

Facebook Inc.

Buy Trade – Position Open



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USA | TECHNOLOGY | TRADING NOTE

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Description

Facebook Inc. (NASDAQ:FB) is focused on building products that enable people to connect and share through mobile devices, personal computers and other surfaces. The Company's products include Facebook, Instagram, Messenger, WhatsApp and Oculus. The Company also engages in selling advertising placements to marketers. Its advertisements let marketers reach people based on a range of factors, including age, gender, location, interests and behaviors. Marketers purchase advertisements that can appear in multiple places, including on Facebook, Instagram, and third-party applications and Websites.

Source: Thomson Reuters

Company Highlights

- More than 98% of FB's revenue is earned through advertising
- FB's revenue has grown by more than 50% for 5 consecutive years
- FB has 25.7% of the market share for Global Internet Advertising Revenue, the 2nd highest after Google.
- FB has 1.4bn Daily Active Users and 2.13bn Monthly Active Users

Investment Rationale

FB's share price fell drastically after the Cambridge Analytica scandal, when it was revealed that the political analytics company was able to access more than 50mn Facebook profiles without their users' permissions. Since the news broke, FB has lost close to 20% of its price from peak. We believe that while the news seems bad, the potential fallout and damage to FB's intrinsic value has been blown out of proportion and that the current situation represents a buying opportunity for the social media giant.

Our Reasons for Buying FB

- 1) Recent Price Action:** FB share price peaked at around USD193 after its latest earnings release. While the company posted better than expected results, it also released figures that showed a drop in user time spent on the platform. While the company was recovering from that event, the Cambridge Analytica scandal broke, which sent the price tumbling to a low of USD151 before the recent recovery to USD159.79.
- 2) Massive User Base:** FB reported in its latest earnings release that its Daily Active Users totaled about 1.40bn users in the latest quarter and 2.13bn Monthly Active Users. More importantly than just a large user base, FB has shown it is very capable of monetizing its user base. FB was able to generate about USD39.94bn in revenue from advertising off that user base.

Based on the figures from FB, it has 184mn users from USA and Canada, 277mn from Europe, 499mn from Asia Pacific and 441mn from the rest of the world. In terms of revenue, the Average revenue per User from USA was USD26.26, while the Average revenue per user for Europe, Asia Pacific and Others were USD8.71, USD2.52 and USD1.85 respectively.

As the rest of the emerging markets become more affluent and companies start spending more to advertise to them, we believe that FB has great potential to further monetize its users from the rest of the world.

Postive

CLOSING PRICE	USD 159.79
ENTRY PRICE	USD 159.79
STOP LOSS	USD 139.00
TARGET PRICE	USD 220.00
% UPSIDE/DOWNSIDE	+19%/-11%
RISK/REWARD	2.9

COMPANY DATA

Bloomberg Code	FB US
O/S SHARES (MN):	2,396
MARKET CAP (USD mn / SGD mn):	464190 / 464190
52 - WK HI/LO (USD):	195.32 / 138.81
3M Average Daily T/O (mn):	32.56

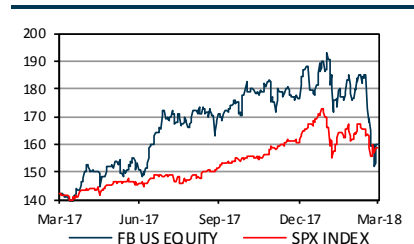
MAJOR SHAREHOLDERS (%)

VANGUARD GROUP	7.09%
BLACKROCK	6.10%
FMR LLC	5.12%

PRICE PERFORMANCE (%)

	1M TH	3M TH	1YR
COMPANY	(10.4)	(9.4)	12.5
SPX RETURN	(2.54)	(0.76)	13.98

PRICE VS. SPX



Source: Bloomberg, PSR

KEY FINANCIALS

USD BN	FY 15	FY 16	FY 17	FY 18 e
Revenue	17.9	27.6	40.7	55.4
EBITDA	8.2	14.8	23.2	33.9
NPAT (adj.)	3.7	10.2	18.2	25.4
EPS (adj.)	1.29	3.49	6.16	8.43
PER, x (adj.)	123.87	45.79	25.94	18.95
P/BV, x	6.73	5.62	6.9	5.0
DPS (USD)	-	-	-	-
Div Yield, %	0.0%	0.0%	0.0%	0.0%
ROE, %	9%	20%	24%	N/A

Source: Company Data, PSR est.

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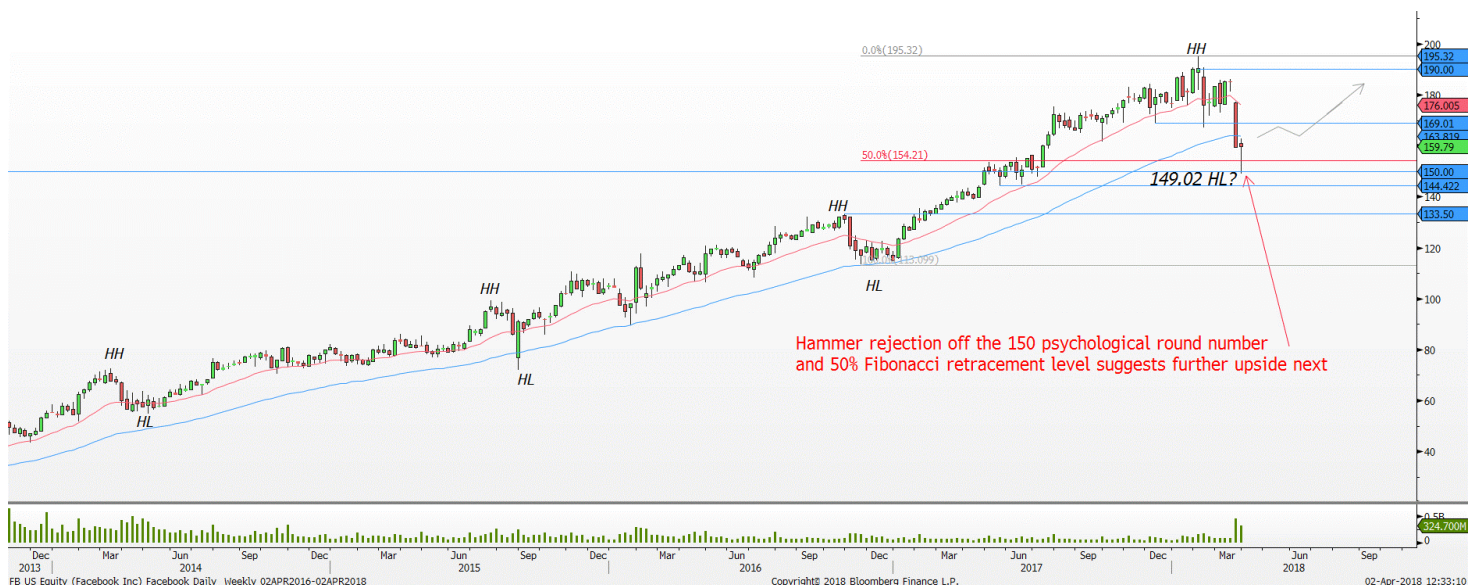
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- 3) Digital Advertising Growth:** In 2017 digital advertising finally surpassed traditional TV ad spending, reaching USD209bn worldwide (41% of all media ad spending) vs TV's USD178bn (35% of all media ad spending). FB has been able to grow its market share consistently over the past few years, up from 17% in 2015 and 20% in 2016 to 25.70% in 2017. Digital ad spending is expected to continue to grow at substantial levels, and is estimated to reach about USD375.8bn by 2021. Assuming FB is able to maintain its 25.7% market share, this would amount to a revenue of USD96.58bn by 2021, which represents a **4 year CAGR of about 24%**. While this is lower than FB's past 5 years CAGR of 52%, it is still very high and it is difficult to sustain such a high CAGR for extended periods of time as the revenue base grows larger.
- 4) Valuations:** FB closed at USD159.79 and trades at a forward PER of 18.95. FB's 4 year average PER is 53.64. FB's total revenue for 2017 was USD40.65bn and over the past 5 years, it has been able to grow that revenue by about 50.75% p.a. FB has been able to generate a free cash flow of USD17.483bn for FY17 and has been able to consistently grow free cash flows, up from USD11.62bn in FY16 and USD7.80bn in FY15. FB has been able to keep its expenses low, resulting in a very impressive **87.58% gross margin in FY17**, up from 86.29% in FY16 and 84.01% in FY15. Its net margin is also a very impressive 39.20% in FY17, up from 36.97% in FY16 and 20.57% in FY15. Given FB's growth prospects and very impressive financials, we believe that FB is undervalued at current prices.
- 5) Cambridge Analytica:** We believe that the Cambridge Analytica investigation has been blown out of proportion and that the potential fallout from the scandal is likely to be limited. Historically, companies who have had significant data breaches did not suffer permanent damage. In 2017, Equifax had the data of 145mn people stolen and its share price collapsed from about USD142 to a low of about USD92. Since then, the price recovered to about USD117.81.

We believe that it is unlikely for the Government to pass legislation that will permanently damage FB's ability to conduct business, as any such legislation would not only impact FB but likely all data based companies as well. On a reputational basis, FB may have suffered some damage with the recent boycott Facebook movement. However, we do not believe that FB has suffered much permanent damage in this regard either, as users will be hard press to find an alternative for Facebook as a social media platform in terms of scale and features.

Technicals: Since hitting a record high of USD195.00 psychological round number in the last week of January 2018, price went into a severe correction. From the peak to the trough, FB has fallen as much as 23%.

FB Weekly chart – Hammer rejection off the 150 psychological round number



Support 1: 150.00 Resistance 1: 169.00
Support 2: 144.42 Resistance 2: 190.00

Source: Bloomberg, PSR

Red line = 20 period moving average, blue line = 60 period moving average, Green line = 200 period moving average

Nonetheless, from the most recent price action, we might be seeing some near-term rebound soon after eight weeks of being in a correction. After breaking below the USD150.00 psychological round number briefly in the last week of March, buyers readily defended the round number as there was no daily close below the USD150.00 psychological round number.

As a result, a bullish reversal candlestick pattern, hammer was formed on the week ended 30 March 2018 suggesting for a reversal higher. Moreover, the USD150.00 psychological round number also coincided with the 50% Fibonacci retracement level making the support area a more credible one.

Expect the hammer's low of USD149.02 to be the next Higher Low (HL) point for this uptrend where buyers retarget the USD169.00

Conclusion: We believe that the current Cambridge Analytica scandal has provided investors with an opportunity to pick up FB at a discount. We believe that the potential fallout from the scandal will be limited and unlikely to permanently damage FB's business model. We are bullish on FB due to 1) Massive User Base, 2) Digital Advertising Growth and 3) Valuations given FB's growth prospects. As such, we believe that stock is undervalued and the current scandal represents a buying opportunity.

Counter	Sector	Ticker	Currency	Last Price	Time Horizon	Entry	Stop Loss	Target	Bloomberg Consensus T/P
Facebook Inc	Technology	FB	USD	159.79	3-6 Month	159.79	139.00	220.00	220.60

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