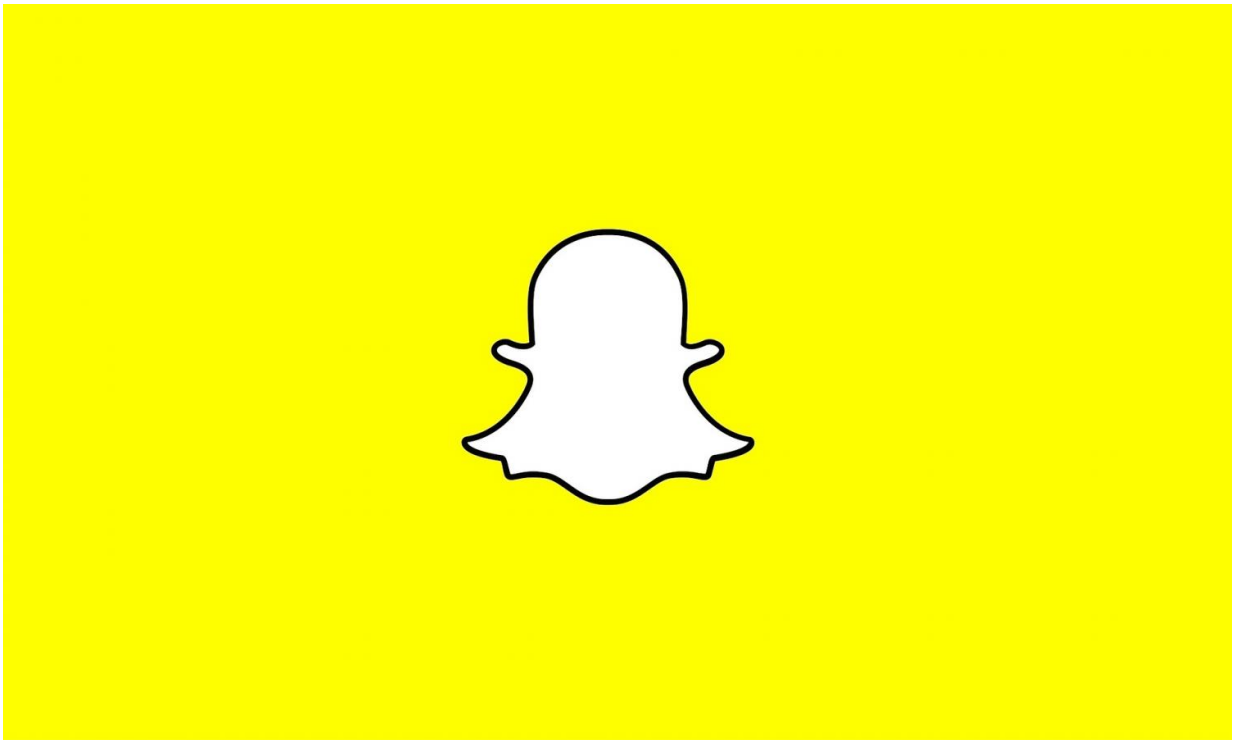


# Three things Snap needs to figure out before its next earnings report

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Shares of the Los Angeles company that makes the Snapchat messaging app breached an all-time low Friday, following weaker-than-expected second quarter financial results.

They closed at \$11.83, down 14 percent, or \$1.94. Shares previously

traded as low as \$11.90.

Snap Inc.'s market capitalization now sits at about \$14 billion, or about how much venture capitalists thought the [company](#) was worth a couple of years ago when Snapchat had 100 million users.

Snapchat counts 173 million users these days. But the increase has come too slow in the minds of investors, who have equated choppy user growth with diminished money-making potential for the unprofitable company.

Snap Chief Executive Evan Spiegel, who along with his co-founder have enough voting control to direct the firm's fate, say little has changed in their calculus. Neither plans to dump stock anytime soon, and the company has waved off rumors of a potential \$30 billion acquisition offer from Google.

Spiegel told financial analysts Thursday that he's "very excited" about upcoming features - which Snap is counting on to maintain user interest - and that employees are "having a great time" working on the ideas.

But Wall Street may want reassurances that are a bit more concrete. Here are three things the Snapchat maker must show three months from now when it reports earnings, or losses, for the July-to-September period.

## DEEPER PENETRATION AT HOME AND ASSURANCE THAT FACEBOOK ISN'T A KILLER

Snap said Thursday that about 25 percent of smartphone owners in the U.S. are Snapchat users. Facebook has about 80 percent penetration, according to third-party measurements, suggesting that Snapchat has plenty of room to grow.

Analysts such as Ralph Schackart at William Blair have suggested investors should wait it out as Snap captures more interest.

"Snap's slight miss on daily active users and revenue should not materially change the bull or bear debate on the company," Schackart said. "We are encouraged by the company's early efforts to increase engagement and content creation on the platform through new products and features."

But Snapchat isn't as essential an app for many adults as Facebook, and its long drawn complaints that its focus on creating posts versus consuming them makes learning the app complicated.

The start of school and football season provides tailwinds that could propel interest in Snapchat as people encounter new friends and dial into sports highlights. If the penetration figure doesn't budge in the next earnings report, that could put a wrinkle in Snap's positioning as a complement to Facebook.

#### INCREASED REPEAT ADVERTISERS AND PICKUP IN FIRST-TIME, SMALLER ADVERTISERS

Analysts said Thursday they were glad to see that Snap is gaining more money from the same clients.

Snap generated 142 percent more revenue during the first half of 2017 than the first half of 2016 from advertisers who bought an ad during that span last year. The figure counted spending by the same parent company, meaning a new division of a conglomerate giving Snapchat ads a whirl this year would have counted in Snap's favor.

But experts aren't impressed that Snap can't generate steady sales growth - "there is little excuse at this late in the game," James Cakmak of

Monness, Crespi, Hardt & Co. said ahead of the earnings release.

"We've defended Snap since day one, but now need to see monetization moving in the right direction," Cakmak said.

Snap could win over skeptics if its efforts to provide training, software and discounts to small businesses turn into a solid pipeline of ad buys.

## KEEPING SALES IN LINES WITH COSTS

Snap warned that its technology costs rose in the last part of the second quarter as users flocked to a new, data-intensive feature, Snap Maps.

The company hasn't put ads in Maps, which highlights the locations of a user's friends and interesting locales around the world. Snap is new to placing ads in World Lenses, the 3-D, digital sketches that include the internet celebrity known as Dancing Hot Dog.

Spiegel teased upcoming features tied to its digital storage locker for posts, Memories, where there also aren't ads.

If users spend increased amounts of time in these features but don't encounter ads in these sections, Snap's costs could soar. That's not a problem for Facebook, which often holds off on introducing ads as long as possible because it has more than \$35 billion in cash and short-term investments.

Holding out from placing ads is more difficult for Snap, which has \$2.8 billion in cash and marketable investments.

Spiegel expressed confidence the company could bring ads throughout the Snapchat interface. Until the company demonstrates ads in new sections are valuable, analysts and investors are left to do a lot of

guesswork and potentially bet on increased losses.

"As a very-early stage company, Snap remains incredibly difficult to value vs. other companies in our coverage universe," Pivotal Research's Brian Wieser said Thursday.

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