Tidefall Capital LP
Q2 2021
July 16, 2021

	Q2 2021	Year To Date	Since Inception (Jan 21, 2020)
TIDEFALL (net of fees)	8.9%	22.5%	126.9%
S&P (total return)	8.5%	15.2%	32.3%
TSX (total return)	8.6%	17.3%	20.2%

We remain enthusiastic about Facebook stock as we believe the strength of its network is consistently underappreciated and that recent fears over Apple's IDFA (identifier for advertisers) change are overblown and will actually improve intrinsic value as it accelerates the company's expansion to in-app commerce.

Nearly a decade after Facebook hit 1 billion users (2.9 billion today), there remains a consistent bear thesis that Facebook is highly vulnerable to disruption. The failure of MySpace and the rise of TikTok and Snap are routinely cited as proof of the lack of a moat. We disagree; MySpace had nowhere near the scale as it peaked at 76 million users and new viral social competitors have done little to stop Facebook's ability to steadily grow its network.

Investors are not recognizing the increasing utility of the core Facebook app in daily life. Facebook Groups has 1.8 billion users and takes advantage of Facebook's unrivaled scale to create hyper-local networks that provide exclusive information and connections. Facebook Marketplace launched in late 2016 and has over 1 billion users, making it a welcomed replacement for Craigslist (and encroaching on eBay). Facebook Shops which just launched in 2020, has over 1 million storefronts and proved invaluable to small businesses during the pandemic. Love it or hate it, Facebook is becoming increasingly hard to avoid and even harder to disrupt.

The most recent concern with Facebook is its increasing tensions with Apple. Since Apple controls the iOS operating system, it can impede Facebook's access to user data. Apple is wisely using increased user privacy controls as a public relations cover to decrease advertising effectiveness (where Apple receives near zero economic share) and promote in-app purchase monetization (where Apple receives 30% of all digital goods sales; the notorious "app store tax").

Apple's IDFA update in iOS 14.5, which is currently being rolled out, forces users to opt-in to third party tracking between apps. Although the vast majority of users prefer to see relevant advertising, the idea of being "tracked", and by Facebook specifically, is highly unappealing. Unsurprisingly, most users are not opting-in to the IDFA prompt, which limits ad targeting effectiveness, especially with view-through ad attribution, where a user sees an ad but days later purchases the item outside of the app. Facebook has responded by taking out full page ads, highlighting how small businesses could be harmed by Apple's change and even warned of a "more than 50% drop in revenue."

However, we believe that investors are focusing too much on the media headlines and battle to win public opinion rather than the likely financial outcome. Although users opting out of sharing their IDFA does hurt Facebook's ability to track them outside of the app it does not impact its ability to analyze their data inside the app. We expect the tracking change will be a manageable transition due to Facebook's robust internal data sources and comprehensive analytics platform.

The specific 50% drop in revenue that Facebook has publicly warned about is only in relation to its outside of app advertising tool called Audience Network which third parties use in their own apps to display ads. This ad tool is such a small part of Facebook's business that it is not even segmented in its financials. Based on developer payout disclosures from 2018, we estimate that Audience Network is less than 3% of Facebook's total revenue.

The IDFA change, although significant, somewhat reminds us of previous dire media headlines about Facebook such as the implementation of GDPR, Europe's 2018 privacy law, which ended up being quite manageable. Although there may be some difficult quarters this year as advertisers adapt to the change, we are confident this will not prevent Facebook from its relentless growth in average revenue per user (ARPU), which has increased over 800% in the past decade.

Part of our long term confidence in Facebook's continued ARPU growth is due to the second order effects of Apple's IDFA update that incentivizes Facebook to achieve complete control of advertising attribution by facilitating commerce transactions, which are the largest source of Facebook's ad demand. Although common in Asia, Social Commerce growth has been slow in the West but looks well suited to visual based social platforms like Facebook and Instagram. Once a user completes just one in-app transaction, Facebook will have their shipping and payment info saved which greatly reduces the friction to future purchases. We believe that Social Commerce is likely to be a dominating retail trend over the next decade as the Creator Economy takes hold. In a March Clubhouse event, Zuckerberg discussed this potential favorable outcome for Facebook:

"It's possible that we may even be in a stronger position after Apple's change, particularly if it encourages more businesses to conduct commerce on our platforms, by making it harder for them to use their data in order to find the customers that would want to use their products outside of our platforms."

Despite Facebook's in-app commerce potential, shares trade today at 21x 2022 earnings (ex-cash) a figure that includes billions in R&D that are expensed as incurred as it invests aggressively in its AR/VR initiatives. It's difficult to think of many other companies with deep network effects that have grown earnings per share at over 30% per year the past 5 and 10 years, yet are valued inline with the S&P.

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