What if Facebook isn't so special after all?
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As the fateful day of Facebook's initial public offering draws closer, the giant social network's financial results are attracting more attention. And while its recently updated securities filing shows some blockbuster numbers—including a mind-boggling 900 million active users, half a billion of whom use the site daily—it also reveals some potential red flags, including rapidly rising costs for marketing and other expenses. All of this raises the question that investors will need to answer before too long: Is Facebook unlike anything we have seen before, or is it just another modestly profitable Web business?

There's no question Facebook is huge—possibly the largest digital-only social enterprise that has ever existed—and it's still growing at a fairly rapid rate. Just a few months ago it crossed the 800-million-user mark, and it has now passed 900 million, which suggests it will probably rack up a billion active users sometime later this year. And more than half of that user base visits the site at least once a day, a level of engagement other Web services would likely kill for.

That's the good news—plus the fact that Facebook's revenue for the first quarter of 2012 hit $1 billion, up more than 44 percent from the same period last year. The bad news? Well, for one thing, revenue actually fell compared with the previous quarter; this doesn't look good coming from what is supposed to be a growth company. And net income—in other words, profit—also dropped 12 percent compared with the same quarter in 2011. In fact, Facebook's profit was lower in the most recent quarter than it was in the previous five quarters.

While the quarterly dip in revenue could be just a seasonal blip in an otherwise growing advertising business (although Facebook's payment-related revenue also flattened), the fall in net income is a bit more worrisome. Running a Web business without making a profit may be taken for granted when it comes to such startups as Instagram, which Facebook just acquired for $1 billion. But when you get to be Facebook's size—and you ask the public markets to value your company at almost $100 billion—investors and analysts are going to want to see money, and lots of it, flowing to the bottom line.

According to Facebook's filing, which is embedded below, the main reason for its lower profit was higher costs, particularly for marketing: Costs related to marketing and sales more than doubled to $159 million from $68 million a year earlier—almost as much as the company spent in all of 2010. In total, Facebook's cost of revenue climbed more than 65 percent compared with the same quarter in 2011.

It may be stretching things somewhat to compare Facebook to Groupon (GRPN), another highly anticipated public offering, but one of the main criticisms of the group-buying service—and something that has helped push the stock down almost 50 percent since its IPO—is that it has to continually spend more on marketing than it can ever hope to recoup in profit. Like the Red Queen in *Through the Looking Glass*, the company has to run faster and faster just to stay in the same place, because users leave and it must spend to acquire new ones.

Facebook's problem is somewhat different: It has nearly a billion active users, but it makes a remarkably tiny amount from each one—about $5 per year. That's not a lot, considering over half of those users visit every day. And while the amount Facebook makes from the average user rose in the most recent quarter, it grew just 6 percent. Some of the marketing costs the company is racking up are no doubt increasing that number. But how much more can Facebook squeeze out of its existing user base?

As I tried to describe in a recent GigaOM Pro report (subscription required) on Facebook's IPO, the biggest question about the social network is whether it can grow in any substantial way from its already massive base. With almost a billion users currently, the upside for the company is likely relatively limited, unless you assume Facebook will eventually be used by everyone on the planet. So growth then has to come by increasing the revenue it gets from

each user. But what if it has to spend increasingly large amounts of money to do that, either to market itself or to acquire new avenues, such as Instagram, for reaching users?

In a recent essay on Facebook's prospects, investment adviser Josh Brown called it a "red giant"—a star that, having grown too large, starts to consume its own resources and eventually implodes and becomes a white dwarf. Investors who are looking for a meteoric return on the company's initial offering should consider that they may wind up with shares of something very different.

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