

Facebook operates the world's largest family of social networking websites including the flagship Facebook site, Instagram, Facebook Messenger, and WhatsApp. The sites enable users to communicate with friends and family by posting to the site; commenting on others' posts; sharing photographs, website links, and videos; messaging and playing games. Facebook also partners with application developers to add functionality to the sites, and allows users to pay for virtual goods and services through its Payments function. Facebook derives about 55% of its revenue from outside the U.S. and Canada. Facebook went public on May 18, 2012.

## Analyst's Notes

Analysis by Joseph Bonner, CFA, July 2, 2020

### ARGUS RATING: BUY

- Raising target price to \$270
- Facebook is again back in the media-cycle crosshairs due to its policies on user speech, and is facing a limited advertiser boycott related to this issue.
- The company has thus far largely refused to limit speech on its sites, covering itself in the twin mantles of free speech and user freedom, i.e., letting users decide for themselves what content they wish to see. However, this rigid position is becoming more untenable given the increasing social unrest and political polarization in the U.S.
- Given the broad diversification of the company's advertising base, we see the boycott itself as only a minor and passing threat to Facebook's revenue stream.
- Always of greater importance is whether the boycott generates a 'delete Facebook' movement among users. Facebook's 2 billion-plus user base is the company's key asset, and significant erosion of that base would be a substantial negative for FB shares.

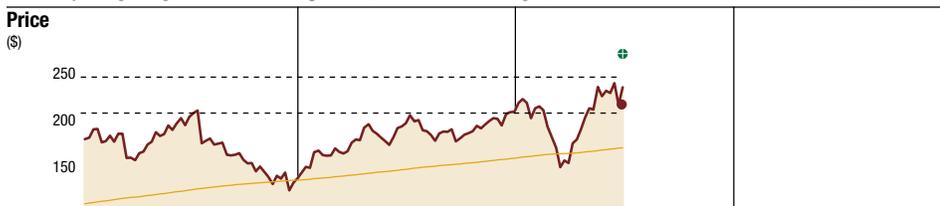
### INVESTMENT THESIS

We are maintaining our BUY rating on Facebook Inc. (NGM: FB) and raising our target price to \$270 from \$240. The recent limited advertiser boycott of Facebook due to its user speech policies is probably not a fundamental threat to the company's business, though it is definitely a reputational threat. Facebook has thus far largely refused to limit speech on its sites, covering itself in the twin mantles of free speech and user freedom, i.e., letting users decide for themselves what content they wish to see. However, this rigid position is becoming more untenable in an environment of increasing social unrest and political polarization.

Given the broad diversification of the company's advertising base, we see the boycott itself as only a minor and passing threat to Facebook's revenue stream. Always of greater importance is whether the boycott generates a 'delete Facebook' movement among users.

### Market Data Pricing reflects previous trading week's closing price.

— 200-Day Moving Average    + Target Price: \$270.00    ● 52 Week High: \$245.19    ○ 52 Week Low: \$207.11    ● Closed at \$216.08 on 6/26



EPS (\$)		Revenue (\$ in Bil.)	
Quarterly	1.69, 1.74, 1.76, 2.38	Quarterly	12.0, 13.2, 13.7, 16.9
Annual	7.57	Annual	55.8
	0.85, 2.12, 2.56, 1.71		15.1, 16.9, 17.7, 21.1
	6.43		70.7
	1.27, 1.64, 2.22		17.7, 16.7, 18.0, 22.7
	7.23 (Estimate)		75.2 (Estimate)
	2.08, 2.25, 2.62, 3.22		19.8, 21.8, 24.0, 28.5
	10.17 (Estimate)		94.0 (Estimate)
FY ends Dec 31	2018, 2019, 2020, 2021		

## Argus Recommendations

Twelve Month Rating	SELL	HOLD	BUY
Five Year Rating	SELL	HOLD	BUY
Sector Rating	Under Weight	Market Weight	Over Weight

Argus assigns a 12-month BUY, HOLD, or SELL rating to each stock under coverage.

- BUY-rated stocks are expected to outperform the market (the benchmark S&P 500 Index) on a risk-adjusted basis over the next year.
- HOLD-rated stocks are expected to perform in line with the market.
- SELL-rated stocks are expected to underperform the market on a risk-adjusted basis.

The distribution of ratings across Argus' entire company universe is: 65% Buy, 34% Hold, 1% Sell.

## Key Statistics

Key Statistics pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified

### Market Overview

Price	\$237.55
Target Price	\$270.00
52 Week Price Range	\$137.10 to \$245.19
Shares Outstanding	2.41 Billion
Dividend	\$0.00

### Sector Overview

Sector	Communication Services
Sector Rating	OVER WEIGHT
Total % of S&P 500 Market Cap.	11.00%

### Financial Strength

Financial Strength Rating	HIGH
Debt/Capital Ratio	9.7%
Return on Equity	19.6%
Net Margin	28.6%
Payout Ratio	--
Current Ratio	4.40
Revenue	\$73.36 Billion
After-Tax Income	\$20.96 Billion

### Valuation

Current FY P/E	32.86
Prior FY P/E	36.94
Price/Sales	7.79
Price/Book	6.43
Book Value/Share	\$36.94
Market Capitalization	\$571.74 Billion

### Forecasted Growth

1 Year EPS Growth Forecast	12.44%
5 Year EPS Growth Forecast	24.00%
1 Year Dividend Growth Forecast	N/A

### Risk

Beta	0.95
Institutional Ownership	78.31%

Please see important information about this report on page 5

**Analyst's Notes...Continued**

Facebook's 2 billion-plus user base is the company's key asset, and significant erosion of that base would be a substantial negative for FB shares.

**RECENT DEVELOPMENTS**

Facebook is again back in the media-cycle crosshairs. This time it is facing an advertiser boycott, primarily directed at Facebook/Instagram, for the month of July, though some advertisers may boycott other digital sites for other periods of time. The boycott has been organized by a pop-up group called 'Stop Hate for Profit,' backed by organizations such as the Anti-Defamation League and the NAACP. The organization has called on Facebook to change its policies governing user speech on its platforms. In particular, it would like the company to more strictly police content on a range of political issues, and to remove its policy exemption for speech by politicians. The advertiser boycott initiative comes at a time of substantial social unrest and political polarization in the U.S. ahead of the 2020 presidential election.

The boycott campaign, announced on June 17, has gained some prominent advertisers, though many of Facebook's largest advertisers remain on the sidelines. Still, Unilever's June 26 decision to halt advertising spending on Facebook and Twitter for the rest of 2020 sent FB shares into a one-day 8% tailspin (though FB shares have since recouped that loss). Unilever is one of the largest advertisers in the world, though it is halting advertising only on

Facebook in the U.S., which accounts for about 30% of Unilever revenue. In all, while Facebook is certainly vulnerable to headline risk, the boycott has thus far had a limited impact on revenue due to the broad diversification of the Facebook advertising base. The overall health of digital advertising as a subset of total ad spending will likely have a greater effect on Facebook revenue. Major advertising agency WPP expects digital advertising to decline 3% in 2020 due to the COVID-19-related economic slowdown, though we expect Facebook to do a little better than that.

Facebook has begun taking steps to police speech in response to the recent torrent of criticism. On June 26 (coincidentally the same day that Unilever made its announcement), Mark Zuckerberg said that Facebook was taking action surrounding election misinformation, voter suppression, hateful speech in advertising, and the labeling of speech by politicians. However, Facebook's actions fall far short of the activists' goals. While the media drumbeat will likely continue, Facebook at least recognizes the importance of getting the 2020 election right after the debacle of Russian interference and the Cambridge Analytica scandal in the 2016 election.

On May 15, Facebook announced that it had acquired GIPHY, the popular online generator of animated images. According to press reports, Facebook paid \$400 million in cash for GIPHY. The company had planned to integrate GIPHY into its Instagram video platform, while still allowing third-party access. However, the acquisition has spurred antitrust investigations in both the U.K.

**Growth & Valuation Analysis**
**GROWTH ANALYSIS**

(\$ in Millions, except per share data)

	2015	2016	2017	2018	2019
Revenue	17,928	27,638	40,653	55,838	70,697
COGS	2,867	3,789	5,454	9,355	12,770
Gross Profit	15,061	23,849	35,199	46,483	57,927
SG&A	4,020	5,503	7,242	11,297	20,341
R&D	4,816	5,919	7,754	10,273	13,600
Operating Income	6,225	12,427	20,203	24,913	23,986
Interest Expense	-29	-166	-392	-652	-904
Pretax Income	6,194	12,518	20,594	25,361	24,812
Income Taxes	2,506	2,301	4,660	3,249	6,327
Tax Rate (%)	40	18	23	13	25
Net Income	3,688	10,217	15,934	22,112	18,485
Diluted Shares Outstanding	2,853	2,925	2,956	2,921	2,876
EPS	1.29	3.49	5.39	7.57	6.43
Dividend	—	—	—	—	—

**GROWTH RATES (%)**

	2015	2016	2017	2018	2019
Revenue	48.6	57.4	48.6	37.7	26.6
Operating Income	24.6	99.6	62.6	23.3	-3.7
Net Income	25.4	177.0	56.0	38.8	-16.4
EPS	17.3	170.5	54.4	40.4	-15.1
Dividend	—	—	—	—	—
Sustainable Growth Rate	9.0	15.7	24.3	25.7	20.7

**VALUATION ANALYSIS**

	2015	2016	2017	2018	2019
Price: High	\$110.65	\$133.50	\$184.25	\$218.62	\$208.93
Price: Low	\$72.00	\$89.37	\$115.51	\$123.02	\$128.56
Price/Sales: High-Low	17.6 - 11.5	14.1 - 9.5	13.4 - 8.4	11.4 - 6.4	8.5 - 5.2
P/E: High-Low	85.8 - 55.8	38.3 - 25.6	34.2 - 21.4	28.9 - 16.3	32.5 - 20.0
Price/Cash Flow: High-Low	42.7 - 27.8	30.7 - 20.5	25.3 - 15.9	21.9 - 12.3	17.3 - 10.6

**Financial & Risk Analysis**
**FINANCIAL STRENGTH**

	2017	2018	2019
Cash (\$ in Millions)	8,079	10,019	19,079
Working Capital (\$ in Millions)	44,803	43,463	51,172
Current Ratio	12.92	7.19	4.40
LT Debt/Equity Ratio (%)	—	—	9.4
Total Debt/Equity Ratio (%)	—	0.6	10.5

**RATIOS (%)**

	2017	2018	2019
Gross Profit Margin	86.6	83.2	81.9
Operating Margin	49.7	44.6	33.9
Net Margin	39.2	39.6	26.1
Return On Assets	21.3	24.3	16.0
Return On Equity	23.8	27.9	20.0

**RISK ANALYSIS**

	2017	2018	2019
Cash Cycle (days)	—	—	—
Cash Flow/Cap Ex	3.6	2.1	2.4
Oper. Income/Int. Exp. (ratio)	3,433.3	2,818.9	1,241.6
Payout Ratio	—	—	—

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**Analyst's Notes...Continued**

and Australia.

As might be expected, the stay-at-home restrictions imposed during the pandemic have led to a spike in users and usage at Facebook and its allied applications Messenger, WhatsApp, and Instagram. Facebook added 105,000 new users in 1Q, the most in any quarter for at least the last ten years. In March, the company reported that total messaging had increased 50% and that time spent on the company's applications had increased 70%. At the same time, the advertising market has been devastated as whole industry verticals have halted advertising and many large advertisers have pulled back ad spending to cut costs. Facebook noted that travel and automotive were the worst hit verticals in March, partially offset by strength in gaming technology and e-commerce. Management said that it saw 'signs of stability' in the advertising market in April, though it remains cautious for the rest of 2020.

Our 2020 non-GAAP EPS estimate is \$7.23 and our 2021 forecast is \$10.17. Our estimates imply 14% average annual earnings growth over the next two years. Our long-term earnings growth rate forecast is 24%.

**MANAGEMENT & RISKS**

Like all advertising-dependent companies, Facebook could be severely hurt by the COVID-19 economic slowdown and the concomitant decline in ad spending. However, Facebook may be more resilient than other ad-reliant companies since much of its

revenue comes from direct-response advertising by e-commerce sites.

While user growth has migrated toward developing markets, the U.S., Facebook's home market, is still its most lucrative. As such, a meaningful defection of U.S. users (other than to Facebook's own sister applications Instagram and WhatsApp) could materially impact the company's performance and business model. A significant loss of advertisers would also be a material problem.

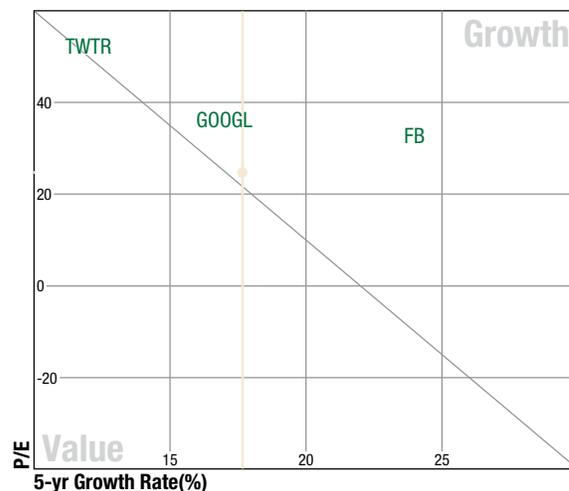
The Cambridge Analytica and the 2018 follow-on scandals highlighted the risks inherent in Facebook as the repository of a vast amount of personal information on its users, which it uses to make its targeted advertising more valuable to marketers. If large numbers of users refuse to allow Facebook to use their personal data, the company's advertising could become less valuable. Facebook is vulnerable to extreme regulatory backlash in the U.S. and around the world related to antitrust; the spread of misinformation, including election interference; the spread of unlawful content in private groups and encrypted communications, e.g. child pornography; and the misuse of members' private information. We say extreme regulatory backlash since some politicians have begun to raise the issue of not just huge fines but also of a break-up of the company. Facebook may also be subject to attacks from individuals or organizations attempting to steal member information.

Facebook is almost entirely dependent on advertising revenue, which has grown to more than 98% of total revenue. The secular

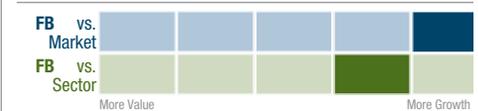
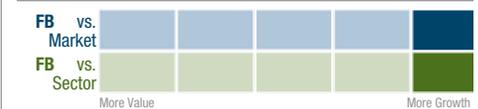
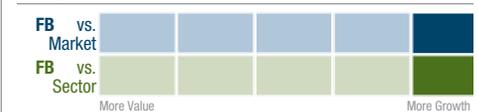
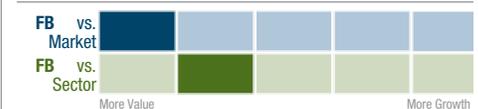
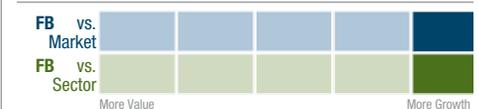
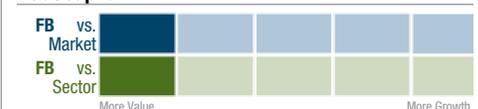
**Peer & Industry Analysis**

The graphics in this section are designed to allow investors to compare FB versus its industry peers, the broader sector, and the market as a whole, as defined by the Argus Universe of Coverage.

- The scatterplot shows how FB stacks up versus its peers on two key characteristics: long-term growth and value. In general, companies in the lower left-hand corner are more value-oriented, while those in the upper right-hand corner are more growth-oriented.
- The table builds on the scatterplot by displaying more financial information.
- The bar charts on the right take the analysis two steps further, by broadening the comparison groups into the sector level and the market as a whole. This tool is designed to help investors understand how FB might fit into or modify a diversified portfolio.



Ticker	Company	Market Cap (\$ in Millions)	5-yr Growth Rate (%)	Current FY P/E	Net Margin (%)	1-yr EPS Growth (%)	Argus Rating
FB	Facebook Inc	571,736	24.0	32.9	28.6	40.7	BUY
GOOGL	Alphabet Inc	432,673	17.0	36.3	20.7	35.8	BUY
TWTR	Twitter Inc	24,174	12.0	52.2	36.4	50.8	BUY
PINS	Pinterest Inc	9,393	—	-211.6	-120.5	254.5	HOLD
<b>Peer Average</b>		<b>259,494</b>	<b>17.7</b>	<b>-22.6</b>	<b>-8.7</b>	<b>95.5</b>	

**P/E**

**Price/Sales**

**Price/Book**

**PEG**

**5 Year Growth**

**Debt/Capital**


## Analyst's Notes...Continued

trend of advertisers devoting more and more of their advertising dollars to internet-based advertising has generally softened the impact of cyclical swings in the online advertising market; however, this trend may not continue indefinitely. The flagship Facebook platform is at saturation, meaning that growth in that platform will likely slow over time. Facebook's emerging platforms, Instagram, Messenger, and WhatsApp have been building their respective user bases nicely and are in the early stages of monetization. It thus remains unclear whether returns from these emerging platforms will be able to offset any slowdown in flagship Facebook.

Mobile is a critical growth engine for Facebook and the company derives 94% of its advertising revenue from mobile applications. Management has also warned that it is willing to sacrifice short-term margin expansion for long-term membership growth and increased member engagement.

Competition in the internet space is intense and Facebook is up against a number of larger companies with greater resources, including Google, Microsoft, and Apple. As Facebook expands internationally, it must manage its entry into new markets, where it may have limited understanding of the local culture. It also faces pressure from 'national champion' competitors, especially in China, from which it is currently banned. Government regulation and the possible censorship of site content could also become much more burdensome in the coming years, both in the U.S. and in international markets. The Snowden revelations involving the use of American internet company data by the NSA could make Facebook's penetration of foreign markets much more difficult, and result in restrictions or outright bans by foreign governments.

Facebook has expanded its role from simple interpersonal communications, i.e., timeline posts, to become a broad-based news media outlet. However, this expansion has been fraught with allegations of bias. It has also raised concerns about the company's role in disseminating fake news, in which bad actors game Facebook's news algorithms to plant false news stories or propaganda. Management is now in an 'arms race' with individuals and nation states trying to use its service to distribute fake news to influence elections or to just generally sow societal discord. Foreign governments' continuing attempts to use the company's advertising systems to influence public opinion has brought this issue into a harsher light.

Like any fast-growing tech company, Facebook must successfully manage its explosive growth trajectory. It must also ensure 24/7 system reliability in the face of increasingly toxic computer network attacks from sources who would like nothing more than the headlines from a successful attack on a high-profile target like Facebook.

Goodwill and intangible assets are a significant 20% of total assets. Though Facebook does not have a history of write-downs, such assets are always subject to reappraisal. Moreover, since they are such a significant part of the company's assets, any write-down could be a serious negative for FB shares.

More than most internet start-ups, Facebook is identified with its founder, chairman and CEO Mark Zuckerberg, and his possible loss would undoubtedly be a major blow to the company.

### COMPANY DESCRIPTION

Facebook operates the world's largest family of social networking websites including the flagship Facebook site, Instagram, Facebook Messenger, and WhatsApp. The sites enable users to communicate with friends and family by posting to the

site; commenting on others' posts; sharing photographs, website links, and videos; messaging and playing games. Facebook also partners with application developers to add functionality to the sites, and allows users to pay for virtual goods and services through its Payments function. Facebook derives about 55% of its revenue from outside the U.S. and Canada. Facebook went public on May 18, 2012.

### VALUATION

Facebook shares have risen about 16% year-to-date compared to a 3% decline for the S&P 500. The forward enterprise value/EBITDA multiple of 14.5 is 25% below the peer average, less than the average discount of 29% over the past two years. We are maintaining our BUY rating on Facebook and raising our target price to \$270.

On July 2 at midday, BUY-rated FB traded at \$234.24, down \$3.32.

## About Argus

Argus Research, founded by Economist Harold Dorsey in 1934, has built a top-down, fundamental system that is used by Argus analysts. This six-point system includes Industry Analysis, Growth Analysis, Financial Strength Analysis, Management Assessment, Risk Analysis and Valuation Analysis.

Utilizing forecasts from Argus' Economist, the Industry Analysis identifies industries expected to perform well over the next one-to-two years.

The Growth Analysis generates proprietary estimates for companies under coverage.

In the Financial Strength Analysis, analysts study ratios to understand profitability, liquidity and capital structure.

During the Management Assessment, analysts meet with and familiarize themselves with the processes of corporate management teams.

Quantitative trends and qualitative threats are assessed under the Risk Analysis.

And finally, Argus' Valuation Analysis model integrates a historical ratio matrix, discounted cash flow modeling, and peer comparison.

### THE ARGUS RESEARCH RATING SYSTEM

Argus uses three ratings for stocks: BUY, HOLD, and SELL. Stocks are rated relative to a benchmark, the S&P 500.

- A BUY-rated stock is expected to outperform the S&P 500 on a risk-adjusted basis over a 12-month period. To make this determination, Argus Analysts set target prices, use beta as the measure of risk, and compare expected risk-adjusted stock returns to the S&P 500 forecasts set by the Argus Market Strategist.
- A HOLD-rated stock is expected to perform in line with the S&P 500.
- A SELL-rated stock is expected to underperform the S&P 500.

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