
How Did Meta Become a Value Stock and Why Isn't It Considered "Sustainable"?

ESG risk helps explain Meta's style migration and index inclusion.

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As Google CEO, Eric Schmidt once described Facebook's business as a "rocket ship." The company's journey from Harvard dorm room in 2004, to largest ever tech IPO in 2012, to world's fourth-most-valuable public company in mid-2021, justified the metaphor.

However, its trajectory started to change in the fourth quarter of 2021 and reversed sharply in 2022. Rebranded as "Meta Platforms" to reflect a bet on the next digital frontier, the company's share price fell more than 64% in calendar year 2022, in part because of how changes Apple made to its privacy settings undermined targeted advertising. Meta announced its first-ever revenue drop in the second quarter of last year. By November, the company was eliminating 11,000 jobs.

Data privacy, the main issue that triggered Meta's 2022 decline, was among the company's key risks enumerated by Morningstar Sustainalytics, a division that provides sustainability research. Most sustainable funds in Morningstar's database were avoiding Meta in early 2022.¹ Data privacy and other environmental, social, and governance risks have excluded the company from Morningstar sustainability indexes.

Meanwhile, Meta's price decline and growth slowdown resulted in changes to its style index inclusion. After spending years in the large-growth segment of the Morningstar Style Box, Meta finished 2022 as the ninth-largest constituent of the Morningstar US Large-Mid Broad Value Index,² which is aligned with the style box, joining names like Berkshire Hathaway, JPMorgan Chase, and Johnson & Johnson. Meta continues to be excluded from the Morningstar Sustainability Style Indexes,³ which emphasize companies within broad style segments that face fewer ESG-related risks.

Among the findings of this report:

- ▶ Data privacy, one of the key ESG risks Meta has faced, helps explain its miserable 2022 performance.
- ▶ Meta's 2022 travails resulted in a shift from growth to value, while ESG risk prevents Meta from inclusion in the Morningstar Sustainability Style Indexes.

¹ Hale, Jon. "Most Sustainable Funds Sidestepped the Meta Plunge." Morningstar.com. Feb 4, 2022.

<https://www.morningstar.com/articles/1077975/most-sustainable-funds-sidestepped-the-meta-plunge>

² For a full discussion of the Morningstar Broad Style Indexes' methodology, see:

<https://indexes.morningstar.com/docs/rulebook/morningstar-us-sustainability-large-mid-cap-broad-growth-FS0000HY5T>

³ For a full discussion of the Morningstar Sustainability Styles Indexes' methodology, see

<https://indexes.morningstar.com/docs/rulebook/morningstar-us-sustainability-large-mid-cap-broad-value-FS0000HY5U>

- ▶ Investors would do well to consider Meta's ESG risks going forward.

ESG Risk Becomes Material for Meta

For long-term shareholders, Meta Platforms, which was called Facebook before it shifted its gaze to the "metaverse," has been a stomach-churning investment. From its May 2012 IPO to its peak in mid-2021, the share price rose tenfold. Facebook was the "F" in the "FANG stocks," an acronym first coined in 2013 in reference to market-leading tech companies Facebook, Amazon.com, Netflix, and Google (now Alphabet)—all of which occupied the large-growth section of the U.S. equity market. When the pandemic hit and accelerated trends toward digitization, Facebook benefitted. The share price hit its peak of \$380 per share in the third quarter of 2021.

Then, things started to go south. On Oct. 4, 2021, Facebook shares fell 5%, prompted by negative headlines about the firm's policies and an outage on its properties. Then came the company's fourth-quarter earnings release on Feb. 2, 2022, issued with a negative outlook. Changes to privacy settings in Apple's iOS operating system would undermine Meta's ability to target and measure advertising. The estimated financial impact was \$10 billion in 2022 alone. Market reaction was severe. Meta's share price lost 26% the next day, wiping out \$230 billion in market capitalization. Things got worse over the course of the year, with Meta's share price sinking to a low of \$93 per share in October.

The Apple privacy issue was not the only headwind. Seven interest-rate hikes by the U.S. Federal Reserve to combat stubbornly high inflation sent stocks plunging in 2022. Growth equities, which had paced the market for years, especially when the pandemic accelerated digitization, fell the furthest. Meta's 2022 swan dive brought its 10-year return, as of last year's end, lower than that of the broad equity market, measured by the Morningstar US Market Index. Despite a rebound in the first quarter of 2023—the stock has climbed back over \$200 per share—Meta remains well off its historic highs.

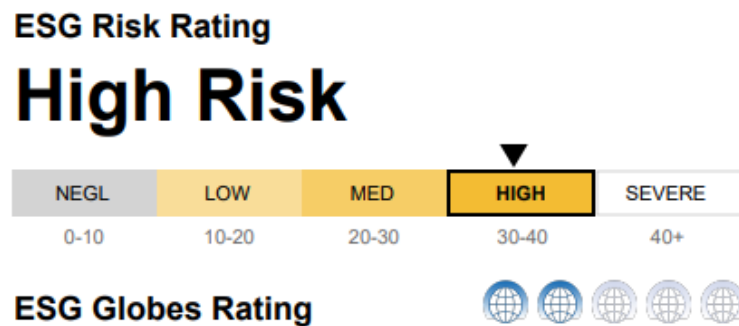
Exhibit 1 After Rising Tenfold From Its IPO, Meta Cratered in 2022 and Has Since Rebounded



Source: Morningstar Direct. Morningstar US Market Total Return USD index variant displayed.

For sustainable investors, the issue with Apple was not unforeseen. Morningstar Sustainalytics assessed the company's risk level as high with data privacy its top ESG risk. In early 2022, Meta ranked near the bottom of the internet software peer group in terms of its overall ESG Risk evaluation: 229th out of 235. The Sustainalytics ESG Risk Rating⁴ displayed in Exhibit 2 assesses firms' exposure to and management of financially material ESG risks.

Exhibit 2 Meta Platforms — High ESG Risk Rating



Source: Sustainalytics. Rating as of 2022.

In the view of Sustainalytics, the top-three material ESG issues Meta faces include:

- ▶ Data Privacy and Security
- ▶ Product Governance
- ▶ Business Ethics

Sustainalytics' negative assessment of Meta was hardly an outlier within the world of sustainable investing. A Morningstar analysis in February 2022 carried the title "Most Sustainable Funds Sidestepped the Meta Plunge." Morningstar sustainability indexes avoided the company.

From FANG to Value

How did 2022 affect Meta's investment style assignment? There are 10 factors that drive placement on the Morningstar's equity Style Box (five growth, five value) as well as the Morningstar Broad Style Indexes, which are methodologically aligned with the style box.

⁴ For a full discussion of the rating methodology, see <https://connect.sustainalytics.com/esg-risk-ratings-methodology>

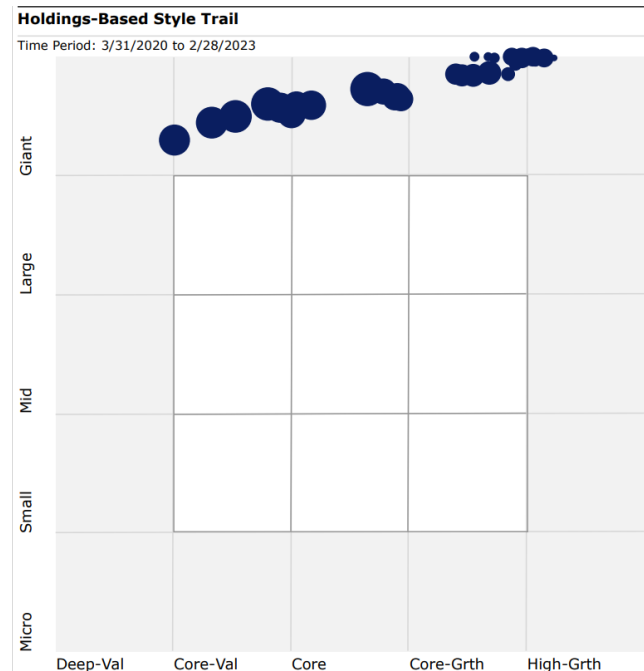
Exhibit 3 Morningstar Style Box Assignment Is Driven by 10 Factors

1. Determine a value score			2. Determine a growth score			3. Determine a style score		
Factors		Weight %	Factors		Weight %	Subtract the value score from the growth score.		
Forward-looking	Price/projected earnings	50.0	Forward-looking	Long-term projected earnings growth	50.0	Growth score	0 to 100	
Historical	Price/book	12.5	Historical	Earnings growth	12.5	Value score	0 to 100	
	Price/sales	12.5		Sales growth	12.5	Style score	-100 to 100	
	Price/cash flow	12.5		Cash flow growth	12.5			
	Dividend yield	12.5		Book value growth	12.5			

Source: Morningstar.

A declining share price and slowing growth pushed Meta from the high-growth area of the equity style box to value. Morningstar's Holdings-Based Style Trail chart in Exhibit 4 provides a view of equity style changes over time based on historical portfolios, with the oldest appearing as the smallest dots plotted on a granular view of the Morningstar Style Box, and the most recent portfolios are indicated by the largest dots. Meta shifted leftward on the style box starting in late 2021 and throughout 2022, before a rebound in early 2023 pushed it back toward the middle.

Exhibit 4 After Spending Years as a High-Growth Stock, META Migrated to Large Value in 2022, Then Core in 2023



Source: Morningstar Direct.

Meta's investment style evolution has led to changes in its index inclusion. The Morningstar Broad Style Indexes divide the equity market into value and growth halves. Stocks that do not exhibit a clear style

orientation are partially allocated to both indexes, creating some overlap in constituents. The indexes reset their membership in June and December, while constituent weights are rebalanced quarterly.

As seen in Exhibit 5, the company's index inclusion went from pure growth in mid-2021, to a mix of growth and value through 2022, to pure value by the end of 2022.

Exhibit 5 Facebook/Meta Platforms—Broad Style Index Allocation

Date	Morningstar US Large-Mid Broad Growth Index (FB/META Constituent Weight %)	Morningstar US Large-Mid Broad Value Index (FB/META Constituent Weight %)
June 30, 2021	4.01	0.00
Dec 31, 2021	2.37	1.23
June 30, 2022	0.87	1.26
Dec 31, 2022	0.00	1.52

Source: Morningstar Indexes.

In mid-2021, Facebook, as it was then known, was the fourth-largest constituent of the Morningstar US Large-Mid Cap Broad Growth Index and was not included in the Morningstar US Large-Mid Cap Broad Value Index. Thanks to share price depreciation, the company was partially allocated to both growth and value indexes by the start of 2022, with the majority of its weight in growth. Price declines and deteriorating fundamentals shifted the company toward the value side of the market throughout 2022. After the broad style indexes' December 2022 reconstitution, Meta was removed entirely from growth and was the ninth-largest constituent of the Morningstar US Large-Mid Cap Broad Value Index.

ESG Risks Keep Meta out of Sustainability Style Indexes

While Meta may be a prominent constituent of Morningstar value indexes, it has not merited inclusion in the sustainable value index and was not a member of the sustainable growth index before that. The Morningstar Sustainability Style Indexes represent broad equity market segments while emphasizing companies facing fewer material ESG risks.

Contributing to the risk rating is Meta's controversy level, which registers a 4 on a five-point scale. ESG controversies are incidents with material impact.

Exhibit 6 Meta Platforms—Controversy Level 4 of 5

Highest Controversy Level	Level	Events
<p>4 High Outlook Negative ⬇️</p> <p>Customer Incidents - Data Privacy and Security, Quality and Safety</p>	5 Severe	0
	> 4 High	2
	> 3 Significant	4
	> 2 Moderate	6
	> 1 Low	4

Source: Sustainalytics. Controversy Assessment as of 2022.

Controversies have kept Meta out of the Morningstar Sustainability Style Indexes.

Exhibit 7 Morningstar Sustainability Style Indexes

Index construction process



Source: Morningstar Indexes.

Meta's exclusion from the sustainability style indexes had performance implications in 2022. The Morningstar US Sustainability Large-Mid Broad Growth Index declined slightly less than the Morningstar US Large-Mid Broad Growth Index in 2022, in part because it did not include poor performing Meta.

ESG Risk Should Remain Part of the Investment Calculus for Meta

Looking forward, Meta has a negative momentum assessment for ESG risk exposure and risk according to Sustainalytics. So, the company's ESG risk exposure is high and headed in the wrong direction. The

data privacy issues that flared up with Apple still linger. On Data Privacy and Security, Sustainalytics writes:

"Meta's business model relies heavily on user data from its social media platforms, exposing it to elevated privacy and security risks. Changes to data privacy regulations in its operational jurisdictions could restrict its ability to collect, transfer, and use data, potentially affecting its advertising services including ad targeting."

On Product Governance, Sustainalytics flags Meta's dependence on advertising revenue and the potential impact to those revenues from "failure to enforce editorial standards to the satisfaction of customers" ... for "hate speech, fake news, and other ethical issues."

On Business Ethics, Sustainalytics flags issues "relating to antitrust, intellectual property, and anti-corruption."

Other issues include "shareholder rights," as they related to the company's dual-class share structure, which gives majority voting power to founder Mark Zuckerberg.

Meta's rebound in the first quarter of 2023 is perhaps a sign that its share price decline in 2022 went too far. Meta's ESG risk must be constantly weighed against its price. From one perspective, the share price coming into 2023 sufficiently discounted ESG risk.

The fact is, Meta retains many attractive business attributes. Noting the value to advertisers of its nearly 3 billion monthly users, Morningstar equity analyst Ali Mogharabi writes:

"Now that Meta has emerged as the clear-cut social media leader, we believe that its offering, consisting mostly of Facebook, Instagram, Messenger, and WhatsApp, have strengthened network effects for the firm, where all of these platforms become more valuable to its users as people both join the networks and use the services."

But Mogharabi echoes Sustainalytics' risk assessment, while also noting competitive pressures that Meta faces from rivals like TikTok. Clearly ESG risk remains critical to the investment calculus for Meta. The experience of 2022 demonstrates how ESG-related risks can suddenly become material. ■■

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