, which represented 98.3% of its total revenue for the three months ended March 31, 2020. Facebook provides financial data for different regions, which is helpful for understanding market changes based on geographic trends.

Market position: As of June 2020, Facebook is a global leader, owning 74% market share, according to statcounter. Its top competitor Pinterest holds the second largest share at only 12%. Facebook's strategic moves and acquisitions in a variety of markets have kept its global dominance relatively steady.

Major Shareholders: Although Zuckerberg himself is the largest shareholder (400+ million shares) of Facebook, the Vanguard Group holds approximately 184 million shares, BlackRock holds approx. 158 million shares, FMR holds 124 million shares, and T. Rowe Price Associates holds 108 million shares.

Forecast: For the purposes of this high-level forecast, the primary drivers that will be examined are COVID-19, Monthly Active Users (MAUs), and Average Revenue Per User (ARPU). In addition, other considerations will be provided for advertising boycotts, R&D changes, the partnership with Jio, the effective tax rate, and stock buybacks.

Primary Analysis

COVID-19: The effects of the coronavirus on a software company like Facebook are difficult to pinpoint. Due to stay-at-home orders around the globe, one would expect MAUs to spike like they did in Q1. On the other hand, with businesses unable to operate normally, the demand for advertising can be expected to decrease, resulting in a lower ARPU. While this inverse relationship revealed itself in Q1, it's hard to say whether Q2 will feel a similar impact. Further, the paths to returning to normal for each geographic region are not the same. As such, one can expect different MAU and ARPU changes around the globe. Because of this uncertainty, Facebook is not providing specific revenue guidance both for Q2 and full-year 2020. However, the first three weeks of April showed ad revenue being "approximately flat" compared to the same period in 2019.

MAUs: The changes forecasted for MAU growth in the four geographic regions (U.S. and Canada; Europe; Asia Pacific; and Rest of World) are all slightly different due to the various factors in play. In the U.S. and Canada region, a slower pandemic response has created a delayed reopening plan, particularly for the entertainment sector. As such, one could expect a slight increase in MAU growth YoY. In Europe, a swifter response has led to quicker reopening plans, thus the YoY MAU growth is expected to decline slightly. In Asia, a change in YoY MAU growth similar to Europe is offset by the investment in Jio (explained below). Lastly, the YoY MAU growth for the rest of world region is kept as an average due to the various differences in individual reopening plans.

ARPU: Similar to the MAU forecasts, the changes estimated for ARPU growth in the four geographic regions (U.S. and Canada; Europe; Asia Pacific; and Rest of World) are all unique. In the U.S. and Canada region, a slower pandemic response, an increase in political divisiveness and boycotts, and a decrease in advertising demand contribute to a negative growth rate for short term ARPU expectations. Europe and the rest of world regions are no exception, although the forecasts for these two regions are slightly less extreme since the current political boycotts will have virtually no effect in these regions. Lastly, the Asia Pacific region represents the most optimistic outlook due to the investment in Jio, the quicker reopening plans in countries like China and the Philippines, and the macro outlook of Facebook's aggressive push into the region.

Other Considerations

Advertising Boycotts: In response to a campaign to boycott Facebook due to a lack of action to prevent hate speech, several high-profile companies announced their intentions to pause or greatly reduce all advertising on the platform. This list includes:

Starbucks Corp (SBUX)
Unilever (ULVR)
Adidas AG (ADSG)
Walt Disney Co (DIS)
Coca-Cola Co (KO)
Merck & Co (MRK)
Target Corp (TGT)
Ford Motor Co (F)
HP Inc (HPQ)
Lululemon Athletica Inc (LULU)
Levi Strauss & Co (LEVI)
Beiersdorf AG (BEIG)
Chipotle Mexican Grill Inc (CMG)
Diageo Plc (DGE)
Clorox Co (CLX)
Verizon Communications Inc (VZ)
The North Face (VFC)
Ben & Jerry's
Magnolia Pictures
Patagonia

Although it remains to be seen whether smaller companies will follow suit, the ARPU estimates for the U.S. and Canada region have been reduced to incorporate this notable trend.

Research and Development: In the Q1 investor call, members of the Facebook management team stressed that the company would continue to invest in a variety of different areas, including but not limited to the core product, AR/VR, and capital expenditures. Despite the economic hardships, the model shows a continuation of this trend.

Jio Investment: On April 21st of 2020, Facebook announced that they were investing \$5.7 billion in Jio Platforms Unlimited, a popular digital services company in India. Together with Jio, Facebook intends to play a crucial role in the transformation of the country as it progresses both physically and digitally. This investment represents a catalyst for the Asia Pacific region.

Effective Tax Rate: The effective tax rate is set at 18%, primarily based off of the Q1 earnings call in which management stated that it would “be in the high-teens.” It is important to note that this number could shift dramatically in 2021 based on the results of the presidential election.

Buybacks: For the purposes of this model, a rolling average is used to estimate share count analysis. The average repurchase price is set at an increasing rate that is consistent with historical data.

Conclusion

Facebook is a long-term-oriented company. A swift drop due to COVID-19 left the stock trading at \$65 lower than its position in mid-February. However, a relatively positive Q1 earnings report, the positive externalities of stay-at-home orders, and the increase in traders on free platforms such as Robinhood, have taken Facebook to an all time high. Although Facebook will need to weather the storm in the near future to combat the losses in revenue due to recessionary macro trends, boycotts, and other measures, the company is positioning itself to remain a global titan in the software industry.

Sources

Balu, Nivedita. "Factbox: More Companies Join Facebook Ad Boycott Bandwagon." *Reuters*, Thomson Reuters, 20 July 2020.

Fischer, David, and Ajit Mohan. "Facebook Invests \$5.7 Billion in India's Jio Platforms." *About Facebook*, 25 Apr. 2020.

Transcribers, Motley Fool. "Facebook Inc (FB) Q1 2020 Earnings Call Transcript." *The Motley Fool*, The Motley Fool, 30 Apr. 2020.