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Market Preps to Snap Up Shares

INTERNET: IPO could mean billions to firm's co-founders.

By BUSINESS JOURNAL STAFF

The clock has started ticking in the countdown to the long-anticipated public debut of Snap Inc., maker of the Snapchat app, in what is expected to be the largest tech stock offering of the year.

Snap filed last week with the Securities and Exchange Commission for a $3 billion offering. Details regarding the date, price, and portion of the company that would be offered to the public were not disclosed in the filing, though it has widely been expected to happen before the close of the first quarter and at a valuation of around $25 billion.

If it hits that number, it would be the largest in the history of the L.A. tech industry. It would also vault the company, launched in 2011 by co-founders Evan Spiegel, chief executive, and Bobby Murphy, chief technology officer, into the No. 5 spot of largest public companies in Los Angeles, ranked by market cap.

The stunning rise would value the company ahead of established local companies Edison International, CBRE Group Inc., Mattel Inc., Lions Gate Entertainment, Aecom, and Herbalife.

It is also expected to create a new class of very wealthy Angelenos within the company's workforce of 1,859 people. Spiegel and Murphy each hold 113 million shares of the company's Class A common stock, about 22 percent of the float. They also each hold more than 107 million shares of preferred Class C stock. Class C shares, which Murphy and Spiegel control entirely, carry 10 votes to each common share's vote.

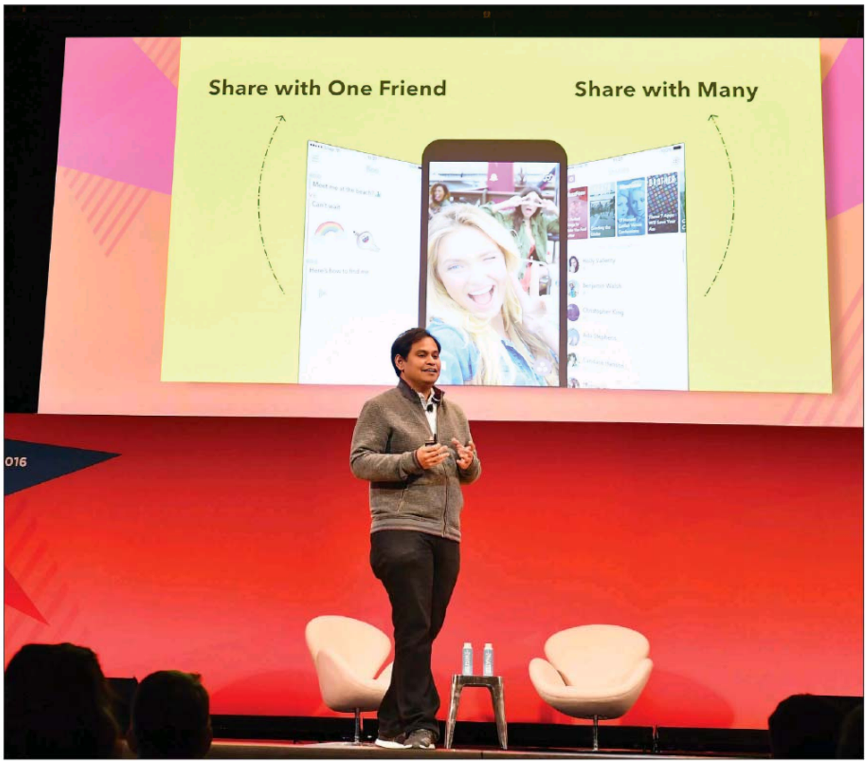
Spiegel and Murphy each hold a 22 percent share of the company, which can be expected to rise in value as investors buy shares when the offering becomes effective, which is worth $5.5 billion at a $25 billion valuation.

What's more, the offering document says Spiegel will receive an additional 3 percent of company shares, which would be worth $750 million at the anticipated valuation for the successful offering. Already on last year's list of Wealthiest Angelenos at No. 34 with an estimated net worth of $1.6 billion, the offering would give Spiegel a net worth of $6.25 billion, sending him to No. 7 on the Business Journal's list.

Spiegel

Murphy, tied with Speigel last year at 34, would jump 26 spots to rank ninth, with only Viacom's Sumner Redstone between him and his partner. The pair, still in their 20s, would move ahead of Wonderful Co. co-founders Stewart and Lynda Resnick, media mogul Haim Saban, and developer Rick Caruso.

Other key insider shareholders are Timothy Sehn, Snap's vice president of engineering, who holds 3.4 million shares; Chief Strategy Officer Imran Khan, with more than 1.4 million shares; and Michael Lynton,



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Picturing Future: Snap's Imran Khan speaks at a Snapchat panel during 2016 Advertising week New York on Sept. 26.

the former Sony Entertainment chief executive who stepped aside earlier this year to devote himself to his post as Snap's chairman. He holds 1.5 million shares.

Spiegel's 2016 compensation from the company was more than $2.4 million, which included $503,000 in salary and a $1 million bonus. Kahn took home $5.5 million in 2016, with $241,000 in base salary and a $5.2 million bonus. That paled, however, in comparison with his prior year's compensation. In 2015, the CTO was awarded more than $145 million in restricted stock units.

The largest institutional shareholders are Benchmark Capital Partners, which holds 65.8 million shares (12.7 percent) of common stock, and Lightspeed Venture Partners, with 43.3 million shares (8.3 percent).

Building value

Snap's valuation is based largely on the perceived worth of Snapchat's youthful audience, which is enticing to advertisers. In September, it was reported that Snapchat had 150 million daily active users; the company said in March that about 23 percent of daily active users fell between the ages of 13 and 18. The company reported in its SEC filing last week that its daily active user count is now 158 million. Some 27 percent of its users are between the ages of 25 to 34. The second most represented age group, those ages 13 to 17, account for 22 percent of the user base.

Snap generated $405 million in revenue last year, a 586 percent increase from the $59 million it saw in 2015. It lost $373 million and $515 million in 2015 and 2016, respectively.

Those numbers compare to prefiling projections of $367 million in 2016 advertising revenue and nearly $1 billion in 2017 made by eMarketer last year.

Since its founding, the company has raised more than $2.6 billion in venture capital, according to Crunchbase.

It closed a $1.8 billion Series F round in May that included investors such as General Atlantic, Sequoia Capital, T. Rowe Price, Lone Pine, Glade Brook Capital, IVP, Coatue Management, and Fidelity Investments, among others, according to TechCrunch.

The company reported $987 million in cash on hand as of Dec. 31.

Snap's overall revenue and profit numbers ahead of its IPO are significantly lower than those of Facebook Inc. and Alphabet Inc. (formerly Google Inc.) at the time of their respective initial offerings.

Alphabet, which went public in August 2004, raised $1.67 billion at a valuation of more than $23 billion, had revenue of $962 million, and made $106 million in profit. Facebook, which had the third-largest IPO of all time with a $16 billion raise and $104 billion valuation, was even further advanced; the company had more than $3.7 billion in revenue and earned $1 billion in the year before it went public.

Snap's pre-IPO balance sheet looks more in line with a third tech unicorn, albeit one the company might not invite comparisons to: Twitter Inc. Twitter's SEC filings ahead of its November 2013 IPO showed the company had $317 million in revenue and a net loss of $79 million. While Twitter's IPO was by some measures the most successful of the three – its stock price rose 73 percent on its first trading day, raising $1.8 billion at a valuation of $24 billion – the company's stock has since dived.

That said, Snap's outsized losses could also be attributable to simple accounting. When Alphabet, Facebook, and Twitter went public, all three owned their own servers and therefore did not have to include those costs on their balance sheet. Snap, which rents storage and server space from Google, must include those expenses when calculating profitability.

Disappearing partner

Snapchat, originally named Picaboo, was dreamed up in spring 2011 by Spiegel and fellow Stanford Kappa Sigma fraternity brother Reggie Brown. The pair brought on Murphy, another frat brother, to help develop the app at the Pacific Palisades home of Spiegel's father that summer. Spiegel was 20 years old at the time.

Relations between the startup co-founders became fraught after a few months, however, and Brown was pushed from the company in the fall of that year. Brown alleged in a lawsuit filed in 2013 – when the startup had reached a valuation of $800 million – that he overheard Spiegel and Murphy plotting to oust him and deny him equity and credit for his role inventing the app. Brown kept extensive notes, text messages, and pictures from his time at Snapchat, which he presented as evidence in court.

Brown, claiming he was the rightful owner of one-third of the startup's equity, settled with Snapchat for $157.5 million in 2014, according to the IPO filing, along with an acknowledgement that he had conceived of the idea for the ephemeral messaging app.

It was not the only legal hurdle Snap has encountered. As word leaked out that the company was preparing to file for an initial offering last year, a spate of lawsuits followed. The company was sued by several parties over the app's underlying intellectual property; by a former head of user growth; and for exposing minors to explicit material via the app's Discover feature.

The legal distractions have done nothing to slow the expansion of the company, which has taken ever-larger spaces in and around Venice and has recently leased some 300,000 square feet in Santa Monica.

Picking winners

One of the biggest questions left unanswered by Snap's S-1 filing is how much of the initial offering will be a new issuance of stock and how much will consist of existing shares sold by investors and employees.

The documents filed with the SEC leave blank fields specifying where the allocations of stock will come from and will be updated in the days immediately preceding the offering.

The breakdown between Snap's new stock issuances – referred to as primary sales – and existing share contributions – called secondary sales – is important, according to Lloyd Greif, chief executive of downtown investment bank Greif & Co.

Dollars raised from a new issuance can go directly toward strengthening the company's financial position or toward fueling growth, while sales of existing stock essentially mean employees and investors are cashing out to enrich themselves.

"It's a big question and something that we'll have to watch for," Greif said. "If the ratio skews toward primary sales, it means they are drinking their own Kool-Aid. If a lot of existing shares are offered, it means people are taking chips off the table. The breakdown will speak volumes about how the insiders view Snap's future prospects."