

Zuckerberg and Facebook Face a Pivotal Week Ahead; Get the Boxing Gloves On

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Facebook has faced a tsunami-like storm of criticism from users, advertisers, and regulators over the past few weeks since the Cambridge Analytica data leak situation became public as potentially 87 million Facebook users had their data exposed. Clearly this represents the darkest chapter in Facebook's 14-year history as the global criticism of the handling of the Cambridge situation has reached a feverish pitch both in the Beltway and EU, as regulation chatter continues to swirl over the Facebook story. While the reaction from the Street has been a confluence of fear, uncertainty, and fundamental worries resulting in a stock down 15%+ since the Cambridge crisis began, this coming week with Zuckerberg appearing in a series of Congressional hearings on Tuesday and Wednesday will be a pivotal chapter to help assuage politicians, users, and regulators around data privacy/content with Facebook needing to strike a conciliatory tone across the board. Navigating the PR minefield has been a difficult journey for Facebook as the initial silence post Cambridge has now turned into an aggressive media blitz heading into the hearings this week, which is a smart move in our opinion. We believe taking ownership as Zuckerberg and Sandberg have done around Cambridge this past week is a positive initial step that has been viewed favorably by the Street as transparency and a "tighter security and privacy platform" will be a key theme for Facebook going forward post the Cambridge nightmare. While we expect to hear some more details around Cambridge and the timeline of events this coming week during the expected Congressional grilling, the important data points to listen for will be around new features, strategy, and security enhancements going forward that Facebook will implement along with its 20,000 employees (by year-end) focused on this key area of security and data content filtering to restore trust back to the platform and give regulators a higher level of comfort going forward.

"Contained" fundamental damage thus far to Facebook. 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. Regulation remains the major X variable not just for Facebook, but its social media brethren Google, Twitter, Snapchat, as well as the rest of the ecosystem with slight to modest regulatory oversight at this point the best case scenario, with more drastic and heavy handed regulation both within the Beltway and EU a clear bearish sign for the sector, which we continue to believe is a less likely scenario at this point. To this point, we will be in DC this coming week to get a better sense on the Hill around the tone and regulatory chatter during and post the Zuckerberg/Facebook hearings with multiple outcomes possible. **We maintain our Highly Attractive rating** despite this white knuckle period ahead for Facebook which could result in a range-bound stock in the near-term, although fundamental damage at this point appears limited to the name which is a positive takeaway in a cloudy situation.