Pre-IPO Coverage: SurveyMonkey (SVMK)

Online survey provider SurveyMonkey (SVMK) will IPO on Wednesday, September 26. At a price range of $9-$11 per share, the company plans to raise up to $171 million with an expected market cap of ~$1.2 billion. At the midpoint of the IPO price range, SVMK currently earns our Very Unattractive rating.

SVMK looks different from many recent IPO's in both positive and negative ways. On the positive side, its losses are lower and it doesn't have a dual class share structure that prevents investors from having a vote on corporate governance matters. On the negative side, its high debt and slow growth make it hard to believe SVMK can justify its lofty valuation.

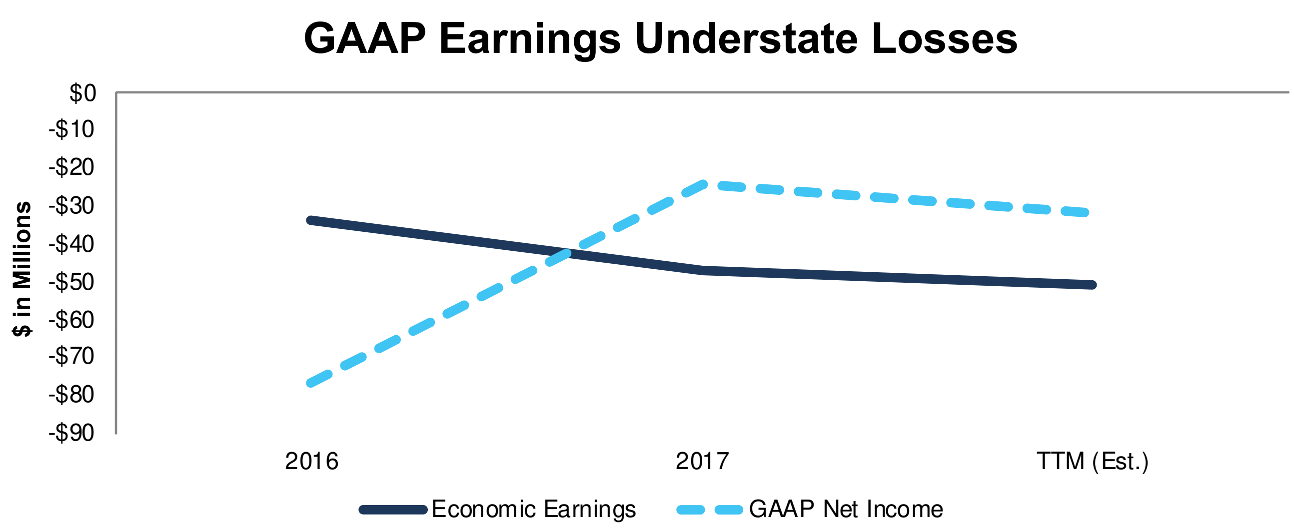
This report aims to help investors sort through SurveyMonkey's financial filings to understand the fundamentals and valuation of this IPO.

Losses Are Worse Than Reported

SVMK earns revenues by charging monthly/annual fees for premium plans that offer unlimited surveys and questions along with customizable features and customer support. The company has over 16 million active users, but only 600 thousand (4%) are paying users. The company earned $121 million in revenue from these users through the first six months of 2018, up 14% year over year.

At first glance, SVMK's GAAP losses narrowed from -$76 million in 2016 to -$32 million over the trailing twelve months (TTM). However, Figure 1 shows that economic earnings, the true cash flows of the business, declined over that period. The company's economic losses increased from -$34 million in 2016 to -$47 million in 2017 and an estimated -$51 million TTM.[1]

Figure 1: SVMK GAAP Net Income and Economic Earnings Since 2016



Sources: New Constructs, LLC and company filings

Non-operating items overstated SVMK's GAAP losses in 2016 and understated its losses in 2017. Adjusting to remove these non-operating items reveals the company's growing losses.

The most notable non-operating expense in 2016 was $25 million (12% of revenue) in restructuring expense.

[1] SVMK's S-1 does not give us enough information to definitively calculate its economic earnings over the TTM period.

The most notable non-operating income in 2017 was a $12 million (6% of revenue) tax benefit due to tax reform.

Price Increase Can't Drive Profitability

SVMK's user growth has been minimal over the past year, but it has grown revenue by raising prices on existing users. The company increased its average revenue per user (ARPU) from $351 in the first six months of 2017 to $400 in the first six months of 2018, a 14% increase. According to the S-1, this increase was:

"Largely driven by a change to our individual user plans in 2017 that offered paying users new plans with more functionality and required our users to renew their subscriptions at higher price points."

One would think that raising prices should increase margins, but that was not the case. In fact, SVMK's gross margin fell from 71% in the first half of 2017 to 70% in the first half of 2018.

If SVMK's margins fall even as it raises prices by double-digits, it's hard to find a long-term path to profitability. SVMK, which was founded in 1999, is a mature company, unlike many other recent IPO's. After nearly 20 years of losses, SVMK can't keep claiming that profitability is just around the corner.

Limited Market Opportunity

SVMK estimates that its addressable market in the U.S. is $25 billion (compared to its $233 million in TTM revenue), but that number is based on unrealistic assumptions. To reach that $25 billion number, SVMK assumes that every single knowledge worker in the U.S. is a potential paying customer. Needless to say, we don't think every single white-collar worker in America needs a premium survey service.

A more realistic analysis from Research and Markets estimates the global online survey market at ~$4.1 billion, and growing to $6.9 billion in 2022. That analysis suggests SVMK has ~5% market share.

That 5% market share makes SVMK the second-largest online survey provider, but it's behind the 800-pound gorilla in the room, Google (GOOGL). Google Surveys accounts for an estimated 91% of the online survey market.

Google's dominant market share is the biggest challenge facing SVMK. For low-end users that just want to make simple surveys, Google Surveys is the easiest and cheapest option.

Meanwhile, high-end institutional clients are more likely to work with professional marketing firms to create their customer surveys. According to SVMK, they have customers within 98% of Fortune 500 firms, but only 71 of those companies (14%) have an organization-level agreement with them.

With pressure on both the low and the high end, SVMK has a limited market opportunity with midsize customers. It will need to grab a significant portion of that addressable market to justify its valuation.

Our Discounted Cash Flow Model Reveals SVMK Is Overvalued

When we use our dynamic DCF model to analyze the future cash flow expectations baked into the stock price, we find that SVMK is overvalued at the midpoint of its IPO price range.

To justify the midpoint of its IPO range at $10/share, SVMK must immediately achieve 25% pre-tax margins – equal to GOOGL – and grow revenue by 11% compounded annually for 10 years. See the math behind this dynamic DCF scenario.

11% annual revenue growth may be possible for SVMK given the projected growth in its underlying market, but the margin expectation seems unlikely. The company earned -9% margins in 2017, which was worse than the -4% margin in 2016.

If SVMK can grow revenue by 11% compounded annually for 10 years but only earn 10% pre-tax margins – equal to enterprise services company LogMeIn (LOGM) – the stock is worth just ~$2/share today, an 80% downside. See the math behind this dynamic DCF scenario.

High Debt Limits Upside & Bankers Need to Get Repaid

After putting off its IPO for 19 years, it's fair to question why SVMK chose to go public now. The answer to that question lies in the company's $417 million in total debt. As Figure 2 shows, SVMK's 34% debt to equity is the third-worst of the 13 IPO's we've covered so far in 2018.

Figure 2: Debt to Equity for 2018 IPO's

Company	Ticker	Debt to Equity
BJ's Wholesale Club	BJ	144%
EVO Payments	EVOP	46%
SurveyMonkey	SVMK	34%
Puxin	NEW	24%
Dropbox	DBX	13%
Domo	DOMO	12%
GreenSky	GSKY	9%
AXA Equitable Holdings	EQH	8%
Avalara	AVLR	4%
Eventbrite	EB	4%
Spotify	SPOT	2%
Elanco Animal Health	ELAN	1%
Tilray	TLRY	0%

Sources: New Constructs, LLC and company filings

Of the expected $150 million in proceeds from the IPO, SVMK plans to use $100 million to pay down its debt. It's no coincidence that the underwriters of the offering – J.P. Morgan (JPM) and Merrill Lynch (BAC) – are also among SVMK's largest creditors.

The need to pay down its debt limits the amount of capital SVMK can invest in potential growth opportunities. It will be hard for the company to justify its valuation if most of its available cash is going towards its debt.

No Dual-Class Shares Is a Positive

Corporate governance stands out as the only area where SVMK has a clear advantage compared to other recent IPO's. There's just a single share class, which means every investor will have an equal say in corporate governance.

Even better, no single investor or group of insiders will hold enough shares to control the direction of the company. The largest shareholder, Tiger Global Management, will hold 25% of shares after the IPO.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

As investors focus more on fundamental research, research automation technology is needed to analyze all the critical financial details in financial filings. Below are specifics on the adjustments[2] we make based on Robo-Analyst[3] findings in SurveyMonkey's S-1:

Income Statement: we made $37 million of adjustments, with a net effect of removing $6 million in non-operating expense (3% of revenue). You can see all the adjustments made to SVMK's income statement here.

Balance Sheet: we made $26 million of adjustments to calculate invested capital with a net increase of $25 million. The most notable adjustment was $17 million in accumulated asset write-downs, mostly related to a $16 million goodwill impairment in 2016. This adjustment represented 4% of reported net assets. You can see all the adjustments made to SVMK's balance sheet here.

Valuation: we made $458 million of adjustments with a net effect of decreasing shareholder value by $458 million. There were no adjustments that increased shareholder value. Apart from the debt referenced above, the largest adjustment to shareholder value was $36 million in outstanding employee stock options. This option adjustment represents 3% of SVMK's proposed market cap.

[2] Ernst & Young's recent white paper "Getting ROIC Right" demonstrates the link between an accurate calculation of ROIC and shareholder value.

[3] Harvard Business School Features the powerful impact of research automation in the case study New Constructs: Disrupting Fundamental Analysis with Robo-Analysts.

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Disclosure: David Trainer, Kyle Guske II, and Sam McBride receive no compensation to write about any specific stock, style, or theme.

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Value Investing 2.0: Diligence Matters: Technology is Key to Value Investing With Scale

Accounting data is only the beginning of fundamental research. It must be translated into economic earnings to truly understand profitability and valuation. This translation requires deep analysis of footnotes and the MD&A, a process that our robo-analyst technology empowers us to perform for thousands of stocks, ETFs and mutual funds.

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