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Russia-Ukraine war to hit Meta ad revenues as competition with TikTok spikes

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Meta Platforms Inc. was already expecting 2022 to be a rough year in terms of revenue growth, and Russia's invasion of Ukraine only stands to make matters worse.

Meta's legacy Facebook platform reached a global saturation point in 2021, with the company shedding about 1 million daily active users on its legacy platform in the last three months of the year. After reporting the decline and forecasting weaker-than-expected revenue growth, Meta faced one of the largest share price wipeouts in history, plummeting over 25% in one day.

Weeks after reporting its DAU drop, Russia invaded Ukraine, and Moscow blocked access to Meta's legacy Facebook and Instagram, LLC platforms. Meta followed by pausing ad targeting in Russia, which accounts for 1.5% of the company's ad dollars, according to Meta CFO Dave Wehner, who spoke at a Morgan Stanley conference in March.

The decision means Meta will likely report lower ad revenues, particularly in European zones, said Pedro Palandrani, research director at exchange-traded fund manager Global X ETFs.

Russian impact

"It's definitely one of the things that are probably going to weigh on the results of the company this quarter," Palandrani said in an interview.

From a PR standpoint, it was easy for Meta to take a stance on the Russia-Ukraine conflict, given broad global unification around Ukraine, but more complex conflicts like in Yemen could spell challenges for Meta and its competitors if they choose to pick sides in the future, said Will Duffield, a Cato Institute policy analyst focusing on internet governance.

Navigating geopolitical tensions is only one of several challenges facing the company, analysts said. They pointed both to rising inflation and to continued competition from TikTok as key headwinds.

On the first point, the exacerbated inflationary environment can weaken e-commerce and consumer spending budgets. Meta, which derives the vast majority of its revenue from advertising, could feel greater impact in its ad segments beyond the effects of just pulling advertising out of Russia, said Mark Shmulik, senior internet analyst at AB Bernstein.

Dancing with TikTok

As to TikTok, Bank of America analysts listed TikTok usage as a top risk to Meta's stock, noting that the Chinese platform remained the leader in DAUs for social media apps, citing external research.

Younger generations are trending towards TikTok, and Meta has not been very successful in keeping appeal to young people, especially on its legacy blue Facebook offering, Cato's Duffield said.

Meta CEO Mark Zuckerberg has both publicly and privately called the platform a formidable competitor to Instagram Reels. Additionally, *The Washington Post* reported earlier this month that Meta paid Republican PR firm Targeted Victory to vilify TikTok in a publicity campaign, with Meta arguing that TikTok deserves scrutiny as its popularity increases.

Targeted Victory's campaign against TikTok is a sign that Meta is beginning to crack, Duffield said.

"If you're spending energy talking about someone else's product — even behind the scenes — that's not energy you're spending to build your own product, it shows that you're very concerned if you're willing to go that route," he said.

Regulatory pressure

Global X's Palandrani and Bernstein's Shmulik called the company's efforts against the Beijing Byte Dance Telecommunications Co. Ltd. platform "strategic" as Meta itself continues to face scrutiny about its awareness of its platforms' harms to users and democracy, following a whistleblower leak last year. Additionally, Meta faces mounting antitrust efforts in the U.S. and large-scale regulation bills in the European Union.

Regulatory conversations against tech and social media companies are typically not heavily weighed into valuations, though Shmulik said that negative headlines and potential actions out of Washington are not lost on investors.

"The reality is that when you are a tech company, sometimes the narrative becomes the truth, whether we like it or not," he said.

Path forward

To reaccelerate growth, Meta should focus on increasing its average revenue per user rate by figuring out ways to further monetize Instagram Reels as well as building out more revenue opportunities within shops, messaging and marketplace offerings, Palandrani said.

The company also needs to "stop the bleeding" of users on the legacy Facebook platform, Bernstein's Shmulik said, arguing that investors will be paying close attention to DAU figures following last quarter's reaction.

Instagram Reels monetization would be a healthy metric in the eyes of investors, but he does not expect signs of it yet, since Meta needs to first focus on driving up Reels engagement before monetization comes.

Longer term, the company must also prove to investors its ability to deploy and operationalize a working metaverse. In October 2021, the company rebranded from Facebook to Meta, signaling its focus on developing the metaverse — the next iteration of the internet in which people partake in everyday tasks in a fully virtual world.

New Reality Labs

Metaverse investments cost the company about $10 billion in 2021, as reported last quarter within its new Reality Labs segmentation that includes all of its virtual and augmented reality ventures, including the Oculus and Meta Quest headset business.

The metaverse might be the company's biggest profit driver in the long-term, if done correctly, Duffield of Cato said, arguing that the concept is so new that regulators would not attempt to enact policies on AR or VR technology until it is further understood.

Oculus hardware sales have likely reached 10 million units, Palandrani said. The 10 million mark is required to establish a sustainable virtual ecosystem, Zuckerberg previously stated at a 2019 conference. It is an important milestone, said Palandrani, adding that the greatest barrier to VR adoption is a lack of games and apps available to users.

"Finally, we're starting to see many developers being incentivized to come up with new experiences for these technologies," he said.

On April 25, Meta said it will open a retail store in California next month that will allow users to demo and buy its hardware products.

For some, the metaverse is secondary, said Shmulik. While hardware adoption was of interest last quarter, some analysts will focus less on metaverse build-out and more on how the company works to improve the health of its core business. Additionally, the reported high costs of the Reality Labs segment last quarter will leave analysts wondering if those costs can be driven down, he said.

"There's no shortage of negative news flows as [risks] surround the company," said Shmulik. "And it's clear that perhaps the name change might have hedged or decreased the cadence of some of those stories for a while, but it certainly seems like some of them are back."