

# Facebook, Inc. Earnings Model 2Q2020

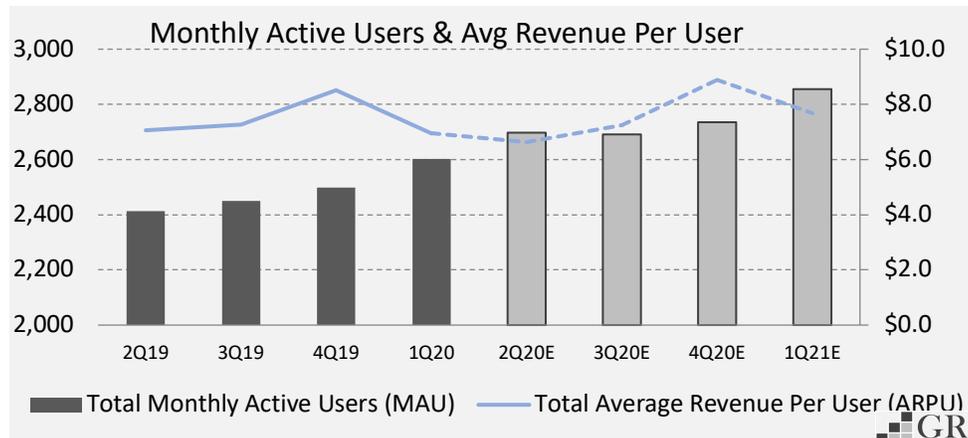
*Pranshu Suri*

## INTRODUCTION

Facebook's first quarter earnings offered a glimpse into how the company reacts to the conditions of its macroeconomic environment. Since then, many other factors have shaped the company's 2Q2020 forecasted earnings, including its two primary revenue drivers—monthly active users (MAUs) and average revenue per user (ARPU), which have subsequently been affected by events such as the COVID-19 global pandemic. These and other external factors that formed the basis for this model are discussed in greater detail below.

## REVENUE DRIVERS

- **Monthly Active Users (MAUs)** – For all geographic regions, the number of MAUs is expected to see an increase in the second quarter due to the COVID-19 pandemic. As nations across the world instituted shelter-in-place and social distancing guidelines, Facebook users will flock to the site and its family platforms (e.g. Facebook, Instagram, WhatsApp) to reconnect with their friends and families virtually. Certain regions with additional impact factors are described in further detail below.
  - *U.S. and Canada:* During the second and third quarters, a more sustained increase of MAUs is projected relative to other regions due to social justice/activism movements on social media such as Black Lives Matter, particularly on Instagram and Facebook. As the economy and businesses began to reopen in the midst of the third quarter, this number is projected to decrease only slightly. Lastly, the 2020 Presidential Election is expected to bring more buzz and an influx of additional users to offset the loss due to the gradual recovery from COVID.
  - *Asia Pacific:* The Asia Pacific region had the highest year-over-year growth in MAUs due to two factors. Firstly, this region is recovering from the effects of COVID-19 more quickly than the rest of the world, and as it does so and lifts social distancing/quarantine regulations, people will find themselves with less time to spend on Facebook and its affiliated sites (similar to the effects in other regions). Additionally, Facebook's recently announced partnership with Reliance's Jio platforms in India will further increase MAUs in this region.
- **Average Revenue Per User (ARPU)** – For all geographic regions, ARPU is forecasted to sharply decline in quarter 2 due to the fewer number of companies seeking to advertise on Facebook. The recent Facebook ad boycotts also have a marginal impact on this decrease in subsequent quarters, but are not expected to have a long-term impact on the company due to the fact that larger corporate advertisers (i.e. those joining the boycott) account for only 6% of Facebook's ad revenue. This decrease is expected to continue in all regions for a few quarters and then stabilize into 2021. It should be noted here that Europe's decrease in the second quarter is further propagated by a depreciation of the Euro relative to the USD by ~2% from the end of March to the beginning of July.



## EXPENSES

- Gross Margins** – In Facebook’s 1Q2020 Earnings Call, CEO Mark Zuckerberg stated: “...we are willing to accept a reduction in margins in the near term, but we understand, and I personally have an appreciation for the importance of maintaining high margins over time.” Therefore, gross margins have been forecasted to decrease slightly in the short-run (upcoming two quarters) and then increase again from 4Q2020 into 2021. This is to account for potential miscellaneous COVID-related expenses that many tech companies have been accruing over the past few months on their balance sheets.
- Research and Development (R&D) Expenses** – R&D-related expenses were also forecasted to increase over the next few quarters due to Facebook’s investment in various industry sectors to combat the adverse effects COVID has had on its revenues. One example of such an investment is Facebook’s recent investment in the gaming industry—specifically, its partnership with Mixer, Microsoft’s game streaming service—which COO Sheryl Sandberg (unintentionally) foreshadowed on the 1Q2020 Earnings Call: “Travel & Auto were our weakest verticals and we saw relative strength in gaming, technology, and ecommerce. These trends have continued into Q2.”
- Marketing Expenses** – For the most part, Facebook’s expenses related to marketing are projected to stay the same, with a slight decrease in quarter 2 to combat the company’s bad press over the ad boycotts.
- General and Administrative (G&A) Expenses** – G&A expenses are forecasted to increase in the second and third quarters of 2020 due to accrued Bad Debt Expenses from COVID. These expenses are expected to recover and decline back to their baseline over subsequent quarters and into 2021.

## SHARE REPURCHASE ASSUMPTIONS

- Average Price** – The average share repurchase price is forecasted to be the simple average of the share price at the beginning and end of the second quarter (\$193.34).

- **Total Amount Over Period (in \$)** – The total repurchase amount over each quarter is projected to decrease for the next few quarters relative to preceding quarters due to the current uncertainty of the macroeconomic environment, as well as to preserve its cash flow for future investment projects.