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Zuckerberg Wins Day One in DC; Positive Step in the Right Direction

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As we are in Washington DC for the Zuckerberg hearings the angst and worries around how these hearings would go over the next few days could be felt from the Beltway to Wall Street to Sand Hill Road. These hearings are more than about Mark Zuckerberg and Facebook, but have wide reaching ramifications across the tech space with Google and Twitter front and center as well as the broader ecosystem of online advertising worried about a new regulatory landscape potentially on the horizon. In our opinion, this is the most pivotal 48 hours of Zuckerberg's career and so far he is performing well above expectations, passing with flying colors on Day 1 of the hearings and the Street is showing a sigh of relief accordingly. Zuckerberg looks confident and is a stark contrast to the fears this was going to be another Rocky movie with a Congressional beating and Facebook/Zuckerberg waving the white towel. Firmly defending the company's platform, strategy, and monetization capabilities through advertising has been a key theme of today's hearings, while taking clear ownership for the Cambridge debacle. The regulatory landscape Zuckerberg continues to walk a tight rope on as more regulation is on the horizon, however Facebook needs to navigate through these hearings with a path for slight to moderate regulatory oversight vs. heavy handed regulation which is the draconian fear of investors that would change the model/landscape. Zuckerberg and Facebook have a clearer set of new security standards and content privacy to be rolled out, which is a positive start as regulators want to make sure Cambridge will ignite change for users and not the status quo. Zuckerberg is defending his platform and the advertising model and not backing himself into a corner with politicians aggressively trying to grill Facebook post Cambridge with the company clearly not doing enough in the eyes of the Beltway and users. Zuckerberg is conciliatory and taking ownership, but firmly holding the stance of Facebook, it's $50 billion advertising fortress and golden business model which is sending a bullish message to the Street. While dancing around GDPR regulations coming down the road and what that means for broader changes to the platform, it appears Facebook is on a path with more advertising transparency and tighter data privacy/content, which is a focus on the Street.

In our GBH Tech Tracker user survey work over the past few weeks post Cambridge, we found that roughly 15% of Facebook users polled will decrease in some capacity their use of the platform in light of the Cambridge issue and we estimate a negligible number of users have deleted their Facebook accounts despite the backlash. We estimate in a worst case scenario that between $1 billion to $2 billion of annual advertising (~3% of revenues) is "at risk" in 2018 based on slower user growth, reduced engagement, and softer advertising revenues with regulation the major variable that is a concern for the Street. In a nutshell, so far the fundamental damage to the Facebook platform has been "contained" in our opinion and is better than feared which is a relief for 1Q/2018, however this will be a long winding road with a defining few weeks and months that lies ahead for Facebook and Zuckerberg, with this coming week in DC kicking off an important chapter to help navigate the treacherous regulatory landscape over the next 12 to 18 months. **We maintain our Highly Attractive rating and $225 price target on Facebook.**

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