

META PLATFORMS, INC. (NASDAQ : FB) – HOLD

Henry McKinney, Analyst, Golden Flyer Investment Fund
April 25, 2022



Key Metrics

Intrinsic Value Estimate: \$262.00
Price (April 25th, 2022): \$186.99
52 Week Range: \$183 - \$384
Shares Outstanding (B): 2.71
Market Cap (B): 507.6
ROIC 43.44%

TTM Ratio Highlights

Price/EPS: 13.6x
EV/EBIT: 9.84x
ROE: 31.1%
• PM: 30.55%
• TAT: 0.73
• Leverage: 1.28x

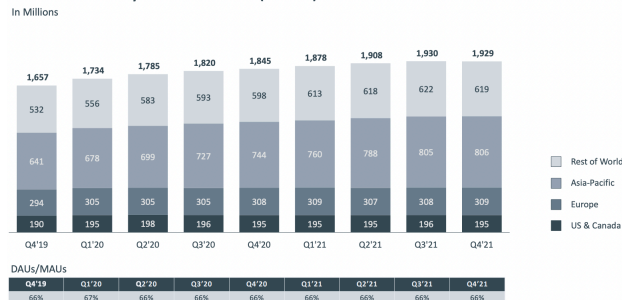
LTM Financials

Revenue Growth 37.18%
Gross Profit Margin: 81.15%
EBITDA Margin: 43.36%
EBIT Margin 37.38%
Net Income 30.55%
EPS Growth 36.45%

Executive Summary and Recommendation

Meta platforms, formerly known as Facebook, is one of the largest technology internet companies in the world with 3.6 billion users. Meta makes its money mainly through advertising revenues, and operates in two segments: Family of Apps, and the newly introduced Reality Labs. The Family of Apps consists of four main segments: Facebook, Instagram, Messenger, and WhatsApp. Reality Labs produces and sells virtual and augmented reality products such as the Meta Quest, better known as oculus goggles. Facebook saw its share price nearly cut in half after announcing its daily active users (DAU) declined for the first time ever. Meta is undervalued because the market **(1) overreacted to Meta's reduction in DAUs, (2) undervalues the amount of cash the company still generates from advertising and (3) perceives the name change from Facebook to Meta as detrimental**. Through my research I've arrived at a **minimum three-year price target of \$262**, representing **29%** upside from the closing price of \$186.99 on April 25, 2022; I recommend **holding** our current position, and reassessing in two to three years.

Facebook Daily Active Users (DAUs)



Facebook Average Revenue per User (ARPU)



Company Overview

Meta Platforms Inc is a multinational conglomerate based in San Francisco, California. It is the parent company of Facebook, Instagram, WhatsApp, Messenger, and an array of subsidiaries. Approximately 47% of Meta's revenues come from the U.S. and Canada, ~26% come from Europe, ~18.5% come from the Asia-Pacific region, and ~8.5% come from the rest of the world. With an average of 1.911 billion DAUs in 2021, and \$118 billion in revenue, the average revenue was approximately \$62 per DAU. Meta is attempting to pioneer the transition into the *metaverse* with its Reality Labs segment. Reality Labs earned \$2.1 billion in revenues in 2021.

Investment Thesis

1. Market overreaction to user decline.

Meta announced for the first time in the company's history that Facebook saw a reduction in DAUs. Companies like this are valued on user data, and a change in the forecast of future user acquisition was likely a large factor in the sell off. Algorithms, models, and analysts assign financial values to each user. When the DAU was reduced, these models' future projections likely changed drastically, reducing the valuation of the company. In an instant, the valuations changed, computers were given the sell initiative, which triggered more stop losses and sell orders. This initiated fear in the market and manual selling followed. The market overreacted to the announcement, and the effect of DAU reduction on the earning power is not as dramatic as the sell-off suggests.

2. A cash generating giant.

Meta's FCF has grown at an average of 185% over the past six years. From 2020 to 2021, the FCF grew 276% to \$50 billion because of the benefits of stay-at-home behaviors from Covid. Although the company will likely not see that level of growth, based on my analysis, it should see cashflows of around \$60 billion in 2024. The AI technology the company has is extremely advanced and has some of the top advertising technology in the world. The current market price suggests an aggressive rate of reduction in Facebook DAUs, thereby significantly reducing Meta's future FCFs. If Facebook's average DAU over the next three years was reduced to 1.5 billion, a level not seen since 2018, my estimated intrinsic valuation would be accurate. Assuming the rate of decline is equal to the rate of incline in DAU

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Facebook saw from 2018-2022, Facebook should have just over 1.6 billion DAUs in 2024 and could generate cashflows justifying an intrinsic valuation well above the \$262 conservative price target.

3. Market perception of the Meta name change.

Meta's transition from Facebook represents a crucial shift in the life of the company. We no longer can expect the double-digit revenue growth rates that Meta once saw when it was called Facebook. Moreover, Meta expects to spend from \$29-\$34 billion in capex in just 2022 alone. The company is going all in on the idea of the AR, VR, and the Metaverse. However, whether you believe in the transition or not, the company's main business segment, its Facebook Ads are still highly profitable and cash generating. The Meta transition has taken the world by storm and distracted the market from the ad power and cash generating ability Meta's Family of Apps still has. This is the main reason that I see the company as hold for the next two to three years. This distraction has caused the market to create a situation where it has undervalued the equity. The security is comparable to a call option- the downside to holding is extremely low, while the upside is at least 29% and up to 100% or more.

Key Risks and Assessments

1. Systematic Risk

The economy is experiencing high inflation and the Federal Reserve is slowing taking a more hawkish stance. These macroeconomic factors have put downward pressure on the market. Additionally, the Federal Reserve is no longer providing stimulus through quantitative easing, and federal stimulus checks. The amount of speculation, euphoria, and liquidity that was seen in the market through 2020 and into 2021 is coming to an end. YTD the S&P 500 is down -9.86% and the NASDAQ is down -16.88%. Many companies are falling out of the sky, and the level of systematic risk is increasing. The majority Meta's drawdown of -44.41% YTD is likely over, but it could move lower due to systematic risk correlation with a historical beta of 1.43. I estimate that if it does move lower, its floor is around 150, and it still sees the base price target in 2-3 years. **Probability: 10% Valuation Impact: ~ -20%**

2. Decline in Advertising Power

The user decline is the largest risk on investors' minds. Assuming that DAUs drop more quickly than anticipated, quarter after quarter, Meta could see its stock price depreciate, especially in the short term where the market is reluctant to invest in tech. Moreover, Meta's main strength is the effectiveness of their ad-targeting. Apple's new IOS updates, that disallow Meta to track user data across apps, likely weakens Meta's consumer targeting ability and accuracy levels. If Apple and other competitors continue to deteriorate Meta's advertising moat, the company's main strength will be eliminated, and its outlook will be changed severely. **Probability: 1% Valuation Impact: ~ -50%**

Probability: 10% Valuation Impact: ~ -15%

Scenario Analysis		
Bull	Base	Bear
Probability 25%	Probability 50%	Probability 25%
2-3 Year target: \$370	2-3 Year target \$262	12 month target \$150
E(R)=\$260		

Figure 3) Risk Matrix

Red -High
Impact

Yellow-Med
impact

Green- Low
Impact

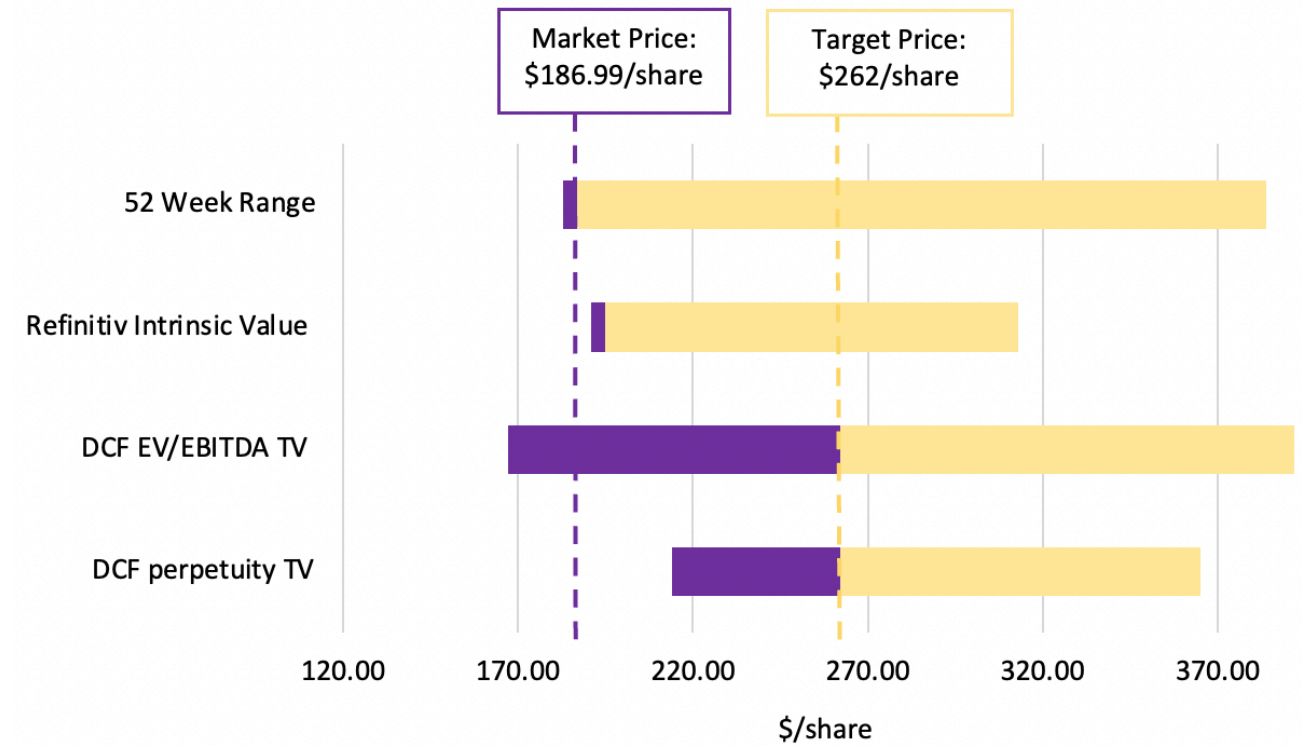
Systematic Risk	DAU Decline
Weaker Ad-Targetting	
Reduction in Spending by Marketers	
Reality Labs Failure	

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Valuation: Meta Platforms Inc (April 25th, 2022)



		Perpetuity Growth Rate				
		2.0%	2.5%	3.00%	3.5%	4.0%
WACC	8.27%	301	313	327	344	365
	9.27%	272	280	290	301	315
	10.27%	249	255	262	270	279
	11.27%	230	234	240	246	252
	12.27%	214	217	221	226	231

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APPENDIX

Proforma Income Statement:

Income Statement		FY2016	FY2017	FY2018	FY2019	FY2020	FY2021	FY2022E	FY2023E	FY2024E	Assumptions
Revenue	17,928	27,638	40,653	55,838	70,697	85,965	117,929	129,722	142,694	156,963	Monish 5-10%
Revenue Growth %		54.2%	47.1%	37.4%	26.6%	21.6%	37.2%	10.0%	10.0%	10.0%	10.0% CAGR
COGS	2,867	3,789.0	5,454	9,355	12,770	16,692	22,649	24,914	27,405	30,146	
COGS % of Sales		13.7%	13.4%	16.8%	18.1%	19.4%	19.2%	19.2%	19.2%	19.2%	Fixed
Gross Profit	15,061.0	23,849.0	35,199.0	46,483	57,927	69,273.0	95,280	104,808	115,289	126,818	
Gross Profit Margin %		86.3%	86.6%	83.2%	81.9%	80.6%	80.8%	80.8%	80.8%	80.8%	Fixed
SG&A	8,836.0	11,422.0	14,996.0	21,570.0	28,941.0	36,602.0	48,527.0	53,000	63,000	33,000	
SG&A % of Sales		41.3%	36.9%	38.6%	40.9%	42.6%	41.1%	40.9%	44.2%	21.0%	
% Growth		29.3%	31.3%	43.8%	34.2%	26.5%	33%	9.2%	18.9%	-47.6%	Fixed
EBITDA	\$ 8,175.00	14,769	23,228	29,233	34,728	39,534	54,720	61,275	63,064	105,559	
Depreciation	1,220.0	1,590.0	2,330.0	3,680.0	5,180.0	6,390.0	7,560.0	9,060	10,368	11,334	Guidance, Refinitiv Estimates
% Growth		30%	47%	58%	41%	23%	18%	19.8%	14.4%	9.3%	
Amortization	730.0	751.0	692.0	640	562	473	407.00	407.0	407.0	407.0	
% Growth		3%	-8%	-8%	-12%	-16%	-14%	42.3%	192.3%		
EBIT	6,225.0	12,427.0	20,203.0	24,913	28,986.0	32,671.0	46,753.0	51,808	52,289	93,818	
EBIT Margin %		45.0%	49.7%	44.6%	41.0%	38.0%	39.6%	40%	37%	60%	
Interest Expense	-37.0	90.0	386.0	439.0	799.00	543.00	321.00	321	321	321	Guidance FY 2022, L5Y Average 2023 and beyond
Other Expenses											
Pretax Income	6,194.0	12,518.0	20,594.0	25,361	24,812.0	33,180.0	47,284.0	52,129.0	52,609.8	94,138.7	
Taxes	\$ 2,506.00	2301	2387	3249	6327	4034	7914	8341	8418	15062	
Tax Rate		-18.4%	-11.6%	-12.8%	-25.5%	-12.2%	-16.7%	16.00%	16.00%	16.00%	Fixed
Net Income	3,688.0	10,217.0	18,207.0	22,112	18,485.0	29,146.0	39,370.0	43,788.4	44,192.2	79,076.5	
Profit Margin %		37.0%	44.8%	39.6%	26.1%	33.9%	33.4%	33.8%	31.0%	50.4%	
Change in Working Capital		-7,803.0	-14,101.0	3,280.0	1,351.0	-11,020.0	14,183.0	5000.0	5000.0	5000.0	Fixed
Capex	2,523.0	4,491.0	6,733.0	13,915.0	15,102.0	15,115.0	18,567	32,000	32,000	32,000	10k Page 52
Free Cash Flows		2,474	2,391	18,598	20,977	13,399	50,336	25,934	27,646	63,497	EBIT-Taxes+D&A-Capex-ΔNonCashNWC
FCF Growth			-3%	678%	13%	-36%	276%	185%			

WACC Calculation

Equity value	507,590
Debt value	581
Cost of Debt	4.0%
Tax rate	16.0%
10y Treasury	2.70%
Beta	1.43
Market Return	8.0%
Cost of Equity	10.28%

E / D +E	100%
D / D+E	0%
WACC	10.27%

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Discounted Cash Flow Full

Assumptions pt1

Growth rate	3.0%
EV/EBITDA Multiple	10.00x
Cost of Debt	4.00%
Tax Rate	16.0%
10y Treasury	2.70%

Assumptions pt2

Beta	1.43
Market Return	8.0%
Equity value	507,590
Debt value	581

Period	0	1	2	3	4	5
Free Cash Flows						
EBIT	46,753	51,808	52,289	93,818	0	0
(Tax)	7,914	8,341	8,418	15,062	0	0
D&A	7,967	9,467	10,775	11,741	0	0
CapEx	18,567	32,000	32,000	32,000	0	0
ΔNon-cash Work.						
Capital (inc) / dec	14,183	5,000	5,000	5,000	0	0
FCF		25,934	27,646	63,497	0	0

WACC

Cost of Equity	10.28%
D/D+E	0%
E/D+E	100%
WACC	10.27%

Terminal Value

EBITDA	105559.0
Exit Multiple	
(EV/EBITDA)	10
Terminal Value	1,055,590
Perpetuity Growth	3.0%
Terminal Value	899,476
Choose Cell H81, H83, or Average of both	977,533

Discounting	1	2	3	4	5
Discount Factor	0.91	0.82	0.75	0.68	0.61
PV of FCF	23,518	22,736	47,355	0	0
PV of TV			899,476		599,547
Enterprise Value	693,156				

Enterprise Value to Equity Value

Cash & Equivalents	16,865.0
Marketable Securities	0
Short term Debt	
Long term Debt	581
Equity Value	709,440

Shares Outstanding	2,710
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Implied Share Price	\$262
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Sensitivity Analysis Variable Tables (Affected by above inputs)

Base Case 7.5% Revenue Growth

		Perpetuity Growth Rate				
		2.0%	2.5%	3.00%	3.5%	4.0%
WACC	8.27%	301	313	327	344	365
	9.27%	272	280	290	301	315
	10.27%	249	255	262	270	279
	11.27%	230	234	240	246	252
	12.27%	214	217	221	226	231

Base Case 10 EV/EBITDA

Base Case 3% Perpetuity Growth TV

		Revenue Growth Rate				
		5.00%	6.25%	7.50%	8.8%	10.00%
WACC	8.27%	305	311	316	321	327
	9.27%	271	276	280	285	290
	10.27%	245	249	253	258	262
	11.27%	224	228	232	236	240
	12.27%	207	211	214	218	221

7.5% Base Case Revenue growth

		EV/EBITDA				
		5	7.5	10	12.5	15
WACC	8.27%	261	294	327	360	392
	9.27%	227	259	290	321	352
	10.27%	202	232	262	292	322
	11.27%	182	211	240	268	297
	12.27%	167	194	221	249	276