

# Etsy: The Real Value in Ecommerce

*An Ecommerce company with a unique emphasis on the seller rather than the buyer. Is the stock attractive after its recent pullback?*

## ETSY: UNIQUE PRODUCTS FROM UNIQUE SELLERS

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Etsy is an ecommerce company that is a platform for mainly individuals and small businesses who sell handmade or artisan products to a customer base that is specifically looking for that. The main thing that differentiates it from Amazon or other online players is that it has built a brand for both sellers and buyers as a place to get unique items.

For instance, in the past I have purchased specific items from Etsy. Most recently, I bought a wooden plate as a birthday gift. The reason why I didn't just go to Amazon for this plate comes down to two reasons. One, the quality of the wood was very good and I could see that through the website. The second was the ability to contact the seller effectively and customize the plate by engraving the names of the recipients, with the perfect font and color. While this may have costed a little more than plates from Amazon, Etsy managed to give me more options to make it as unique as I wanted it to be. That's what makes it a truly special site for people willing to pay the extra dollar for special or handmade product.

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### AT ITS CORE, ETSY IS FOR THE SELLERS

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#### ✓ Unique everything

We have millions of one-of-a-kind items, so you can find whatever you need (or really, really want).

#### ✓ Independent sellers

Buy directly from someone who put their heart and soul into making something special.

#### ✓ Secure shopping

We use best-in-class technology to protect your transactions.

Amazon is king in the Ecommerce space but the amount of Ecommerce players in the space can't be ignored. Even more so, it feels like they are all selling the same products. The only difference is price. This is why I like Etsy. They have managed to build a very unique brand in a space that has become more and more competitive. But that's not all. I believe the key to their longevity has been to put their focus into attracting sellers rather than buyers.

To me, they feel like an original content player because of the fact that the more sellers they can attract, the more unique content they can have on their site. It's not like Amazon where you can have a million sellers with no way of deciding how to choose between any of them. Etsy may have a saturated market but they do help create more appeal by allowing shops to really brand themselves on Etsy's platform, whether its creating a store front or provided marketing assistance.

For those wondering why Amazon can't do what Etsy does, it comes down to the costs for the seller. Etsy's core focus is making its platform the best place for small business owners by have little to no costs to start selling. Etsy's rates are 20 cents per item listed and 5% commission per transaction. Amazon has monthly fees and can sometimes take over 15% commission on specific items Etsy's rates along with no standard monthly fees make this the most fiscal platform to sell on when thinking about selling on Amazon or Etsy.

When looking at where the company is today, Etsy has created a large brand for sellers, with over 1,000,000 active shops, but are actively looking to increase merchandise sales by expanding that brand to the customer side.

Based on the numbers reported in their August 1<sup>st</sup>, 2019 earnings report, the company currently reported that active buyers over the past quarter grew 19% to a total of 43 million. This growth not only reflects the growth in U.S. consumers but also the growth in their international markets as well. Their GMS(Gross Merchandise Sales) increased 37% this quarter.

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Both of these numbers indicate that this company is really hitting on all cylinders and the growth avenues they are in do not seem to be relatively high when comparing to other growth oriented assets.

## GROWTH DRIVERS: OPTOMIZING THE SELLER

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While Etsy is primary growth focus is to increase its brand as a handmaid ecommerce platform for shoppers, the rest of the growth will essentially come from optimizing the seller's ability to reach their customers as well as give them more value with every purchase.

For example, Etsy gives sellers the ability to create their own storefront through Etsy's platform or you can link an existing site you already have. For the storefronts, there are loads of customizable options but I think looking down two or three years from now, they still have room to grow in that segment as far as storefront optimization and features that sellers can display for potential buyers.

In the near future, there are a couple of ways that Etsy is trying to maximize their seller's ability to grow.

This September, Etsy is starting a price shipping tool that they believe will drive total merchandise sales, based on their testing in 4 markets. It essentially allows sellers to offer free shipping to customers by baking their shipping costs into the price of the item rather than having it as a separate price. For example let's say you sell a shirt for \$20 and your shipping cost is \$5. You would use that tool to incorporate the shipping price into the price of the shirt. So from the customers end, they see free shipping but they will be paying \$25 for the shirt.

I'm not a phycology expert so I can't say how effective this little pricing tool will be for consumers but Etsy has also developed different pricing tool strategies that it shares with its sellers to help maximize the benefit of the price tool.

The second way in which Etsy plans on helping its seller base is by giving them options to advertise and market themselves.

Here's why I think this could be a key in expanding Etsy's margins going forward.

The expansion with Etsy Ads helps create a new layer that is extremely beneficial in giving sellers more tools to reach customers as well as a better connection to holding onto unique businesses in the long run.

Currently, Etsy spends a portion of their Capex on marketing the products of individual items to their designated customer. Etsy does all the work in finding the right customer for a seller's

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product but with Etsy Ad's, they are essentially shifting all those costs to the seller. It's uncertain whether or not this service will be free or will be a premium service or maybe a bit of both but this type of business definitely has the room to expand overtime.

The only risk is that with Etsy, they are dealing with small businesses, sometimes very small. The shift in advertisement strategy may ultimately create a bigger cost threshold for small businesses.

The specifics have not come out yet, as this program will probably be rolled out next year. The success will come down to pricing because Etsy has recently increased its take away for every item purchased to 5%, up from the 3.5% that was in place before and that increase could have put a big strain on the overall cash that these small businesses have to ultimately spend on the Etsy Ads.

Yet, I'm still bullish on this bet due to the fact that this side of the business traditionally has high margins and also has the capacity to grow by adding tools and additional metrics at a relatively low cost.

## ETSY: HIGH GROWTH FOR A DECENT VALUE

Currently, Etsy is trading at \$52.79, 28% down from its all-time high. The stock has not performed as well as other growth stocks due to its exposure to China as well as slowing consumer trends among wealthier people.



(2-year Chart provided by stockrover.com)

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**Regardless of the reason, I believe Etsy is trading at a big discount and should be currently trading somewhere between \$60 and \$70.**

I came to this conclusion after looking at a couple of factors that I value when looking at growth stocks.

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### Current Valuation and Debt

The current valuation of the any growth stock will always be higher than the market, as it should be. In today's world, companies can grow and scale at extreme rates when compared to the companies of old. Tech stocks have the biggest and fastest range when it comes to growth and Etsy is no exception to this.

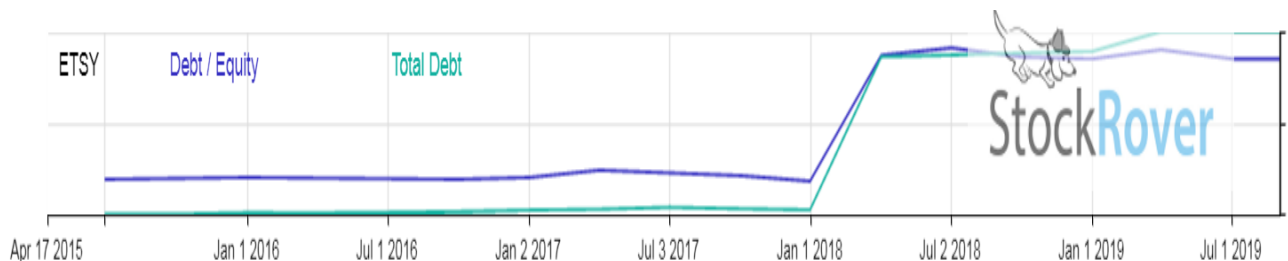
Etsy currently has a Price to Earnings (P/E) ratio of 64. While that may be more than 3.5 times the S&P current P/E, the historical numbers show a stock at the lower end of its valuation range.

The 5 year historical P/E range for Etsy is 44 – 124. 66 sits closer to the lower end of the range, which makes me feel a little better considering its valuation is so high.

On the margin side, I usually like my growth companies to have above 60% gross margins. Etsy meets that requirement but has seen a decline by 3 basis points in the gross margins going from just under 72% to over 68%.

As long as they maintain above 65%, I think cyclical trends will continue to affect the stock but won't have an effect on my long term view of the stock.

The current debt of the company is one that is tricky to assess as well, with it being a growth stock.



While the chart doesn't show any numerical values, it's pretty obvious to see the debt start to skyrocket in January of 2018. This was a really huge change for the company considering it operated with little to no debt since its IPO. The most interesting thing was when you take a

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look at the stock, it was actually when the stock ended up breaking out and then going from around \$20 to over \$70 in just over a year.



Currently, the company is expected to increase its total debt in 2019 but by a relatively small amount. The total debt will be somewhere close to half the total sales, which is good for a growth company. What I really don't want to happen is the total debt exceed the sales as that really limits the company during down cycles and adds tremendous risk if the cash flow isn't superb.

### Growth and Estimates

When assessing a growth stock, the factor area that I weigh the most are the future earnings and sales estimates. In this market, the value of a growth rate cannot be understated.

Investors are more willing to be patient with growth than ever before so it's hard to find value in the growth area, but when you do, it usually doesn't stay in the value range for long.

Current Year (12/2019)	Next Year (12/2020)
801.54M	987.36M
7	8
807.20M	1.02B
797.12M	956.21M
603.69M	801.54M
32.77%	23.18%

Current Year (12/2019)	Next Year (12/2020)
0.80	1.07
8	8
0.82	1.12
0.99	1.33
0.70	0.87
0.61	0.80
31.15%	32.97%

(Information provided by zacks.com)

The estimates above show the expected sales and earnings as well as their growth rates for this year and next year.

What is important to not is the fact that Etsy is currently growing the sales by more than 15% and growing their earnings by more than 20%

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Both growth rates rank in the upper echelon of stocks that sit between 50 and 70 current P/E ratios. This is probably the main reason that the stock continues to trade at a high valuation. As long as the growth can continue on these fronts, you can expect there to be consistent buyers in the stock.

This is paired along with the fact that they are creating additional avenues of revenue including Etsy Ad's, which is not included in these estimates so even though they are high, they can be even higher once Etsy starts giving more clarity about the program.

### Cashflow and Investments

Cashflow for any growth company is just as important as the revenue growth. While it may not be the end all be all for a growth company to have low or negative free cashflow, I find that the high growth companies that can consistently create cashflow, whether they are coming from negative or low totals, end up being the outperformers of the growth sector.

Date	Cap Ex	Operating Cash Flow	Cap Ex as a % of Sales	Free Cash Flow as a % of Sales	ROIC	Return on Assets
12/31/2018	56	199	9.30%	23.70%	12.40%	8.60%
12/29/2017	13	67	3.00%	12.30%	21.00%	13.50%
12/30/2016	48	47	13.10%	-0.30%	-6.50%	-5.10%
12/31/2015	21	29	7.60%	3.00%	-35.80%	-9.70%

(Information provided by stockrover.com)

The information above points out a couple of things. First off, the company is coming off a year of explosive operating cash flow growth with capex coming under 10% of the total sales.

The Free Cash Flow is growing at a great rate when looking at it in relation to the sales of the company. This tells me the business can generate cash at a great rate without spending the whole reserve to do so.

On the investment side, the numbers did come down from 2017 to 2018. We see a dip in the ROIC and the ROA but on the bright side, they are still at decent levels. The only real thing I really don't like is the level of depreciation within the numbers but it could just be an anomaly as those numbers have been volatile from the beginning.

I personally liked what I heard from management about their future initiatives to grow the business. Whether it is the price tool or growing ads or to their recent acquisition of Reverb,

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management seems very keen on building well connected layers on top of their core market place platform. I believe management will be proven right in their investments overall.

## THE VERDICT

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Etsy has a great business model that leaves room for innovation growth and margin expansion. After looking at some of the fundamentals, I think this stock relative to other growth stocks is a buy considering its recent drop of more than 20% and the cash flow and growth estimates are not diminishing or moving down anywhere close to warrant that type of decline.

## Specifics

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Date: 9/2/19

Rating: Buy (Risk Level – Medium Low)

6 Month Target: \$61

Buying Timeframe: Within this quarter

Support and Breakout Price points:

Key Support at \$48

Breakout level above \$58

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