Twitter Inc.

NYSE:TWTR

Analyst: Arthur Jeanneröt
Sector: Information Technology

BUY

Price Target: $21

Key Statistics as of April 27, 2016

Market Price: $14.62

Industry: Internet Software and Services

Market Cap: $10.32B

52-Week Range: $13.91-$41.09

Beta: 1.14

Thesis Points:

- Twitter is a unique product in the social media space, which ensures it will be around for a long time.
- The Twitter service has reached maturity, causing investors to worry about the company's future ability to generate profits and forcing it to reinvent itself.
- With shares near an all-time low, Twitter could be a prime acquisition target.

Company Description:

Twitter is a leading social network with over 300 million monthly active users. Twitter was founded by Jack Dorsey in 2006, and went public in November 2013. Since it started as an SMS-based group messaging service, Twitter has become one of the leading social networks alongside Facebook (FB), Instagram (owned by Facebook) and LinkedIn (LNKD). The company also diversified its business with the acquisition of video apps Periscope and Vine, and is starting to make its foray into live video.

Thesis

Twitter is a unique product in the social media space, which fulfills a critical purpose: live information. Since it was founded ten years ago, the platform has become essential for people looking for the latest news. Thanks to its constantly updating live feed, Twitter has often proven its superiority over mainstream media for initial reporting of important news. After a very successful IPO, which sent the share price soaring from $26 to a high of $70 in less than two months, Twitter shares took a sharp downturn and hit an all-time low of $13.91 in February 2016. This was mainly due to a shift in the company's business model, which is no longer attracting new users. After replacing many key executive as well as its board, the company is now on path to reinvent itself, especially by focusing on live video. With its current market capitalization of $11 billion, Twitter is dramatically undervalued compared to its peers and is a very attractive takeover target in the tech media sector. With Yahoo! (YHOO) putting its core business up for sale, Twitter could be next.

Porter's 5 Forces

The bargaining power of customers (in Twitter's case, marketers) is relatively high, as there is a variety of competing social networking platforms to advertise on. If most of Twitter's customers were to switch their ads to Facebook (FB) or Google (GOOG), it would cause a dramatic fall in the company's revenues.

The bargaining power of suppliers (in this case, users) is also high, since they are the core driver of Twitter's revenues. If the majority of Twitter users leave, the ads will stop generating clicks and the company's revenues will be severely impacted.

The threat of new entrants is also high, as there is perpetual innovation going in the social media space. As we have seen in the past with examples such as MySpace, it is hard to dominate the social media field for an extended period of time.

The intensity of existing rivalry is also fairly high, as there is already a handful of different social media platforms. Luckily for Twitter, the way it works differentiates it greatly from really "social" networks such as Facebook, Instagram, Snapchat and Tumblr, so it is not unrealistic to imagine Twitter could keep its spot as the go-to source for news.

Barriers to entry are relatively low, as the only requirements needed to start a social network are a computer and programming skills. The difficulty in social network resides in gaining enough traction to be able to sell advertising space to marketers.

Business Model

Twitter's business model is fairly simple: the company sells advertising space to marketers through what it calls "Promoted Products. Promoted products consists of accounts, tweets and trends that clients can pay to have promoted to Twitter's audience. The company can then provide marketers with all sorts of metrics on the effectiveness and reach of their marketing campaign. Naturally, this is a very profitable business, with very high gross margins (67% in 2015). The key to success in this business is to stay relevant and maintain audience, or marketers will sell their ads to a competing platform. This is why the company invests heavily in research and development and pursues strategic acquisitions like it did in the past with Vine and more recently Periscope.

Twitter

Since it was launched ten years ago, Twitter has become an essential component of the social media sphere. Because of the way Twitter works (chronological newsfeed, hashtags), it has naturally become a reference for the latest information. Despite having grown at a very rapid pace, the service now seems to have reached maturity, with the numbers of monthly active users stagnating around 300 million. One of the issues with Twitter is that a large part of its user base is actually composed of non-registered users. Even though those users cannot be included in the company's statistics, they can have an impact on the company's revenue if they engage with promotional content, which would generate ad revenue. Twitter recently made several changes to the core layout of Twitter, most notably the implementation of "Moments" and "While You Were Away" (WYWA). Moments is a collection of media (tweets, vines, periscope, etc.) relevant to a particular news story and WYWA is a personalized summary of the important activity of a user's feed since their last login.

Periscope

Twitter acquired Periscope in January 2015, before the app was even launched. The exact amount paid for the acquisition was not disclosed, but most estimates fall within the $75-$100 million range. Periscope is a live video-streaming platform, which enables anyone with an iOS or Android smartphone to stream content live from their smartphone (or GoPro for iPhone users). The app was released on Apple's App Store in March 2015, and on Google's Play Store in May 2015. Since then, it has gained considerable traction, reaching ten million users in just four months, and winning Apple's app of the year award for the 2015. Periscope was a very strategic acquisition for Twitter, which is focusing on live video to grow its business. It is still too early to assess the revenue-generating potential of Periscope, but judging from the interest in live video demonstrated by technology companies, it could become as popular as Snapchat. Furthermore, the integration of Periscope with Twitter will create new ways for marketers to promote their products, since a Periscope stream can be displayed wherever a Tweet can. This should allow Twitter to diversify its ad offerings, which could be a source of future growth. Furthermore, content marketers can also promote their Periscope channel on Twitter the same way they promote their own Twitter channel, which is a potential additional source of revenue for the company.

Vine

Vine as a video-sharing app available on iOS, Android and Windows Phone. The concept behind Vine is short, looping video clips of 6 seconds or less that users can share with each other. Twitter acquired the company in October 2013, before the app was available to the public. Vine was launched in January 2013 on iOS and in June on Android, and quickly became the most downloaded app on the App Store. As of 2015, Vine had over 200 million monthly active users, who played about 1.5 billion Vines every day. Twitter does not currently generate revenue directly on Vine, or at least not through the placements of commercials before videos. However, marketers who use Twitter's promoted products can promote their own Vine channel via Twitter, which would still generate revenue but would not be attributed directly to Vine.

Financials & Valuation

Twitter is currently not profitable, as the company invests heavily in R&D and SG&A, but the company still looks attractive on several metrics. First, like all the young Internet companies, Twitter has been growing revenues at a staggering pace. Between 2011 and 2015, the company's revenues have increased more than twenty-fold, from $106 million to over $2.2 billion. In my valuation, I forecast revenues to exceed $10 billion by the end of the forecast period in 2026. The company's return on invested capital (ROIC), which stood at 19.3% in 2015 or about 2 times the WACC, is expected to taper off to reach 10.8% in the continuing period, or just 1.1 times the WACC. In order to value the company, I used a discounted cash flow model with a focus on return on invested capital. Most of the assumptions were based on industry metrics, implying that as the company matures, it should resemble the industry as a whole. This returned an intrinsic value of $16.46, which implies that shares of Twitter are currently undervalued by about 12%. The 1-year price target came out at $20.5, which represents a potential return of 40.2%.

Conclusion

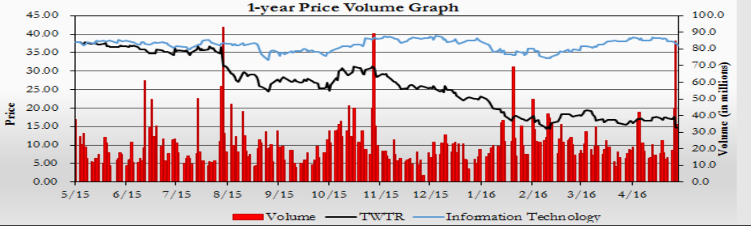
Twitter is currently undervalued and represents an attractive investment opportunity. Even though the company's core product has reached maturity, the company is still innovating, most notably in live video where it is focusing its efforts. Since the start of their downward trend in January 2014, Twitter shares have lost almost 80% of their value. Without making a case that they were fairly valued at $69, I believe it is reasonable to say that the current stock price of Twitter does not accurately represent the company's future prospects. The company is also extremely discounted compared to its peers, and this valuation gap is bound to narrow in the future as Twitter's new businesses pick up growth. Furthermore, at such a discounted valuation, the company could be an attractive acquisition target for a large Internet company such as Facebook or Alphabet.

Siena Market Line
1st week of May 2016

Twitter, Inc. (TWTR) — CENTER FOR GLOBAL FINANCIAL STUDIES — BULLISH

Analysis by Arthur Jeannerot	Current Price:	$14.62	Intrinsic Value	$16.46	Target 1 year Return: 40.22%
5/1/2016	Divident Yield:	0.0%	Target Price	$20.50	Probability of Price Increase: 99.6%

1-year Price Volume Graph



Description

Twitter, Inc. operates as a global platform for public self-expression and conversation in real time.

General Information

Sector	Information Technology
Industry	Internet Software and Services
Last Guidance	November 3, 2015
Next earnings date	July 26, 2016
Estimated Country Risk Premium	9.39%
Effective Tax rate	31%
Effective Operating Tax rate	31%

Market Data

Market Capitalization	$10,158.66
Daily volume (mil)	26.88
Shares outstanding (mil)	694.85
Diluted shares outstanding (mil)	675.20
% shares held by institutions	47%
% shares held by investments Managers	35%
% shares held by hedge funds	1%
% shares held by insiders	16.67%
Short interest	7.94%
Days to cover short interest	2.28
52 week high	$38.96
52-week low	$13.91
Levered Beta	1.14
Volatility	53.67%

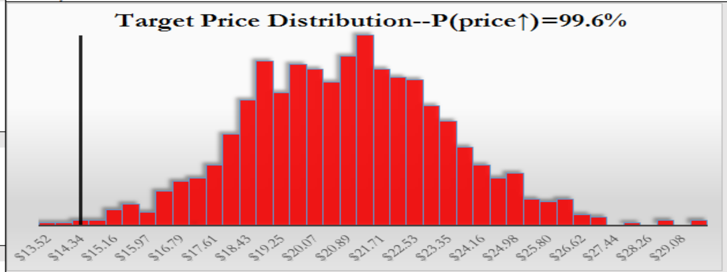
Past Earning Surprises

Quarter ending	Revenue	EBITDA
3/31/2015	-14.13%	-166.97%
6/30/2015	-1.18%	-146.45%
9/30/2015	0.57%	-118.91%
12/31/2015	-2.21%	-109.10%
3/31/2016	-3.98%	-82.90%
Mean	-4.19%	-124.86%
Standard error	2.6%	14.6%

Peers

- LinkedIn Corporation
- Facebook, Inc.
- Yahoo! Inc.
- Alphabet Inc.
- Match Group, Inc.
- Pandora Media, Inc.
- Rackspace Hosting, Inc.

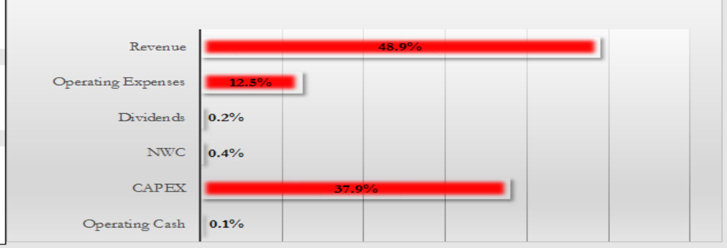
Target Price Distribution--P(price↑)=99.6%



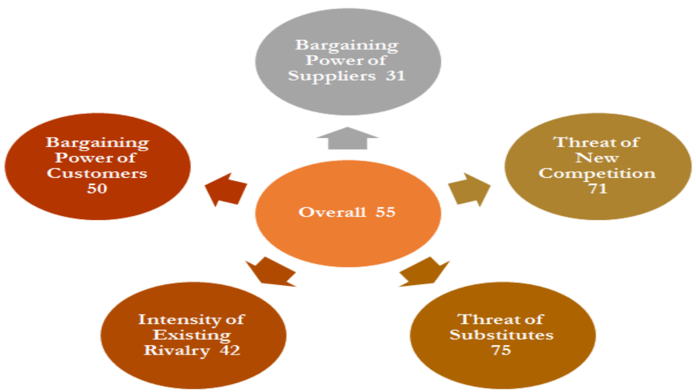
Management	Position	Total compensations growth	Total return to shareholders
Kordestani, Omid	Executive Chairman	N/M	0% per annum over 0y
Dorsey, Jack	Co-Founder, Chief Executive	N/M	0% per annum over 0y
Noto, Anthony	Chief Financial Officer	-99.45% per annum over 1y	-35.49% per annum over 1y
Bain, Adam	Chief Operating Officer	N/M	0% per annum over 0y
Kaiden, Robert	Chief Accounting Officer	N/M	N/M
Messinger, Adam	Chief Technology Officer and	N/M	N/M

Profitability	TWTR (LTM)	TWTR (5 years historical average)	Industry (LTM)
ROIC	11.7%	32.33%	15.35%
NOPAT Margin	38%	46.80%	19.7%
Revenue/Invested Capital	0.31	0.69	0.78
ROE	8.7%	69.85%	16.60%
Adjusted net margin	35%	45.22%	18.4%
Revenue/Adjusted Book Value	0.25	1.54	0.90
Invested Funds	**TWTR (LTM)**	**TWTR (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	27.2%	35.1%	71%
Estimated Operating Cash/Total Capital	0.9%	0.9%	N/A
Non-cash working Capital/Total Capital	3.6%	4.2%	-13%
Invested Capital/Total Capital	73.8%	68.2%	45%
Capital Structure	**TWTR (LTM)**	**TWTR (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.21	0.06	0.09
Cost of Existing Debt	5.96%	5.39%	2.92%
Estimated Cost of new Borrowing	4.48%	4.01%	2.92%
CGFS Risk Rating	CCC	B	BBB
Unlevered Beta (LTM)	1.05	1.00	1.08
WACC	9.30%	12.73%	13.88%

Sensitivity Attribution Analysis



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	49.6%	38.5%	1.26
3/31/2017	16.0%	53.5%	1.70
3/31/2018	10.5%	48.5%	1.42
3/31/2019	9.1%	44.1%	1.22
3/31/2020	8.4%	40.0%	1.07
3/31/2021	7.7%	36.9%	0.97
3/31/2022	7.0%	36.4%	0.95
3/31/2023	6.3%	34.2%	0.90
3/31/2024	24.3%	40.5%	1.27
3/31/2025	50.5%	49.9%	2.15
3/31/2026	23.1%	51.4%	2.24
Continuing Period	2.1%	33.4%	0.79

Period	Invested Capital	Net Claims	Price per share
Base Year	$430.07	-$888.50	$16.12
3/31/2017	$912.67	-$2,330.44	$20.27
3/31/2018	$2,647.75	-$3,741.10	$24.39
3/31/2019	$4,889.13	-$5,236.25	$28.50
3/31/2020	$7,785.39	-$6,717.26	$32.54
3/31/2021	$9,699.39	-$8,193.58	$36.46
3/31/2022	$11,637.99	-$9,841.30	$40.36
3/31/2023	$13,474.06	-$11,406.75	$43.92
3/31/2024	$15,080.48	-$12,968.96	$48.05
3/31/2025	$16,512.54	-$14,737.49	$54.10
3/31/2026	$17,747.90	-$17,789.64	$61.15
Continuing Period			