Pricey, if Chastened, LinkedIn

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LinkedIn 's once highflying stock has plunged to $101.11 from $195, following the Feb. 4 release of disappointing 2016 guidance. A buying opportunity? Probably not.

The guidance is an example of what this column pointed out two years ago ("Valuing LinkedIn," April 26, 2014). LinkedIn's (LNKD) revenue growth continues to slow, big time. From 114% in 2010, it has dropped each year, to 35% in 2015. This year the company projects even less, 20% to 22%.

Meanwhile, cost increases remain stubbornly high. The 44% rise last year marks the fourth year out of the last five that they outpaced sales, much of that from increasing management stock compensation. The intense competition in the social-media space isn't likely to ease costs soon.

The company reported 2015 revenue of $3 billion, but a net loss of $166 million or $1.29 per share on generally accepted accounting principles (GAAP), much wider than 2014's GAAP loss of 13 cents. An important item hurting the bottom line is noncash stock-compensation expense, so LinkedIn bulls focus on the much better-looking non-GAAP figures, which exclude such costs, among others. In 2015, non-GAAP net EPS was $2.84 versus $2.04 in 2014. Looks good, but investors ignore GAAP accounting and the sales growth deceleration at their peril.

David Trainer, whose skepticism informed our 2014 missive, says LinkedIn is still significantly overvalued. Stock compensation represents ownership, notes Trainer, president of New Constructs, an independent forensic-accounting research firm: "At the end of the day, you are taking value out of the hands of shareholders."

In 2016, stock compensation will jump again, to an estimated $630 million from $510 million last year, about double the $319 million in 2014. Over the years, LinkedIn investors have been diluted by a factor of nearly three: Shares outstanding have ballooned to 130 million from 46 million in 2010. That will rise about 5% again this year.

Additionally, margins are declining, Trainer says. To justify the current price, the company's pretax margin would have to rise to 4%, last achieved in 2014, from negative 2.7% over the 12 months ended last September. When calculating pretax margins and net operating profit after tax, New Constructs strips out nonoperating gains and losses from results.

Many investors also might miss the significant off-balance-sheet debt in the form of operating-lease obligations to finance office space and data centers, Trainer says. New Constructs estimates that at $1.1 billion, roughly equal to LinkedIn's long-term debt.

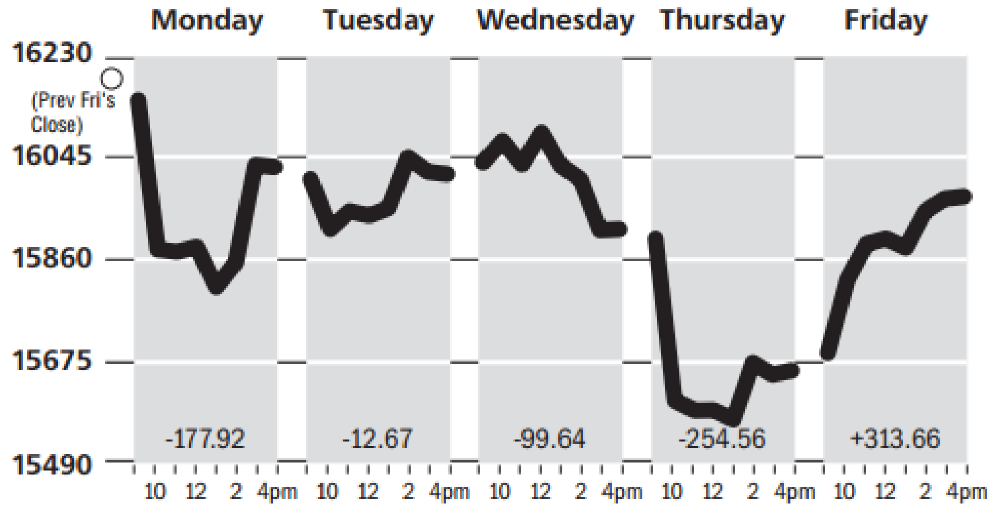
How "cheap" is LinkedIn? Even using the flattering non-GAAP EPS, the answer is not very. The stock trades at 31 times 2016 consensus analyst non-GAAP EPS of $3.23 this year. That's down from LinkedIn's once triple-digit price/earnings ratios, but it's too high for a company whose sales growth is steadily deteriorating, with non-GAAP EPS growth of 14% this year. The consensus GAAP EPS is another loss of $1.77, even wider than 2015's. When the stock compensation is taken into account, the "cheap" multiple appears less attractive.

LinkedIn declined to comment.

There's much more skepticism and fear in the market now, not auspicious for firms relying on non-GAAP profits. And with no positive catalyst in sight, LinkedIn's sales growth is likely to continue decelerating.

Investors should steer clear.

(See Trader: “Friday Stock Rebound Eases a Brutal Week”)



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