Social media startups' value is enormous, if you trust investors

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Snapchat is not even 3 years old. It's run by a couple of 20-somethings with no prior business experience. And it has never made a cent.

Yet investors are fighting for the opportunity to throw hundreds of millions at the mobile messaging service that is all the rage with teens.

The tiny Venice Beach, Calif., startup just turned down a $3 billion all-cash offer from Facebook Inc. And then, according to the Silicon Valley rumor mill, it rejected an offer from Google Inc., this one for $4 billion.

That's a big pot of cash for a smartphone application that could vanish almost as quickly as the messages people send on it.

Snapchat Inc. is just one of several young tech startups with no revenues and no profits that are commanding valuations that rival those of long-established companies such as Domino's Pizza Inc., JetBlue Airways Corp. and Sotheby's.

Among the better-known Silicon Valley companies with monster-truck-sized valuations are mobile payments startup Square Inc. at $3.25 billion, online storage startup Dropbox Inc. at $4 billion, private transportation service Uber Technologies Inc. at $3.5 billion and home rental service Airbnb Inc. at $2.5 billion.

These sky-high valuations for companies with untested business models are giving some people a bad case of dot-com deja vu.

The tech industry may not be in another bubble, said Aswath Damodaran, professor of finance at the Stern School of Business at New York University, referring to the rapid rise and fall of Internet companies in the late 1990s and early 2000s. But these paper valuations are a "form of delusion," he said.

What is pushing up the price tags? The ability of these companies to draw a fast-growing following of young users, analysts say.

Technology giants are willing to spend large sums of money buying these startups to keep up with young people's rapidly evolving online habits. And investors are looking to place early bets on what could turn out to be the next Facebook or Twitter Inc.

Take Pinterest Inc., whose service people use to post images of their favorite things - outfits, home design, recipes, vacation spots - to share with friends.

The San Francisco company just raised $225 million from investors, valuing it at $3.8 billion - up from $2.5 billion in February.

Like many other startups, Pinterest has tens of millions of users, some of whom spend hours a day on the service, yet it has just begun to explore how it will make money, which means it could be years before it turns a profit.

Still, although valuations in Silicon Valley are clearly inflated, they may not be as bubbly as they sound, some experts say.

Twitter is just the latest social media company to show it can make money from its massive audience. And its successful initial public offering - it ended its first day of trading with a $25 billion market cap despite never having turned a profit - has whetted investors' appetite for companies with significant growth potential.

Contributing to the current fervor: Investors are feeling more optimistic, with the Dow Jones industrial average and Standard & Poor's 500 indexes rising to record highs.

With interest rates low and big companies not growing much, investors are more willing to take risks in the hunt for bigger returns. A federal law enacted last year that will allow startups to raise money from smaller investors could send tech valuations even higher.

Investors' target: social media. With the success of Facebook, LinkedIn Corp. and now Twitter, the sector has proved it is not a passing fad.

But not every social media company that has clinched a multibillion-dollar valuation will prosper, Damodaran said.

"It's like the guy who sells the Brooklyn Bridge to eight people when he doesn't own the bridge. It's the same story being told over and over again. And that worries me," Damodaran said. "They can't all be winners."

The decision to turn down billions of dollars drove people to rant on social media this week after the Wall Street Journal first reported the Snapchat news. Tweeted novelist Kurt Andersen: "I'll bet anyone $3 that Snapchat is worth less than $3 billion 3 years from now."

Snapchat captured the fancy of young people with a self-destruct feature that makes messages - called "snaps" - disappear seconds after they are viewed.

Eight months ago, investors handed Snapchat about $13 million and estimated its paper worth at about $70 million.

In June, the company raised $60 million and its valuation jumped to $800 million. Last month, Kara Swisher of technology blog All Things D reported that Snapchat might raise $200 million at a valuation of $4 billion.

But Evan Spiegel, 23, and Bobby Murphy, 25, two former Stanford fraternity brothers, are taking the position that their startup is worth billions more.

Having previously nixed a $1 billion offer from Facebook, Snapchat belongs to an exclusive club of white-hot startups that have rejected mammoth offers in high-stakes gambles, hoping to become multibillion-dollar companies in their own right.

Many of those bets haven't paid off. Take daily deals service Groupon Inc., which foundered after rejecting Google's nearly $6 billion bid in 2010 before its IPO, or social media pioneer Digg, which once fetched a heady valuation of more than $160 million, only to sell for about $500,000 last year.

Facebook is one of the lucky companies to spurn suitors and come out on top. It turned down a $1 billion buyout offer from Yahoo Inc. and one for $15 billion from Microsoft Corp. Today it has a market cap of $120 billion.

But for every Facebook, there are plenty of Myspaces. Very few startups grow up to be huge successes.

And now Facebook is on the prowl for those companies that have gained the rapt attention of young people and pose a threat to its own online hegemony.

In April 2012, Facebook made its biggest acquisition with a cash-andstock deal initially valued at about $1 billion for Instagram. Instagram soared in popularity by giving young people a fun way to share photos on mobile devices.

In May, Yahoo borrowed a page from Facebook and paid $1.1 billion to buy blogging service Tumblr, a 6-year-old company with more than 100 million users but little revenue. Tumblr is popular with young people, in sharp contrast to Yahoo's older user base.

The powerful momentum of these young companies "threatens the incumbents very quickly," said Internet veteran Jonathan Miller, an investment partner with Advancit Capital.

"What used to take three years can now take a half a year because the adoption is so fast," he said.

With Snapchat, investors are enamored by the numbers. Nine percent of U.S. smartphone users are on Snapchat, according to a Pew Research Center study released last month. Some 350 million "snaps" are shared each day on Snapchat, up from 200 million in June.

After Facebook Chief Executive Mark Zuckerberg first met and was rebuffed by Snapchat, Facebook released a Snapchat rival called Poke.

At the TechCrunch Disrupt conference in September, Snapchat's Spiegel called the Poke app "the greatest Christmas present we ever got."

Poke never took off - a big problem for Facebook, which is chasing young users. Facebook Chief Financial Officer David Ebersman told analysts last month that the social media giant had seen a decrease in daily users, specifically among younger teens. Facebook has a large war chest to deal with that problem: $9.3 billion in cash and investments.

But the clock may be ticking on Snapchat. For all its early success, its founders may end up regretting not taking the money, said David Wessels, a finance professor at the University of Pennsylvania's Wharton School.

"We see one CEO after another come through the Wharton school and say, 'I wish I had taken the money when I had the chance,' " Wessels said. "Never take the money for granted. It won't always be there tomorrow."