

In the Year of Facebook, Beware the Social Media Stocks

Eric Jackson

01/04/12 - 07:00 AM EST

NEW YORK ([TheStreet](#)) -- Most believe the stock/business story of 2012 is going to be **Facebook** -- specifically its rumored IPO which should come before the middle of the year. That's probably true. Yet, ironically, 2012 is also the year in which you need to protect yourself from other falling social media IPOs.

There have been a number of social media IPOs in the last year. With each new one, we get a five-minute segment on *CNBC* or *Bloomberg TV* debating whether there is a new Web bubble.

If the question "is this a new bubble?" is really "are all these new social media IPOs currently overvalued and set to drop pretty dramatically?" then I think the answer is yes and we're likely to see it occur in 2012.

The "other" social media IPOs that are bound to come under selling pressure in 2012 include: **Groupon**([GRPN](#)), **LinkedIn**([LNKD](#)), **Pandora**([P](#)), **Zillow**([Z](#)), **Zynga**([ZNGA](#)) and **Angie's List**([ANGI](#)).

Even though Facebook will continue to fascinate investors and media pundits as its IPO date draws closer, here are five reasons why other social media stocks are bound to falter in 2012:

1. **They will become much more liquid in 2012 as their lock-ups end.** These stocks all sold a smaller amount of equity in their IPOs (5% in the case of LinkedIn). They hoped to get their stock price up and anchored in the minds of investors which would help keep it there once the companies got the chance to really sell stock. For most of these companies, the chance to unload shares starts six months after their IPO. However, sometimes -- as was the case with LinkedIn recently -- a company that agrees to do a secondary offering of new equity after the IPO lock-up will agree that insiders will wait for an additional period before they can start to sell more of their shares. But, no matter what, there starts to appear a lot more of the company's equity on the market starting six months or so after an IPO. When this occurs, the stock price typically gets pulled back to earth.

2. **They will sell a lot more of their stock to get as much cash as they can.** More important than the insider VCs and CEOs being able to sell their shares is the fact that most of these companies will want to sell a great deal of additional equity to the market this year in order to beef up their cash reserves. It would be imprudent if they didn't. For example, with Groupon, their stock is still valued at \$12 billion. That's 10x what they should do this year in revenues. If I were on Groupon's board -- as smart people like Starbucks' Howard Schultz and Ted Leonsis are -- I would be pounding the table telling them to raise as much cash as possible at this stage.

3. **Their growth rate will be slower than expected.** At this point in the life cycle of all these young companies, hope springs eternal. The future is endless possibility. There have been -- at least for most of



these companies -- few if any real disappointments... yet. And that's a big word. On Tuesday morning, Groupon's shares dropped as much as 9% to below their offer price when an investment bank released a study showing that its merchants intend to use the service far less this year compared to last year. On a huge risk-on day for the market, Groupon tanked. This survey is being read as future intent, but what will happen to Groupon's stock once it releases earnings which unmistakably show a slowing in growth? Investors will decide that this stock deserves a much more "human" price-to-sales number and that's significantly lower than where it's trading at present.

4. When you need to raise cash, why would you hang on to these stocks? None of us knows exactly what will happen in the markets this year but most of us expect there to be at least as much volatility as last year. There's also a feeling among many -- including me -- that there's bound to be some unexpected negative market event this year: a tsunami, a flash-crash, the euro break-up, panic selling. When those times come -- and you got to believe they will -- why will investors hang on to these social media stocks as opposed to **Apple**([AAPL](#)) or **Google**([GOOG](#)) or **Microsoft**([MSFT](#))? When the panic comes, the playbook will be to dump high-flying stocks like these ones to protect yourself.

5. The roadmap for these stocks is Youku ([YOKU](#)). The Chinese online video site Youku is a good role model for what will likely happen to most of these social media stocks. Youku flew out of the gate in Dec. 2010 and -- within a few short months -- touched \$70/share. Its lock-up ended in June. About three weeks before, its stock started to head south. It then announced a large secondary offering. The price kept dropping. It's now at \$16/share, even though its results have marginally improved in the intervening time. The company has well over \$500 million in cash on its balance sheet, so it can't really complain. It's just the folks who bought in at the \$60s that have been really hurt.

So, buyer, beware with all these social media names in 2012.

Past performance is not necessarily indicative of future results. The risk of loss exists in futures trading.