



Is Snap Overvalued? What We Think About the Company's Value...

Has the world gone crazy?



Let's Talk About Snap!

“Snap” (The company behind Snapchat) went public recently, and everyone wants to talk about it – one question, specifically...

*“Is it **overvalued**? How could a simple app be worth **\$20 or \$30 billion**?”*

Disclaimer: This is NOT Investment Advice

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Is Snap Overvalued?

- **SHORT ANSWER:** Yes, but not by *quite as much* as you might think
- The company's current value (\$20-\$21 / share, for an Equity Value between \$25 and \$30B) is **not** absolutely insane...
- **But** at that level, the company is most likely **extremely undervalued** or **extremely overvalued** – “middle of the road” is unlikely!
- *Potentially*, there's about 2x upside and 4-10x downside
- For the company to be valued *appropriately*, you have to believe there's a **40% chance** it will become the next Facebook (Hmmm...)



Other Snap Valuations

- Lots of other people have published valuations of Snap; they have their merits, but I disagree with most of them
- **PROBLEM #1:** EV / Revenue, EV / Active Users, etc. multiples are useless for a high-growth, rapidly changing company like this
- **PROBLEM #2:** Most people haven't explained the *reasoning* behind their revenue growth and margin assumptions in a DCF
- **PROBLEM #3:** Most people haven't projected the company's cash flows far enough into the future to be useful – you can't assume that a company like Snap “matures” in only 5-10 years



How We Think About Snap

- For a high-growth, high-risk, super-speculative company like this, we believe **three outcomes** are possible:
- **Outcome #1:** Facebook-like success story, with Daily Active Users (DAUs) and Average Revenue per User (ARPU) approaching FB's
- **Outcome #2:** Twitter-like story, with DAUs and ARPU closer to Twitter's results
- **Outcome #3:** "Crash and burn" – DAUs and ARPU only rise modestly over current levels, even 10 years into the future



The Key Drivers for Snap

- **Daily Active Users (DAUs):** 144 million average in the last fiscal year; company won't hit 1.2 billion users like FB, but will it come closer to 300 million or 600 million?
- **Average Revenue per User (ARPU):** FB is at almost \$20.00, while TWTR is around \$5.00 – \$6.00; Snap is at \$2.00 – \$3.00 right now
- **Operating Margins:** FB's forecast EBIT margin is 55% (45-50% historically); TWTR's is... negative, but we'll be optimistic and say 25%, which is their projected *EBITDA margin*
- **Other:** D&A, CapEx, and the Change in WC reach fairly low %'s of rev (3-5%) over 10 years



The Scenarios for Snap

- **Facebook Case:** 600 million users over 10 years with ARPU increasing to \$30.00+; operating margins hit break-even in Year 5 and reach 40% by Year 10
- **NOTE:** FB owns its servers while Snap use Google Cloud; we've assumed lower CapEx and lower margins for Snap as a result
- **Twitter Case:** 400 million users over 10 years with ARPU increasing to over \$8.00; operating margins hit break-even in Year 6 and reach 25% by Year 10
- **Crash and Burn:** Just over 200 million users and ARPU of \$5.00 by Year 10; operating margins climb to 10% by Year 10



Other Assumptions for the Snap DCF

- **Depreciation & Amortization % Revenue:** 9% for FB and 13% for TWTR; but Snap uses Google Cloud, so we assumed a decline from 13% to 3% over 10 years
- **CapEx % Revenue:** 16% for FB and 9% for TWTR, but Snap doesn't own its assets, so we assume 5% in the long term
- **Change in WC % Change in Revenue:** Assume it changes from (20%) to 3% over 6-7 years, in-line with Facebook's current figures
- **Discount Rate:** 7.5% if you calculate WACC with FB and TWTR as comps, but it's more like 12% for earlier-stage Internet co's, so we start it at 12% and make it decline to 7.5% over 10 years



Other Assumptions for the Snap DCF

- **Terminal Value:** We use both the Multiples Method and the Gordon Growth Method
- **Multiples:** FB, TWTR, and Google trade at forward EV / EBITDA multiples of 11-15x, so we use 5x, 8x, or 10x in the cases
- **WHY:** We want the *implied* growth rates to be reasonable!
- **Gordon Growth Method:** By Year 20, FCF is growing at 2-3% depending on the case, and U.S. long-term GDP growth is ~2.5%
- **So:** Our rates are 1.1%, 1.5%, or 2.2% depending on the case



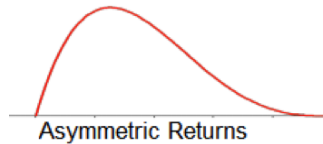
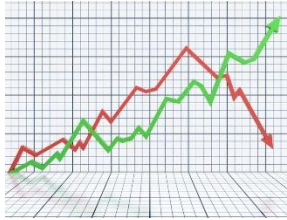
The Results of Our Snap DCF

- **Facebook Case:** Company might be worth **2x its current price** – implied share prices between \$40.00 and \$50.00
- **Twitter Case:** Company might be worth **1/4th its current price** – implied share prices between \$4.00 and \$6.00
- **Crash and Burn Case:** Company might be worth **1/10th its current price** – implied share prices between \$2.00 and \$3.00
- **Our Preference:** We don't like probability weighting, Monte Carlo, etc. because they're too speculative – how do you justify your probability weightings when presenting a stock pitch?



The Results of Our Snap DCF

- **Our View:** Valuation is more useful for assessing *the best-case outcome* and *the worst-case outcome*
- Better to be “vaguely right” than “precisely wrong” – you want cases where the company is mispriced by a **HUGE** amount
- **Here:** It’s tough to say since the scenarios are so far apart
- **BUT:** It seems *very likely* that Snap is **overvalued** at \$20-\$21
- To be valued appropriately, Snap would need to have a **40% chance** of becoming the next Facebook (30% for the others)



The Results of Our Snap DCF

- That's *possible*, but we don't think it's *plausible* – how many other social-media companies have replicated FB's success?
- A low chance of the FB outcome and a higher chance for the others makes the company's implied share price **~\$10.00**
- **So:** Likely overvalued, but we also **wouldn't** use this company in a "Short" stock pitch
- **Why:** No clear catalysts that would push down stock price; may not be good ways to mitigate risk (depends on options volume) – plus, there's that pesky 1-year lockup period on 25% of the shares sold in the IPO...



Recap and Summary

- **Is Snap overvalued?**
- Yes, most likely, but not to the extent that others have claimed
- Must look at a **long-term DCF** (20 years) and assume revenue growth and margins based on the **possible scenarios**
- **Facebook Case:** 2x upside... with very aggressive assumptions
- **Twitter Case:** 4x downside... with more reasonable assumptions
- **Crash and Burn Case:** 10x downside with... “other” assumptions

