Meta Platforms, Inc. (NASDAQ: META)

Recommend to Buy| PT: $277.70

March 26th, 2023

CIMG Investment Research

A Social Media Conglomerate Reinventing Itself

The Facebook was created by Mark Zuckerberg in the early 2000s with the idea of integrating the social connections that constitute our lives with the internet. The company was able to revolutionize and dominate this portion of the internet, amassing over 3.5bn monthly active users and growing revenues 20x over the past decade. Through this growth period, the company moved beyond their original product offering providing new services like messaging through WhatsApp and Messenger as well as a social media platform targeting younger audiences in Instagram. Over the last 24 months, Facebook has been forced to reinvent itself and its strategic vision as it competes with new threats from regulators, big tech, and other social media companies. We remain confident in this strategic vision and see an opportunity to invest behind cost rationalization, expansion of ad surfaces, and a margin of safety created by an attractive valuation.

Investment Thesis

Zuckerberg's Year of Efficiency is Improving the Perpetual Quality of This Business: Over the past several years, growth at Meta dominated their focus causing both inflated project development and headcount. Late last year, Meta announced they had failed to properly prioritize profitability and would be making significant changes to their business to solve this. This started with rationalizing 11,000 jobs in November and continued with another 10,000 in March. The company said these jobs would come from non-core projects and bloated management structures. Facebook also has made the decision to lower data center spending, adopting a new model where they are able to upgrade data centers when needed as opposed to building it all on the front end. The company has also reviewed and adjusted their strategy relating to data centers. Now, data centers will be built with greater scalability as opposed to spending more on the front end for future consumption which will greatly reduce capital expenditures. The D&A of capital structures has also been guided down as Meta has revised and extended the useful life of their network. Through these adjustments, Meta has been able to lower their NTM expense outlook by 5bn and capex by 4bn creating revenue agnostic FCF expansion.

Reels Prove to be Meta's 3rd Act, With the Ability to Provide Meaningful Topline Growth: At the launch of reels, Meta released an inferior, rushed product that was unable to produce entertaining short form content. Since its release, Meta has invested over 50bn in capex that is largely dedicated to improving its Algorithm to create better reels as well as feed and stories. During this revitalization of the product, Meta has seen success with reels plays doubling over the last 12 months. Reels also provide a fix of ad scarcity that previously existed on Meta's products. Before reels, Meta was limited to ads mainly from feed and stories creating scarcity; as a result, however, the number of ads delivered has increased 18% LTM, which we believe could lead to outsized revenue growth in a better CPM environment. We also think revenue growth could result from reels becoming a tailwind as opposed to currently being a headwind. Due to growth focus and its nascent ad structure, reels currently exists as a 6% revenue headwind due to the fact it doesn't monetize as well as other areas of Facebook and Instagram. We have confidence in Meta's ability to successfully execute this transition because of the company's previous results with the monetization of stories, coupled with the fact that reels is trending in the right direction with monetization efficiency doubling over the past 6 months.

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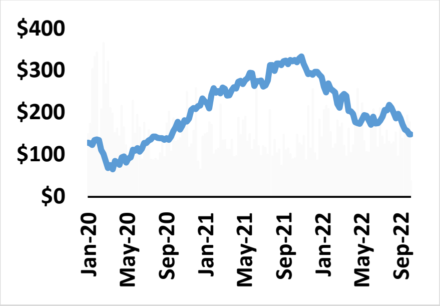
Figure 1: META Stock Chart



Price	$203.48
PT	$277.70
Dividend Yield	0.00%
Upside	41%
52-Week Range	$88.09 – $236.86
Mkt Cap	$527.55b
LTM P/E	23.98x
LTM EV/Sales	4.46x
LTM EV/EBITDA	11.71x
TTM Revenue	$116.6B

The Market Misunderstands the TikTok and ATT Threat, Allowing Us to Buy a Great Company at a Historically Cheap Valuation. The market currently sees TikTok as a daunting threat to Meta that is actively taking share and advertising dollars away. While TikTok did result in users spending less time on Instagram and Facebook, this trend bottomed at a 20 minute difference favoring TikTok 1 year ago but is now reversing with the current difference being 14 minutes. During the rise of TikTok, Instagram MAUs as well as time spent have consistently increased over the past 4 years. From the advertising perspective, TikTok also cannot compete due to their significantly smaller user base and less valuable demographic that results in lower CPMs.

Valuation

To value Meta, we used a blended valuation consisting of a DCF and 3 year EV/EBITDA valuation. With the DCF we used ARPU by region to drive revenue with faster growth in less developed markets including India, Latin America, and Southeast Asia. We also are ascribing no value to their reality labs segment and are modeling in above street estimates on reality lab expenditures to account for a margin of safety. There is some FCF divergence with the street, which is largely coming from not adding back SBC and conservative estimates. With the blended valuation we are receiving half of our value from the DCF and half from the multiple based analysis to get upside of 41%.

Company Overview

Meta Platforms operates social networking apps Instagram and Facebook and messaging platforms Whatsapp and Messenger, generating substantially all of its revenue by selling ad placement on these apps. Since changing its name from Facebook, Inc. in 2021, Meta also operates Reality Labs, a catch-all for augmented and virtual reality hardware, software, and content that Meta produces, as well as R&D for the buildout of the Metaverse. As the pandemic caused a pull-forward in social media usage worldwide, Meta's headcount ballooned to meet unprecedented demand. After facing advertising headwinds in 2022, Meta announced major layoffs among other cost-cutting initiatives as part of its "Year of Efficiency". Meta's current strategy is centered around improving monetization of Instagram Reels, cutting costs associated with non-crucial projects, and shifting Reality Labs focus away from Metaverse development and towards mixed reality projects.

Industry Overview

Meta operates in a resilient duopoly within the digital advertising market. Meta and Google are the largest market players, each controlling approximately 25% of global market share, with smaller players Amazon, Alibaba, and Tik Tok accounting for less than 10% market share each. Despite pioneering short-form content, Tik Tok failed to substantially disrupt the digital advertising market, namely because its target market of young teenagers lacks the financial capital for advertisers to yield a substantial ROI.

The market is divided between search ads, where advertisers pay for space at the top of a search based on key words (Google, Amazon), and display ads, where advertisers pay for display space as a user scrolls or clicks through a feed (Snapchat, Facebook). Digital ad spend has remained strong in the face of recessionary pressures as advanced AI targeting improves purchase conversion rates.

For years, display ad providers collected data to improve their ad targeting by tracking third-party site use. However, after the implementation of the iOS 14.5 update of April 2021, apps were blocked from tracking third-party data without an explicit user opt-in. This created a headwind for display ads, as search ads on engines like Google would have access to purchase data that apps such as Instagram and Twitter would not. In response, app-based advertising platforms have invested in advanced AI systems to improve targeting. Meta has also pivoted to ad formats that open the promoted product in-app rather than opening a third-party store, allowing Meta to track purchase data.