

Consumer Discretionary B | Ted Bauer & Kenzie Meyer | Tanner Thompson & Joel Yang

Introduction

Etsy is an e-commerce website and app that is the global marketplace for unique and creative goods. These items fall under a wide range of categories, including bags, jewelry, clothing, home decor and furniture, toys, art, and craft supplies and tools. What sets Etsy apart from other websites such as eBay and Amazon, is that these items are handcrafted by sellers and can be personalized to fit the buyer's needs. Etsy puts a huge emphasis on their sellers and believe they are the heart and soul. Etsy first traded on the NASDAQ on April 16, 2015. The IPO price was \$16 per share, and as of May 15, 2019, their share price is \$61.89.

Etsy's six core geographic markets: United States, United Kingdom, France, Germany, Australia, and Canada. People using Etsy to buy and sell in nearly every country in the world. Approximately 35% of sales happened entirely outside of the United States. Etsy translates listings into 10 languages, which helps reach a truly global audience. Since 2017, Etsy has had a 55% growth in gross merchandise sales (GMS). GMS is the dollar value of items sold on Etsy, within the applicable period. GMS excludes shipping fees and net of refunds associated with cancelled transitions; GMS does not represent revenue.

Recommendation

We recommend a **BUY** for Etsy. Etsy has been growing faster than the overall e-commerce market and is expected to continue growing faster than the market. As mentioned above Etsy uses gross GMS as one of their key metrics, which reflects the total value of items sold on the site. Etsy's GMS is projected to grow 16-20% on average in the next five years, with revenue growing slightly faster. EBITDA margins are expected to expand to 30% or higher during the next five years as well. Etsy is said to have one of the best business models in the e-commerce industry because they have element of eBay's high-margin marketplace, Google's advertising, PayPal's payments, and are moving towards Amazon's shipping while capturing profit with no inventory on the books.

Etsy is operating in uncharted waters currently. No other company can match what Etsy is doing right now. The true two-sided marketplace that is Etsy has created is a very rare occurrence in modern business. Companies like eBay and Amazon are surely scared and at risk of Etsy growing into fruition. Etsy operates in almost the same areas of the economy as eBay and Amazon; however, Etsy offers creative, personal and unique products. eBay and Amazon offer, what Etsy calls, commoditized items. Huge inventories of the same item are a good investment if consumers tastes don't change. Etsy prevents this loss to taste change through truly unique and personalized items.

Investment Thesis

Etsy's mission is to "Keep Commerce Human." In a world of increasing automation and commoditization, creativity cannot be automated, and human connection cannot be replace. This mission statement is what makes Etsy's marketplace so special. Etsy is extremely differentiated in the fact that most goods are homemade and customizable. Through our valuation analysis and our key drivers, we believe that Etsy has a competitive advantage compared to its competitors, which are few.

A two-sided marketplace like this doesn't exist anywhere except on Etsy. The unique ecology of this platform offers a large opportunity for future growth in a competition-free environment. Etsy offers items that specialty retail stores offer; however, they offer a best in class search and a handmade, personalized touch to everything. This eliminates the feeling of customers feeling that they are buying a standardized commodity and makes them more connected with their shopping experience.

Best-in-Class
Search and
Discovery

Human
Connections

A Trusted
Brand

Our Collection of Unique Items

The above graph shows how Etsy is trying to build a sustainable competitive advantage.

Etsy's unique collection of items for sale by actual people differentiates them from traditional large retail experiences as it is becoming even more tailored to buyers' preferences. With machine learning, customers can search for items in a much more effective manner. Models created by Etsy engineers help determine which items are relevant for a customer every time with little effort or fuss.

Key Drivers

Etsy's business focuses on two main key drivers: their sellers and buyers. Without either of these two groups, Etsy would not be able to stay in business.

Sellers

The sellers are at the core of Etsy. Etsy values its sellers and wants to help them all be successful. They have a seller-aligned business model: they make money when their sellers make money. United States (US) Etsy sellers, contribute \$4.7 billion to the US economy. As of March 31, 2019, Etsy has 2.2 million active sellers.

Etsy makes all its money from its sellers:

- Price per listing – \$0.20
- Service fee – 5% of sales
- Etsy payment processing of 3-4.5% depending which country the bank account is located
- Pattern allowing sellers to create custom websites with custom domains, free month trial, then \$15 monthly

Growth and Retention of Active Sellers

For Etsy to survive, they will need to continue to grow and retain the population of sellers. In order to continue support their sellers' growth, they are focusing on making Etsy the best place to start and run a creative business. In July of 2018, they launched Etsy Plus, which sellers can opt into for \$10 per month. This subscription gives sellers access to enhanced tools and credits to use such as shop customization options, targeted restock notifications, discounts on branded packaging and promotional materials, and free or discount custom web addresses. By 2023, Etsy wants to expand seller output by two times.

Investment in Marketing

Etsy increased their marketing in 2018 by 45% from 2017. In Q4 of 2018, Etsy wanted to increase their marketing even more to test new channels such as TV and paid social. They also wanted to see how elevated spending in google products would impact returns. Etsy increased digital marketing spending by 58.7% in 2018 to \$112.2 million. Their marketing channels included, TV advertising, digital video, paid social media, and performance marketing. Their preliminary results showed improved brand awareness, increased visits, and improved purchase intent. However, in Q1

of 2019, they took a step back in marketing to recalibrate and reassess their spending. Etsy believes they are well positioned for continued growth in 2019.

Seller Tools and Services

Pattern: A website creation tool that allows sellers to create their own sales platforms on a custom website

Promoted Listings: This function allows sellers to increase views on their listings on a pay-per-click basis. 15% of sales came through promoted listings in 2018.

Etsy Shipping Labels: Etsy supplies its sellers with labels at a discount from FedEx, USPS and UPS. These services are looking to be expanded in the six core geographic countries.

Investment in Technology

Etsy wants buyers and sellers to have smooth transaction across borders, languages, and devices. Their technology infrastructure has allowed them to expand their efforts across the platform. In 2017, Etsy announced their migration to Google Cloud. This migration will enable them to grow their core Etsy.com marketplace, prioritize the buyer and seller experience, improve search and discovery effectiveness, and increase the pace of launching new features. The migration should help enhance their overall infrastructure by pricing faster processing speed and improved page load time. In Q3 of 2018, they successfully migrated their website and mobile apps to Google Cloud. The migration should be completed by the beginning of 2020.

Buyers

Even though the sellers are the backbone of Etsy, without buyers willing to purchase products, Etsy would not be successful. As of March 31, 2019, Etsy has 41 million active buyers and 24.5% of active buyers have been buying from Etsy for more than four years. In a 2018 survey, 78% of buyers agreed that Etsy offers products that they cannot find anywhere else.

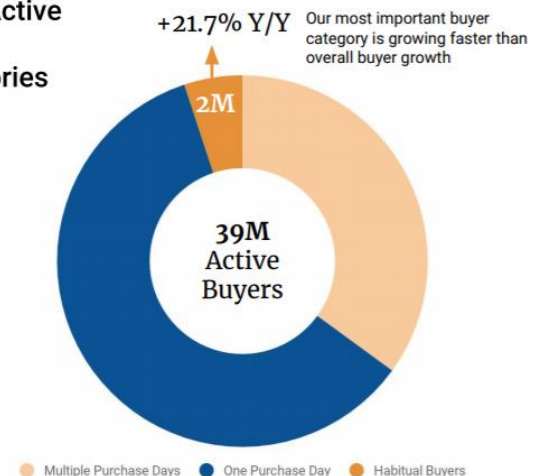
Growth and Retention of Buyers

Etsy is focused on steering more new buyers to the market and encouraging existing buyers to purchase more often. During 2018, there were 17.5 million new buyers. Their app for buyers was downloaded approximately 56 million times as of December 31, 2018. Etsy wants to provide consumers with an enjoyable and accessible experience no matter where they are, and what device they are using to access the marketplace. Etsy is focusing on expanding their mobile capabilities since mobile is integrated into everyone's daily lives.

Habitual Buyers

In 2018, Etsy really focused on increasing their number of habitual buyers. Habitual buyers are buyers who have spent \$200 or more and made purchases on six or more days in the previous 12 months. In 2018, the number of habitual buyers grew by 2 million, an increase of 21.7% compared to 2017, which is faster than overall active buyer growth. Clearly their efforts to convert buyers into more loyal shoppers has been successful so far.

2018 Active
Buyer
Categories



Consumer Buying Trends

The trend in personalized goods is increasing. Millennials, in particular, value customization when shopping. Modern consumers expect the ability to customize everything to fit their individual preferences. About one out of every three consumers want the ability to personalize their products and look for that when shopping. With the ability to find almost anything online, and with consumer's busy lives, they are seeking for products that have a compelling story.

AI – Google Driven Search

Etsy is using cloud data and machine learning to optimize how customers find new items. A few years ago, a search would yield a wide variety of products without much of an ability to narrow the scope. Now, Etsy is using big data to take its search to the next level in terms of its adaptivity to what you want and find relevant. The engine now can learn what style you have based on color and overall design. Someone who orders a lot of blue things will thusly see more blue colored items in their future searches.

Valuation

For our valuation we chose to rely mostly on a DCF. We believe that this method gives a good look as to what the earnings for Etsy will be in the next 5 years. For our WACC we used the Bloomberg number of 11.7%. We also used a growth rate of 4.9% after year 5 into perpetuity. With Revenue projected into the future growing at around 30-40% for the next 5 years on average. This gives us a price target of \$82. We weight this at 90%.

We then used a relative valuation to see how much their earnings are worth relative to their competitors. Keep in mind that Etsy is a unique company so using multiples doesn't give us a great picture of the outlook in growth and revenue as some of the intangibles of Etsy are impossible to value. We created a subgroup to compare price to earnings between two other firms (eBay and ASOS) and Etsy. The weighted average p/e was created by multiplying the 5 year-average of the p/e ratios by the market cap of the firm, these products are summed then divided by the summed market cap of all three firms. The average p/e is 90.84x, this times Etsy's 2018 N/I of \$41,000,000 gives us a value of equity of \$7,040,000,000, divided by shares outstanding gives us a target of \$58. A weighed total of $10\% @ \$58 + 90\% @ \$82 = \$79$



The black line represents a 100-day moving average,
which shows general trend.

Risk Factors

Overall Market Conditions

Etsy's financial outcomes and success of operations are heavily dependent on the economy as it is in the consumer discretionary sector. When expansion ends, the economy will start to contract, and consumers will spend less on nonessential goods as the sign of a recession.

Retention of Buyers and Sellers

Sellers are the backbone of Etsy and without them, Etsy would not be in business. Sellers may be the heart and soul of Etsy, but without buyers wanting to purchase their goods, Etsy would not be able to survive. A beautiful search experience is important to keep buyer coming back. Tailoring searches will help deliver this idea. In terms of retention of sellers, Etsy has a large opportunity to grow seller base by providing excellent tools that keep them happy and help them sell more things.

Shipping Costs

Effective since July 16, 2018, Etsy increased the seller transaction fee from 3.5% to 5%, and now apply it to the cost of shipping in addition to the cost of the item. Amazon is a key competitor when it comes to shipping because they offer free 2-day shipping. When consumers have to pay shipping, they are less likely to purchase goods as that shipping price is now mentally added into the price of the product. Buyers prefer free shipping and Etsy is working hard to help educate sellers about shipping prices, and in the future hopefully get rid of them all together.

Management

In May of 2017, Joshua Silverman was appointed the new CEO of Etsy. He is leading the company as it helps empower creative entrepreneurs around the world and is also a member of the board of directors. Silverman has a long history of leadership: President of Consumer Products and Services at American Express, CEO of Skype, CEO of shopping.com, and he held various executive roles at eBay. Silverman co-founded Evite, Inc. where he was also CEO. He currently is on the board of directors of Shake Shack.

As CEO of Etsy, Silverman has beat earnings 7/8 times and confidence in the Executive team is up from 68% to 84%. Belief in Etsy's success over the next three years is up from 73% to 85%, since Silverman has become CEO.

Along with Josh, there are five other executives and the average age is 52 years old. Each of the key management positions are heavily compensated by stock bonuses, which is a positive for the company.

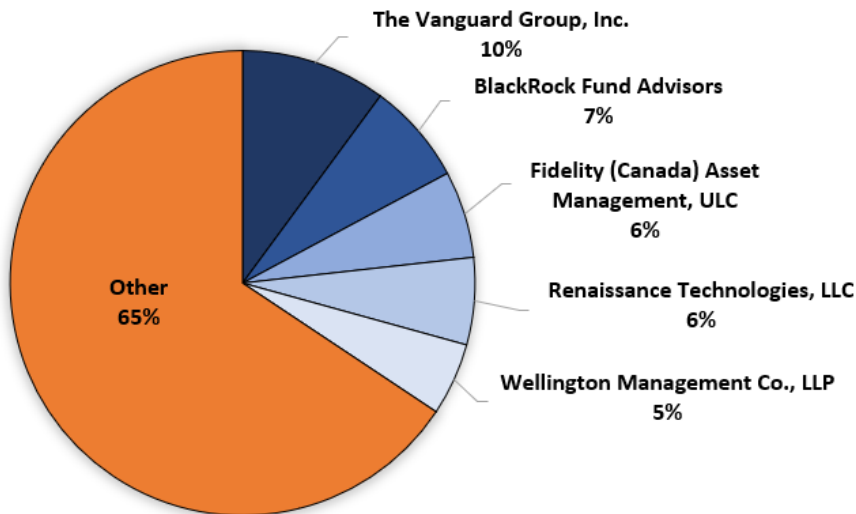
Peer Analysis

E-commerce discretionary is a new area of the market and is becoming more segmented than ever before. Amazon is a dominant force in the retail space for any category you can think of. Facebook is ramping up their marketplace, which is competing with eBay now for a platform to sell and buy things. With more people wanting to break the chain of commoditized consumption, Etsy is meeting this need where no one else is by providing customizable goods. ASOS sells a large range of apparel and is a near competitor that is more established.

Company	Revenue	Operating Margin	CAPEX/Rev	EPS
Etsy	200M	12.35%	21%	\$0.32
eBay	2,848M	20.74%	5%	\$0.77
ASOS	1,248M	4.51%	10%	\$0.69

Ownership of Shares

Top 5 Shareholders



Institutional/Mutual Funds vs Insider Holdings

Total Shares Held – 120,160,00	
Institutional Holdings	97.66%
Insider Holdings	1.02%
Unknown Holdings	1.32%