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NEWS

Is Meta Stock Still A Buy After Facebook Parent Surges On Earnings, Outlook?



JED GRAHAM | 07:00 AM ET 07/29/2023

Meta Platforms (META) continued to rally strongly in Friday stock market action, maintaining momentum after soundly beating Q2 earnings estimates late Wednesday. Meta added an exclamation point with its much-stronger-than-expected sales outlook for Q3. The turnaround for Meta stock has come in waves, as the parent of Instagram and Facebook progressed from multiple rounds of layoffs and cost cuts to renewed revenue growth to excitement over generative AI's potential to provide a long-term sales and profit boost.

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Is Meta Stock A Buy?

Meta stock has now rallied 170% so far in 2023, second only to **Nvidia (NVDA)** in the S&P 500. Investors have good reason to be excited about the outlook, and there are some potential near-term catalysts that might continue to fuel Meta stock. The company is hosting a Sept. 27 conference to reveal more about its AI and metaverse initiatives. The event will feature the launch of Meta's new Quest 3 mixed reality headset.

The launch of the Threads text-based social media site to capitalize on Twitter turmoil seized the spotlight in early July by racking up more than 100-million sign-ups in the first week. But that gave way to doubt whether people would stick around. Now that Meta has belatedly begun rolling out basic features that Twitter users take for granted, we may find out how serious of a challenge Threads will pose as daily user statistics are updated.

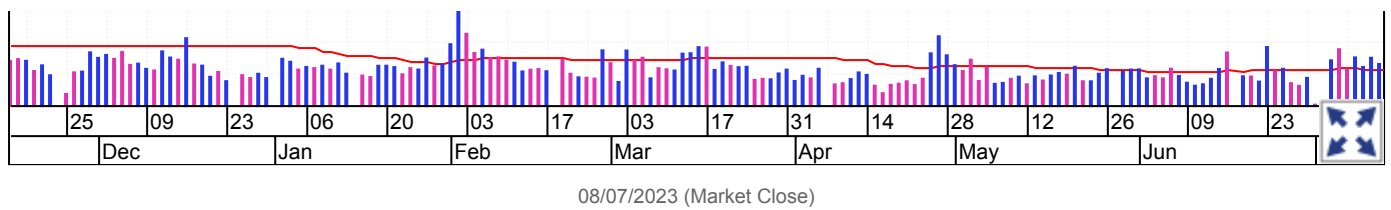
Still, it wouldn't be surprising to see Meta stock's fantastic run take a breather. While there are definitely reasons to be excited about the impact of generative AI on Meta results, that's more of a long-term story. A closer look at the earnings turnaround also suggests Meta's earnings momentum may be somewhat less than meets the eye. That's only partly because of ongoing expenses on the metaverse that won't pay off anytime soon. Regulation also continues to pose risks.

Meta stock is trading at an 18-month high, but does not currently have a buy point.

Meta Platforms (META)

\$316.56 5.83 ↑ 1.88%





Meta Earnings And Outlook

The Menlo Park, Calif.-based social media giant late Wednesday said it earned \$2.98 a share on sales of \$32 billion in the June quarter. Analysts polled by FactSet had expected Meta earnings of \$2.91 a share on sales of \$31.08 billion. On a year-over-year basis, Meta earnings increased 21% while sales advanced 11%.

Meta's second-quarter earnings results broke a streak of six straight quarters of year-over-year declines. Meanwhile, Meta's revenue rose for the second quarter in a row after three straight quarters of declines.

The results reflected continued user growth in all regions. The number of people using at least one Meta app on a daily basis rose to 3.07 billion from 3.02 billion in Q1. That includes Facebook, Instagram, Messenger and WhatsApp. Facebook daily active users rose to 2.064 billion from 2.037 billion overall. In the U.S., 202 million people used Facebook on a daily basis, up from 200 million in Q1.

For the third quarter, Meta predicted revenue of \$32 billion to \$34.5 billion, growing by a range of 15.5% to 24.5%. The midpoint of \$33.25 billion was well above Wall Street's prediction of \$31.22 billion.

Reels Monetization

Meta CEO Mark Zuckerberg highlighted improving monetization of Reels short-form videos to an annual run rate of over \$10 billion in Q2. That compares to a \$1-billion annual run rate a year ago. In other words, on a quarterly basis, Reels ad revenue accounted for about \$2.25 billion of the overall \$3.2 billion in revenue growth vs. a year ago.

The massive jump in Reels revenue came as the number of short-form videos played across Facebook and Instagram reached 200 billion per day, up more than 40% from 140 billion last fall. That growth is partly because Meta, in a bid to compete against TikTok, has programmed its AI discovery engine that recommends content to users

to prioritize Reels videos. As a result, time spent watching Reels videos subtracts to an extent from other activity on Facebook and Instagram. Still, Meta says that part of Reels growth reflects "incremental engagement," meaning that it is a net contributor to overall time spent on Meta's apps.

Yet the biggest reason Reels revenue is rising so fast is that Meta has been taking a while to figure out how to optimize ads on the TikTok competitor it launched in 2020. Basically, Meta had been running a lot of ad-free content, sandbagging revenue. Now, the rising ad load on Reels has provided a one-time jump in ad sales.

Meta Regains Its Competitive Edge

The Q3 revenue outlook might give the impression that Meta has returned to fast growth, but that seems uncertain.

Consider Q3 guidance for year-over-year sales growing by a range of \$4.3 billion to \$6.8 billion. Meta expects the weaker dollar to provide a 3% tailwind or as much as a \$1 billion lift. The higher ad load alone on Reels could provide a boost of about \$1.5 billion.

On top of that, CFO Susan Li noted that revenue declined 4.5% in the year-ago quarter. "We're really lapping a much-weaker demand period a year ago."

Li credited "improvement in the macroeconomic landscape" as a big factor in Q3 guidance. She highlighted "stabilization" in key advertiser segments like online commerce and gaming.

Another part of Meta's turnaround story involves overcoming the industry upheaval caused by Apple's privacy change. Starting with the iOS 14.5 update in the spring of 2021, Apple began requiring apps downloaded through the App Store to let users opt in or out of tracking their activity across third-party sites. With the bulk of users opting out, Meta lost the data needed to help businesses narrowly target advertising to consumers likely to have an interest in their products or services.

In February 2022, Meta revealed just how big of a revenue hit Apple's privacy shift would deliver: \$10 billion in 2022 alone, amounting to about \$2.5 billion per quarter.

The good news is that Meta seems to have come a long way in rebuilding its advertising edge, partly by substituting user data with AI and automation.

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Meta Growth Avenues

A big part of the Meta growth story is the ongoing shift to digital advertising, which grew 5.5% from a year earlier in Q2 vs. 2% for the ad market across all media, according to a July 13 Deutsche Bank note.

Business messaging is another growth area. Click-to-message ads, which open up a WhatsApp or Messenger chat with businesses, have reached a \$10-billion annual rate, Zuckerberg said on the Q4 call. In the latest call, he noted that the number of businesses using paid messaging products has doubled from a year ago.

Zuckerberg sees generative AI as a major impetus for improving — and monetizing — business communications.

One of the biggest issues limiting monetization of business messaging is that "it's quite human labor-intensive," so Meta's click-to-message ads have taken off where the cost of labor is relatively low. But in a world where every business has an AI agent, "the kind of success that we're seeing in Thailand or Vietnam with business messaging could kind of spread everywhere," he said.

"The two technological waves that we're riding are AI in the near term and the metaverse over the long term," Zuckerberg said.

"There are 1 billion or 2 billion people who have glasses today. I think in the future, they're all going to be smart glasses," essentially wearable computers. He also predicted that "all the time that we spend on TVs and computers, I think that's going to get more immersive and look something more like VR (virtual reality) in the future."

Threads is a wild card. It could become Meta's "fifth great app," Zuckerberg said. The goal now is to build the Threads community so there are hundreds of millions of people using it at a high rate. "Then we'll worry about monetization."

Meta Worries

Despite Meta's resurgence, the company won't shed its new "**year of efficiency**" ethos, Zuckerberg said.

Still, its Reality Labs division focused on the metaverse and smart-glasses opportunity lost \$3.7 billion in Q2. And Meta said it expects year-over-year losses to rise in 2023 and to grow "meaningfully" again in 2024.

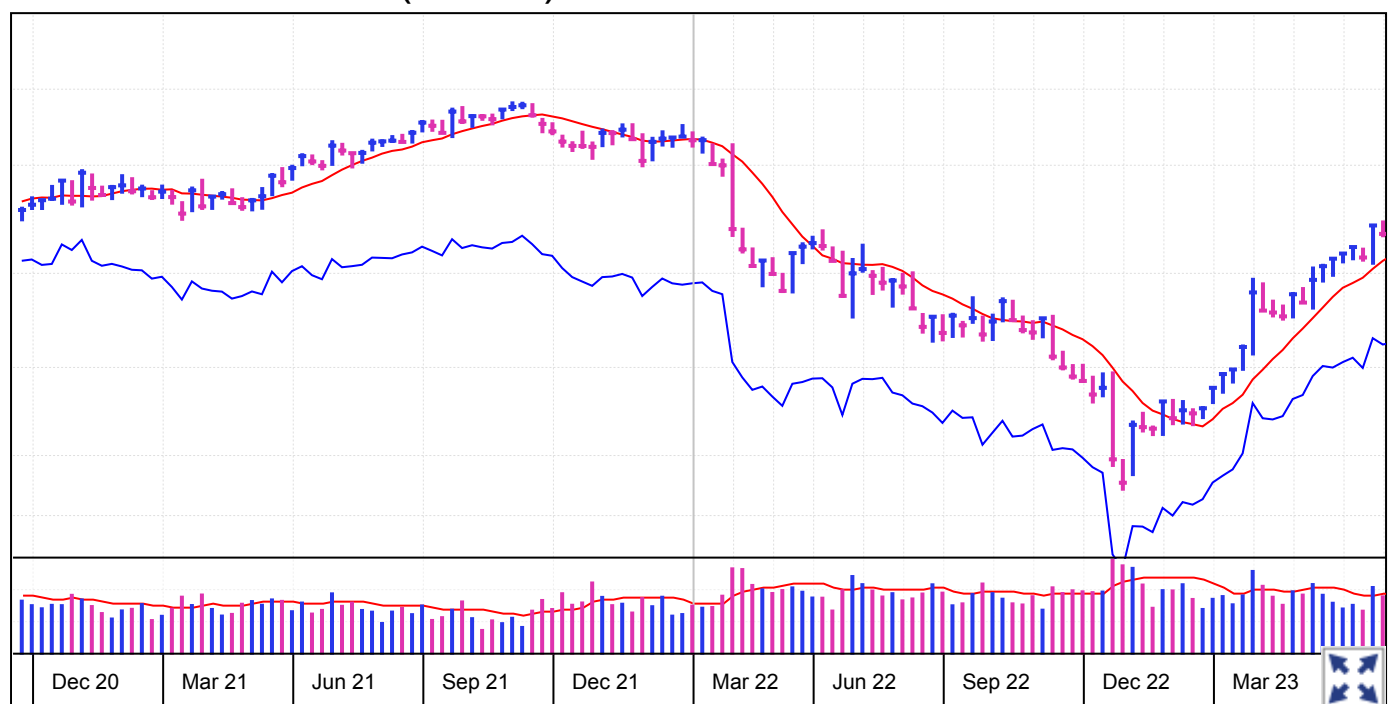
Regulation is the other main worry. Meta was hit with a \$1.3 billion fine in Q2 for violating the European Union's General Data Protection Regulation by transmitting data on EU citizens to the U.S.

"We continue to see increasing legal and regulatory headwinds in the EU and U.S.," Li said. "The adoption of guidelines that require penalties to be assessed on a percentage of global revenue" is of particular concern.

Meta has yet to launch Threads in the EU due to regulatory issues.

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08/07/2023 (Market Close)

Meta Stock

In Friday **stock market action**, Meta stock climbed 4.4% to 325.48. That matched Thursday's 4.4% post-earnings gain. Shares leapt 10.7% for the week to an 18-month high.

Meta stock is part of the **IBD Leaderboard** portfolio of elite stocks, picked up in March as Meta broke out of a short, **flat base** with a 197.16 **buy point**, according to a **MarketSmith** analysis.

Meta's 65% advance since that breakout did offer one more recent entry point. Meta etched out a **three-weeks-tight** pattern in late June and early July, creating an entry above 298.12.

Despite the massive gain this year, Meta stock's run has kept a steady pace that has kept the stock from getting extended. A weekly chart shows Meta stock pulling back to just above its 50-day line just ahead of its big earnings report on Wednesday.

Yet now Meta is well above its 50-day moving average and it would be too risky to chase.

Bottom Line: Meta stock has come nearly full circle. Wall Street thought the old Facebook was indomitable, then lost faith in Meta. Now faith is restored. But risk is creeping in that Meta's growth story that mostly reflects a turnaround is a bit overhyped. Wait for Meta to establish a new entry point. Meta stock is not currently a buy.

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