

Facebook Initial Public Offering Valuation Case Study

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Facebook makes money from advertising. Estimates show that advertisement gives Facebook most of its revenues. For instance Facebook accrued 95 percent of its revenues from advertising in 2009 and 85 percent of revenue in 2011 also came from advertising. The advertisers have the opportunities to target and segment the users based on their demographic details through the use of Facebook advertisement platform.

Facebook asks users to provide accurate account information, but content uploaded by users does not automatically become Meta's property. Meta's terms state that users retain the rights they have in their content while granting Meta a non-exclusive, transferable, sublicensable, royalty-free and worldwide license needed to host, use and distribute that content in accordance with users' settings. Facebook uses account activity and connections to personalize services and advertising, subject to its terms and privacy policies.

The second source of revenue for Facebook is the sales of virtual goods. Examples of the virtual goods are the social games. Sales are facilitated through Zynga, an online gaming company. Consumers purchased virtual goods with a net worth of \$9 billion in 2011. The forecast indicated that the revenue generated by Facebook will be \$14 billion in 2016. The third source of revenue for Facebook is based on the geographical locations of data centers. For instance, the United States accounted for 56 percent of revenue in 2011.

There are two aspects of services and products Facebook owns a directional advertising platform designed for the advertising firm and a social network service for the common users. Social context is Facebook's core value driver for advertising firms. Facebook's social network service provides an excellent user experience. The clean and simple user interface is widely accepted, and Facebook generates a rapid website using its powerful server.

Why is Facebook going public? What is the planned use of proceeds from the offering?

Facebook is going public for various reasons. First, Facebook is going public due to the objective situation. The outdated 1964 Security and Exchange Commission rule requires any private company whose number of shareholders exceeds 500 to adhere to certain financial disclosures, such as filing of financial reports, the same way as public companies. Therefore, the requirement to publicly avail financial details is triggered as the firm's shareholders tend to exceed 500. Secondly, Facebook is

considering going public to raise funds from a large number of investors it will have. The firm will have enough monetary resources to invest in the business and develop new products, making the company more competitive. Also, the shareholders will have the opportunity to gain a good value for their stake in the long run. Finally, the move will assist in further development. It will amplify the brand value and raise its reputation. More users have become attracted to Facebook due to the awareness created, and the market share has expanded as well. The proceeds gained will be used for general corporate purposes and working capital.

Test the sensitivity of the DCF analysis in Exhibit 11 to the assumptions on sales growth and EBIT margins. What are the challenges in using multiple analyses (Exhibit 12) to value Facebook?

McNeil's team relied on the use of market multiples from the recent transaction and comparable firm and the discounted cash flow (DCF) analysis as the primary approach to value companies. The DCF analysis is sensitive to the assumptions used. Application in a fast-growing company is difficult since its value is tied up in intangibles and patents. Prof Damodaran argues that Facebook had the opportunity to dominate its market based on his DCF analysis. However, there are two caveats. First, considering Zuckerberg's controlling stakes in the organization, other shareholders will have minimal contributions to the strategic choices. Secondly, the phenomenal success of Facebook is expected at a \$75 billion valuation, with anything less considered a failure. The market multiple analysis consists of publicly traded companies such as mobile phone manufacturers, online retailers, and social networking companies. Since the use of market multiple is part science and part art, it is significant to identify the right set of ratios and the right set of comparables.

As a potential shareholder, what are your concerns about Facebook or its stock offering? What is your final recommendation for the CXTechnology Fund?

First, Mark Zuckerberg controls Facebook since he owns 56 percent of the votes. It means he is the decision-maker for the company. The shareholders or low-level managers adhere to all decisions implemented by the top manager because the organizational structure is centralized. Any slight mistake could lead to high losses since one person implements all the decisions. Innovation is an integral aspect of any company dealing with technology. Secondly, sustaining creativity on Facebook is hard since it is a social network company. Therefore, investing in Facebook is worrying. Also, class A shares are the only ones available at IPO, but class B is unlisted. Lastly, the number of Facebook users has increased since 2004. Facebook should strive to maintain a large number of users to keep

attracting advertisement companies. If the company fails to maintain its users, the generated revenue will be reduced. Moreover, Facebook faces stiff competition from LinkedIn, Twitter, Google+, and MySpace. As an investor comparing different social networks, I see that space is an important aspect of investing.

Recommendation

The CXTechnology Fund is a practical aspect of investment. First, Facebook is less sold compared to buying due to the enthusiasm of the public for the Facebook IPO. Therefore, an increase in stock price is reported within a short period. Thus, it is a favorable opportunity for short-term investors. Secondly, since the IPO open price is above the intrinsic value of Facebook, the trend suggests that when the enthusiasm of the public also reduces, the stock price of Facebook will drop. Hence, the CXTechnology Fund should be used to purchase stock during the price cooldown. Thirdly, the decision on whether to buy or sell stocks relies on the ability to analyze future trends. The CXTechnology Fund analyses the stock price. Lastly, overbuying the stock is not a wise decision. Other company stocks are added to the Facebook investment portfolio by CXTechnology to disperse the risk. (Mark, 2018)

Work Cited

Mark, K. (2018). *Facebook, INC: The Initial Public Offering*. Ivey Publishing.