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Thoughts on Social Media Space; Twitter and SNAP Getting Sea Legs Again-FB News Feed Overhaul a Near-Term Worry

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We believe there are a confluence of factors that have catalyzed the growth prospects of both Twitter and Snapchat in the near-term, with some of this momentum clearly happening at the expense of the Facebook platform. Over the past year Facebook's ability to grow its MAU, engagement, and strong ad growth trajectory was a result of Zuckerberg & Co. being viewed by advertisers/publishers as the "only game in town" among social media platforms able to reach an unparalleled consumer base/targeted demographics. With over 2 billion MAUs for Facebook (and roughly 900 million on Instagram) and a best of breed advertising/engagement platform with wide ranging demographics vs the likes of 330 million users on Twitter and roughly 190 million on the millennial dominated Snap platform, the decision was not a tough one for many advertisers. However, since the News Feed overhaul changes announced in early January, coupled by a myriad of organic initiatives that both Twitter and SNAP have deployed in the field/platform enhancements, we believe the tide is slightly turning based on our recent advertiser checks and analysis from the field. To this point, we estimate between 15% to 20% of traditional social media advertisers that have previously only advertised on Facebook are now "experimenting" and starting to advertise on the Twitter platform, which we believe will add roughly 150 bps to 200 bps of much needed incremental ad growth for the company in 2018, and in some cases also looking closely at the SNAP platform as the app redesign is a long-term positive catalyst for ad growth in our opinion. While Facebook continues to remain our favorite name in the space, we do believe a renaissance of growth and new MAU/engagement is starting to benefit both SNAP and Twitter as organic initiatives/targeted ad algorithms, app redesign, and a host of content driven campaigns are serving as positive catalysts in the field for 2018, although clearly there is still more wood to chop before victory can be declared for both names.

Facebook (Highly Attractive, $225 Price Target)

While there continues to be evolution around Facebook's ad growth model and monetization strategy, it appears the company is executing extremely well in the field (e.g. engagement, MAU growth, ad growth) and all key metrics look healthy heading into 1H18 despite the speed bump from this News Feed overhaul. With MAUs currently north of 2 billion total users, Facebook will continue to grow its massive global installed base in our opinion while importantly monetizing users especially on the Instagram side of the house, which remains the “core 1-2 punch” that underlies our bullish thesis on the name. With this golden jewel platform on pace to be over 1 billion MAUs by mid 2018 based on our estimates, we view this still as an underappreciated asset by the Street that could be a major growth catalyst for Facebook over the next 12 to 18 months on the advertising front with healthy monetization and ad growth set to play out in 2018 based on our forecasts. While the News Feed changes could be worrisome in terms of an ad growth hiccup, we still believe this overhaul was the right move for longer term user engagement and driving “meaningful content”, which remains the core ingredient in Facebook’s recipe for success for the coming years. Facebook must invest in newer growth initiatives in our opinion to further expand its drivers around ad growth rates, AR, mobile platform expansion, video, consumer engagement, and Instagram/Messenger monetization into 2018 and beyond. This is an integral part of Facebook’s strategy that we expect to play out over the coming years despite worries on the Street around a stepped-up investment profile for the coming year. To this point, it appears Facebook will be releasing a video chat/Portal device at its F8 Developer Conference in May which will be the company’s first in a line of new hardware products to get further entrenched in the consumer smart home/ecosystem in our opinion. While Facebook’s brand and consumer success has helped create a tech titan, now its about the company (with the help of Building 8) expanding its consumer reach and touch points through a myriad of next generation devices/wearables (e.g. smart speaker product potentially slated for summer timeframe) with the underlying goal of further building out its advertising and consumer kingdom vs. the likes of Amazon, Google, and others. This will not be an easy task and the jury is still out on how this premium video chat portal strategy will play out, although we believe its a smart move for Facebook to expand its tentacles into this area of the fertile smart home market.

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News Feed overhaul a "containable" near-term risk; long term benefits. As we have highlighted, Facebook's move to overhaul its "bread and butter" News Feed content to focus more on friends/family rather than promotional videos and ad content, many questions still remain for investors, advertisers, users, and the rest of the Facebook ecosystem around the potential impact of this platform change. That said, while near term this major change will cause some disruption and uncertainty for advertisers on the Facebook platform, with the right "hand holding strategy" and consistent advertising ROI we see minimal negative financial implications from this move for Zuckerberg & Co in 2018. We continue to believe this was the right strategic move at the right time for Facebook as the overhaul will: 1) drive further engagement on the platform for users over time and catalyze ad growth in the medium to longer term, 2) limited ad inventory will ultimately help drive up pricing power and more than offset decreased ad load, 3) calm political pressures and grandstanding from the Beltway which are getting louder post the Russia Meddling situation, and 4) make sure MAU growth and trends remains rock solid into 2018 and beyond. We do believe Facebook's move is well timed which speaks to the growing scrutiny social media platforms are getting from regulators both in the US and EU around content standards and security. While the tightening focus from the Beltway is something to keep a close eye on, we ultimately believe through further investments in security (partially speaks to Facebook's stepped-up investment profile for 2018), ad content AI, improved content algorithms/screening mechanism, and with other platform enhancements that Facebook, Twitter, Google and their social media brethren can keep regulators at bay with this background noise not impacting the core business model. **We maintain our Highly Attractive and $225 price target on shares of Facebook.**

Snapchat (Highly Attractive, $24 Price Target)

With strong secular ad growth trends on the mobile landscape heading into 2018, SNAP now needs to better monetize its growing installed base with additional content, partner programs, international growth expansion, and the self-serve

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platform helping expand the company's tentacles to advertisers that have previously bypassed the platform, a dynamic we saw play out with a strong 4Q performance that shocked the naysayers on the name. We viewed 4Q as another important step in gaining credibility with the Street, proving that this "one trick pony" can expand its tentacles and increase engagement/ad growth potential into 2018 and beyond. Our recent checks with advertisers show that anecdotally speaking trends are slowly moving in the right direction as engagement, pricing, and ad load/inventory should improve during the course of 2018 as the "long overdue" app redesign helps put the SNAP train (hopefully) back on the tracks in our opinion. We note that SNAP's major overhaul of its app design will make it easier and more intuitive for new users to be attracted to the platform, as the complexity has been a clear inhibitor especially for older demographics (key advertising target market) vs. the likes of Twitter, Instagram, and Facebook. While DAU and growth remain an uphill battle, we believe heading into 1H18 SNAP's multitude of newer organic initiatives (e.g. self service platform, programmatic ad model, app redesign) will start to pay dividends and stabilize growth and start to turn this story around over the coming year, building on its 4Q success. While this app redesign is the right move in our opinion, there has been clear backlash to this strategy based on petitions and other wide ranging negative commentary among SNAP's core user base over the last month, which must be successfully hand held through this design change and evolution of the platform, otherwise it could backfire and alienate "power users" of the platform thus remaining a clear risk on the story. To this point, SNAP clearly has challenges ahead and a lot of wood to chop on its platform as well as with investors to make sure this transition period and app overhaul leads to brighter days ahead for the rest of 2018. It all comes down to monetization in our opinion, and SNAP is going through a painful maturation phase to turn this one trick pony platform into a broader, ad centric consumer app that will enable SNAP to increase ARPU and DAU growth over the next 12 to 18 months. While Facebook remains our clear favorite social media name, we are positive on SNAP as the risk/reward and engagement potential still exists, although now its about the company executing and better monetizing its ~190 million DAUs

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in what we would characterize as a "make or break 2018" for SNAP with 4Q results/guidance the first step in this rocky road to recovery. **We maintain our Attractive rating and are raising our price target from $17 to $25 to reflect our increased confidence in the company's turnaround initiatives and underlying growth prospects.**

Twitter (Attractive, $35 Price Target)

Our GBH Tech Tracker results have been incrementally positive on Twitter as feedback from advertisers and user engagement appear to be trending positive thus far in 2018 and this past quarter was a major step that shows the monetization and ad growth machine at Twitter is finally heading in the right direction after years of a "one step forward two steps back" strategy. Overall, 4Q was a breath of fresh air for investors that have patiently awaited for this turnaround story to manifest after years of pain and it looks like the Twitter growth train is back on track heading into the rest of 2018 although risks remain. To this point, we believe that rich video content, targeted engagement, and stronger data analytics around advertising campaigns is the trifecta enabling Twitter to see discernible improvement in advertising/engagement metrics, which is the fuel in the engine for Dorsey & Co. for 2018 and beyond. A tailwind for Twitter in the near-term in our opinion is the Facebook News Feed overhaul, which is forcing publishers and online advertisers to "dip their toe in the water" on the Twitter platform and start to ramp up ad investments on this platform. In our opinion, Twitter could see potentially a benefit of what we estimate is between 150 bps-200 bps of incremental ad growth in 2018 as some advertisers/publishers start to more heavily bet and experiment on the its ad platform, which is showing increasing signs of an ad growth and MAU turnaround for the next 6 to 12 months. The combination of consecutive quarters of accelerating DAU growth, improving advertiser feedback/demand, and GAAP profitability are all clear positives which should gain further steam heading into 1H18. Overall, while clear execution/competitive challenges remain for Twitter in 2018 with the Noto departure not helping matters, recent 4Q results/guidance and

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positive checks thus far in 1Q is another step in the right direction for the company as it appears some organic growth initiatives, secular tailwinds, cost controls, and stabilization trends in MAU are slowly changing the narrative of the Twitter story. **As such, we are raising our rating on Twitter from Neutral to Attractive and increasing our price target from $25 to $38 to reflect our improving advertising checks/growth prospects for 2018.**

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