



Tim Beyers | July 25, 2012

CURRENT PRICE: [FB](#) \$ 235.68 ↑ \$ 1.66 (0.7%) CúvùGÍ Yř B≈AÖG"AAñ"ÁuAñ v ùN ù

Think about the last time you called a friend to catch up. Has it been a while? Don't feel bad if you said yes; you might just be like me and a nation of others who live that part of our lives on **Facebook** ([NASDAQ: FB](https://www.nasdaq.com/markets/stocks/quotes/FB)) now. That's one example of how the social media pioneer set about revolutionizing the online world when it launched in 2004.

Here's another. Just as **Google** ([NASDAQ: GOOG](#)) used search to redefine digital advertising, Facebook has changed how we engage in commerce by involving our friends. The network tracks what we like, what we play, where we go, and who matters most to us. It's a model that disrupts traditional demographics, and an adventurous business team is focused on wringing value out of it.

Facebook is a \$60 billion business, yet its growth story is still in the early stages. Doubters haven't been shy about explaining what Facebook is getting wrong. But for Rule Breaking investors who understand what it's getting right, Facebook is a multibagger opportunity.

Hacking Out a Profit

I can't blame the skeptics. Much of what we know about founder Mark Zuckerberg may be fiction, thanks to the Oscar-nominated movie *The Social Network*, yet the story resonates because of the [real legal battles](#) it depicts. Add the complaints that greet most every major change Facebook rolls out, and the company's path to the top has been anything but a straight line.

Yet that's good news for long-term investors. Facebook tries, fails, and tries again — all with the goal of continuous improvement. In his letter to shareholders as part of the company's pre-IPO prospectus filing, CEO Zuckerberg refers to this process as "The Hacker Way."

"Hackers try to build the best services over the long term by quickly releasing and learning from smaller iterations rather than trying to get everything right all at once," he said. In this sense, Facebook is essentially what Google was when it went public in 2004: an experimenter with great ambitions and deep pockets. Google's stock has more than quintupled since.

Facebook is also like Google in that it keeps a tight grip on every piece of infrastructure that plays a role in capturing, managing, and delivering data to users. The social network [designs its own servers](#), builds its own data centers, and writes much of its own software. The goal? Smooth out the Internet's rough edges in order to preserve the user experience.

Why Facebook Isn't Google — and Why That's Good

A need for control is where the similarities end. Google CEO Larry Page has his company focusing on "more wood behind fewer arrows," with extreme projects living within the skunkworks outfit Google X. Facebook, by contrast, has embraced a companywide culture of trying just about anything.

WHAT IT DOES:

Facebook is the world's largest social network, with more than 900 million monthly active users.

WHY BUY:

- Facebook is the top dog and standard-setter in modern social media.
- A massive user base protects a growing franchise built through a "hacker culture" of rapid experimentation.
- A recent sell-off prices the stock at a large but more reasonable premium.

KEY DATA:

- **Headquarters:** Menlo Park, Calif.
- **Website:** www.facebook.com
- **Sign of a Breaker:** Top Dog
- **CAPS Rating:** 1 star (13 out of 100)
- **Market Cap:** \$61,500
- **Cash/Debt:** \$3,900 / \$706
- **Revenue (TTM):** \$4,000
- **Earnings (TTM):** \$972
- **Revenue (2009/'10/'11):** \$777 / \$1,974 / \$3,711
- **Earnings (2009/'10/'11):** \$229 / \$606 / \$1,000
- **Recent Price:** \$28.75

TALK ABOUT IT:

[Visit Facebook's discussion board here!](#)

Data as of 07/20/12. Dollar amounts in millions except recent price.

And that's led to crazy amounts of innovation. Think of how Facebook advertising works. While Google generally charges per click, Facebook is collecting entirely new data, such as "likes," logins, and gaming preferences via its highly profitable partnership with Zynga. Facebook's revenue is rising fast — it's increased fivefold, to \$4 billion, in less than three years — because no one else has what the social network has.

Let me say that again, because it's important. *Nobody else on Earth knows about you what Facebook knows about you.* The information in its databases amounts to an entirely new form of demographics covering hundreds of millions of people.

Access doesn't come cheap for corporate customers such as Ford. We know because Facebook maintains a 24% net profit margin despite huge hiring and capital expenses. It's a large delta that could widen with further breakthroughs.

The Mobile Myth Revealed

Facebook skeptics also tend to bring up one more bugaboo: mobile. The social network hasn't brought ads to its mobile app.

Is that really as bad as it sounds? Non-believers take it as an admission of shortcomings when Zuckerberg says improving Facebook's mobile experience is a top priority, but that's not the same as calling mobile a missed opportunity. The evidence points to the contrary; mobile is a huge source of data thanks to Facebook Connect, which a large and growing number of mobile apps use for logging in users.

Karl and I [saw this for ourselves](#) at this year's South By Southwest Interactive conference in Austin, Texas. At the time, the social network said it had served more than 430 million mobile users in December. Imagine what could be if that number keeps rising.

Risks and When We'd Sell

Expect volatility if you own Facebook. A lockup that's prevented some insiders from cashing in expires on Aug. 19, which could flood the market with sell orders. Critics worry that Facebook is attracting fewer unique visitors, that it doesn't take privacy seriously enough, or that a social media bubble is about to burst. It's all drama, yet it ensures Facebook's chart will zigzag over the short term. What to do? Buy slowly. Take a nibble here and there, keeping commissions low as you build a position at good prices. And hold for the long term.

We have good evidence the market is expecting a decade of 35% annualized free cash flow gains from Facebook. Track that number. If our thesis is right, the social network will eclipse it. But if Facebook falls short for several quarters in a row, we'll reevaluate and suggest you do the same.

The Foolish Bottom Line

Facebook has all sorts of issues. Run by a young and mistake-prone CEO, it's expensive compared to most stocks and operates in the new and still misunderstood social media market. Skeptics see that as reason enough to stay away.

Here's what they miss: Zuckerberg has invested the bulk of his fortune in making Facebook a success. Despite his many misses, he's managed to keep the company not just alive but thriving. Mix in a culture of innovation and a surprisingly reasonable valuation ([more on that in our Buyer's Guide](#)), and you've got a business we think will be a friend to your portfolio.

See the team's and David and Tom Gardner's holdings [here](#). The Motley Fool owns shares of Facebook, Ford, and Google.



© 1995 - 2020 The Motley Fool. All rights reserved.

Market data provided by FactSet and Web Financial Group.