

ETSY – 15 Points Investment Thesis

11th March 2021

Market Cap: ~\$28bn

ETSY first showed up in my Momentum Algorithm filter in October 2020. I spent some time on understanding its business model and below is my understanding of its business with my short 15 point investment thesis.

- 1) ETSY's business model is that of a niche online retail marketplace platform. It's the platform where one can buy antique, handcrafted, and unique goods. A product has to be more than 20 years old for it to be qualified as antique on ETSY.
- 2) The platform has 3.7mn sellers and 69mn buyers and 80mn listings. Etsy has got a very small piece of big e-commerce global market.
- 3) The company believes the online market size across all relevant retail categories for the Etsy marketplace, within its six core geographic markets – U.S., U.K., Canada, Germany, Australia and France – represents a \$249 billion market opportunity, and a \$1.7 trillion market opportunity when offline is included. By 2023, it estimates that the online market opportunity will expand to \$437 billion and \$2 trillion when offline is included. The top six product categories on the Etsy marketplace – houseware and home furnishings; jewelry and accessories; craft supplies; apparel; paper and party supplies; and beauty and personal care – recently accounted for about 75% of the overall GMS.
- 4) The company's revenues fall into two major categories, namely, marketplace revenue (77% of revenue in Q2 2020) which is comprised of listing fee, transaction fee and payments platform; and services revenue (23%) which is comprised of optional value-added services including on-site advertising, shipping label/protection and other.
- 5) There is a strong tailwind for small businesses and artists as people want to support a smaller business which is an inherent call option. ETSY is riding a structural change in consumer behavior and favorable secular dynamics for global e-commerce growth with COVID pulling forward demand significantly.
- 6) It creates two way network effects. Network effect gets stronger as more buyers and sellers join the platform. More sellers bring more buyers and the loop continues.
- 7) No significant investment needed to start business like ETSY. Great thing is that there is virtually no capital needed to grow the business.
- 8) ETSY makes money off of other people's investments. Someone else is making products and storing at their place (no manufacturing facility needed), FedEx's of the world are shipping them from seller to buyer (no warehouse or transportation infrastructure needed).
- 9) Buyer pays upfront. ETSY collects 8-16 cents for a dollar and gives rest to the seller. NEGATIVE WORKING CAPITAL.
- 10) ETSY converts about 30% of its revenue to Net Profits & OCF.
- 11) It seems like it is run by a capable management which has not diluted equity meaningfully so far.
- 12) Business generates tremendous amount of cash which can be used to make business better and also return it back to shareholders.

- 13) LTM growth in Sales, Advertising Fees grew north of 100%.
- 14) LTM FCF has been about \$670mn. Today's market-cap is about ~\$28bn. Business is available at ~40x FCF.
- 15) In my view, business that is growing at very rapid pace which throws good amount of cash back available at ~40x FCF is reasonably priced as long as execution stays on track.

Risks:

- 1) Execution Failure
- 2) Competition from Amazon, Ebay, Shopify, etc.

Business Performance Last 5 Years:

	2016	2017	2018	2019	2020	LTM
Rev (mn \$)	365	441	604	818	1726	1726
Gross Margin %	66%	66%	68%	67%	73%	73%
EBITDA Margin %	5%	7%	12%	11%	25%	25%
Net Income (mn \$)	-29.9	81.8	77.49	95.89	349.25	349.25
Net Income Margin %	-8%	19%	13%	12%	20%	20%
FCF Margin %	-5%	16%	18%	19%	30%	30%
Diluted Shares o/s	113.56	122.27	127.08	125.72	136.41	136.41
ROE	-9%	22%	19%	24%	61%	61%