Chewy Analyst Report

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March 10, 2020

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Fair Value Analysis and Valuation Summary

Our Suggestion

HOLD

Our View of Moat

Narrow

Years of Forecast

10 Years

Chewy Inc.

Income Statement Forecast (in US$,000)				WACC = Cost of Equity = 9%	
			Estimate		
Fiscal Year, ends 31 Jan	2020	2021	2022	2026	2031
Net revenue	7,146,264	8,924,375	10,495,065	17,491,842	21,947,880
Revenue Growth %	*47.4%*	*24.9%*	*17.6%*	*9.2%*	*3.5%*
Gross profit	1,820,807	2,422,011	3,043,569	5,772,308	7,681,758
Gross margin %	*25.5%*	*27.1%*	*29.0%*	*33.0%*	*35.0%*
SG&A	(1,397,969)	(1,818,946)	(2,203,964)	(3,673,287)	(4,389,576)
Advertising and Mkt	(513,302)	(636,278)	(734,655)	(1,224,429)	(1,536,352)
Total expenses	(1,911,271)	(2,455,224)	(2,938,618)	(4,897,716)	(5,925,928)
Total expenses %	*26.7%*	*27.5%*	*28.0%*	*28.0%*	*27.0%*
EBIT	(90,464)	(33,213)	104,951	874,592	1,755,830
EBIT Margin %	*-1.3%*	*-0.4%*	*1.0%*	*5.0%*	*8.0%*
EBITDA	(54,800)	(16,402)	127,372	918,665	1,823,739
EBITDA Margin %	*-0.8%*	*-0.2%*	*1.2%*	*5.3%*	*8.3%*
Other Income			-	-	-
Interest Income/expense	(2,022)	(1,215)	-	-	-
Provision for income taxes			-	183,664	368,724
Net income	(92,486)	(34,428)	104,951	690,928	1,387,106
Net Profit Margin %	*-1.3%*	*-0.4%*	*1.0%*	*4.0%*	*6.3%*

Our Fair Value (Base)

$38.39

As of Mar 10, 2022

Market Price

$42.09

As of Mar 8, 2022 closing

Price Range

$38.39 $42.09

Bear — Base — Market — Bull
$25.56 — $52.94
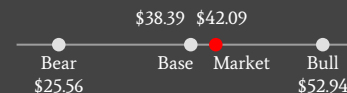
Within our range of fair price

Main Thesis: Moat and Market Trends

Moat Analysis: Narrow Moat

We believe Chewy only has narrow moat, because:

✖ **Operational efficiency** could hardly exceed Amazon without large economies of scale

✖ **Low switching costs** for customers while customers care more about price

✔ **Some network effect** is enjoyed by Chewy but still is not the primary moat

✔ **Intangible assets** appear as main feature of Chewy's moat, which includes customer service, proprietary brands, but also is the least certain

Market Trends: Moderate Growth

Market implications for future growth:

Price is the main drivers of revenue growth in the long run, according to market research

Per customer sales show more potential as more loyal customers spend more
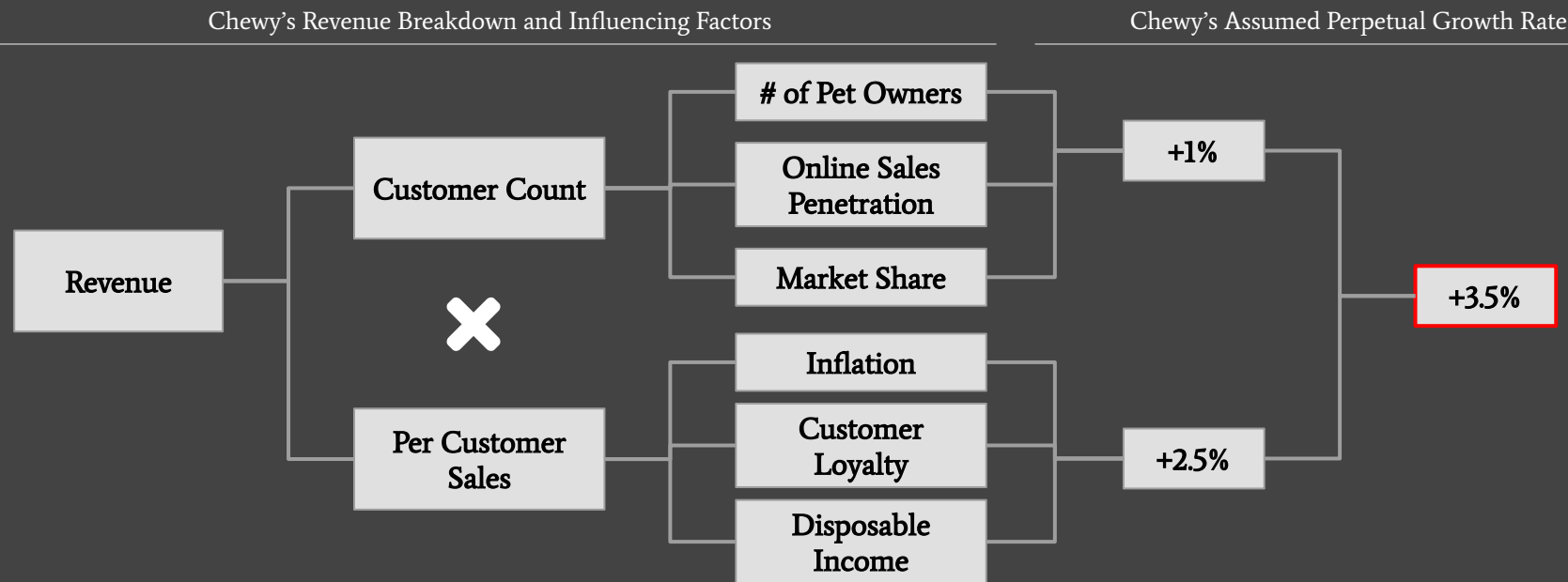
Convenience, price and assortment are three main criteria for pet product selections

Online penetration is crucial to customer growth but might slow down as pandemic ends

Main Thesis: Chewy's Growth Assumptions

Growth Assumptions: Per Customer Sales will be the main driver of revenue growth

Chewy's Revenue Breakdown and Influencing Factors   Chewy's Assumed Perpetual Growth Rate

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                                    ┌──────────────────┐
                                    │  # of Pet Owners  │
                                    └──────────────────┘
                                    ┌──────────────────┐      ┌──────┐
              ┌──────────────────┐  │   Online Sales    │      │ +1%  │
              │  Customer Count   │──│   Penetration     │      └──────┘
              └──────────────────┘  └──────────────────┘                  ┌────────┐
┌──────────┐                        ┌──────────────────┐                  │ +3.5%  │
│ Revenue  │          ✖             │   Market Share    │                  └────────┘
└──────────┘                        └──────────────────┘
              ┌──────────────────┐  ┌──────────────────┐
              │  Per Customer     │  │    Inflation      │
              │     Sales         │  └──────────────────┘
              └──────────────────┘  ┌──────────────────┐      ┌──────┐
                                    │    Customer       │      │ +2.5%│
                                    │    Loyalty        │      └──────┘
                                    └──────────────────┘
                                    ┌──────────────────┐
                                    │   Disposable      │
                                    │    Income         │
                                    └──────────────────┘
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Note:
1. We assumed no overseas expansion of the company, slowly growing online penetration, and relatively stable Chewy's market share
2. Chewy once disclosed that on average, historically, 2nd year customers spend $400+, 5th year customers spend ~$700, and 9th year customers spend ~$900

Differences with the market
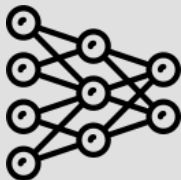
Moat Optimism
- Belief that Chewy's Pet Profiles provide a competitive advantage for their algorithm
- Native to the e-commerce market and already established platform

Beating Out Competition
- Chewy and Amazon represent different services to customers
- The construction of fulfillment centers will provide competitive delivery options

Customer Acquisition
- Explosive customer growth can be maintained post-pandemic
- Chewy's strength lies in its ability to transform customers into recurring revenue

Catalyst for Market Price Correction

Customer Acquisition
- Strategy to acquire new customers
- What is the cost to acquire a new customers
- Necessity of marketing in the future
- Is it sustainable growth

Partnership Relations
- Contracts for partnerships
- How much impact have they made
- Strategy for partnerships in the future
- What investment is needed for partnerships

Chewy Sales vs. YoY Growth (%)

Chewy COGS & SG&A as a Percent of Sales

Thank you

Q & A

Income Statement Forecast — Estimate

Fiscal Year, ends 31 Jan	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Net revenue	7,146,264	8,924,375	10,495,065	12,231,998	14,127,958	16,021,104	17,491,842	18,737,261	19,685,366	20,478,687	21,200,560	21,947,880
Revenue Growth %	47.4%	24.9%	17.6%	16.6%	15.5%	13.4%	9.2%	7.1%	5.1%	4.0%	3.5%	3.5%
Gross profit	1,820,807	2,422,011	3,043,569	3,669,599	4,379,667	5,126,753	5,772,308	6,276,982	6,693,025	7,065,147	7,420,196	7,681,758
Gross margin	25.5%	27.1%	29.0%	30.0%	31.0%	32.0%	33.0%	33.5%	34.0%	34.5%	35.0%	35.0%
Selling, General and Administrative	(1,397,969)	(1,818,946)	(2,203,964)	(2,691,040)	(3,108,151)	(3,364,432)	(3,673,287)	(3,934,825)	(4,133,927)	(4,095,737)	(4,240,112)	(4,389,576)
Advertising and Marketing	(513,302)	(636,278)	(734,655)	(856,240)	(988,957)	(1,121,477)	(1,224,429)	(1,311,608)	(1,377,976)	(1,433,508)	(1,484,039)	(1,536,352)
Total operating expenses	(1,911,271)	(2,455,224)	(2,938,618)	(3,547,279)	(4,097,108)	(4,485,909)	(4,897,716)	(5,246,433)	(5,511,903)	(5,529,245)	(5,724,151)	(5,925,928)
Total Operating expenses %	26.7%	27.5%	28.0%	29.0%	29.0%	28.0%	28.0%	28.0%	28.0%	27.0%	27.0%	27.0%
EBIT	(90,464)	(33,213)	104,951	122,320	282,559	640,844	874,592	1,030,549	1,181,122	1,535,901	1,696,045	1,755,830
EBIT Margin %	-1.3%	-0.4%	1.0%	1.0%	2.0%	4.0%	5.0%	5.5%	6.0%	7.5%	8.0%	8.0%
EBITDA	(54,800)	(16,402)	127,372	148,935	314,593	679,212	918,665	1,079,767	1,235,291	1,594,676	1,759,344	1,823,739
EBITDA Margin %	-0.8%	-0.2%	1.2%	1.2%	2.2%	4.2%	5.3%	5.8%	6.3%	7.8%	8.3%	8.3%
Other Income	-	-	-	-	-	-	-	-	-	-	-	-
Interest and other, net	(2,022)	(1,215)	-	-	-	-	-	-	-	-	-	-
Provision for income taxes			-		19,164	134,577	183,664	216,415	248,036	322,539	356,169	368,724
Net income	(92,486)	(34,428)	104,951	122,320	263,395	506,267	690,928	814,134	933,086	1,213,362	1,339,875	1,387,106
Net Profit Margin %	-1.3%	-0.4%	1.0%	1.0%	1.9%	3.2%	4.0%	4.3%	4.7%	5.9%	6.3%	6.3%

Operating Performance / Profitability — Estimate

Fiscal Year, ends 31 Jan	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
ROA %	-5.3%	-1.5%	4.4%	4.6%	9.2%	15.9%	20.2%	22.5%	24.6%	31.1%	33.2%	33.2%
ROE %	-2312.6%	-51.4%	-28.4%	-22.3%	-31.8%	-53.7%	-66.6%	-71.9%	-79.1%	-100.0%	-107.7%	-107.7%
ROIC %	15.4%	5.3%	-12.4%	-11.3%	-21.2%	-35.8%	-43.8%	-47.4%	-51.0%	-63.9%	-68.4%	-68.6%
Asset Turnover	4.1	3.9	4.4	4.6	4.9	5.0	5.1	5.2	5.2	5.2	5.3	5.3

Forward Valuation Summary — Estimate

Fiscal Year, ends 31 Jan	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Price/Sales	5.9	2.0	1.7	1.4	1.2	1.1	1.0	0.9	0.9	0.9	0.8	0.8
Price/Earnings	-408.6	-509.2	167.0	143.3	66.6	34.6	25.4	21.5	18.8	14.4	13.1	12.6
EV/EBITDA		-994.9	128.1	109.6	51.9	24.0	17.8	15.1	13.2	10.2	9.3	8.9

Balance Sheet

Balance Sheet Forecast			Estimate									
Fiscal Year, ends 31 Jan	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
ASSETS												
Cash and Cash Equivalents	563,345	763,265	629,704	611,600	494,479	560,739	612,214	655,804	688,988	716,754	742,020	768,176
Accounts Receivables	100,699	135,149	152,394	167,562	193,534	219,467	239,614	256,675	269,663	280,530	290,419	300,656
Due from Parent-net	21,869	-	-	-	-	-	-	-	-	-	-	-
Inventories	513,304	642,990	714,527	797,593	881,352	955,121	995,358	1,024,132	1,067,864	1,102,483	1,132,633	1,172,558
Prepaid Expenses and Other Current Assets	27,561	58,801	73,465	85,624	98,896	112,148	122,443	131,161	137,798	143,351	148,404	153,635
Total Current Assets	279,102	432,580	448,585	629,789	1,226,778	1,600,204	1,570,090	1,662,379	1,668,260	1,847,475	1,969,629	2,067,772
Operating Lease Right-of-use Assets	297,213	342,242	437,723	534,459	617,301	668,200	729,541	781,484	821,027	813,442	842,116	871,801
Property and Equipment, net	210,017	327,261	388,706	470,461	565,118	640,844	699,674	749,490	787,415	819,147	848,022	877,915
Other Non-current Assets	12,905	12,905	12,479	14,194	18,596	22,165	22,723	23,790	25,311	26,844	27,768	28,423
Total Assets	1,746,913	2,282,612	2,408,998	2,681,493	2,869,275	3,178,684	3,421,566	3,622,536	3,798,064	3,902,551	4,031,381	4,173,163
LIABILITIES AND STOCKHOLDERS' EQUITY												
Trade Accounts Payable	778,365	1,025,841	1,236,663	1,421,172	1,616,227	1,802,979	1,933,113	2,052,995	2,142,916	2,210,656	2,270,221	2,351,679
Current Portion of Lease Liabilities	19,142	24,427	36,037	42,977	48,920	52,571	56,972	60,698	63,535	62,991	65,048	67,178
Accrued Expenses and Other Current Liabilities	583,355	748,879	881,585	1,027,488	1,186,748	1,345,773	1,469,315	1,573,930	1,653,571	1,720,210	1,780,847	1,843,622
Total Current Liabilities	1,380,862	1,799,146	2,154,285	2,491,637	2,851,896	3,201,323	3,459,400	3,687,623	3,860,022	3,993,857	4,116,117	4,262,479
Operating Lease Liabilities	328,231	382,411	466,282	556,079	632,977	680,224	737,164	785,381	822,088	815,047	841,664	869,219
Preferred Stock Non Redeemable	-	-	-	-	-	-	-	-	-	-	-	-
Preferred Stock Convertible	-	-	-	-	-	-	-	-	-	-	-	-
Other Long-term Liabilities	33,821	34,107	157,426	183,480	211,919	240,317	262,378	281,059	295,280	307,180	318,008	329,218
Total Liabilities	1,742,914	2,215,665	2,777,993	3,231,195	3,696,792	4,121,864	4,458,942	4,754,064	4,977,390	5,116,084	5,275,789	5,460,916
Common Stock - Par Value	977	1,067	-	-	-	-	-	-	-	-	-	-
Common Stock - Par Value	3,173	3,112	-	-	-	-	-	-	-	-	-	-
Additional Paid in Capital	1,930,804	2,039,142	-	-	-	-	-	-	-	-	-	-
Accumulated Deficit	(1,936,958)	(1,976,373)	-	-	-	-	-	-	-	-	-	-
Shareholders' Equity	3,999	66,948	(368,995)	(549,702)	(827,517)	(943,180)	(1,037,376)	(1,131,528)	(1,179,326)	(1,213,533)	(1,244,408)	(1,287,752)
Total Liabilities & Shareholders Equity	1,746,913	2,282,612	2,408,998	2,681,493	2,869,275	3,178,684	3,421,566	3,622,536	3,798,064	3,902,551	4,031,381	4,173,163

Cash Flow Statement

Cash Flow Statement Forecast			Estimate									
Fiscal Year, ends 31 Jan	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Operating Activities												
Net Income	(92,486)	(34,428)	104,951	122,320	263,395	506,267	690,928	814,134	933,086	1,213,362	1,339,875	1,387,106
Adjustments for Non-cash Expenses:												
Depreciation and Amortization	35,664	16,811	22,422	26,615	32,033	38,368	44,073	49,218	54,169	58,774	63,299	67,908
Stock-based Compensation Expense	121,265	90,947	110,198	107,642	124,326	134,577	110,199	118,045	124,018	81,915	84,802	87,792
Non-cash Lease Expense	25,996	-	-	-	-	-	-	-	-	-	-	-
Amortization of Deferred Rent	-	-	-	-	-	-	-	-	-	-	-	-
Other	306	-	-	-	-	-	-	-	-	-	-	-
Net Change in Operating Assets and Liabilities:												
Accounts Receivable	(20,221)	(34,450)	(17,245)	(15,168)	(25,972)	(25,934)	(20,147)	(17,061)	(12,988)	(10,867)	(9,889)	(10,237)
Inventories	(195,496)	(129,686)	(71,537)	(83,066)	(83,759)	(73,769)	(40,236)	(28,775)	(43,731)	(34,619)	(30,150)	(39,925)
Prepaid Expenses and Other Current Assets	(9,661)	(31,240)	(14,664)	(12,159)	(13,272)	(13,252)	(10,295)	(8,718)	(6,637)	(5,553)	(5,053)	(5,231)
Trade Accounts Payable	95,316	247,476	210,822	184,509	195,055	186,751	130,134	119,882	89,921	67,740	59,565	81,458
Accrued Expenses and Other Current Liabilities	186,895	165,524	132,707	145,902	159,261	159,024	123,542	104,615	79,641	66,639	60,637	62,775
Operating Lease Liabilities	(12,884)	14,436	-	-	-	-	-	-	-	-	-	-
Other Long-term Liabilities	(1,497)	286	123,319	26,054	28,439	28,397	22,061	18,681	14,222	11,900	10,828	11,210
Cash Flow from Operating Activities	133,197	305,677	600,971	502,650	679,506	940,430	1,050,258	1,170,022	1,231,701	1,449,290	1,573,916	1,642,854
Investing Activities												
Capital Expenditures	(130,743)	(134,055)	(83,867)	(108,370)	(126,690)	(114,094)	(102,902)	(99,034)	(92,094)	(90,507)	(92,174)	(97,801)
Cash Advances Provided to Parent, Net of Reimbursem	-	-	-	-	-	-	-	-	-	-	-	-
Cash Reimbursements from Parent, Net of Advances	9,048	21,869	-	-	-	-	-	-	-	-	-	-
Other	(2,442)	-	426	(1,714)	(4,402)	(3,570)	(557)	(1,067)	(1,521)	(1,534)	(923)	(655)
Cash Flow from Investing Activities	(124,137)	(112,186)	(83,441)	(110,085)	(131,092)	(117,663)	(103,459)	(100,101)	(93,615)	(92,040)	(93,098)	(98,456)
Financing Activities												
Net Debt Transactions (borrowing, repayments)	-	-	-	-	-	-	-	-	-	-	-	-
Net Equity Transactions (stock sales, repurchases, divic	-	6,429	(651,091)	(410,669)	(665,535)	(756,507)	(895,322)	(1,026,331)	(1,104,903)	(1,329,483)	(1,455,553)	(1,518,242)
Cash Flow from Financing Activities	342,197	6,429	(651,091)	(410,669)	(665,535)	(756,507)	(895,322)	(1,026,331)	(1,104,903)	(1,329,483)	(1,455,553)	(1,518,242)
Change in Cash and Cash Equivalents	351,257	199,920	(133,561)	(18,104)	(117,121)	66,260	51,476	43,590	33,184	27,766	25,266	26,156