Yardeni Research

DISRUPTIVE TECHNOLOGIES BRIEFING
March 21, 2019

Fangdango: Disrupting the Disruptors

The arrows aimed at Facebook and the broader Internet community are coming fast and furious. Facebook is being faulted for broadcasting the live stream of the murders in New Zealand. The company is being investigated by the Department of Justice (DOJ), the Federal Trade Commission (FTC), and the Securities and Exchange Commission (SEC), to name a few. Politicians are piling on with barbs and threats of their own.

While this period of Facebook's tar and feathering is often compared to Microsoft's antitrust years, the scrutiny Facebook faces seems far worse. The sins and the prosecutors are more diverse, and the ramifications threaten the other Internet giants as well. Below, Jackie looks at some of the biggest threats Facebook and other social media companies face:

(1) *Criminal investigation*. The DOJ and the US Attorney's office for the Eastern District of New York are looking into the data-sharing deals Facebook struck with tech companies, including smartphone companies, according to a 3/13 *NYT* article. Among Facebook's data-sharing arrangements, per a 12/18 *NYT* article: Microsoft's Bing search engine was allowed to see the names of almost all Facebook users' friends without consent; Netflix and Spotify were able to read Facebook users' private messages; Amazon could obtain users' names and contact information through their friends; and Yahoo could see streams of friends' posts.

According to the December article, Facebook doesn't believe these arrangements are problematic because it considers its partners extensions of itself. Partners are "service providers that allowed users to interact with their Facebook friends. The partners were prohibited from using the personal information for other purposes." However, Facebook has been historically bad at monitoring its partners and their use of Facebook data.

(2) *FTC investigation*. In 2009, Facebook changed the privacy settings of the 400 million people using its service, making some of their information available to all on the Internet. It also shared the information with its tech partners. The company considered it "instant personalization." However, in 2011 the FTC deemed the privacy changes a deceptive practice. Facebook and the FTC entered into a consent agreement whereby Facebook introduced a privacy program to review new products and features overseen by two chief privacy officers.

Facebook's data-sharing deals have put the company in the FTC's crosshairs again. "F.T.C. officials, who spent the past year investigating whether Facebook violated the 2011 agreement, are now weighing the sharing deals as they negotiate a possible multibillion-dollar fine. That would be the largest such penalty ever imposed by the trade regulator," said a 3/13 *NYT* article.

Politicians are calling on the FTC to be even more aggressive. Representative David Cicilline (D-RI) in a 3/19 *NYT* op-ed wrote: "After each misdeed becomes public, Facebook alternates between denial, hollow promises and apology campaigns. But nothing changes. That's why, as chairman of the House Subcommittee on Antitrust, Commercial and Administrative Law, I am calling for an investigation into whether Facebook's conduct has violated antitrust laws."

He added that Facebook's actions have reduced competition, while the quality of its products has declined and its advertising prices have continued to rise. This, he said, is a smoking gun. He implied the agency should consider bringing a monopoly case against the company.

The European Union (EU) has also been actively monitoring the Internet giants' behavior. Yesterday, the EU fined Google $1.7 billion after determining the company spent 10 years preventing other websites from using the advertising services of rivals. The company ended this behavior after the charges were filed about three years ago. The latest decision brings Google's EU antitrust fines up to $9.4 billion since 2017.

(3) *SEC investigation*. The SEC is investigating whether Facebook warned investors that developers and other third parties may have obtained users' data without their permission or in violation of Facebook's policies, a 7/12 *WSJ* article stated. The SEC "seeks to understand how much the company knew about Cambridge Analytica's use of the data, these people said. The agency also wants to know how Facebook analyzed the risk it faced if developers were to share data with others in violation of its policies, they added," the article stated. The agency has taken the stance in other cases that companies must disclose material data leaks or breaches of which they are aware.

(4) *Outcry over New Zealand video*. The New Zealand mosque shooter's video was live-streamed on Facebook and seen 200 times before the company took it down. None of the viewers flagged the video to Facebook moderators. And before Facebook was notified, the video was copied and a link to the copy was posted and subsequently reposted. As a result, it's estimated that the video has been viewed millions of times on the Internet despite the best efforts of Facebook, YouTube, Twitter, and others.

The inability to catch the video more quickly or prevent it from being duplicated led many to believe the large Internet sites like Facebook have become too big to monitor their own content. One interesting suggestion was putting all videos on a time delay, to give Facebook a head start in detecting which videos are inappropriate. If live TV can be on a delay, the thinking goes, so can Internet video feeds.

(5) *Politicians pile on.* Everyone from President Donald Trump to Democratic presidential hopefuls has pounced on the tech companies. Senator Amy Klobuchar (D-MN) has floated the idea of taxing tech companies when they use consumers' data. "When they sell our data to someone else, well, maybe they're gonna have to tell us so we can put some kind of a tax on it, just like we do with other businesses," she told Recode's Kara Swisher, according to the 3/16 transcript. She's also sponsoring privacy legislation that requires notice of a data breach within 72 hours and allowing users to opt out of data-sharing.

Another presidential hopeful, Senator Elizabeth Warren (D-MA), has suggested breaking up big tech companies like Facebook, Google, and Amazon. She contends that the tech giants have gotten so big that they are controlling how we use the Internet, while stifling competition and innovation. Warren's solution: unwind previously executed mergers, like Facebook/Instagram, Amazon/Whole Foods, and Google/DoubleClick.

Warren would also spin out any online marketplace, exchange, or platform for connecting third parties, label them a utility, and hold them to stricter data-sharing regulations. This would affect Google's search product and Amazon's Marketplace.

"Small businesses would have a fair shot to sell their products on Amazon without the fear of Amazon pushing them out of business. Google couldn't smother competitors by demoting their products on Google Search. Facebook would face real pressure from Instagram and WhatsApp to improve the user experience and protect our privacy," she explained, according to a 3/8 Recode article.

Even President Trump has pounced. Dan Scavino, President Trump's social media director, said Facebook banned him from posting comments on Monday. Facebook said the ban was temporary and occurred after its system thought Scavino was a bot because his account had a certain amount of identical, repetitive activity.

A story about the suspension was retweeted on Trump's Twitter account with the threat "I will be looking into this! #StopTheBias." The President in November said his administration would look into Facebook, Google, and Amazon for potential antitrust violations and has claimed that tech companies have colluded against conservatives.

(6) *The pressure is on*. FANG shares have largely performed well despite privacy concerns, antitrust whispers, and political barbs (the acronym stands for Facebook, Amazon, Netflix, and Google's parent Alphabet). Measured from the stock market bottom on December 24 through Tuesday's market close, FANG shares have climbed 28.9% compared to the S&P 500's 20.4% surge. Likewise, FANG shares are up 7.8% y/y versus the S&P 500's 4.4% appreciation.

However, since the news of the Facebook criminal investigation broke in the 3/13 *NYT*, Facebook shares are down 6.0% through Tuesday, while the rest of the FANG shares are up 2.7% and the S&P 500 has risen 1.5% (*Fig. 1*).

FANG's forward P/E has fallen sharply to 48.1, down from the 60 neighborhood over the past six years (*Fig. 2*). The forward P/E of most FANG members has fallen sharply from the start of 2013 to today. Facebook's has fallen from 39.7 to 21.6 last Friday, Amazon's from 140.9 to 55.2, and Netflix's from a stratospheric 225.4 to 77.5. The exception: Alphabet's forward P/E has climbed from 15.1 to 24.4 (*Fig. 3*). The fact that FANG shares have climbed in recent years despite the P/E compression attests to their rapid earnings growth (*Fig. 4*).

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