

Facebook Inc**Facebook investors wake up to era of slower growth**

Social network shocks those who rushed into the supercharged Faangs group of tech stocks



Facebook's forecast of a significant slowing in growth rates and a squeeze on margins later this year spooked investors © FT montage / Getty Hannah Kuchler in San Francisco JULY 26, 2018

Even after politicians turned on [Facebook](#) this year, investors could take comfort from resilient revenues and strong profit margins.

Now they have to consider not only the regulatory threats on the horizon but the more immediate shock of a sharply slower growth rate.

Their reaction was considerable: after missing earnings forecast, [Facebook lost more than \\$100bn in market capitalisation](#) — the biggest one-day value plunge of a listed company in US history.

The social media group had been trading at an all-time high, with 44 out of 52 analysts rating the stock a “buy”, as investors piled into technology stocks and shrugged off the [Cambridge Analytica](#) data leak.

But it was not regulatory risk that caused the stock to tumble. It was the forecast of a significant slowing in the second half of the year, making analysts scramble to recast their models for a world in which Facebook’s annual revenue growth is in the 20s, not the 40s. David Wehner, chief financial officer, also forecast margins would slip from 44 per cent this quarter to the mid-30s in two years.

While politicians and the press have beat up on [Facebook](#), investors have been bidding it up. The [depth of the stock’s dive](#) reflects both the concerns over the company’s ongoing growth and the extent to which investors had rushed into the club of super-charged stocks that it leads, [the so-called Faangs](#): Facebook, Apple, Amazon, Netflix and Google.

Daniel Ives, an analyst at GBH Insights, said Facebook was held to a “higher standard” among investors. “Their outlook for the second half and for 2019 puts the company firmly in the investor

penalty box.”

Pinning down the reason for the drop in forecasts was hard. Neither Facebook nor analysts blamed the scandal surrounding Cambridge Analytica, the research firm that worked for Donald Trump’s presidential election campaign. Mr Wehner said there were “several factors” behind the lowered projections, including currency, new advertising formats and privacy.

Daily active users fall in Europe

% change, quarter on quarter



Source: company
© FT

“We expect currency to be a slight headwind in the second half versus the tailwinds we have experienced over the last several quarters,” he said. “We plan to grow and promote certain engaging experiences like Stories that currently have lower levels of monetisation, and we are also giving people who use our services more choices around data privacy, which may have an impact on our revenue growth.”

The introduction of the [General Data Protection Regulation](#) in Europe knocked user growth and engagement. European daily active users fell 3m in the quarter, a fall of about 1 per cent, and monthly active users were down, but by less. The company said this was consistent with the outlook it had provided the previous quarter and did not say whether it expected the decline to last.

But Facebook said GDPR had so far had no significant impact on advertising in Europe, and that the vast majority of users had chosen to opt in to data collection, including allowing Facebook to track other websites they visited. In future, Mr Wehner said, there would be only a “modest impact” on revenue growth.

Mr Ives agreed. His surveys of advertisers show only about 3 per cent of Facebook's revenue was "at risk" from worries about privacy after GDPR and Cambridge Analytica.

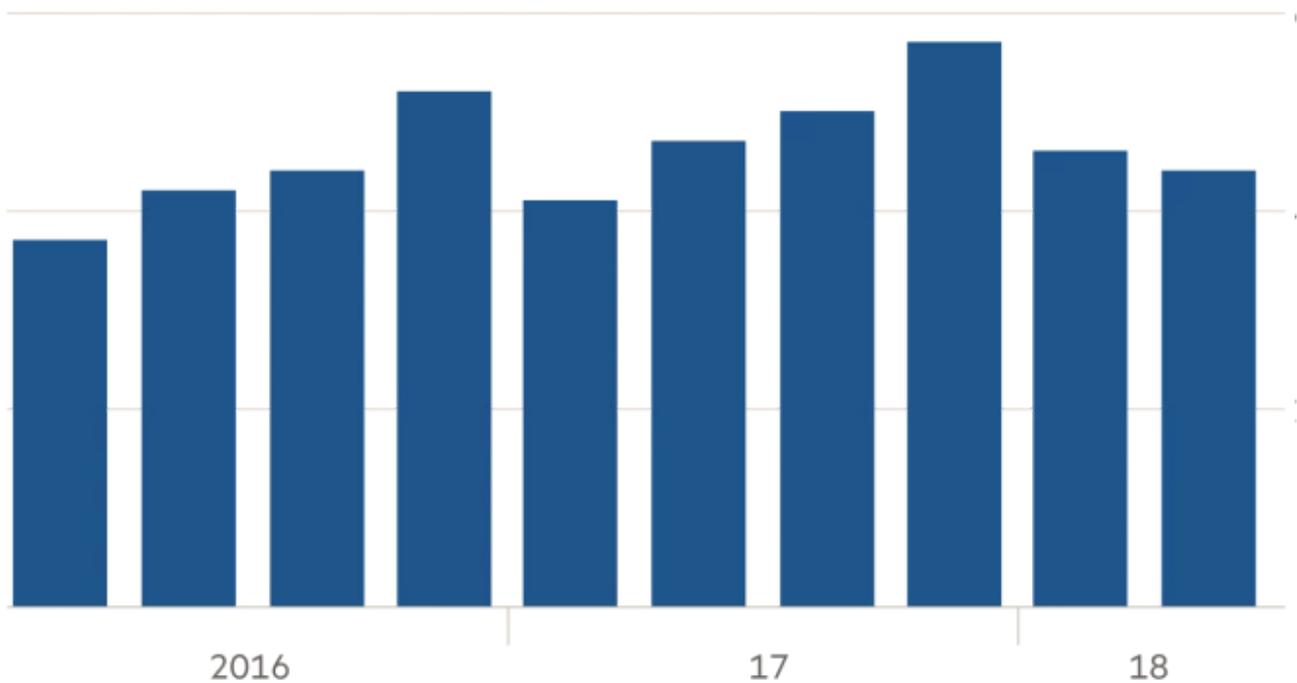
While privacy concerns have awoken politicians and regulators, investors were shocked by the re-emergence of an older concern: that Facebook has reached the limit of how much advertising it can show in its news feed.

Engagement slipped in the [fourth quarter last year](#), when Facebook said users in North America had spent millions of hours less on the platform and daily active users declined for the first time.

Facebook margins are coming under pressure

Operating profit margin (%)

Company forecasts a significant slowing in the second half of the year and a squeeze on margins in the medium term to the mid-30s



Source: company
© FT

At the start of this year, Facebook warned that time spent in the news feed was likely to fall as it rejigged the algorithm to reduce the passive consumption of news and videos, in favour of prioritising "meaningful connections" with friends and family.

Sheryl Sandberg, Facebook chief operating officer, was optimistic that the increasing inventory of Stories, the photo collection format that was borrowed from Snapchat, would be an "important opportunity for growth" because they are full-screen and more "authentic" and "engaging".

But, she added, it would take time to determine whether Facebook could sell adverts in Stories at the same rate as it could in the news feed. "We definitely see it takes a while for advertisers to

adopt new formats,” she said.

Ms Sandberg also spoke about long-term opportunities to make money from Facebook Messenger and WhatsApp for business.

Jessica Liu, an analyst at Forrester Research, said the Facebook family of apps, including Instagram, Messenger and WhatsApp, was “alive and well”. Facebook announced the total user base of all its apps for the first time, at 2.5bn monthly active users.

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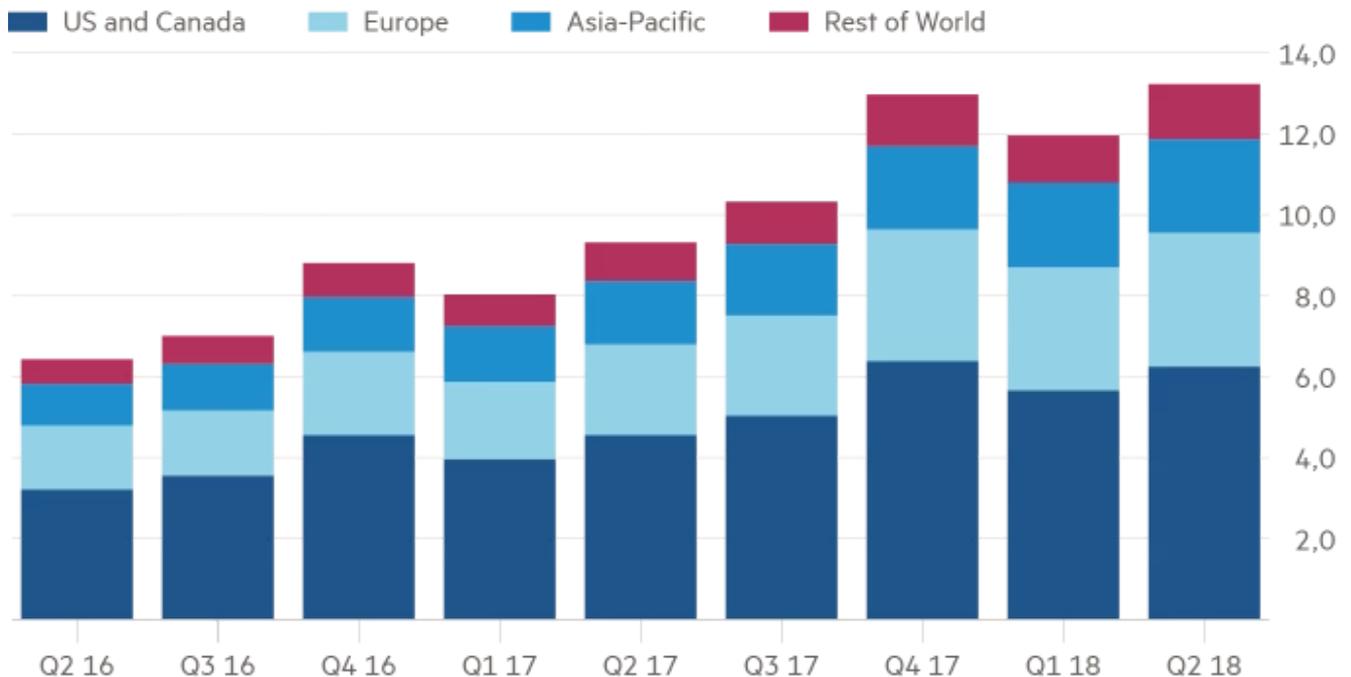
“A slight hit in one area like Facebook core users can be offset by other areas, such as Instagram growth,” she said.

Mr Ives said changes to the news feed had exacerbated advertising problems. “Engagement continues to be an issue on the Facebook platform. Engagement drives advertising.”

But he has maintained a “buy” rating on the stock because he believes Facebook’s forecast is proof of a “six- to nine-month transition period” as the social network tries to create “the next leg of [its] growth story”.

Facebook revenue by user geography

\$m



Q2 18: GDPR takes effect

Source: company

© FT

Brian Wieser, an analyst at Pivotal Research, has a “sell” rating on the stock, however. He argued that Facebook was hitting the limits of its growth in the digital advertising market, which has rapidly won budgets from print and other media — but not yet television.

Facebook's opportunities for growth will then be taking market share from [Google](#), the other (larger) player in the digital advertising industry, or creating the high-quality video content that attracts advertising dollars from TV. Facebook is investing in longer-form, produced video for its Watch service — but that would inevitably have a lower margin, he said.

“If they hit a 20 per cent growth rate in the fourth quarter and they do not expect acceleration next year, at some point it will come down to the teens and they will then converge with the global industry,” Mr Wieser said.

Additional reporting by Robin Wigglesworth in New York

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