

Facebook: More than just a thumbs up

Ever since its inception in 2004, Facebook has changed the way people interact with each other and the world. The company, with Mark Zuckerberg at the helm, has gone from strength to strength, despite increasing public scrutiny and heightened regulation. When most people think about Facebook, they think about scrolling through friends' posts, liking the occasional photo and searching for long lost friends, but it is so much more than that. The company has continually reinvented itself, adding not only features, but also making strategic acquisitions which compliments Facebook's core business.

THE BUSINESS

Besides its social media platform and namesake Facebook, the business has also acquired Instagram, WhatsApp, Messenger and Oculus. Instagram focuses its attention on photo and video sharing, while WhatsApp and Messenger are complimentary messaging services. Oculus focuses on virtual reality hardware and technology. Through these collective businesses, Facebook has tried to emphasise community, building relationships and fostering meaningful interactions between users.

HOW THEY OPERATE

The key to Facebook's success has been advertising. Advertising is big business, with Facebook raking in USD69.66 billion in 2019 alone. They have continuously improved the way ads are delivered, and how individual users are targeted. This is important for advertisers, who want the most bang for their buck as the global consumer comes under pressure. Facebook has taken this a step further, helping advertisers strategically set up ads, ensuring that the ad doesn't only reach the right audience, but that the content of the ad is more targeted.

Facebook is also exploring other avenues to generate revenue.

- Take Instagram for example. Not only is it an excellent platform to advertise on, but what about click through sales? The idea is to advertise a piece of clothing on Instagram, if a person likes it, instead of being redirected to the product's website, they can buy it using Instagram itself. Suddenly, Instagram becomes a significant "retail outlet".
- WhatsApp is another avenue of untapped potential, with implications not only for advertising, but how businesses interact with their clientele. Instead of clients having to contact the business's call centre and listen to elevator music while waiting for help, rather, you can chat to a consultant directly via WhatsApp.

WHY FACEBOOK?

Facebook has a capital-lite business model that is scalable. It employs more than 44 900 people, and presently have 15 data centres globally to handle the more than 2.5 billion active monthly users (almost a third of the world's population). The average revenue generated per user reached USD29.25 in December 2019 from its core products, Facebook and Messenger services.

This enabled the business to achieve an adjusted operating margin in excess of 40% for the year ending 2019. This adjusted operating margin is expected to decline over time to what we believe is a more sustainable level of 35%. The moderation in the operating margin is due to new users predominantly being based in less affluent geographies, leading to less revenue per user. This is to be expected as developed markets become saturated and the pick-up in new users in those regions start to taper off.

In addition to its high operating margins the business also sits on a war chest of cash, in excess of USD54 billion. This can be deployed in strategic acquisitions or to buy back shares if the opportunity arises. This means that you get a business that is a well-oiled machine, without having to worry about balance sheet stress.

IN A NUTSHELL

At Cadiz, we are always on the lookout for well-run companies which show a history of superior returns with low financial risk. By investing in Facebook, we believe the risk of losing capital is low, while the potential for above-market returns is skewed in our favour. Despite heightened regulation and public scrutiny, we believe Facebook will be able to continue to deliver superior returns in the future, which should reward our patience over time.

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