Is Snap a snip?

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By early 2017, the dearth of technology company initial public offers (IPOs) was becoming something of a concern. And then, Snapchat came along. Launched at US$17 a share, just above the pre-IPO range of US$14-US%16, the share price surged by over 40 per cent during its first day of trading and by over 10 per cent on the second to end the week at US$27.1, having hit an intra-day high of US$28.8.

At that price, Snapchat was worth US$34.7bn, even though it had recorded a net loss of US$515m in 2016 – up from US$373m in 2015 – on revenues of a mere US$405m, and the issued shares carried no voting rights which were reserved by the founders. Not surprisingly, some commentators reacted with warnings to prospective investors, noting that Snapchat operated in a competitive environment, that its business model was unproven and that shareholders would be diluted if large volumes of free shares were issued to employees.

So, what exactly was so exciting about the product itself? In essence, unlike other social media platforms, Snapchat allowed the user to send off a photograph which would disappear from view after 10 seconds, thereby eliminating the possibility of (potentially embarrassing) photos being hacked and leaked – unless, of course they had been "grabbed" by a viewer while visible, the so-called "screenshot". Inevitably, this basic service is being extended – Snapchat Discover is excellent for homing in on un-newsworthy news – but, unlike Facebook and Twitter, Snapchat is not designed as a tool to communicate with the wider world of acquaintances – misleadingly referred to as "friends" – or complete strangers, respectively. Snapchat is intended for groups of real friends.

They do use the service provided. Roughly 160 million people open the app an average of 18 times a day, with 60 per cent of them sending a snap every day and 25 per cent creating collections of photos called "stories". Unsurprisingly, most participants are aged 18-24 years, and it is claimed that it is precisely this demographic that is trying to avoid any apps such as Facebook that are frequented by the "uncool" – that is, anyone over 35 years.

In principle, the idea that so many people are spending so much time unproductively is rather worrying, but the counter-claim is that they are no longer watching much TV; so, the net effect on leisure time is not significant. But the

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deep-rooted problem is that the service is free, and as noted, it is not raising much by way of revenue which, as with all social apps, has to be driven by advertising.

So, how can Snapchat's apparently absurd valuation be justified? The answer goes roughly as follows:

- The model is standard for a successful social media business: roll out a "cool" platform for free, get users hooked on it, then get them to pay for things that are being advertised.
- Snapchat is a pure mobile play. With the residents of countries such as the USA increasingly divesting themselves of fixed-wire connectivity, advertising will be inexorably drawn towards the mobile sector.
- The founders have been kept on board – in this case through the retention of 88.5 per cent of the voting power which is a unique feature of this IPO. The founders are the true entrepreneurs, and they can ignore the short-termism characteristic of public companies with widely distributed voting shares.

Social apps are in many ways a weird kind of business because what is being "sold" is a means to communicate which has no inherent value. Growth is bound to slow down due to the law of large numbers which means that, with a million users, you need a million new users to grow by 100 per cent, but with two million users, you need a further two million users to replicate that growth. However, the short-term prognosis is almost certainly positive because Snapchat's revenues will undoubtedly grow rapidly and the valuation of the company means that most large institutions will feel obliged to hold some shares in their portfolios.

But, will Snapchat evolve into a Facebook or a Twitter? At the time of writing, Facebook was valued at roughly US$400bn after its share price had climbed inexorably since hitting a trough that ended in June 2013. Twitter, in contrast, had hit a peak of US$69 in January 2014 before falling to US$30 in May. A recovery saw a new peak of US$52 reached in October, but by mid-2016, the share was languishing at US$14. Twitter is currently worth US$10bn compared to US$45bn at its peak and is unlikely to recover again, having reported losses of US$457m in 2016, following on from US$520m in 2015. Twitter has never made a profit despite the early-morning musings of President Trump – indeed the Trump effect was precisely zero which does not bode well for Twitter's future.

Perhaps, it just needs to be taken over. In February 2014, Facebook offered roughly US$19bn for WhatsApp, which again looked to be a superficially absurd valuation but which was justified on the grounds that 450 million people used the app every month with 70 per cent active on any given day and that new registrations amounted to one million daily. What Facebook really wanted was WhatsApp's repository of phone numbers and access to a younger demographic – Facebook had recently offered US$3bn for Snapchat! – and as indicated, the Facebook share price has never looked back since the acquisition was completed.

Snapchat will clearly never become another Facebook, and whether it actually has a future which involves the word "profit" is a moot point. However, it is not going to disappear in the immediate future. This may not hold good for many others once valuable brands, such as Twitter, and the fact that Amazon, Google and Facebook have not merely imposed an effective lock on their original spheres of influence but are moving rapidly to lock up anything else that shows signs of life is rather worrying.

Facebook currently serves as a sales channel and news distributor, while Google has YouTube and Amazon is an online retailer, cloud services provider, drone developer and entertainment company rolled into one. Apple, which as it happens has no stranglehold on smartphones even though it has by far the highest market valuation of the four, provides iCloud storage and music streaming.

Curiously, although these companies arose as disruptors and are in principle themselves vulnerable to new disruptors – geeks in the garage – they can, in principle, resort to buying up everything that moves to preserve their hegemony. Like banks, they are potentially too big to fail. It is argued that they could be joined by others such as Airbnb, Netflix, Tesla and Uber – but that may well not be the case.

Uber, for example, is notionally worth roughly US$70bn, but is in deep trouble due, in particular, to breaches of employment and consumer protection law and an allegedly poisonous culture. Its preferred method for cornering the market is to subsidise fares which is why it has lost roughly US$4bn since launching in 2009. As it has raised more than double this amount from investors, it is not in imminent danger of going under, but in essence, either it succeeds in cornering the market or it will eventually implode.

It is commonplace for comparisons to be made between the likes of Google and the nineteenth-century robber barons. However, in the former case, the public do not have to buy anything – they willingly download the apps and give up their privacy without being pressurised to do so, which, in turn, makes it hard to make the case for tight regulation. Furthermore, they have a great deal of freedom in determining where to file their tax returns. But the public can be fickle. Yes, Snapchat may be the flavour of the month for now, but will it truly ever be worth US$30bn when measured by its financial performance?

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