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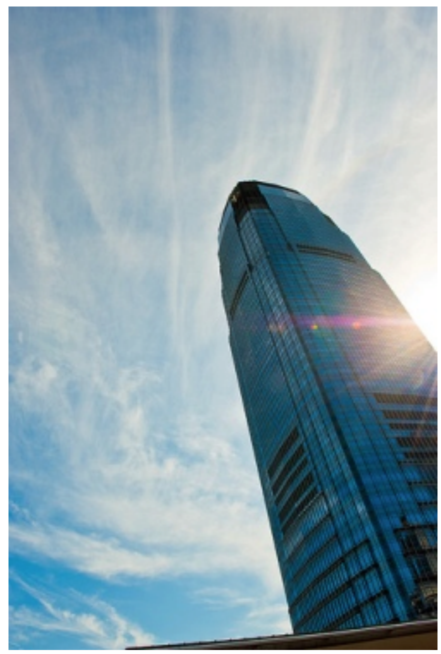
A $50 Billion Facebook Valuation Might Not Be So Crazy

By Nicholas Jackson



When the news broke last night that Facebook had raised $450 million from Goldman Sachs, arguably one of the world's most powerful banks, my Twitter feed was clogged with notes of shock and awe. That investment, along with an additional $50 million coming from a Russian firm that already had a stake in Facebook, valued the social network at $50 billion. $50 billion?! That's twice what Starbucks is worth and more than United, American, Delta, JetBlue and Southwest Airlines combined. (As of this writing, more than 65 percent of respondents to a Mashable poll said the valuation was too high.)

But I don't understand what everybody is so shocked about. Sure, this investment is reason to argue about the function that secondary trading markets do or do not serve and whether or not Goldman plans to sneak its way around Securities and Exchange Commission regulations that restrict shareholders of a private company to 500 or fewer individuals by arguing that an investment pool of well-to-do clients constitutes only one investor. But the valuation itself shouldn't be that surprising for two reasons: Goldman is positioning itself, as it has in the past, to win the prestigious assignment of handling Facebook's initial public offering when that day (inevitably) comes, perhaps even spurred by the Goldman investment itself in a bit of circuitous manuevering; and Facebook has been valued at $50 billion on the secondary market for months.

While Facebook already boasts more than 500 million users (the service could be over 600 million by now and Lev Grossman, the senior writer for *Time* magazine that penned CEO Mark Zuckerberg's profile for the Person of the Year issue, suspects it will reach one billion users by 2012 [video]), analysts anticipate it's user base will continue to make significant gains as the international market opens up. The company is making, off of those users, a fraction of what Google and AOL make on each of their users, according to a piece in *Fortune*, but when you have one out of every 12 people in the world using your service, it doesn't really matter how much you make off of each one as long as you're making something. In addition, Facebook still hasn't shifted its focus to monetization. Despite a continued laser-eyed approach to growth, the company managed to bring in $2 billion in revenue in 2010, a significant amount more than than roughly $1.3 billion that eMarketer was predicting as recently as mid-August, and more than three times 2009 revenues of $665 million. Back then, before Facebook was making any money at all, investments from Digital Sky Technologies, the Russian firm that went in with Goldman Sachs, already valued the company at $10 billion.

After Procter & Gamble, the world's largest advertiser with an annual budget approaching $10 billion, expressed serious interest in Facebook, other large advertisers started watching the social network. And they should. It's the easiest way -- and getting easier every day as Zuckerberg and his team work to shift how we think about privacy in a digital age -- to reach an incredibly specific group of individuals that is still large enough to warrant the investment of time. (In short, that's the reason why *TV Guide* magazine is stumbling along with a CPM, the amount that advertisers pay per 1,000 impressions, estimated to be around $10 and other magazines are showing stronger performances. All advertisers know about *TV Guide* subscribers is that they watch TV. If they want, Procter & Gamble can target 30- to 35-year-old women from Memphis who are bold enough to list "Desperate Housewives" as their only interest.) Facebook will be able to monetize its enormous user base, probably "more efficiently in coming years as its business strategy shifts," eMarketer analyst Debra Aho Williamson told Andy Zaky for a *Fortune* story.

No doubt, this is a company worth a serious chunk of change. And that's something traders on the secondary market have known for some time. In November, TechCrunch reported that more than $40 million was spent on Facebook shares in a single weekend during a share auction held by SecondMarket, a New York- and Palo Alto-based broker-dealer that uses an online platform to facilitate the trading of illiquid, restricted investments. With 1.9 million shares bought and sold at an end price of $20.76 each out of an outstanding 2.5 billion shares, that weekend trade valued the company at about $50 billion. A couple of weeks later, Sharespost sold 165,000 shares at $25 each, valuing Facebook at $56 billion, according to Business Insider.

It's likely that we won't know whether the traders on the secondary market overvalued or undervalued Facebook until the company starts selling shares to the public. Part of the Goldman Sachs deal requires that the investment bank bring in as much as 1.5 billion additional dollars from wealthy clients. The investment of these clients could move the SEC to force an IPO, but even if it doesn't, analysts anticipate one by 2012. Then, the firm will hold a prime seat.

A story in today's *New York Times* reminds us of Goldman's 1994 investment of $135 million in Ralph Lauren, which is now worth more than 16 times the $480 million valuation at the time. Goldman also oversaw eBay's IPO and it now makes millions of dollars from fees that originate with the online auction site. It continues to manage then-CEO Meg Whitman's fortune. The Facebook investment, $450 million, is only 1/2000th of Goldman's $900 billion balance sheet. That isn't a reckless investment by the company and it could be a small price to pay just to manage Mark Zuckerberg's future fortune.

Image: Goldman Sachs tower, saebaryo/Flickr.

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