

## GoPro Inc. (GPRO): Short @ \$7.00

**Short Thesis:** GoPro's main challenge is to take a niche product and make it appealing to a mass audience. Despite being popular with surfers, skiers and skaters, who capture extreme video footage, GoPro cameras still have not come close to their goal of achieving mainstream adoption. We believe this task will become even more difficult in the near term as the core market for wearable high-definition video recorders is getting smaller due to rising competition from overseas manufacturers as well as the ubiquity of smartphones that have cameras with similar quality as GoPro's high-end cameras. Finally, we also believe that the era of the "look at me" in social media may be gradually fading.

GoPro's comeback strategy is to release a high-end drone called the *Karma* in 2H16, that will serve as a new accessory to selling its existing line of action cameras as well as the release of its new camera, *Hero5*, during this holiday season. Despite the growth of consumer drone shipments projected for next year, we believe the *Karma* drone will have limited success. The hobbyist market for drones is already crowded with competitors on both the high end (DJI) and the low end (Xiaomi) that already carry the newest wide-angle 4K high-resolution cameras and employ the latest technologies like geo-fencing and collision avoidance. We believe it might be difficult for GoPro to differentiate itself in this crowded market in the near term.

**TABLE 1: GoPro 1Q16 Results**

1Q16 Results			2Q16 Guidance			1Q16 Results			2Q16 Guidance		
EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
-0.63	-0.60	miss	n/a	-0.58	n/a	183.5M	169.1M	beat	n/a	202.3M	n/a

Source: GoPro Inc. and Yahoo Finance

GoPro announced its 1Q16 results with revenues of \$183.5M beating consensus estimate of 169.1M. Despite the top-line beat, revenue growth fell by 49.5% y/y and 58% sequentially. Non-GAAP earnings fell from \$35.6M in 1Q15 to a loss of \$86.7M in 1Q16. 1Q16 loss per share was at (63 cents) wider than analyst expectations of a loss of (60 cents) compared to EPS of 24 cents in 1Q15.

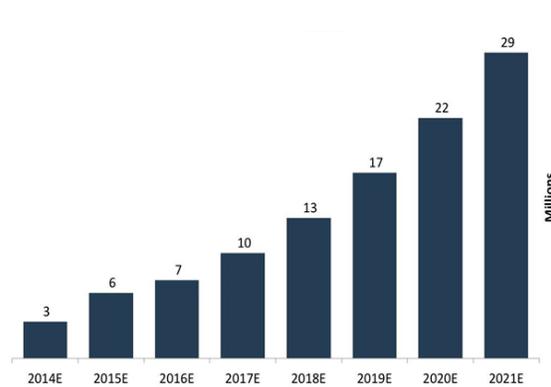
In addition, GoPro expects a fall in sales in the range of 7-17% this year. This is compared to 41% y/y growth in 2014 and 16% y/y growth in 2015. The company affirmed a 2016 revenue guidance range of \$1.35-1.5B. While management expects modest sequential revenue growth in 2Q16, it is projecting the vast majority of this year's revenue to occur in 2H16.

Moreover, the company delayed the launch of its *Karma* drone which was previously scheduled for 1H16, to the back half of 2016 (possibly during the holiday season) along with the release of its newest action camera, *Hero5*. Essentially, what it all comes down to is that GoPro's total sales has to amount to ~\$1.0B during 2H16, if the company is to meet its 2016 revenue target. We believe this target may be too optimistic and may run the risk of being taken down later this year.

Our view is based on 1) the gradual transition and phase out of its current *Hero4* product line, 2) the lack of new products until the 2016 holiday season and 3) the intense competition in both the wearable camera and the consumer drone markets.

## **I. Growth in Consumer Drone Shipments**

**FIGURE 1: Estimated Global Consumer Drone Shipments**



In recent years, hobbyists have started buying smaller consumer drones for aerial photography, while companies have used them to enhance or automate work processes. Shipments of consumer drones are expected to more than quadruple over the next 5 years, fueled by increasing price competition and new technologies that make flying drones easier for beginners (see Figure 1). Furthermore, technologies like geo-fencing and collision avoidance will make flying drones safer and make regulators feel more comfortable with larger numbers of drones flying the skies.

Source: BI Intelligence, 2016

### **Additional Facts about the Consumer Drone Market**

- The global drone market could be worth \$127B by 2020, up from just \$2.0B today, according to consulting firm *PWC*. In addition to defense, delivery, or aerial photography, the firm believes that drones will soon be used for verifying business claims, boosting crop yields, and creating special effects for Hollywood blockbusters.
- The U.S. is currently the world's largest drone market. Research firm *KPCB's* 2014 figures show that the U.S. controlled 35% of the drone market, compared to 30% for Europe, 15% for China, and 20% for the rest of the world.
- Growth in the enterprise sector will outpace the consumer sector in both shipments and revenues as regulations open up new use cases in the U.S. and EU, the two biggest potential markets for enterprise drones.
- The military sector will continue to lead all other sectors in drone spending due to the high cost of military drones and the growing number of countries seeking to acquire them.

## **II. Consumer Drone Market Already Competitive – GoPro Karma Too Late to Market**

U.S. officials estimate that around one million consumer drones were sold across the country during the 2015 holiday season. That figure would likely include drones from market leader DJI (the world's largest civilian drone manufacturer), 3D Robotics, Parrot, and PrecisionHawk. GoPro's decision to enter the market in 2H16 might be too late since many potential customers probably already bought one of those other drones.

**FIGURE 2: DJI Drone Displays and Demos in Apple Stores**



Earlier this year, Apple and DJI entered into a partnership. Apple unveiled prominent new retail displays for DJI’s *Phantom 4* drone at over 400 of its brick-and-mortar stores (see Figure 2).

The large “feature bay” displays include large signage, hands-on demo models, and plenty of shelf space for DJI’s drones and accessories. DJI employees are also visiting select Apple stores to provide customers with hands-on drone training sessions.

The *Phantom 4* retails for \$1,400 and features DJI’s own wide-angle 4K camera and sensors, advanced autopilot, auto-follow, and object avoidance capabilities. Apple will be the exclusive third-party retailer of the *Phantom 4* during its launch, but DJI will also expand its availability to other retailers. The DJI displays represent Apple’s biggest promotion of third-party products and highlight the growing popularity of DJI’s flagship drones.



Source: DJI

GoPro conquered the action camera market with a first mover advantage. By the time other camera companies launched competing devices, the word “GoPro” became synonymous with action cameras. Currently, DJI is accomplishing the same thing with drones. Now that Apple is bolstering DJI’s reputation with big store promotions, GoPro could be missing its chance to grab a meaningful share of the drone market.

**III. Consumer Drone Prices Falling Fast – Stricter FAA Regulations May Dampen Consumer Demand**

The cost of high-end drones is likely to drop this year as a result of cheaper components and intense competition. For example, Xiaomi’s *Mi Drone* now costs less than GoPro’s stand-alone action camera (see Figure 3). The Chinese tech giant recently launched a 4K drone that costs \$460, that’s \$40 less than GoPro’s 4K-capable *Hero4 Black* camera. Xiaomi’s devices dramatically undercut comparable 4K drones on the market, which generally cost around \$1,000.

**FIGURE 3: Xiaomi’s *Mi Drone* – 1080p Model Costs \$380 while 4K Version Costs \$460**



Source: Xiaomi

The launch of the *Mi Drone* is a sign that competition in the consumer drone market will likely intensify this year. Earlier this month, Xiaomi also started selling Yi Technology’s *Yi 4K Action Camera 2*, which combines the hardware of GoPro’s \$500 *Hero4 Black* with the touch LCD display of the \$400 *Hero4 Silver* for just \$250. Yi Technology (in which Xiaomi is an investor) also recently partnered with Alphabet’s YouTube to create VR videos for its *Jump* platform. Prior to that, GoPro had been YouTube’s sole *Jump* partner.

Filling the skies with cheaper drones could also be hazardous to passenger aircraft. According to a study conducted by a research group at Bard College, 327 incidents of drones flying too close to piloted aircraft occurred between December 2013 and September 2015. This is why the Federal Aviation Administration (FAA) now requires hobbyists to register their drones.

Over 325,000 people registered their drones between December 2015 and early February 2016, according to the FAA. However, that represents less than a third of the one million drones that the agency believes were sold last holiday season. If drone owners continue to ignore FAA regulations, stricter rules might be introduced and enforced, which may lead to a dampening of demand for consumer drones.

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