Linkedin case analysis essay sample

Executive Summary

LinkedIn Corporation went public on the New York Stock Exchange on May 18th, 2011. The Initial Public Offering documents listed the stock at $45 per share. It started trading the next day at an opening price of $83. 20, peaked at $122. 70, and closed at $94. 25. This was an increase of 109. 44% over the IPO price. Almost two years later, the stock has had its low points, but still its market price remains well above the value calculated by many analysts. Critics feel that company's days of fast-paced growth are numbered. There is also the growing threat of intense competition from Facebook, Google, Monster, and private companies like, Viadeo. We've completed a SWOT analysis of LinkedIn in order to highlight some key points. (SEE APPENDIX A) Based on this analysis and LinkedIn's financial history, we seek to calculate a fair book value for today's LinkedIn stock, as well as a projection of the stock price in 2016, five years after the IPO. We will use the Constant Divided Growth Model, Valuation by Multiples, and the Capital Asset Pricing Model in our calculations.

Background

Reid Hoffman, Allen Blue, Jean-Luc Vaillant, Eric Ly, and Konstantin Guericke founded LinkedIn in 2002. The company launched in May 2003 as LinkedIn Ltd., but changed its name to LinkedIn Corporation in 2005. They are currently headquartered in Mountain View, CA, and have over 20 offices worldwide. LinkedIn Corporation is the world's largest professional online network, under the leadership of CEO Jeff Weiner. They have recently attained the 200 million members milestone, with members in over 200 countries, and catering to 19 languages. LinkedIn’s primary purpose is to allow members to “ create, manage and share their professional identity online, build and engage with their professional network, access shared knowledge and insights, and find business opportunities, enabling them to be more productive and successful”. (LinkedIn)

Mission Statement

Our mission is to connect the world’s professionals to make them more productive and successful. Our members come first. We believe that prioritizing the needs of our members is the most effective, and ultimately the most profitable, way to accomplish our mission and to create long-term value for all of our stakeholders. We will continue to concentrate on opportunities we believe are in the best interests of our members. Our long-term approach enables us to invest, innovate and pioneer in unexplored segments of our industry to increase the value proposition of our proprietary platform and extensive data. Our solutions are designed to enable professionals to achieve higher levels of performance and professional success and enable enterprises and professional organizations to find and connect with the world’s best talent. (LinkedIn Prospectus) Vision

To create economic opportunity for every professional in the world. This vision not only applies to each of our employees, but every LinkedIn member, each of whom has the ability to create economic opportunities for others. We believe this is the fundamental power of our network. (LinkedIn Prospectus)

LinkedIn has three streams of revenue: premium account subscription accounts, fee-based job postings, and sale of advertising space. Basic membership is free, but for a fee members can have access topremium features, such as: expanded search capability, greater profile visibility, and direct messaging. There are three subscription levels, which fees increase with additional features. As of September 30th, 2012, paid memberships only accounted for 20% of LinkedIn’s total revenue. This percentage remains unchanged from the same time frame from the prior year. They also provide hiring solutions to organizations of all sizes and industries. This business segment provides for 54% of their revenue, a 4% increase from 2011. Recruiters are able to search the profiles of candidates, whether they are actively seeking new employment or not. Searches can be narrowed down by skills, education, experience, and location. Recruiters can also connect to candidates through professional and business organizations. Their third line of business is marketing solutions, which brings in 26% of their revenue.

This business segment has shown a 4% decrease from the prior year. Any organization can purchase packages for advertising space on LinkedIn. com, and can target those ads to specific groups. LinkedIn clients and members include: individuals from a wide range of industries, students, recent graduates, large corporations, small- and medium-sized businesses, educational institutions, government agencies, and non-profit organizations. (SEE APPENDIX B) LinkedIn Corporation’s professional networking competitors include Viadeo, Xing, Monster, and Facebook’s Branch Out. Viadeo(a French company), is the second largest network in the world, but lags far behind in membership with only 50 million members. However, they are aiming to compete with LinkedIn in emerging countries, such as Brasil, China, and India. In an interview with Viadeo CEO, Dan Serfaty, he pointed out what he felt differentiated their strategy from LinkedIn's. " We are a multi-platform, multi-product, multi-features and mulit-brand company. We're called Tianji in China, Apna Circle in India, Unyk in Brazil and Viadeo in Europe. That sets us apart from LinkedIn, which has a very global approach. When they go into a market, they play up the fact that they're international and start with the top of the pyramid.

We aim for the core of the market, the middle of the pyramid. So it's a very different go-to-market strategy." They pride themselves on a higher percentage of paid accounts in their home country than LinkedIn, as well as 50% of their revenue being from paid memberships, and a more tailored approach based on the diverse needs of their international members. (Businessinsider. com) XING AG (a German company) comes in third with 12 million members, half of whom are in German-speaking countries. Xing's focus on the German-speaking population has made it less of a threat to LinkedIn. Although, Monster. com operates under a different model, it has been around since 1994, giving it an established reputation with recruiters and job seekers. They do not offer professional networking like LinkedIn and the others. Job seekers can search for jobs, fill out applications, and submit resumes. Recruiters can search through of pool of applicants and post job openings. They also offer marketing solutions.

Their services are free to job seekers, but one can purchase additional services such as instant resume distribution to recruiters in a specified field and resume writing. Monster can definitely compete with LinkedIn in the talent acquisition and advertising market. Facebook has introduced a professional network called Branch Out. As of August 2012, they had 30 millions members and growing. They have similar offerings to LinkedIn, but with the added benefit of having easier access to Facebook's 1. 06 Billion monthly active users. Even though their website claims that using Branch Out will not give recruiters and employers access to your Facebook account, the two are still connected. You need a Facebook account to be a member of Branch Out, and it does go through your Facebook friends list to build your connections on the site. Some may feel reluctant to use Branch Out due to the fear that their social life and professional life may collide. If Facebook can manage to convince the 20 and 30 somethingpopulation, interested in joining the corporate world that the two profiles can remain completely separate, that may boost membership. Due to Facebook's large membership base, the possibilities are significant as long as the recruiters of the corporate world buy into the idea.

Problem

Is LinkedIn adequately valued compared to its industry?

Analysis

In 2011, LinkedIn Corporation decided to issue an IPO of 7, 840, 000 shares of their Class A common stock. Owners of Class A common stock are entitled to one vote per share, versus Class B common stock which entitles owners to 10 votes per share. As of December 31, 2011, Class B shareholders held93. 7% of the voting power, thereby limiting the influence of Class A shareholders in company affairs. (LinkedIn 2011 Annual Report) Even though the company was going public, the original founders and shareholders were not willing to relinquish control of its future direction. The IPO's underwriters were Morgan Stanley, Bank of America Merryl Lynch, J. P. Morgan, Allen & Co. LLC, and UBS Investment Bank. The net proceeds from this IPO were intended for investment in product development, field sales growth, capital expenditures, and future acquisitions. The company went public on May 18th, 2011, and started trading on the New York Stock Exchange as " LNKD" the next day at an initial offering price of $45 per share. The stock peaked at $122. 70 by midday to end at a closing price of $94. 25. This brought the organization's market capitalization from $4. 25 billion to $8. 9 billion in only its first day of trading.

When compared to other companies in the technology industry that are considered " internet information providers", such as Facebook, Priceline, Ebay, and Google, the significant increase in stock price and the fact that it has consistently remained well above it's initial offering, has some analysts questioning whether the market is reflecting LinkedIn's true value. Besides a closing of $59. 07 on November 29th, 2011, the price has ranged well above that, with its highest price being $127. 20 on January 28th, 2013. The additional jump in the stock price could have been attributed to the fact that LinkedIn was the first online networking site to go public (Facebook went public a year later), and that many investors were caught up in the excitement of being " early adopters". However based on what the stock price has been this past week, it remains at a level that some consider as overvalued. This is a company that was only profitable in 2010, one year before the IPO, after operating for six years.

As per the IPO prospectus, Mr. Weiner himself advised potential shareholders that a decline in growth rates and increases in costs, would threaten future profitability. He also stated that they did not expect to be profitable in 2011. He mentions a long list of risks that the company may face due to the nature of their business, short operating history, competition, and possible discrepancies in their financial reports (past & future). LinkedIn's Net Income for 2011 turned out to be $11, 912, 000, compared to 2010's Net Income of $15, 385, 000. This decrease in Net Income came despite 115% increase in Net Revenue. However, these figures do mirror the organization's intent to focus on growth instead of profits. " We plan to continue to invest heavily in sales and marketing to expand our global footprint, grow our current customer accounts and continue building brand awareness. In the near term and consistent with our investment philosophy for 2011, we expect sales and marketing expenses to increase on an absolute basis and as a percentage of revenue and to be our largest expense on an absolute basis and as a percentage of revenue." (LinkedIn 2011 Annual Report)(SEE APPENDIX D)Their 2012 Annual Report is not yet available, but their quarterly income statements for 2012 reveal the same trend of increased revenue and expenses, and decreased net income. (SEE APPENDIX E)Almost two years after the IPO, some critics still contend that the stock is overvalued.

Our goal with this case is to determine what the company's value will be three years from now, and if it falls more in line with the industry. Data from LinkedIn's existing Statement of Cash Flows was collected, as well as past financial statements for the last three years, in order to forecast future cash flows. Historical stock prices were also collected. This information provided some guidance in determining the estimated percentages to be used in our calculation of Discounted Cash Flows. In order to calculate the Discounted Future Cash Flows through 2016, we reviewed the cash flow statements of similar companies on Wikiwealth. com examined their growth rates. We decided to use rates similar to Facebook's (80%, 60%, 30%, 15% and 5%) due to industry and organizational similarities. Usingthe " Valuation by Multiples Method", we were able to project a fair value for the stock that puts it more in line with its peers and the company's prospects. Using financial resources provided by Yahoo Finance, MSN Money and Bloomberg Watch, we took the average of P/E ratios for industry competitors and used it as a multiplier for the LinkedIn dividend (1. 16).

This resulted in a stock price of $97. 98, and which also supports the claim that the stock is overvalued. We thenobtained a required rate of return of 18. 29% using the CAPM (Capital Asset Pricing Model), with Required Market Rate of 11%, and an assumed risk-free rate of 3. 25%. Using this required rate of return, the terminal value of the company was calculated by multiplying the FCF of 2016 by (1 + . 05) / (required rate – growth rate). Once the terminal value was determined, we were able to obtain the value of the company by taking the sum of FCFs and the terminal value, then discounting to the present day We then calculatedLinkedIn's Horizon Value of $3, 570, 060using the Constant Dividend Growth Model. We obtained the Terminal Price per Share of $1. 20, by dividing the dividends by the required rate of return minus the growth rate. Finally, we calculated a stock value of $1. 20 for LinkedIn in 2016 by dividing the corporate value by the number of outstanding shares.(SEE APPENDIX F)

Conclusions and Recommendations

Whether one considered the stock overvalued or not, as with any maturing company, LinkedIn’s growth will eventually plateau and begin to decline as they reach uncovered markets. This does not even take into account the threat of competition from the likes of Facebook, Google, Monster, and Viadeo. LinkedIn has an advantage over Google and Facebook, as it is only one of the three sites still allowed in the government-controlled web of The People’s Republic of China. However, these two online giants could very well diminish LinkedIn’s market share in the rest of the world; and Viadeo could do the same in China decreasing the competitive edge that the company now enjoys. When faced with the natural cycle of a decreasing growth rate and the threat of fierce competition in the national and global market, the growing revenues and memberships that LinkedIn now boasts, could easily reach their peak. If the management team remains complacent about their current and future competitors, and does not implement measures that will keep the company at the forefront of the industry for years to come the 2016 projected price per share of $1. 20 is what stockholders have to look forward to. Although their income statements reflect increasing investment in research and development, those efforts need to be increased, with metrics in place that will continually assess the effectiveness of new projects and current offerings.

One such step, they’ve taken so far is to disable their “ LinkedIn Answers” section, due to lack of usage, as of January 31, 2013. While focusing on increasing domestic and global membership, LinkedIn needs to also increase their rate of paid subscriptions. They can do that by reassessing their fee structure and customer needs, and offering more services based on those needs. Intensifying their efforts towards college students and recent graduates could prove to be fruitful for LinkedIn, as that is a continuous stream of fresh members eagerly entering the job market. Also, focusing on the needs of their rapidly growing international market may increase paid memberships from those markets. (SEE APPENDIX C) Those who have invested heavily in LinkedIn stock should proceed with caution, and pay close attention to its competitors at home and abroad. As per our calculations, the stock is indeed overvalued. The fair stock value of $97. 98 that we obtained is 20. 5% less than the market price. Someone who wishes to cash in now could earn that 20. 5% premium. LinkedIn Class A shareholders, may soon need some incentive to hold on to the stock, such as increased voting rights so that they have stronger voice in the direction of the company.

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