

Etsy, Inc. (ETSY): Buy @ \$11.00

Buy Thesis: We believe Etsy has successfully positioned itself for the continuing growth trend in “non-commoditized” e-commerce. Fears of Amazon dominating the local artisan marketplace with the entry of Amazon *Handmade* are proving to be overblown. We believe the Etsy merchant base will continue to expand and remain loyal to the Etsy marketplace, despite listing with Amazon for a small share of their business. This is mostly due to seller services support provided by Etsy, which helps local artisans scale their business, as well as provide Etsy with a healthy recurring revenue stream. Moreover, the rise in cross-border e-commerce especially with the EU, will likely maintain a continued buildup in the number of active buyers.

TABLE 1: Etsy 1Q16 Results

1Q16 Results			2Q16 Guidance			1Q16 Results			2Q16 Guidance		
EPS	Cons.	Result	EPS	Cons.	Result	Total Rev.	Cons.	Result	Total Rev.	Cons.	Result
0.01	-0.02	beat	n/a	-0.01	n/a	81.85M	75.15M	beat	n/a	79.8M	n/a

Source: ETSY, Inc. and Yahoo Finance

Etsy reported solid results for 1Q16 with its first quarterly profit since its IPO on 04/16/15. Revenue of \$81.8M (+39.8% y/y) came in above consensus estimate of \$75.1M driven by a 12.3% growth in sellers and a 20.1% increase in the number of active buyers. EPS of 1 cent beat consensus estimate of a loss of (2 cents). Etsy maintained its FY16 revenue growth outlook of ~24% y/y while expecting GMS growth this year to be at the midpoint of a 13-17% range.

1Q16 Highlights

- Gross merchandise sales (GMS) grew to \$629.85M from \$531.92M in 1Q15
- Without the impact of currency fluctuations, Etsy says GMS would have increased 19.1%
- Mobile continues to be a top performer for Etsy, representing ~63% of website visits in Q1, compared with ~59% a year ago; consumers purchased 47% of total sales through mobile devices, up from 43% a year ago; Etsy’s mobile app, which launched in 2011, has had 35M downloads
- Revenue, which the company generates from listing fees, seller services and commissions on sales, grew 39.8% in 1Q compared with a year ago
- Seller services revenue of \$43.5M, up 59.6% y/y from \$27.3M; this represented 53.2% of revenue in Q1, compared with 43.6% in 1Q15; Etsy generates revenue from sellers with such services as promoted listings in search results, credit card processing fees and by providing shipping labels
- Marketplace revenue, or revenue from listing fees and commissions from sellers of \$35.7M, up 18.5% y/y from \$30.2M
- Marketplace launched a new seller service, *Pattern* by Etsy, which helps sellers create their own custom websites in addition to their shops on Etsy; CEO Chad Dickerson stated that more than a third

of Etsy sellers are interested in opening an e-commerce site of their own and more than half sell in other online channels with Etsy being their largest sales channel

- Active sellers: 1.60M, up 12.3% from 1.43M
- Active buyers: 25.0M, up 20.1% from 20.8M
- Net income of \$1.19M compared with a \$36.6M loss in 1Q15

I. Mobile Commerce to Drive Healthy Growth in U.S. Online Sales

According to *Forrester Research*, online sales in the United States are expected to reach \$530B in the next five years, up 58% from \$335B in 2015, and mobile devices are expected to be a key driver in that growth (see Figure 1). As consumers become more accustomed to using their phones everywhere, shopping is a byproduct of that ubiquity. *Forrester* estimates that mobile devices have influenced more than \$1 Trillion in total purchases in 2015 between online and offline transactions.

FIGURE 1: U.S. Online Sales Forecast: 2016-2020 (\$ Billion)



More importantly for retailers is the rising trend of shoppers browsing and buying on their smartphones and tablets in the coming years.

Forrester projects that an additional 26M shoppers will be both browsing and buying from retail sites, reaching 270M by the end of this decade, as bigger smartphones and faster wireless networks make it easier for consumers to use the Internet to shop on their phones. *Forrester* estimates that 244M consumers have already browsed or bought online in 2015.

Source: Forrester, 4/28/16

II. Seller Services Multi-year Revenue Stream still in Early Growth Stage

Seller services revenue constitutes a growing revenue stream for Etsy representing 53.2% of revenue in 1Q16, compared with 43.6% in 1Q15. We believe the seller services revenue stream is still in the early growth stage as the company plans to introduce more services designed to assist active sellers in scaling their business through outsourcing of manufacturing and various administrative and marketing tasks.

Recently, a new service called *Pattern* was introduced in April. *Pattern* provides customized online stores that let Etsy merchants sell their goods outside of the Etsy marketplace. The product – the company's first subscription revenue generator – is integrated with the sellers' Etsy shops, so they can manage their inventory and data analytics in one place.

The new service is free for the first month and costs \$15 a month afterwards. Only sellers who use the direct checkout product – which allows buyers to pay using a variety of methods including credit cards and PayPal – can use *Pattern*. The websites are designed to suit all devices, including smartphones and desktop computers, an extension of Etsy's focus on driving more mobile traffic.

III. Etsy to Benefit from Growth in U.S.-EU Cross-border E-commerce

We believe that international markets present a tremendous growth opportunity for ETSY, particularly since this segment remains underpenetrated. At the 1Q16 call, management stated that international revenue continues to expand, growing roughly 47% in the first quarter. Percent international GMS was 30.3%, a slight decrease compared with the 35% last year, but an increase compared to the 29.2% last quarter. The company defines international GMS as transactions with either the buyer or the seller residing outside the U.S. Management is confident that it can grow percent international GMS over time to represent 50% of total GMS.

According to PayPal's *2nd Annual Global Report*, done in conjunction with research firm *Ipsos*, many shoppers in foreign countries prefer to buy from U.S.-based online retailers, but few U.S. shoppers choose to shop online internationally. The report surveyed 23,200 online shoppers in 29 countries about their online purchasing habits. The report showed that 25% of all online shoppers have shopped at a U.S.-based online retailer in the past year, while only 22% of American shoppers have bought from an international online site during that same period. Another report by *Traxpay.com* shows which foreign countries have the highest percentage of total cross-border sales with U.S. online retailers:

- China – 84%
- UK – 70%
- Australia – 69%
- Germany – 48%
- Canada – 33%
- The Nordics – 24.9%
- France – 10%
- Spain – 10%

Furthermore, according to *Forrester*, cross-border shoppers tend to spend more money online (€337) than consumers who only shop at domestic web stores (€228). According to the research, customers from smaller EU countries and countries with a less developed e-commerce industry tend to spend more when shopping online at foreign websites. When asked the question “*In the past three months, have you ever ordered products from a website outside of your home country*”, 30% of the Swedes, 29% of the Spaniards and 28% of the Italians answered with “yes.” In Germany this percentage was only 16%.

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Analyst Certification

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