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X-Trade Brokers

Snapchat IPO: 10 things you need to know

Key takeaways:

Snapchat is often referred as the next big thing in the social media. Snap Inc. decided to go public this year which means that it will be available for trading. In this report we take a closer look at the company, its product, business model, opportunities and risk factors.

We also analyse price behaviour of seven major technological stocks throughout their first 90 days of trading.

XTB clients can trade SNAP.US on the xStation platform

What is Snapchat?

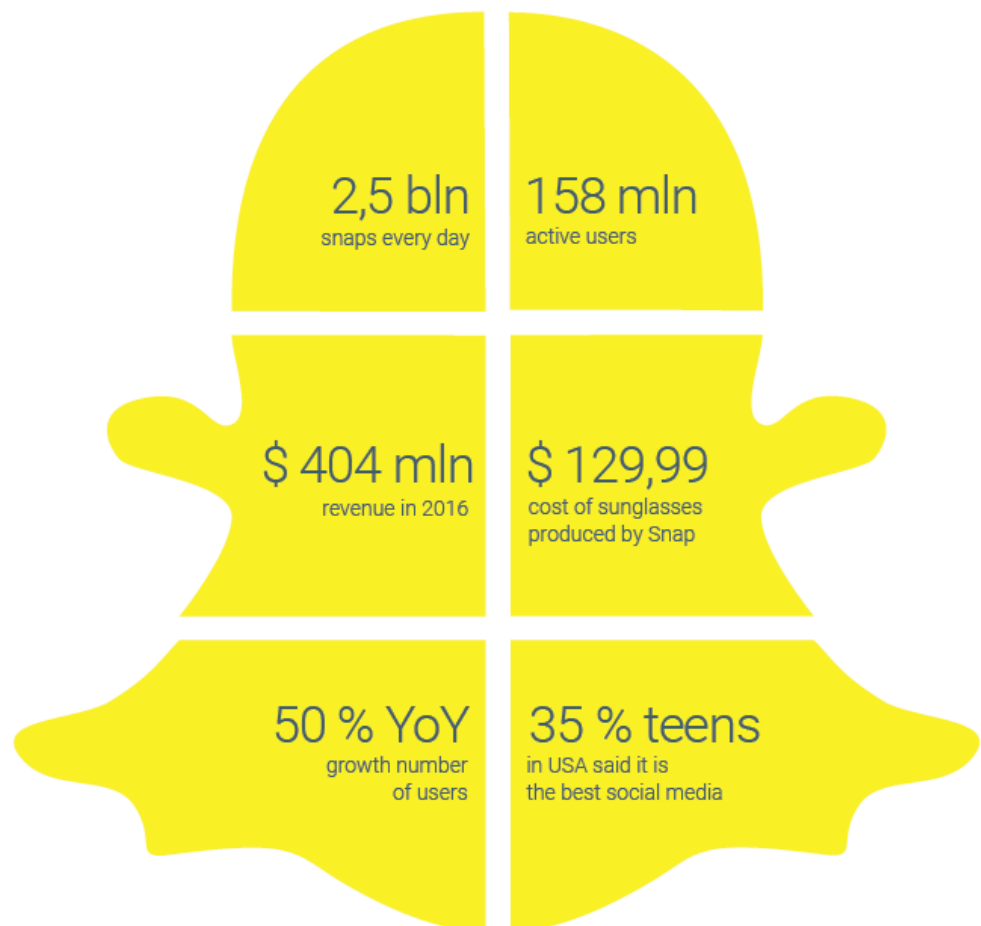
Snapchat is a mobile social media application that enables users to quickly take pictures and 10-second videos and send them to friends. Snapchat opens directly into the Camera, making it instantly accessible to take pictures and edit them with additional features like lenses and geofilters). Unlike most other platforms, these pictures are automatically deleted after 24 hours and are not publicly available, a feature that encourages users to share content without privacy concerns. Snapchat has become extremely popular among young users in the United States and has achieved international recognition.

The mobile application is owned by Snap Inc. which defines itself as a camera company wanting to improve the way people live and communicate. Snap will debut on NYSE and Nasdaq exchanges at the beginning of March.

Why should I be interested in Snapchat?

Snapchat is often referred as the next big thing in the social media. It's often compared to Facebook, the social media company that achieved tremendous success and saw its share price more than triple since its IPO (Initial Public Offering) in 2012. Snap Inc. decided to go public this year which means that it will be available for trading. In this report we take a closer look at the company, its product, business model, opportunities and risk factors. We also analyse price behaviour of seven major technological stocks throughout their first 90 days of trading.

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February 2017 Source: Nasdaq, SEC, cnbc.com, spectacles.com, businessinsider.com

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How can I trade Snap?

XTB offers two instruments to trade Snap: CFD (read more about CFD trading) and Synthetic stocks on Snap shares. Both will be available in xStation under the SNAP.US symbol. It will be possible to trade once continuous trading phase on the underlying exchange starts. A trading account is required to trade SNAP.US.

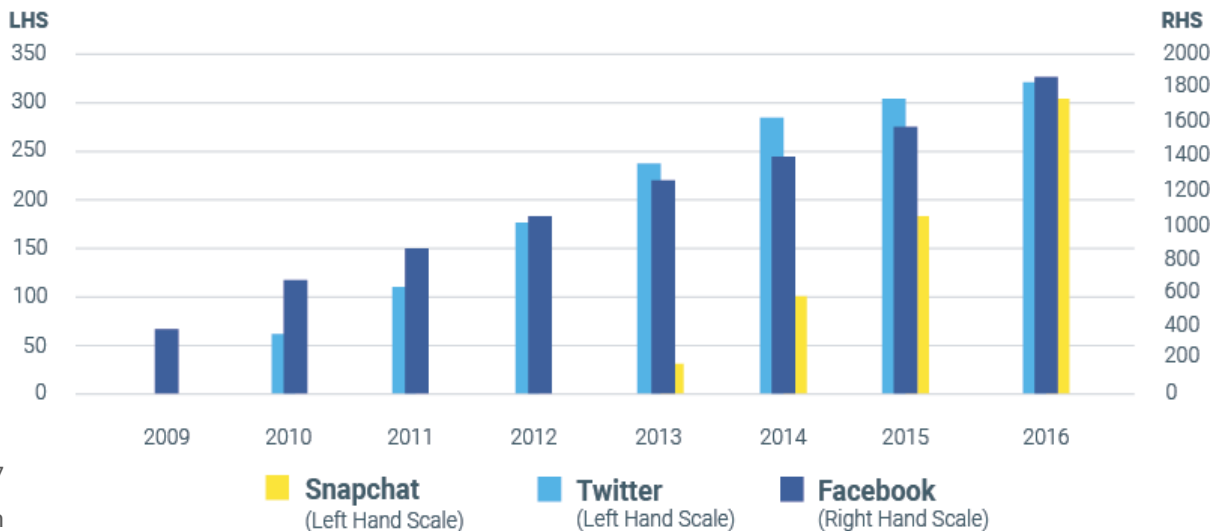
How does Snap make money?

Snapchat may be a great application but to investors the real question is if it's a good business. Therefore, the fundamental question is: how is Snap making money on Snapchat? The application is free to use and thus Snap needs to seek revenues elsewhere. In the SEC filing we can read that the company *aims at taking an increasing pie of a rapidly growing mobile advertising market*. The main channels to generate revenues include lenses, geofilters, live stories and discoveries. These are four key features available to users. Lenses allow users to change their faces and add humor elements. Snapchat provides sponsored custom lenses with prices starting from \$450k a day. Geofilters are frames on pictures and videos that depend on locations and occasions and Snap sells sponsored geofilters. Live stories allow users at the same event or location to contribute snaps to the same community narrative. Snapchat incorporates sponsored stories to try and camouflage advertisements. Finally, there is a "discover" function where content providers from old and new media alike (BuzzFeed, CNN, WSJ among others) provide video content and again, advertisements are meshed in charging Snap clients a given rate (usually starting at \$20) per thousand views. In general, Snapchat tries to deliver advertisements in a way that is not annoying to its users and in fact attempts to use their engagement to makes these ads interesting.

How much money is Snap making?

As reported in the SEC filing Snap.Inc recorded revenue growth of more than six times higher in 2016 (when revenues stood at \$404.5 million) compared to 2015. At the same time the company incurred a net loss of \$514.6 million, as compared to a net loss of \$372.9 million for the year ended December 31, 2015. It is not uncommon for tech start-ups to be losing money at this stage. Investors could tolerate losses for as long as they see a rapid increase in product popularity and revenues growth. Indeed Snap advertises a brisk growth in a number of active users. While there were "just" 33 million of monthly active users (MAU) in 2013, this number increased to 100 million in 2014, 180 million in 2015 and 301 million at the end of 2016. This number still pales in comparison to Facebook which had 1.86 billion MAU at the end of 2016 but is nearly on par with Twitter with 319 million MAU.

The number of Snapchat users has increased nearly tenfold over the past three years



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Source: Statista

Investors could hope that a growing number of active users could translate into higher revenues and profits in the future. Facebook serves as a positive benchmark here. The company had just above 300 million active users in 2009, similar to Snapchat today and advertising revenues above \$700 million. In 2016 Facebook saw its advertising revenues balloon to above \$26 billion and generated a net income above \$10 billion. Obviously, Facebook is a success story. Twitter was able to increase a revenue flow from \$317 million in 2012 to \$2.53 billion in 2016 but the company is yet to show an annual profit.

What are the main opportunities for Snapchat?

Snap operates in the fastest growing segment of mobile advertising, which the company expects to grow nearly by three times - from \$66 billion in 2016 to \$196 billion by 2020. According to Statista, Snapchat was the most popular social media site in the United States by February 2016, surpassing Facebook, Instagram and Twitter. Because of its unique way of delivering advertisements and a focus on privacy, Snapchat could be seen as a tool to access young customers which could be otherwise difficult to target. Snap could expect to obtain a relatively high revenue per customer compared to other mobile applications as it has a large user base in United States where the mobile advertising market is large. Technological progress has already increased access to high speed Internet on many markets outside the United States which is critical for a smooth use of the application. If the company is successful with international expansion it could maintain a brisk growth in a number of active users which could result in higher revenues in the future and help Snap obtain profitability.

What are the risks behind Snapchat?

Snapchat is incurring substantial losses and could be a long way from profitability. Even the company itself admits in the prospectus that it may never reach long-term profitability. While the number of users is increasing at a rapid pace, a change in customer taste - especially in regards to a fast-changing group of young users or a potential new rival product - could seriously affect the company's business model. Even if this is not the case, Snap needs to find a way to monetise this increasing user base but delivering more advertisements whilst maintaining high user engagement at the same time could be difficult. Furthermore, Snap relies heavily on Google Cloud for the vast majority of computing, storage, bandwidth, and other services which could be seen as a strategic risk but it also creates costs behind every single 'Snap' that is being sent. The company needs to increase revenues but at the same time it must improve a gross profit margin that was below 10% for the final quarter of 2016 compared to more than 60% for Google and Twitter, and more than 80% for Facebook. Finally Class A shares are being offered which are non-voting shares, which could also affect their price.

How much is Snap worth?

Snap set its proposed valuation at nearly \$21 billion this past week measuring with the \$15 midpoint of a proposed 14-16\$ a share price range. This might seem like a lot of money for a company with revenues of just above \$400 million and burning its cash flow at a rapid pace. A midpoint price would value Snap at nearly 52x sales, higher than any other large technological IPO in the past (Twitter is a current record-holder with issuance price nearly 45 times sales, Facebook was sold at 28x and Google at 16x). Then again it's about user growth and increasing revenues per user. Snapchat is extremely popular in the US where the advertising market is very large and a mobile segment shows the highest growth. ZenithOptimedia estimates that by 2018 the US advertising market will exceed \$200 billion and will be larger than the next 5 markets combined.

Snapchat is the most popular social media in the United States, the largest advertising market

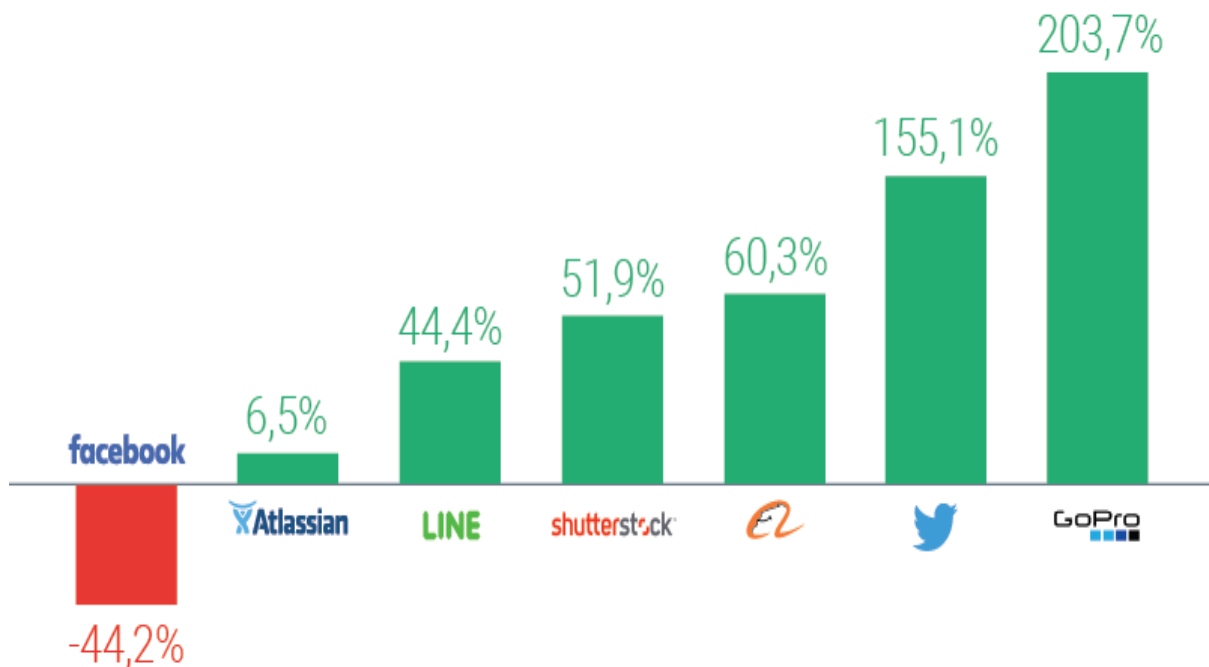
How did other TECH stocks trade after the IPO?

Technological IPOs are common on Wall Street but large offerings have been relatively rare. We have analysed the price behaviour of seven major companies during the first 90 days after their respective IPOs: Alibaba, Atlassian, Facebook, GoPro, Line, Shutterstock and Twitter. They all debuted between May 2012 and July 2016. These companies achieved a business and market success of different degrees, but in this analysis we focus solely on the first 90 trading days.

Looking at selected major tech IPOs from previous years, all seven companies generated substantial gains measuring from the IPO price (that is the price that investors were offered before a debut) to the opening price during the IPO day (the first day of public trading). These gains ranged from 10.7% in the case of Facebook to as much as 73.5% for Twitter shares. However, in the case of those seven companies, traders were better off waiting before liquidating their investments. Over the first 90 days of public trading a value of stock usually increased. Comparing a closing price on the 90th day of public trading to the IPO price, an average gain stood at a respectable 68.2%. GoPro and Twitter led the pack of six gainers with returns of 203.7% and 155.1% respectively. Facebook however saw a negative return of 44.2%.

Because few retail investors would be able to buy shares in the public offering it makes sense to analyse how these tech companies performed after the public trading commenced. Interestingly, the first trading day was mixed for these seven companies and a rate of return during the first day was actually negative at -0.6%. However, these stocks performed much better over the first 90 days of public trading. During this period those seven companies yielded a rate of return of 25.2% on average, with five of them showing a positive return (GoPro, Twitter, Alibaba, Shutterstock and Line) while two of them produced a loss (Facebook and Atlassian).

Technological companies that we analysed returned 25.2% on average over the first 90 days of trading



*compared to the IPO price, Source: Bloomberg

About the author

Przemysław Kwiecień PhD CFA is a graduate with high honors of the Warsaw University and the London Metropolitan University. He has served as the Chief Economist and Head of Research at the XTB since 2007. He puts a lot of emphasis on interlinks between the economy and financial markets, specializing in currency forecasting. His work has been appreciated on numerous occasions including regular presence among the top FX forecasters in the Bloomberg ranking. He holds a PhD in economics and a prestigious CFA designation. His prior experience includes advising to the minister of finance and serving as economist in a banking industry.



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