Facebook, Inc.

Q2 2020 Earnings Preview Report

Overview:

Facebook (NASDAQ: FB) is scheduled to release earnings for Q2 of 2020 on July 29th at 2:00 PST. Previously, Facebook had reported mixed results for Q1 of 2020. While revenue ($17.7 B) beat consensus estimates by 1.7% or $300 million, EPS ($1.71) missed consensus estimates by $.04. However, Facebook did see substantial growth in Monthly Active Users (MAUs) due to COVID-19 lockdowns across the globe for Q1. Going forward, consensus estimates expect revenue to fall to $17.2 billion and EPS to fall to $1.37 for Q2 of 2020 from the deteriorating macro-economic conditions cause by the pandemic.

Profile:

Facebook, Inc is social media and social networking service that is based in Menlo Park, California, USA. It generates substantially all of its revenue through selling advertising placements to marketers. The company's products include Facebook, Instagram, Messenger, WhatsApp, and Oculus. Facebook generated approximately $70.6 billion in revenue for 2019.

Management Guidance:

Facebook management has not provided specific revenue guidance for the Q2 of 2020 or 2020 due to the increasing uncertainty in their economic outlook. However, they have given specific guidance on the following…

- Total expenses will be between $52-56 billion for 2020
- Tax rate is projected to be in the high teens for 2020

Outlook:

I am bearish on Facebook. However, my model suggests a more neutral outlook on revenue for Q2 of 2020. I am projecting revenue of $17.0 billion and EPS of $1.17 which is slightly below consensus estimates of revenue of $17.2 billion and EPS of $1.37. Looking forward, I am forecasting revenue of $74.7 billion and EPS of $5.87 for 2020 which is once again below consensus estimates of $77.1 billion for revenue and $7.27 for EPS. My key model assumptions are discussed below.

Monthly Active Users (MAUs)

I expect that Facebook will continue to see strong growth in MAUs for 2020 due to COVID-19. Even with the reopening of most countries, I expect that we will continue to see sporadic lockdowns across the globe, continued border closures, and more people staying at home, which will increase the demand and MAUs for Facebook's products. As a result, I have projected similar growth rates in MAUs from Q1 of 2020 for the rest of the year. In 2021, as a vaccine is hopefully ready for mass distribution, I am projecting growth rates of MAUs to return to 2019 levels. However, I assume that the extreme growth experienced in the Asian Pacific region before the pandemic will begin to slow and normalizing around 8% in 2021. In addition, I have projected growth rates in the Rest of World region to remain constant with Facebook's partnership with Jio in 2021.

Average Revenue Per User (ARPU)

I am projecting reduced or flat growth in most quarters in 2020 for ARPU as the economic outlook is uncertain around the globe. I suspect that many companies will significantly reduce their marketing budget during this time to hoard cash which will decrease the revenue from Facebook's advertisement auctions as there will be less bidders. In 2021, I am expecting an uptick in ARPU growth from 2020 levels as companies begin expanding their marketing presence with less uncertainty in the economy as a vaccine is readily available. However, I am expecting more sluggish growth than usual when compared to a more normalized period like 2019. I do see one bright spot for ARPU growth in the Rest of World region due to Facebook's partnership with Indian telecommunications company Jio.

Operating Expenses

I expect Facebook's operating expenses to be around $55.2 billion for 2020 which is near the higher side of management's guidance of $52-56 billion. While I have projected most of the expenses to be similar to historical figures, I expect G&A expenses to increase significantly as a percent of revenue. This is due to an increase in COVID-19 related costs and a substantial increase to Facebook's bad debt expense as they are unable to collect accounts receivables from insolvent customers. Looking forward into 2021, I expect operating expenses to decrease as a percentage of revenue when compared with 2020 levels as the economy improves and COVID-19 related costs decrease. Mark Zuckerberg

Risks:

COVID-19

I suspect that if a vaccine is not readily available by Q1 of 2021, companies will continue to hoard cash and decrease their marketing budgets which will decrease ARPU growth in 2021 from my model. I would also assume that Facebook would continue to see abnormal growth in MAUs as people continue to stay indoors if there is no cure for COVID-19. It is also possible that small and medium businesses who make up a substantial portion of Facebook's ad revenue will be unable to weather the economic fallout from COVID-19 which could be another potential catalyst for reduced ARPU growth in future periods.

Political Boycotts

Facebook seems to be caught in the crosshairs of political boycotts at the moment as many national companies have suspended purchasing advertisements on their social media platforms, due to their concerns of hate speech and misinformation being spread on them. These national brands include Unilever, Verizon, and Starbucks. I do not expect these national brands to largely effect Facebook's revenue as the top 100 advertisers on the platform only make up about $6.4 billion of revenue. However, if these boycotts spread to small and medium sized businesses which account for 76% of all ad spending on Facebook according to Deutsche Bank, ARPU could fall significantly from my projections. In addition, individual Facebook users could follow suit and boycott Facebook's social media platforms slowing or decreasing growth in MAUs.

Regulation

In 2019, Facebook received a $5.0 billion fine from the Federal Trade Commission (FTC) which is the largest penalty ever imposed on a company for violating consumers' privacy rights. It is possible that Facebook continues to face regulatory scrutiny in the future as politicians argue that "Big Tech" (Alphabet, Facebook, Apple, Microsoft, etc.) has become too powerful and continues to violate consumers' privacy rights. This could result in continued monetary penalties for Facebook which would increase operating expenses in future periods from my projections. It is also possible that the government requires Facebook to spinoff some of their core products as they argue Facebook has become too powerful which could substantially reduce revenue in future periods. However, I believe that would require the Democrats to take political power from Republicans in the federal government and a potential larger catalyst.