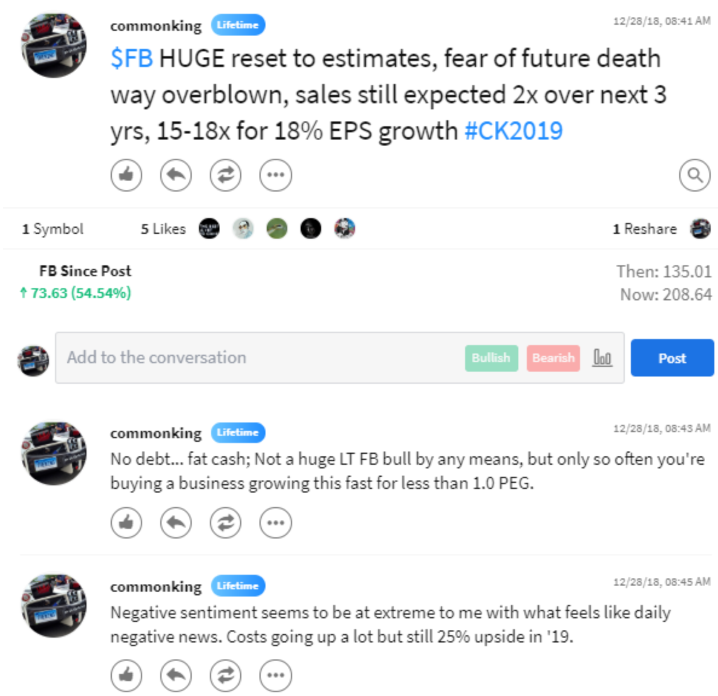
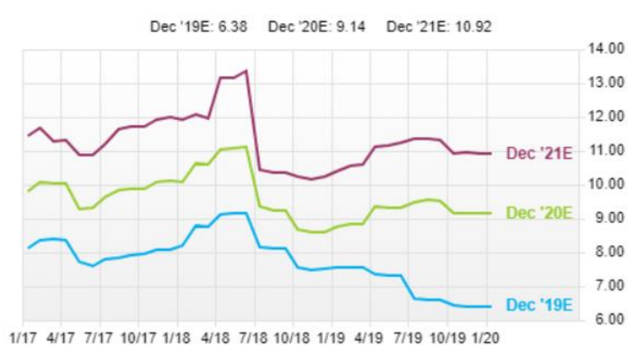
Facebook (FB) – Similar to a few other mega cap write-ups, I do not think there is THAT much I can tell you about Facebook that you do not know. The clear leader in social media, wide-reaching platforms include Facebook, Instagram, Messenger and WhatsApp. With 1.6 billion daily active users and 2.5 billion monthly active users, literally 1/3 the world population is using one of FB's services at least once a month. The importance of social media in digital advertising cannot be understated and participation from B2C is almost required for customer acquisition and getting eyes on your product. You basically don't exist if you do not have a presence Facebook/Instagram. FB's scale results in [one of] the best ad offering(s) and their ability to collect and leverage data should snowball and further enhance the products, widening their already staggering lead and advantage. FB has proven their ability to innovate (or steal) on an expediated timeline, launching successful Instagram features such as Stories and now an integrated shopping experience. The monetization of WhatsApp could be the next frontier and profit lever. FB along with the digital advertising industry should continue to grow above GDP rates for years to come and exposure to the equity is a must.

One of my key themes and trends is Addiction, ie. your consumer cannot stop using your product. Social media is a form of addiction and only getting worse as children start early. An 8-year old made $26mm on YouTube in 2019. ("U.S. Adults spent 5.9 hours per day on digital media in 2017, up from 5.6 hours the year before and 4.3 hours in 2012. Of that, roughly one third of time spent online is on Social Media.")



Facebook was repriced in 2019 and returned over 50% during the year, attributed mostly to multiple expansion as earnings declined year over year. **FB was a top pick in #CK2019.**



THIS IS NOT INVESTMENT ADVICE. DO YOUR OWN RESEARCH AND MAKE YOUR OWN DECESIONS.

Forward EPS estimates peaked in summer 2018 and while 2020 / 2021 estimates have rebounded, the 2019 estimate has continued to trend downward. However, this is to no one's surprise. The company guided operating income lower and invested meaningfully (increased headcount) early in the year. Despite this, as mentioned the stock returned 50% as the earnings multiple nearly doubled.

	Dec '15	Dec '16	Dec '17	Dec '18	Dec '19E	Dec '20E	Dec '21E
Price/Earnings (x)	45.9	27.2	28.6	17.3	32.2	22.8	19.1
PEG Ratio (x)	2.2	1.3	1.4	0.8	1.5	1.1	0.9
Price/Book Value (x)	6.8	5.7	7.0	4.5	5.8	4.7	3.8
Price/Tangible Book Value (x)	12.8	8.8	9.6	5.9	7.2	5.6	4.3
Price/Cash Flow (x)	35.0	22.8	24.0	13.3	22.1	17.6	15.1
Price/Free Cash Flow (x)	49.1	30.8	29.8	24.9	30.1	26.9	21.6
Price/Sales (x)	16.6	12.0	12.6	6.7	8.3	6.9	5.8
Enterprise Value/Sales (x)	15.6	11.1	11.8	6.1	7.8	6.5	5.4
Enterprise Value/EBITDA (x)	25.0	17.0	17.8	10.3	14.4	12.7	10.5
Enterprise Value/EBITA (x)	-	-	-	11.3	15.8	15.0	-
Enterprise Value/EBIT (x)	28.0	18.6	23.8	13.7	23.1	17.8	14.9
Enterprise Value/FCF (x)	46.2	27.3	27.5	22.3	29.0	24.6	20.1
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sales/Share (x)	6.3	9.6	14.0	19.4	24.7	30.1	35.9
Return on Assets (ROA) (%)	13.2	19.0	18.8	22.7	13.8	16.5	16.4
Return on Equity (ROE) (%)	14.7	20.9	24.5	26.0	18.1	20.7	19.8

Currently valued at ~$600B market value, FB generated $55B in sales in 2018 and estimates are projecting $70B in 2019 and $85B in 2020. 5-year CAGR of nearly 50% for revenue and even stronger for EBIT/EBITDA/Net Income/EPS. FCF has also grown 40%.

While not trading at the dirt-cheap levels of 17x that of YE 2018, I estimate the business is fairly valued at 30x 2019 EPS and likely undervalued at ~23x 2020 EPS when factoring in the quality of the business and earnings. There could easily be revenue and EPS growth reacceleration through 2020 as the economy remains strong and advertisers keep spending and we will see early signs of how successful new offerings are. Additionally, SG&A and other costs could come in belong expectations resulting in further upside surprise.

Dec '14	Dec '15	Dec '16	Dec '17	Dec '18	Dec '19E	Dec '20E		5Yr CAGR
12,466	17,928	27,638	40,653	55,838	70,482	85,821	Sales	48.0%
6,225	8,239	14,835	23,228	29,228	37,943	43,893	EBITDA	49.4%
4,982	6,294	12,493	20,203	24,913	23,707	31,358	EBIT	53.5%
2,925	3,669	10,188	15,920	22,111	18,305	26,362	Net Inc	71.5%
1.10	1.29	3.49	5.39	7.57	6.38	9.14	EPS (Dil)	66.0%
0.00	0.00	0.00	0.00	0.00	0.00	0.00	Divs PS	-
2,664	2,853	2,925	2,956	2,921	-	-	Shs Out (Dil)	3.0%
12.90	15.54	20.47	25.58	29.48	35.19	44.09	Bk PS	37.1%
11,199	18,434	29,449	41,711	41,124	-	-	Cash & ST Inv	29.1%
40,184	49,407	64,961	84,524	97,334	132,498	159,425	Assets	40.3%
12,246	19,727	31,526	44,803	43,463	-	-	Wkg Cap	29.4%
119	107	0	72	0	-	-	LT Debt	-
5,457	8,599	16,108	24,216	29,274	35,520	39,768	Net Op CF	47.3%
-1,831	-2,523	-4,491	-6,733	-13,915	-15,971	-17,641	Cap Ex	-
3,626	6,076	11,617	17,483	15,359	18,843	22,662	FCF	40.0%

No debt and $52 billion in cash as of September 2019, up $10B in the 9 months since previous year end, Facebook remains a cash machine and essentially prints money. They are in a very flexible position to make acquisitions and have a stellar track record of buying and integrating large transactions. There is always the potential to see something in 2020. Pinterest? 😉

THIS IS NOT INVESTMENT ADVICE. DO YOUR OWN RESEARCH AND MAKE YOUR OWN DECESIONS.

	5Y Avg	DEC '18 365 DAYS	DEC '17 365 DAYS	DEC '16 366 DAYS RESTATE	DEC '15 365 DAYS	DEC '14 365 DAYS	DEC '13 365 DAYS	DEC '12 366 DAYS	DEC '11 365 DAYS
Gross Margin	84.52	83.25	86.58	86.29	84.01	82.46	77.67	73.20	76.83
SG&A to Sales	41.65	38.63	36.89	41.33	48.90	42.49	40.56	62.63	29.51
Operating Margin	42.87	44.62	49.70	44.96	35.11	39.96	37.11	10.57	47.32
Pretax Margin	43.06	45.42	50.66	45.29	34.55	39.39	34.98	9.71	45.68
Net Margin	31.91	39.60	39.16	36.86	20.47	23.46	18.94	0.63	18.00
Free Cash Flow Margin	35.10	27.51	43.01	42.03	33.89	29.09	36.33	7.41	25.41
Return on Assets (%)	16.34	24.32	21.30	17.82	8.19	10.07	9.04	0.30	14.33
Return on Equity (%)	18.39	27.90	23.84	19.70	9.14	11.34	10.95	0.38	18.92
Return on Common Equity	18.39	27.90	23.84	19.70	9.14	11.34	10.95	0.40	22.91
Return on Total Capital	24.03	31.33	30.24	23.96	15.57	19.06	19.44	5.47	42.77
Return on Invested Capital	18.36	27.89	23.83	19.68	9.11	11.27	10.12	0.34	17.07
Cash Flow Return on Invested Capital	29.33	36.93	36.25	31.12	21.35	21.02	28.67	16.93	39.59

While capex doubled and net profits took a hit in 2018, the company maintains 85% gross margins. The margins overall are a thing of beauty with industry leading ROE, FCF, ROIC, etc. Profitability remains a focus of the company and while taking a hit in the near term, management has displayed discipline in longer term cost and margin control.

Total LTM Revenue $66.5B

	% of Tot. Rev.	% Chg (Y/Y)	3 Yr Trend
United States+*	44.7**	-1.5	
Germany	4.1**	13.4	
Canada	3.7**	-0.2	
Mainland China	3.4**	7.0	
Japan	3.3**	4.9	
United Kingdom	2.9**	10.0	
France	2.8**	11.3	
Italy	2.3**	1.5	

~45% of revenue derived from the United States, but no longer the main driver of growth. Facebook will need to penetrate markets with higher growth but also figure out how to better monetize them. Currently, all social media and even tech companies offering streaming services are struggling with profitability in emerging and developed international markets. Currently, Facebook is already generating ~$34.55 in revenue per user in the US/Canada compared to $10.68 in Europe, $3.24 in Asia-Pacific and $2.24 ROW.

THIS IS NOT INVESTMENT ADVICE. DO YOUR OWN RESEARCH AND MAKE YOUR OWN DECESIONS.

The long play off the December 2018 lows that created the #CK2019 opportunity was based on a reset of expectations and an overshoot of negativity and sentiment. The Cambridge Analytics and $5B FTC fine are now behind them as if they never happened. FB is a monopoly and is not going anywhere.

Today is a much different situation. The stock has strong momentum and forward estimates are rising and investors expect better days ahead. I would be a buyer of a strong move through $210 on volume, or if you prefer waiting for a pullback, a 200dma test at ~$190 would be a gift. I would be looking to buy a strong bounce off $195 or higher.

Including these two great blurbs from this VIC piece below.

https://valueinvestorsclub.com/idea/FACEBOOK_INC/3819270031#description

3.

The oligopoly structure is protected by barriers to entry consisting of economies of scale in the form of high fixed cost leverage and customer captivity in the form of network effects: Social media cost structures are almost entirely fixed, with sales commissions and data center electricity representing the only truly variable cost components for marginal sales dollars. The high-fixed-cost nature of the business provides significant economies of scale to Facebook as the largest player, allowing it to invest $7.8Bn in research and development in 2017 compared with Twitter's $0.5Bn despite Facebook's industry-leading operating margins of 49% being significantly higher than Twitter's 10% margins. Separately, social networks become more valuable to users as their user base and depth of user information (a.k.a. social graph) grows. Companies with larger social graphs have more captive user bases and therefore more captive advertising customers. The combination of high fixed costs and captive customers is a major deterrent to new entrants and contributes to stable market shares among existing players. Even well-capitalized and highly-motivated entrants such as Google+ and Yammer have been unable to enter the market in a meaningful way.

2.

Facebook's high relative market share in a highly fixed-cost business couples with its network effects to create an incredibly strong competitive advantage: In addition to its network effect advantage, Facebook's high relative market share (>10x the size of the nearest U.S. competitor) allows it to spend more on R&D to match and exceed competitors' features. For example, Snapchat launched its stories feature on October 3rd, 2013 and reportedly spurned a $3Bn takeover offer from Facebook the next month. Facebook began spending on R&D to create its own "Stories" feature, and Instagram launched stories on August 2nd, 2016. In less than six months, users of Instagram Stories surpassed Snapchat's DAU's. In this example, Facebook's economies of scale allowed it to spend heavily on R&D to match a competitor's feature and its captive user base quickly swarmed to the feature once available, preventing Snapchat from gaining market share. This strategy should be repeatable to defend against future encroachment.

If you enjoyed this analysis, please consider subscribing to #CK2020 which contains a write-up on each of my Top 30 ideas for 2020.

The cost is $40 and 100% of the proceeds go to charity. More information available in the link below:

https://www.oakriverinvests.com/single-post/2019/12/24/Launch-of-CK2020

Thanks,

Kyle

THIS IS NOT INVESTMENT ADVICE. DO YOUR OWN RESEARCH AND MAKE YOUR OWN DECESIONS.