

Facebook, Inc (FB)

Long Term: 6-12 Months *Bullish*

\$242.89 (As of 07/20/20)

Short Term: 1-3 Months *Bearish*

2Q2020 Revenue & EPS Forecast:

\$17.2B and \$1.46

12-Month Revenue and EPS Forecast:

\$77.4B and \$7.45

Summary

Facebook, like most companies, is being affected by COVID-19 in a significant way. However, there are additional catalysts that will influence Facebook's performance for the remainder of fiscal year 2020. While the current state of the world is influencing consumer behavior in the short term, there is a multitude of factors to consider when looking beyond this most recent quarter. In North America, Facebook is dealing with ongoing criticism from the public as well as US legislators. Facebook's financial performance is reliant on both public perception of its platforms and advertiser's willingness and ability to spend. On the other side of the world, Facebook has been unable to access China's consumer base due to governmental regulations. The rest of the world strategy appears to be dependent on integrating its existing platforms with acquired ones that have an existing presence in these difficult to reach markets.

In the coming months and years, there is much to be anticipated. The 2020 US election could surely increase Facebook's usership in the United States. Additionally, the addition of Jio to its portfolio could lead Facebook to become a dominant player within India.

Revenue and EPS Drivers

Interest and Other Income (Expense)

- Second Quarter 2020 estimate – increase in net loss by 10%
 - Write-downs of AFS debt securities likely increased in Q2
 - Offset by more favorable interest rates on any variable or floating rate debt
 - Non-operating costs related to COVID-19 likely increased beyond the costs recognized in Q1 as much of the Q1 effects were only incurred in March
- Future Estimates –
 - 3Q2020 to 1Q2021 – slow recovery due to decreased COVID-19 related expenses and recovery of AFS debt investments
 - COVID-19 related expenses will still be incurred due to the costs of employees returning to the office.
 - 2Q2021 and beyond – return to revenues over costs in line with half of FY19's reported numbers

Monthly Active Users (MAUs)

- Overall –
 - 2Q2020 to 4Q2020 – Overall increase in the number of monthly active users. This is due to the likelihood that many people will remain at home, either unemployed or working from home. However, the growth rate of MAU is not as high as some may predict as much of the world is returning to work and seeing its economies recovering. MAU growth will likely return to a more sustainable figure beginning in 2021.
 - Facebook recently announced the rolling out of Instagram Reels. This appears to be a similar product to what the viral app TikTok has to offer. While TikTok's future within the US is uncertain, after coming under fire by the Trump administration, it surely has caught the attention of young consumers, posing a threat to Instagram. Time will tell if Reels helps Instagram recover some of its lost users just as the addition of Stories did with Snap.
- US and Canada
 - US and Canada will likely see the greatest growth rate in MAU due to being severely impacted by COVID-19. Many employers are not exploring the idea of returning to the office until 2021. Additionally, the election in November 2020 will likely increase the use of social media like Facebook and Instagram.
- Asia Pacific
 - The recent developments within Hong Kong have the potential to hurt Facebook's reach in the Asian region. As the use of the platform is prohibited in China, many access it in Hong Kong. Since mainland China has begun tightening restrictions on Hong Kong, there may be an accelerated decrease in the growth rates seen within the Asian market.
- Rest of World
 - The addition of the partnership With Jio Platforms will likely ripen in FY 21. Facebook's CEO noted that this partnership will strengthen FB's reach into the Indian market. I believe it will take time to implement Jio's vision and for Facebook to see a return on its investment. This partnership may assist in the slowing growth in MAU over the last few years for this region.
 - On a recent call, Facebook CEO emphasized the importance of Jio's vision. The two companies are attempting to align their long-term goals in a way that benefits both parties. Announced on July 15th, Google has also taken a stake in Jio Platforms. This could prove to be troubling for Facebook's utilization of its investment in Jio.

Average Revenue Per User (ARPU)

- Overall –
 - As discussed previously, the effects of COVID-19 on the world are disproportionate. European countries have returned to a somewhat sense of normalcy in the past month, while the United States economy continues to suffer due to continued increases in cases. Though Europe has seen some recovery, much of the damage for the second quarter has been done. In addition to pressure from COVID-19, Coca-Cola, Starbucks, and Verizon have announced they are freezing all advertising on Facebook. This will undoubtedly hurt Facebook's revenues this quarter but will be significantly realized in the coming quarters.
- US and Canada
 - The wide shut down of United States' brick and mortar businesses will likely damage Facebook's US and Canada average revenue per user. However, the surge in e-commerce and the advertising spend that comes with it could make up for some of this decline. Additionally, Instagram has rolled out its in-app purchasing feature. As users become more familiar and trusting of the feature, the average revenue per user will continue to climb. While Facebook has several reasons to show increased revenues, there is the withdrawal of several large advertisers to consider. Coca-Cola spends nearly 20% of its advertising spend within the US alone. This hold out could cost Facebook in the coming quarters. Lastly, there is much speculation as to if Facebook will ban political campaign advertising on its platforms. With tremendous pressure on their top line, I believe that they will not completely ban such advertising. This could prove to increase their revenues in the fourth quarter.

Gross Margin

- Gross margin will likely stay fairly flat as Facebook has done extensive investing in its data center infrastructure, thus having better control over costs.

R&D Expense

- Since 2016, Facebook's R&D expense has had a year over year quarterly growth of a range between 19% to 46%. As mentioned in a recent call with the CEO, much of the expense is related to investments in AR/VR. While I believe that Facebook will continue to spend more and more on R&D, particularly on its most recent acquisition of Jio, I believe that it will curtail much of this spending until 2021. As a percent of revenue, Facebook's first-quarter spending was the highest recognized in years. I believe the company will delay some of its spending until the company's performance is more determinable.