

Buy Twilio

David Gardner | September 13, 2018 | Buy Recommendation

Why keep reinventing the wheel? If you have a great idea for a new business, your energy is probably best spent on what differentiates it from competitors, not the basic functions it has in common with them. This labor-saving idea is the guiding force behind my recommendation this month, **Twilio** ([NYSE: TWLO](#)).

Sparing businesses from having to produce their own version of a common tool is a Rule Breaking idea we've presented to you before. For instance, **Shopify** ([NYSE: SHOP](#)) allows small-business owners to buy rather than build e-commerce portals, back-office systems, and payment functions, letting them focus on their own unique storefronts. Twilio's specialty is what it calls "cloud communications." Customers can use Twilio's application program interfaces (APIs) and other software to embed text, voice, and video just about anywhere in the digital realm, and use it however they want.

It says a lot about Twilio that its appeal goes far beyond small operations with limited resources. Twilio ended the second quarter with over 57,000 active customer accounts ranging from small-to-medium-sized businesses to some of the world's largest enterprises. The voice applications on **Facebook's** ([NASDAQ:FB](#)) WhatsApp are powered by Twilio. When your Uber driver calls or texts you from within the app, that's Twilio too. If an Amazon Web Services customer wants to embed voice calling or messaging into a Web page or mobile app, it's just a few clicks away, thanks to Twilio.

Twilio has already been wildly successful for members who bought after our first recommendation in January 2017 — the stock is up 190% while the S&P 500 has risen 29% in the same timeframe. But with the company continuing to gain momentum as it moves forward, we think there are plenty of gains to come.

TWILIO IN 1 MINUTE

WHAT IT DOES

Twilio arms developers with tools to embed communications features like text, voice, and video within their platforms and applications.

WHY BUY

- Twilio's tools are proving popular with tech heavyweights, and its client base exceeds 57,000 accounts.
 - Despite a long track record of remarkable growth, the company's rate of revenue expansion has actually accelerated in the past two quarters.
 - The company's developer base represents a strong competitive advantage it can leverage as it moves into new opportunities.

BUYER'S GUIDE

- **Industry:** Software
 - **Size:** Mid cap
 - **Region:** U.S.
 - **Recent Price:** \$84.31
 - **Allocation:** Even though this is our second recommendation, we don't recommend buying too much of any stock. Many Fools choose to fill out their positions incrementally, starting with a small amount — 2% of their portfolio's overall value, for

Here Comes the 'Third Wave'

Twilio co-founder and CEO Jeffrey Lawson sees his company as part of a "third wave" of enterprise software. First came the monolithic on-site installations of companies like **Oracle** ([NYSE: ORCL](#)) and **SAP** ([NYSE: SAP](#)), followed by "software as a service," the cloud-based approach popularized by Rule Breaker **Saleforce.com** ([NYSE: CRM](#)).

And now we have APIs, building blocks that can be combined in many ways to reliably and securely solve communications problems. Twilio lets customers combine these little modules in a stunning number of permutations, and it charges based solely on how those tools are used in the real world. That's attractive, because customers have so little up-front risk. (It's similar to the model **Amazon.com** ([NASDAQ: AMZN](#)) uses for Amazon Web Services — an influence that may come from Lawson's time as technical product manager at AWS.)

This approach is integral to helping customers differentiate their businesses. While companies like SAP have to pitch themselves to C-level executives, and SaaS companies to department heads, Twilio bypasses busy management types and appeals directly to the developers working on real-world problems. Want to block robocalls? Have empty parking spaces notify drivers? Do something quirky like operate your garage door by voice call? Sure, you can do all that. Each sale is a relatively minor thing, but as Lawson recently pointed out at an investor conference, "those small usage-based quantities add up very quickly."

Moreover, the appeal is incredibly widespread. More than 2 million developers have used Twilio, and that experience — along with the trust the company has created — provides an incredible competitive moat. This pool of developers is also a ready audience for new functionality that Twilio continues to add, from new channels like smart assistants to third-party add-ons to functions like advanced speech recognition to major workflow applications like its Flex call center platform.

Now Even Faster

Twilio's broad appeal shows up in a breakneck pace of growth. Revenue has expanded at a compound annual rate of 59% over the past three years. The law of large numbers tells us that kind of extraordinary pace can't last forever, but so far, Twilio has been doing an impressive job of defying gravity. In fact, revenue growth has actually *accelerated* this year. In the first quarter, the top line jumped 47.8% — better than the 47.2% recorded a year earlier. In the recently reported second quarter, total revenue was up 54% — well ahead of the 49% growth from a year ago.

That's happening because Twilio continues to add customers at an impressive clip, and to get more from the ones it has. The company's net expansion

instance — and adding a little at a time.

KEY DATA

- **Headquarters:** San Francisco, Calif.
 - **Website:** [Twilio investor relations](#)
 - **Market Cap:** \$8.2 billion
 - **Cash/Debt:** \$795 million / \$423 million
 - **Revenue (TTM):** \$492.6 million
 - **Earnings (TTM):** (\$90.1 million)
 - **Revenue (2015/'16/'17):** \$166.9 million / \$277.3 million / \$399.0 million
 - **Earnings (2015/'16/'17):** (\$35.5 million) / (\$41.3 million) / (\$63.7 million)

Save TWLO for Later

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into *RR* here

- See why Twilio scores an 11 on our unique 25-point Risk Rating
 - See how you can tell if this investment is going right — or wrong.

rate — the amount an active customer spent in the latest quarter versus the same period a year prior — was 137% in the most recent quarter (that, too, was up from 131% a year ago).

If the company can keep up its second-quarter pace of revenue growth, sales would increase to 8.7 times their current level in five years. But let's assume — as Wall Street does — that growth will slow to about 38%, which would result in a 5x increase on the top line. That would give the company nearly \$2 billion in revenue in 2022. While it probably won't maintain its current price-to-sales multiple of about 16.7, even half that figure suggests the stock could double in the next five years.

That certainly doesn't make Twilio's shares cheap by any means, but it does hint at the company's potential upside. How businesses communicate with their customers is constantly evolving, and that leaves lots of new opportunities for Twilio to move into over the next several years.

Risks and When We'd Sell

Nevertheless, Twilio does sport a premium valuation today — a market cap of \$8.2 billion for a company with just under \$500 million in sales over the past year, no profit, and modest (albeit growing) free cash flow. The means the company has to continue growing quickly and improve its margins — even a modest setback could send the stock down.

Twilio's gross margin — about 53% over the past year — may seem unusually low for a software company. But Twilio doesn't just offer software; it also offers the network capacity over which communications flow. That's a significant extra expense, but the silver lining is that it should continue to scale as the company gets larger.

The cost of providing network bandwidth is also a bulwark against the company's competitors. That keeps it well ahead of smaller rivals like **Bandwidth** ([NASDAQ: BAND](#)), Plivo, Nexmo, Sinch, and others. But these companies make sure that Twilio keeps feeling pricing pressure, as well as a need to keep investing in the future.

The Foolish Bottom Line

Predicting the future is hard. But if you think communication will remain a critical part of business, and that it will increasingly happen over digital platforms, then you should give Twilio a close look. The company is letting businesses reach their customers in unique ways, making it incredibly easy and cost-effective for them to do so. And management is investing right alongside us — Lawson and fellow co-founder John Wolthuis own over 10% of the company between them. That's not a guarantee of success, but it does increase our confidence that we're on the same wavelength.

Karl Thiel contributed to this report.

John Mackey, CEO of Whole Foods Market, an Amazon subsidiary, is a member of The Motley Fool's board of directors. [David Gardner](#) owns shares of Amazon and Facebook. [Karl Thiel](#) owns shares of Facebook. [Tom Gardner](#) owns shares of Facebook and Shopify. The Motley Fool owns shares of Amazon, Facebook, Oracle, Salesforce.com, Shopify, and Twilio and has the following options: long January 2020 \$30 calls on Oracle. The Motley Fool has a [disclosure policy](#).

See the Trends

The Motley Fool thinks buying and holding for at least 3-5 years sets you up for success.



From the Company Page

Last updated June 25, 4:15 p.m.

Current Price	\$216.52	Today's Change	\$4.35 (2.1%)
Exchange / Symbol	NYSE: TWLO	Market Cap	\$30B
Beta	1.641702	Earnings Per Share (Trailing 12 Months)	-\$2.69



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Market data provided by FactSet and Web Financial Group.