FB: Nomura Starts at Buy, $40 Target Despite Mobile Concerns

By Tiernan Ray

Nomura Equity Research's Brian Nowak this afternoon initiated coverage of Facebook (FB) with a Buy rating and a $40 price target, under the headline "Don't stop believing."

Nowak sees Facebook expanding its sales of display advertising, which, he argues, is bought for "targeted reach" by ad buyers.

"Facebook's industry-leading reach, engaged user base, and comprehensive user dataset will enable the company to continue to grow and take share in the display market."

Advertisers looking for that targeted reach in social networking contexts equate Facebook with social networking, he thinks, giving Facebook an advantage.

At the same time, Facebook's 50-cent to $1 cost per click is way less than the $10 to $15 earned by direct-sales ads, he concedes. And click-through rates are less than half of what they are on average for most Internet display ads. Those are areas where Facebook needs to improve, he thinks.

Nowak also concedes that Facebook struggles to monetize the increasing amount of usage happening on mobile devices, something that will take years, not quarters, to improve.

Mobile monetization (and its challenges) has been among the most discussed Facebook topics since the company went public five weeks ago. Facebook's mobile advertising is new, as the company only recently began showing sponsored story ads in its mobile application in March 2012 and advertising performance is low (both CPMs and ROI). That is, we believe the company's mobile user monetization significantly trails its desktop model [...] We do not expect mobile monetization to improve overnight. It takes time for advertising dollars to shift across media, and we have to bear in mind how small (and young) the mobile display market is. In all, we expect the total U.S. mobile display market to be only $560mn (5% of the total online display market) at the end of 2011.

Nowak projects Facebook will make $4.13 billion in revenue this year and 14 cents EPS, rising to $5.09 billion and 45 cents next year. That is slightly ahead of the average Street estimate for $3.77 billion this year, and $5.02 billion next year, though his GAAP EPS estimates are below the consensus estimates for 20 cents and 51 cents per share, respectively.

That’s his "base case," he writes. But if Facebook is able to do things such as charging for branded “fan pages,” at perhaps $2.50 per fan per year (charged to the owner of the page), then the company could conceivably bring in $11.6 billion in revenue by 2014, what he calls a "bull case."

By weighting the different percentages of the base case and bull case, with a little consideration for a “bear case,” Nowak models upside to the stock:

"Facebook would generate $5.3bn of EBITDA in 2014. Even this weighted average is 30% higher than our..."
current model (the base case) and 9% above the current consensus estimate. This analysis shows that there is significant upside potential to our model if/when Facebook starts to improve its monetization.

Facebook shares today closed up 24 cents, or 0.8%, at $31.84 amidst a terrible equity market overall.