# *Handout A.2*
# Case Study – Facebook, Inc. [FB]

*All information included in this case study is based on public knowledge obtained from the sources listed below.*

**Total Revenues (estimated, in millions US$)**

| Year | | Revenue | Growth |
|---|---|---|---|
| 2006 | $ | 52 | — |
| 2007 | $ | 150 | 188% |
| 2008 | $ | 280 | 87% |
| 2009 | $ | 775 | 177% |
| 2010 | $ | 2,000 | 158% |
| 2011 | $ | 4,270 | 114% |

Facebook, Inc. is a U.S.-based Internet corporation that runs the social networking website, Facebook, which has over 900,000,000 users worldwide. Facebook, Inc. was founded in 2004 by Mark Zuckerberg, along with three others: Chris Huges, Eduardo Saverin, and Dustin Moskovitz.

Facebook is free for users to join and primarily earns money through advertising. The site made $3.7 billion in revenue in 2011, which was an 88% increase over 2010. Roughly 84% of this income came from advertising.

Advertisers tend to be attracted to Facebook for two main reasons: its massive reach (of around 500 million daily users) and its ability to target ads at specific users based on the information they provide to the company through the website.

The remaining revenue comes from payments for games and other add-on applications. Facebook, Inc. takes a 30% cut of revenue from Zynga, the developer of FarmVille and other popular games, and a similar cut from other game development companies. Virtual goods accounted for 12% of Facebook's revenue in 2011, according to documents filed by the company with the Securities and Exchange Commission.

Facebook, Inc. filed for an initial public offering on February 1, 2012. The company planned a $5 billion IPO, the largest in Internet history and one of the largest in the history of the technology sector. Facebook valued its stock at $38 a share, which priced the company at $104 billion: the largest valuation to date for a newly public company. The company's shares began trading on May 18, 2012 and though the stock struggled to stay above the IPO price for most of the day, it set a new record for trading volume of an IPO with 460 million shares.

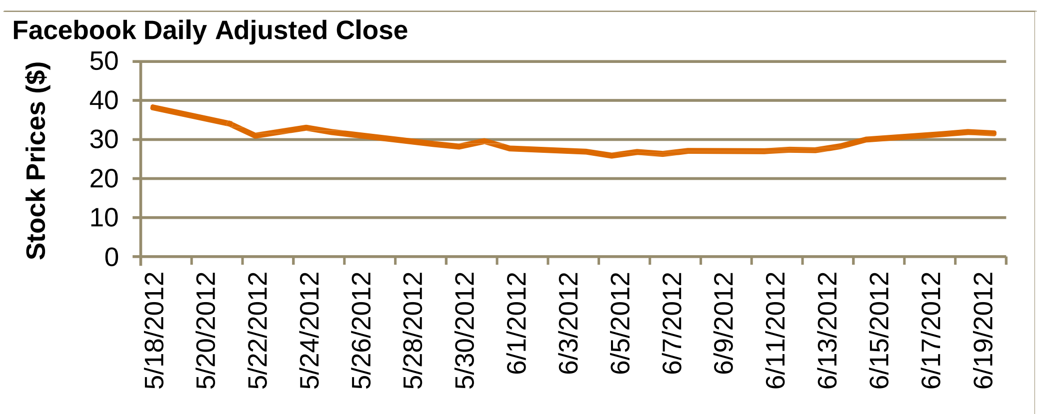
The first day of trading was marred by numerous technical glitches that prevented orders from going through. These glitches and misleading information from underwriters prevented the stock price from falling below the IPO price on the first day of trading. However, the stock price quickly fell in subsequent days, closing at $34.03 a share on May 21 and $31.00 a share on the following day.

Facebook's IPO is now under investigation and a class-action lawsuit is in the works due to the trading glitches that led to botched orders. Additional lawsuits have also been filed due to allegations that an underwriter[1] for Morgan Stanley selectively revealed earnings information to preferred clients. Other underwriters and Facebook's CEO and Board of Directors are facing similar litigation. It is believed that a Facebook financial officer cautioned the underwriters about revenue growth because of a shift of Facebook users to cell phones and mobile devices, where Facebook has less room to advertise and generate revenue. The underwriters then cautioned top clients about this shortly before the IPO, while leaving the general public ready to buy the overpriced shares. The litigation against Facebook alleges that it failed to fully disclose its weakened financial outlook before its IPO.

By the end of May 2012, the stock had lost over a third of its initial value, dropping to $25.50. *The Wall Street Journal* called the IPO "a fiasco." Fortunately, for Facebook investors, by mid-June 2012, the stock value had rebounded to $32 a share.

**Stock Prices over Time**

The graph below shows the adjusted closing price for Facebook stock between mid-May and mid-June 2012.[2]




[1] An underwriter is a company that manages the issuance and distribution of stocks from a corporation. The underwriter works closely with the corporation to determine the IPO stock price before buying stocks from the corporation and selling them to investors. Underwriters generally receive fees from the corporations offering the stock and usually earn profits when selling the shares to investors.

[2] The adjusted closing price on a stock is the closing price of a stock on any trading day with adjustments for dividends and stock splits. Here is a simplified example: if 20 shares of stock are traded at $100 per share, a stock split means the investor now has 40 shares at $50. But showing a closing price per stock of $50 makes it appear the stock price dropped from $100 to $50 when the stock really split. So a calculation is used by analysts to show the adjusted closing price so investors are more easily able to look at historical stock prices.

**Sources:**

- www.fundinguniverse.com/company-histories/facebook-inc-history
- www.fool.com/investing/general/2012/06/05/the-3-mistakes-facebook-investors-are-making.aspx
- uk.finance.yahoo.com/news/how-does-facebook-make-money.html
- business.financialpost.com/2012/06/27/wall-street-analysts-like-dont-love-facebook/uk.finance.yahoo.com/q/hp?s=FB
- www.investopedia.com

**Directions:**

In your group, decide which person or persons will answer each question. Briefly write notes in the space provided. Then be prepared to present your answers to the class.

1. What is the company's service or product?

2. Explain any new financial terms used in this case study.

3. What happened to the stock right after the IPO? Explain.

4. How did the stock perform over time?

5. What are some of the reasons for any change in the stock price?

6. How many people in your group would buy this stock right now? What are your reasons?