

The Brush Fire Continues To Spread for Facebook; A Hand Holding Time Ahead for Investors with Uncertainty Abound

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In a nutshell, the Cambridge Analytica data leak has morphed into a dark chapter in the Facebook story and appears to be gaining further sea legs both in the Beltway and EU around more regulatory pressure/hearings (e.g. FTC investigation) that the company could face over the coming months. We continue to strongly believe this situation if handled well by Zuckerberg & Co. will end up being a “manageable risk” with more noise than actual financial ramifications, however the radio silence from executives over the last few days has added fuel to the growing Cambridge fire and if this data leak fiasco is left to fester it could take on a life of its own leading to tougher regulatory oversight/chatter down the road in our opinion. This will be an overhang on the stock until the Street can get a better handle on if any changes to Facebook’s advertising and content model are in store as uncertainty is a black cloud over the name in the near-term. The 10%+ decline in shares of Facebook over the last few days speaks to the broader worry on the Street that the company’s advertising fortress and Teflon-like social media platform with 2 billion users and growing faces a major test to get through this Cambridge data crisis with its core business model still intact with regulatory headwinds swirling and roughly \$4 billion-\$5 billion of annual advertising revenues potentially “at risk” in our estimation. We continue to keep an eye on the louder chatter coming out of regulators and politicians around Facebook’s business model being used for improper means post the Russian meddling situation and Cambridge issue, with their focus on better understanding the company’s advertising reach/algorithms, news content, and 2 billion+ users being protected from future data leaks and data protection issues. The concern from the Street’s perspective is this latest fiasco could reignite the debate within the Beltway and EU around a tighter regulatory environment Facebook and its social platform brethren (Twitter, Alphabet) could face, leading to major changes/impact to the company’s advertising model and key monetization engines for 2018 and beyond. While the tightening focus from the Beltway is something to keep a very close eye on along with Zuckerberg’s ability to navigate Facebook through this hurricane-like storm, we continue to 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 can keep regulators at bay and not significantly impact its golden business model. That said, we will be keeping a close eye on this developing situation over the coming weeks as this represents a “defining period” for Facebook to hand hold and assure its users and regulators around tighter content standards and platform security in light of this latest PR nightmare.

We maintain our Highly Attractive rating and \$225 price target.