



### COMPANY UPDATE / ESTIMATE CHANGE TARGET CHANGE

#### Key Metrics

FB - NASDAQ - as of	7/26/17	\$165.61
Price Target		\$189.00
52-Week Range	\$113.55 -	\$166.17
Diluted Shares Outstanding (mm)		2,898
Market Cap. (\$mm)		\$479,967
1-Mo. Average Daily Volume		17,975,253
Institutional Ownership		59.4%
Debt/Total Capital (net)	Q2'17	0%
ROE		23.2%
Book Value / Share		\$22.92
Price / Book Value		7.2x
Dividend Yield		0.0%
LTM EBITDA Margin		54.1%

#### GAAP EPS FY 12/31

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$0.60		\$1.04	A \$1.09	\$1.22
2Q	\$0.71		\$1.32	A \$1.28	\$1.43
3Q	\$0.81	\$1.07	\$1.30	\$1.31	\$1.48
4Q	\$1.21	\$1.40	\$1.51	\$1.61	\$1.76
Year	\$3.33	\$4.52	\$5.17	\$5.30	\$5.90
P/E	49.7x		32.0x		28.1x

\*Columns may not equal due to rounding

#### Revenue (\$mil)

		Prior	Current	Prior	Current
	2016A	2017E	2017E	2018E	2018E
1Q	\$5,382		\$8,032	A \$9,745	\$10,176
2Q	\$6,436		\$9,321	A \$10,978	\$11,616
3Q	\$7,011	\$9,337	\$9,656	\$11,572	\$12,211
4Q	\$8,809	\$11,142	\$11,570	\$13,612	\$14,398
Year	\$27,638	\$37,329	\$38,579	\$45,906	\$48,401

Facebook Inc – is the world's largest social network, with almost 2 billion monthly active users. Facebook connects users with friends and family and allows users to share information. A majority of Facebook revenue is derived from mobile advertising, of which Facebook has become the market leader. Other Facebook brands include Instagram, WhatsApp, Messenger and Oculus. Facebook launched in 2004, by Founder, CEO & Chairman, Mark Zuckerberg and is headquartered in Menlo Park, California.

### Facebook Inc.

FB - NASDAQ – Long-term Buy - 3

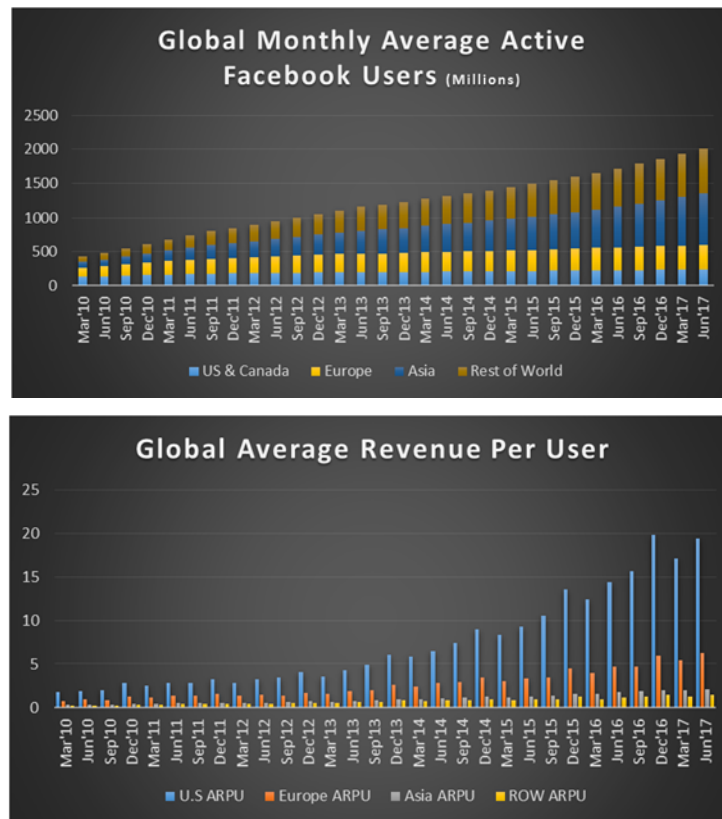
### Facebook Reports Exceptional Q2 Results; Improved Outlook; Raising Price Target to \$189

- Key Metrics.** Facebook ended Q2 with a record 2.006 billion monthly active users vs. our estimate of 1.964 billion, up a better than expected 17% y/y. Daily active users totaled 1.325 billion vs. 1.128 billion last year. The average revenue per user (ARPU) during the quarter was \$4.73 vs. our estimate of \$4.64, up 24% y/y. Mobile ad revenue increased 53% y/y and represented 87% of ad revenue, up from 84% last year. The average price per ad increased 24% y/y with ad impressions increasing 19% y/y. Headcount jumped 43% y/y to over 20,000 employees. Over 15 million businesses now have a Facebook profile.
- Results.** The company reported GAAP EPS of \$1.32, up 87% y/y on revenue of \$9.32 billion, up 45% y/y. Ad revenue of \$9.16 billion increased 47% y/y. Gross margin increased to a Q2 record 86.7%, while operating margin reached a Q2 record 47.2% increasing 450 bps y/y due to leverage gained by the higher revenue base. Facebook's cash balance was a record \$35.4 billion, or \$12 per share, the company has no debt. Operating cash flow totaled a record \$5.36 billion, while free cash flow was \$3.92 billion, an increase of over 78% y/y.
- Guidance.** Expense growth guidance was tightened to 40% to 45% from 40% to 50% growth y/y for FY'17. Management also expects a lower full year tax rate similar to Q2. We expect advertising revenue growth to slow throughout FY'17 from lower News Feed ad load growth despite strength from new platforms which monetize at lower rates.
- Outlook.** We increase our outlook on improving ad rates despite concerns of lower ad load growth and higher expenses in the second half of FY'17. Our Q3'17 GAAP EPS estimate increases to \$1.30 from \$1.07 on revenue of \$9.65 billion from \$9.33 billion. We raise our FY'17 outlook based on higher ARPU, increasing advertiser count, new ad products like Dynamic Ads, and continued growth in global users across products. We expect FY'17 & FY'18 EPS of \$5.17/\$5.90 on revenue of \$38.5/\$48.4 billion vs. our prior view of \$4.52/\$5.30 on revenue of \$37.3/\$45.9 billion, respectively.
- Opinion.** We raise our FYE'18 price target to \$189 from \$170 and maintain our Long-term Buy-3 rating.

**Note Important Disclosures on Pages 7-8**  
**Note Analyst Certification on Page 7**

### ADDITIONAL DISCUSSION

From a geographic and total user basis, the Asia region monthly active user (MAU) base of 756 million was the largest and experienced the fastest user growth, up 28% y/y, a surprising improvement from last quarter's 27% growth rate and last year's 19% growth rate. Asia ad revenue of \$1.55 billion increased 54% y/y as ARPU increased 20%. Rest of World (ROW) segment MAUs of 654 million increased 18% y/y, vs. 19% growth from last quarter and in line with the year ago quarter. ROW ARPU increased 31% y/y, significantly above that during the year ago quarter. ROW revenue of \$947 million increased a strong 56% y/y vs. 49% in the year ago quarter. The U.S. & Canada region experienced the slowest growing user count with 236 million MAUs, up 4%, while average revenue per user increased 35% y/y to \$19.38, a significant slowdown vs. 54% growth in the year ago period. Monetization continues to improve as Facebook's total average revenue per user was \$4.73 vs. \$3.82 last year, growth of 24% y/y. This was a result of the average price per ad increasing 24% y/y vs. 14% last quarter while ad impression growth slowed to 19%, down from 32% as ad load growth begins to decelerate as expected.



Source: Company data

### OUTLOOK

We continue to believe Facebook has an industry leading mobile advertising position due to the network effect of the social media company's 2-plus billion monthly active user base, other company-owned brands such as Instagram, Messenger, WhatsApp, Oculus, and when combined with the Audience Network and new products/management tools like Dynamic Ads that can boost revenue from traffic across the web. While Facebook continues to increase and improve its advertising ability across these new platforms, they currently monetize at a lower rate which we expect will weigh on future growth. However, we expect continual monetization improvement within these products. Facebook's advertiser count now exceeds 5 million advertisers, while the company is building a pipeline of 15 million businesses with a Facebook profile which we view as potential future customers. Results are expected to benefit from enhanced video advertising through mobile first ad campaigns, Instagram Stories monetization, Dynamic Ads, and continued global user growth. However, advertising revenue growth rates are expected to slow as ad load growth slows on News Feed.

Management tightened FY'17 expense growth guidance to 40%-45% from 40%-50%, which is boosting shares considering Alphabet's higher cost quarter. We increase our outlook on improving ad rates despite concerns of lower ad load growth and higher expenses in FY'17. Our Q3'17 GAAP EPS estimate increases to \$1.30 from \$1.07 on revenue of \$9.65 billion from \$9.33 billion. We raise our FY'17 outlook based on higher ARPU, increasing advertiser count, and continued growth in global users across products. We expect FY'17 & FY'18 EPS of \$5.17/\$5.90 on revenue of \$38.5/\$48.4 billion vs. our prior view of \$4.52/\$5.30 on revenue of \$37.3/\$45.9 billion, respectively.

## VALUATION

In our opinion, shares of FB represent a long-term investment opportunity suitable for aggressive growth investors. The company is a generator of significant free cash flow and due to the global scale of the business it has been highly profitable with industry leading operating metrics. We continue to recommend shares of FB as we view Facebook and Alphabet as leading beneficiaries of the shift of advertising dollars away from traditional media and onto mobile and video ad platforms.

**We maintain our Long-term Buy rating and increase our FYE'18 price target to \$189 from \$170 per share.** Facebook posted another quarter of consistently strong operating results including strong revenue growth, free cash flow generation, global user, and ARPU growth. We continue to hold Facebook's management team in high regard and believe they can execute on Facebook's well communicated long-term strategy.

We derive our FY'18 price target of \$189 by multiplying our increased FY'18 GAAP EPS estimate of \$5.90 by our forward P/E multiple of 32x, which is in line with our prior multiple and the current forward multiple. Our price target of \$189 offers a potential total return of 11% based on today's intraday price of \$170 through our FYE'18 investment timeframe. This potential return is lower than what we typically prefer for a Long-term Buy rated stock, but we maintain our positive opinion of FB shares and expect more clarity from management in coming quarters on FY'18 expense guidance. Our price target does not include Facebook's \$35.4 billion cash position which can be used for share repurchases, future acquisitions, and growth initiatives should opportunities arise. We expect Facebook's cash position to grow to over \$100 billion in four to five years, which alone would be worth 20% of today's entire market value.

## SUITABILITY

We assign shares of FB a suitability rating of 3 on our scale of 1-4 (1 = most conservative, 4 = most aggressive). A 3 rating is given based on Facebook's limited history as a public company while also incorporating the company's industry leading market position and management team; expanding product set; global reach; solid balance sheet; and significant free cash flow generation. We believe a suitability rating of 3 incorporates these attributes. Shares of FB are suitable for aggressive growth oriented investors seeking long-term capital appreciation, in our view.

## RISKS & CONSIDERATIONS

Risks to our valuation include but are not limited to:

- Ad load growth is expected to materially slow as the mobile news feed product reaches saturation.
- The ability to grow and/or retain the Facebook user base and their current level of engagement.
- Loss of advertising dollars, as advertising revenue generates a majority of Facebook revenue. We highlight ad blockers as one such potential threat to PC and ad mobile revenue.
- The inability by Facebook to further monetize mobile products, as users shift usage patterns.
- The threat of a new social network, website or app that could draw internet users away such as Snap Inc.
- The lack of adoption of the Facebook platform, and/or the lack of innovation and new products from platform partners.
- The threat of a Facebook infrastructure failure, causing site downtime, or ad server downtime, which could materially affect revenue.

- The unlawful distribution of user information, or the hacking of user information by an outside party and other privacy concerns that may drive users away from the site or create an unwillingness of users to share additional information.
- Regulations and restrictions imposed on Facebook by U.S. or foreign governments (China).
- The loss of key Facebook executives including COO Sheryl Sandberg, and CEO Mark Zuckerberg, who have a majority voting interest in the stock.
- Higher expenses due to legal fees resulting from patent lawsuits.

*Additional information is available upon request.*

Other stocks mentioned: Alphabet (GOOGL-\$965.31 – Neutral), and Snap Inc. (SNAP-\$13.40).

## Facebook Inc. Consolidated Statement of Income (in millions except per share data)

	2011	2012	2013	2014	2015	2016	Q1'17	Q2'17	Q3'17E	Q4'17E	2017E	2018E
Advertising revenue	\$ 3,154	\$ 4,279	\$ 6,986	\$ 11,492	\$ 17,080	\$ 26,885	\$ 7,857	\$ 9,164	\$ 9,496	\$ 11,408	\$ 37,925	\$ 47,799
Payments and other fees revenue	557	810	886	974	847	753	\$ 175	\$ 157	\$ 160	\$ 162	654	602
<b>Total Revenue</b>	<b>\$ 3,711</b>	<b>\$ 5,089</b>	<b>\$ 7,872</b>	<b>\$ 12,466</b>	<b>\$ 17,927</b>	<b>\$ 27,638</b>	<b>\$ 8,032</b>	<b>\$ 9,321</b>	<b>\$ 9,656</b>	<b>\$ 11,570</b>	<b>\$ 38,579</b>	<b>\$ 48,401</b>
Cost of revenue	860	1,364	1,875	2,153	2,866	3,788	1,159	1,237	1,294	1,423	5,113	6,322
Research and development	388	1,399	1,415	2,666	4,817	5,908	1,834	1,919	2,105	2,545	8,404	10,801
Marketing and sales	427	896	997	1,680	2,724	3,768	1,057	1,124	1,255	1,643	5,079	6,688
General and administrative	280	892	781	973	1,295	1,730	655	640	676	752	2,723	3,757
<b>Total Costs and Expenses</b>	<b>\$ 1,955</b>	<b>\$ 4,551</b>	<b>\$ 5,068</b>	<b>\$ 7,472</b>	<b>\$ 11,702</b>	<b>\$ 15,194</b>	<b>\$ 4,705</b>	<b>\$ 4,920</b>	<b>\$ 5,330</b>	<b>\$ 6,364</b>	<b>\$ 21,319</b>	<b>\$ 27,567</b>
<b>Income from Operations</b>	<b>\$ 1,756</b>	<b>\$ 538</b>	<b>\$ 2,804</b>	<b>\$ 4,994</b>	<b>\$ 6,225</b>	<b>\$ 12,444</b>	<b>\$ 3,327</b>	<b>\$ 4,401</b>	<b>\$ 4,326</b>	<b>\$ 5,207</b>	<b>\$ 17,261</b>	<b>\$ 20,834</b>
Interest and Other Income	(61)	(44)	(50)	(84)	-31	90	81	87	95	100	363	410
<b>Income Before Provision for Income Taxes</b>	<b>\$ 1,695</b>	<b>\$ 494</b>	<b>\$ 2,754</b>	<b>\$ 4,910</b>	<b>\$ 6,194</b>	<b>\$ 12,534</b>	<b>\$ 3,408</b>	<b>\$ 4,488</b>	<b>\$ 4,421</b>	<b>\$ 5,307</b>	<b>\$ 17,624</b>	<b>\$ 21,244</b>
Provision for income taxes	695	441	1254	1,970	2,505	2,794	344	594	597	823	2,357	3,762
<b>Net Income</b>	<b>\$ 1,000</b>	<b>\$ 53</b>	<b>\$ 1,500</b>	<b>\$ 2,940</b>	<b>\$ 3,689</b>	<b>\$ 9,740</b>	<b>\$ 3,064</b>	<b>\$ 3,894</b>	<b>\$ 3,824</b>	<b>\$ 4,484</b>	<b>\$ 15,266</b>	<b>\$ 17,482</b>
Net Income Attributable to Participating Securities	332	21	9	15	19	26	5	4	5	7	21	22
<b>Net Income After Participating Securities</b>	<b>\$ 668</b>	<b>\$ 32</b>	<b>\$ 1,491</b>	<b>\$ 2,925</b>	<b>\$ 3,670</b>	<b>\$ 9,714</b>	<b>\$ 3,059</b>	<b>\$ 3,890</b>	<b>\$ 3,819</b>	<b>\$ 4,477</b>	<b>\$ 15,245</b>	<b>\$ 17,460</b>
Basic Shares Outstanding	1,294.00	2,006.00	2,420	2,614	2,803	2,863	2,891	2,900	2,928	2,939	2,915	2,973
Diluted Shares Outstanding	1,508.00	2,166.00	2,517	2,664	2,857	2,916	2,944	2,951	2,944	2,967	2,952	2,959
Basic EPS	\$ 0.52	\$ 0.02	\$ 0.62	\$ 1.12	\$ 1.31	\$ 3.39	\$ 1.06	\$ 1.34	\$ 1.30	\$ 1.52	\$ 5.23	\$ 5.87
<b>Diluted EPS</b>	<b>\$ 0.46</b>	<b>\$ 0.01</b>	<b>\$ 0.59</b>	<b>\$ 1.10</b>	<b>\$ 1.28</b>	<b>\$ 3.33</b>	<b>\$ 1.04</b>	<b>\$ 1.32</b>	<b>\$ 1.30</b>	<b>\$ 1.51</b>	<b>\$ 5.17</b>	<b>\$ 5.90</b>
<b>Y/Y Percentage Change</b>												
Revenue	88%	37%	55%	58%	44%	54%	49%	45%	38%	31%	40%	25%
Cost of Revenue	74%	59%	37%	15%	33%	32%	38%	35%	31%	36%	35%	24%
Total operating expenses	132%	153%	-1%	49%	51%	37%	44%	35%	42%	47%	42%	34%
Total costs and expenses	108%	133%	11%	47%	57%	30%	40%	33%	37%	50%	40%	29%
Operating income	70%	-69%	421%	78%	25%	100%	66%	60%	39%	14%	39%	21%
Net income	65%	-95%	2730%	96%	25%	164%	76%	89%	61%	26%	57%	15%
Diluted EPS	64%	-97%	3910%	85%	17%	159%	74%	87%	59%	24%	55%	14%
Diluted share count	14%	44%	16%	6%	7%	2%	1%	2%	1%	1%	1%	0%
<b>Percentage of Revenue</b>												
Advertising revenue	85.0%	84.1%	88.7%	92.2%	95.3%	97.3%	97.8%	98.3%	98.3%	98.6%	98.3%	98.8%
Payments revenue	15.0%	15.9%	11.3%	7.8%	4.7%	2.7%	2.2%	1.7%	1.7%	1.4%	1.7%	1.2%
Cost of Revenue	23.2%	26.8%	23.8%	17.3%	16.0%	13.7%	14.4%	13.3%	13.4%	12.3%	13.3%	13.1%
Gross Margin	76.8%	73.2%	76.2%	82.7%	84.0%	86.3%	85.6%	86.7%	86.6%	87.7%	86.7%	86.9%
Total costs and expenses	52.7%	89.4%	64.4%	59.9%	65.3%	55.0%	58.6%	52.8%	55.2%	55.0%	55.3%	57.0%
Operating income	47.3%	10.6%	35.6%	40.1%	34.7%	45.0%	41.4%	47.2%	44.8%	45.0%	44.7%	43.0%
Net income attributable to Class A and Class B common stockholders	18.0%	0.6%	18.9%	23.5%	20.5%	35.1%	38.1%	41.7%	39.6%	38.7%	39.5%	36.1%

Source: Company data &amp; Hilliard Lyons estimates.

## Facebook Inc. Consolidated Balance Sheets (in millions except per share data)

	2012	2013	2014	2015	Q1'16	Q2'16	Q3'16	Q4'16	2016	Q1'17	Q2'17
<b>Assets</b>											
Cash and cash equivalents	\$ 2,384	\$ 3,323	\$ 4,315	\$ 4,907	\$ 6,456	\$ 5,108	\$ 6,038	\$ 8,903	\$ 8,903	\$ 7,104	\$ 6,252
Marketable securities	7,242	8,126	6,884	13,527	14,165	18,185	20,102	20,546	20,546	25,202	29,200
Accounts receivable, net	719	1,109	1,678	2,559	2,348	2,801	3,070	3,993	3,993	3,415	3,897
Income tax refundable	451	-	-	-	-	-	-	-	-	-	-
Prepaid expenses and other	471	512	793	659	843	916	1,118	959	959	1,209	1,455
<b>Total current assets</b>	<b>11,267</b>	<b>13,070</b>	<b>13,670</b>	<b>21,652</b>	<b>23,812</b>	<b>27,010</b>	<b>30,328</b>	<b>34,401</b>	<b>34,401</b>	<b>36,930</b>	<b>40,804</b>
Property and equipment, net	2,391	2,882	3,967	5,687	6,467	7,104	7,899	8,591	8,591	9,462	10,628
Goodwill and intangible assets, net	1,388	1,722	21,910	21,272	21,096	20,922	20,787	20,657	20,657	20,486	20,315
Other assets	57	221	637	796	700	703	660	1,312	1,312	1,836	2,096
<b>Total assets</b>	<b>15,103</b>	<b>17,895</b>	<b>40,184</b>	<b>49,407</b>	<b>52,075</b>	<b>55,739</b>	<b>59,674</b>	<b>64,961</b>	<b>64,961</b>	<b>68,714</b>	<b>73,843</b>
<b>Liabilities and stockholders' equity</b>											
Accounts payable	65	87	176	196	149	130	260	302	302	170	323
Developer partners payable	169	181	202	217	216	232	239	280	280	278	278
Accrued expenses and other current liabilities	423	555	866	1,449	1,389	1,770	2,018	2,203	2,203	2,400	2,626
Deferred revenue and deposits	30	38	66	56	55	79	78	90	90	80	88
Current portion of capital lease obligations	365	239	114	7	-	-	-	-	-	-	-
<b>Total current liabilities</b>	<b>1,052</b>	<b>1,100</b>	<b>1,424</b>	<b>1,925</b>	<b>1,809</b>	<b>2,211</b>	<b>2,595</b>	<b>2,875</b>	<b>2,875</b>	<b>2,928</b>	<b>3,315</b>
Capital lease obligations, less current portion	491	237	119	107	-	-	-	-	-	-	-
Long-term debt	1,500	-	-	-	-	-	-	-	-	-	-
Other liabilities	305	1,088	2,545	3,157	3,116	3,145	2,964	2,892	2,892	3,598	4,047
<b>Total liabilities</b>	<b>3,348</b>	<b>2,425</b>	<b>4,088</b>	<b>5,189</b>	<b>4,925</b>	<b>5,356</b>	<b>5,559</b>	<b>5,767</b>	<b>5,767</b>	<b>6,526</b>	<b>7,362</b>
<b>Stockholders' equity:</b>											
Common stock and additional paid in capital	10,094	12,297	30,225	34,886	36,129	37,405	38,756	38,227	38,227	38,639	39,291
Accumulated other comprehensive loss	2	14	(228)	(455)	(276)	(374)	(372)	(703)	(703)	(626)	(370)
Retained earnings	1,659	3,159	6,099	9,787	11,297	13,352	15,731	21,670	21,670	24,175	27,560
Total stockholders' equity	11,755	15,470	36,096	44,218	47,150	50,383	54,115	59,194	59,194	62,188	66,481
<b>Total liabilities and stockholders' equity</b>	<b>15,103</b>	<b>17,895</b>	<b>40,184</b>	<b>49,407</b>	<b>52,075</b>	<b>55,739</b>	<b>59,674</b>	<b>64,961</b>	<b>64,961</b>	<b>68,714</b>	<b>73,843</b>

Source: Company data

### Analyst Certification

I, Stephen Turner, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

### Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

### Suitability Ratings

- 1 - A large cap, core holding with a solid history
- 2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
- 3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
- 4 - Speculative, due to small size, inconsistent profitability, erratic revenues, volatility, low trading volume or a narrow customer or product base

### Investment Ratings

**Buy** - We believe the stock has significant total return potential in the coming 12 months.

**Long-term Buy** - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

**Neutral** - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

**Underperform** - We believe the stock is vulnerable to a price setback in the next 12 months.



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings generally reflect a two to three year time period.

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
<b>Rating</b>				
<b>Buy</b>	36	29%	14%	86%
<b>Hold/Neutral</b>	79	63%	5%	95%
<b>Sell</b>	10	8%	0%	100%

As of 7 July 2017

### Other Disclosures

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