



Why the Facebook IPO is Overhyped

Will it add jobs, make investors phenomenally wealthy, and be the biggest offering in history? Don't bet on it

By Danielle Kurtzleben, January 31, 2012

You've got to hand it to Mark Zuckerberg—he's turned tracking down your second-grade best friend or spying on the mean girls from high school into a business worth tens of billions of dollars.

The financial world is buzzing at the prospect that Facebook will file for an initial public offering on Wednesday. According to the Wall Street Journal, the offering could raise as much as \$10 billion, with the company's overall valuation as high as \$100 billion. By comparison, Google raised around \$1.7 billion in its 2004 IPO, with a valuation of around \$24.6 billion.

With Facebook projections that high, the investing community is head-over-heels excited about the prospect of a public offering. But the event itself might not meet everyone's lofty expectations. Below are three ways the Facebook IPO may be overhyped:

Skyrocketing Stock Values

Facebook is without doubt a successful company with staying power, but that doesn't necessarily make it an attractive investment. "Based on numbers they've pre-released, revenue is growing well, and profits are good," says Brian Hamilton, CEO of Sageworks, a financial information company. "[But] the big exposure of the Facebook IPO is around valuation," he adds.

Figuring out a reasonable estimate of what the company is worth, says Hamilton, is a matter of looking at the IPOs of similar companies. "In the past, really sexy high profile IPOs are priced between four and 10 times sales."—that is, with valuations between four and 10 times of their revenues. So if the company has valuations as high as the buzz seems to indicate, "that multiple could be as little as 18 and as much as 25 times sales. ... There's not many precedents for that." If the stock is valued far too high, he says, that creates a risk for investors. "The whole idea of investing is buy low and sell high or buy at a reasonable price and sell higher. When you buy high and then you're expecting to sell higher later, that's where you're exposed. I'm a little concerned that's the possibility that that could be the case here."

Tech Jobs for Everyone!

At a CNBC debate at the World Economic Forum in Davos last week, Facebook Chief Operating Officer Sheryl Sandberg explained the potential benefits of a public offering of Facebook stock: "If this is seen as an opportunity for jobs and for people to use their work to change the world, that's what we want to be a part of."

The \$10 billion that Facebook may raise from its IPO could very well create a wealth of jobs, according to Peter Wendell, longtime faculty member at the Stanford Business School. "They've got to spend that money somewhere to create growth. A company like Facebook, all you've got to spend on is hiring great people," he says.

Facebook currently employs 3,000, and if fellow internet giant Google is any model, there is plenty of room for growth: Google, which made its public offering in August 2004, has seen its employment skyrocket from around 1,600 at the end of 2003 to 5,800 by the end of 2005 to nearly 32,500 as of Dec. 31, 2011.

And Facebook is a driver for jobs; a 2011 study from the University of Maryland estimated that the Facebook "App Economy" adds 182,744 full-time jobs to the economy. However, an IPO itself isn't often the impetus behind mass hiring rounds, says Hamilton. "The correlations are usually between revenue and employment, not cap and employment," he says. "In general, it's very rarely the case except for in new startups or in truly formative companies where an infusion of capital will lead to hiring. Usually hiring is a direct result of sales or revenue increases."

"The Largest Offering in History"

Will it be the IPO of the year? Sure. The decade? Maybe. The history of the stock market? Likely not. And in all the hoopla surrounding the offering, it can be easy to lose perspective. Speaking on CNBC last week, Facebook founding President Sean Parker said the IPO could be "the largest offering in history," but plenty of other companies have raised far more capital than Facebook is expected to garner in its effort. Visa took in \$17.9 billion when it went public in 2008. General Motors raised \$15.8 billion when it left government control in 2010. International companies have also well outdone \$10 billion. The Agricultural Bank of China raised \$22.1 billion in 2010. As far back at 1998, Japanese cell phone company NTT mobile raised \$18.4 billion.

Still, \$10 billion is nothing to sniff at. Not only does it dwarf Google's public offering; it towers over Pandora's \$235 million, Groupon's \$700 million, and the \$1 billion raised by Zynga, the company behind Facebook apps like Farmville.

For the full story featuring Sageworks' CEO Brian Hamilton, please visit [U.S. News & World Report – Why the Facebook IPO is Overhyped.](#)