

# Investing in Etsy: a Deep Dive

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## 1. Summary:

1. Strong Correlations between R&D Spending( which is increasing), Revenues and Price.
2. Strong protection against competitors with lobbying and fair seller costs.
3. Short term technical strength in price.
4. Recent Close as of 31/07/2021 is \$183.51, down (11.55%) weekly from 207.47. P/E = 53.57.

Etsy is an online store which pairs producers of creative goods to buyers, in a similar way to Ebay pairing sellers and bidders, or Amazon (originally) pairing bookstores with bookworms. The online, E-Commerce industry benefited in a large way when the world locked down in 2020, and saw increased revenues and stock prices as a result.

The lobbying which Etsy has been undertaking sets it apart from other E-Commerce sites, and according to [opensecrets.org](https://www.opensecrets.org), Etsy has committed \$1.3 million to congress since 2016, more than any other major E-Commerce enterprise. These go to acts like the 2019 Save the Internet Act and Relief for Workers Affected by Coronavirus Act. Regardless on your personal views on lobbying, the fact that Etsy lobby's for artists gives it a competitive advantage when encouraging new sellers. Jacob Bogage of the Washington Post wrote an interesting article titled "Etsy is growing up. Here's why it needs Congress's help." which discusses the intricacies of the movement.

This positive effect is somewhat limited by the recent decision to use off-site-ads, which generate revenue for Etsy at the expense of its sellers. Each seller pays 15% of each sale to advertising services, and Etsy made the mistake of creating the program an opt-out service, forcing many sellers to pay these extra fees.

## 2. What will be Discussed:

1. Competition
2. Revenue Growth and Spending
3. Technical Analysis (Trends and Options Pricing)
4. Risks (Recession, Crash, ETF Holdings)

### 3. Competition:

Company	Revenue (m\$)	Market Cap (m\$)	Debt (m\$)	Trustpilot (Excellent%/bad%)
Etsy	2048	25290	1354	24/65
Shopify	3853	190508	1076	9/85
Big Cartel	6			18/71
Ebay	11362	50011	7371	16/70

Most other E-Commerce companies are not an immediate threat to Etsy due to their smaller operations. For example, Aftcr has only 60 employees (to Etsy's 1240) and has a revenue \$560 million less than Etsy. Some competitors are discussed here. Information from Owler.com.

**Shopify** has 88% more revenue than Etsy, and this is achieved by taking on 20% less debt. Shopify is a giant in the E-Commerce industry, and has expanded to be the go-to for general sellers with its Shopify Fulfillment Network (SFN) which gives sellers access to a centralised packing, shipping, branding, and order management system as part of their package. However, I believe that Shopify is unlikely to take clients from Etsy, because Shopify's relentless expansion into other areas has come at the cost of its individuality, lobbying and concentration of artists. It is the go-to for general sellers, but falls behind for the niche of art sales; Etsy concentrates on this group of clients, and so can provide them the best service.

**Big Cartel** is a private company in direct competition with Etsy for the sale of art. While Etsy is a large marketplace of independent sellers, each competing for buyers money, Big Cartel allows sellers to make a separate, independent store. Imagine a mini-internet of websites each selling art, rather than a website of sellers. While Big Cartel is a real competitor for Etsy, its small relative size, and its revenue structure (much higher ongoing costs from subscriptions) is less appealing to many artists. The revenue generation of Big cartel comes from subscription, while Etsy's revenue comes from sales; for artists considering each this is an important distinction as costs scale with Etsy, and are constant for Big cartel.

**Ebay** has been known as an online auction house for many years, but almost 80% of goods sold on Ebay are new, and while many people have switched to Amazon (see below) Ebay is the second largest online retailer in the US. Ebay has roughly 5x the Debt and Revenue of Etsy, but is only twice the Market Cap. This translates into Ebay's P/E of 15.6, against Etsy's 53.57. Similar to Shopify, Ebay offers general sales, so artists do not really consider it for selling handmade goods.

**Amazon Handmade** is Amazon's expansion into the niche area of personalised artistic produce. This is a company I would not consider classically to be in competition with Etsy (AWS and online retail), but because it can afford to support unprofitable projects, it may become dangerous for Etsy. With the support of the wider Amazon environment (AWS generates 40 billion Dollars), Amazon Handmade could be a real threat to Etsy by funding similar initiatives (lobbying etc) although, for the moment, higher fees put off most sellers. This is discussed in Risks later.

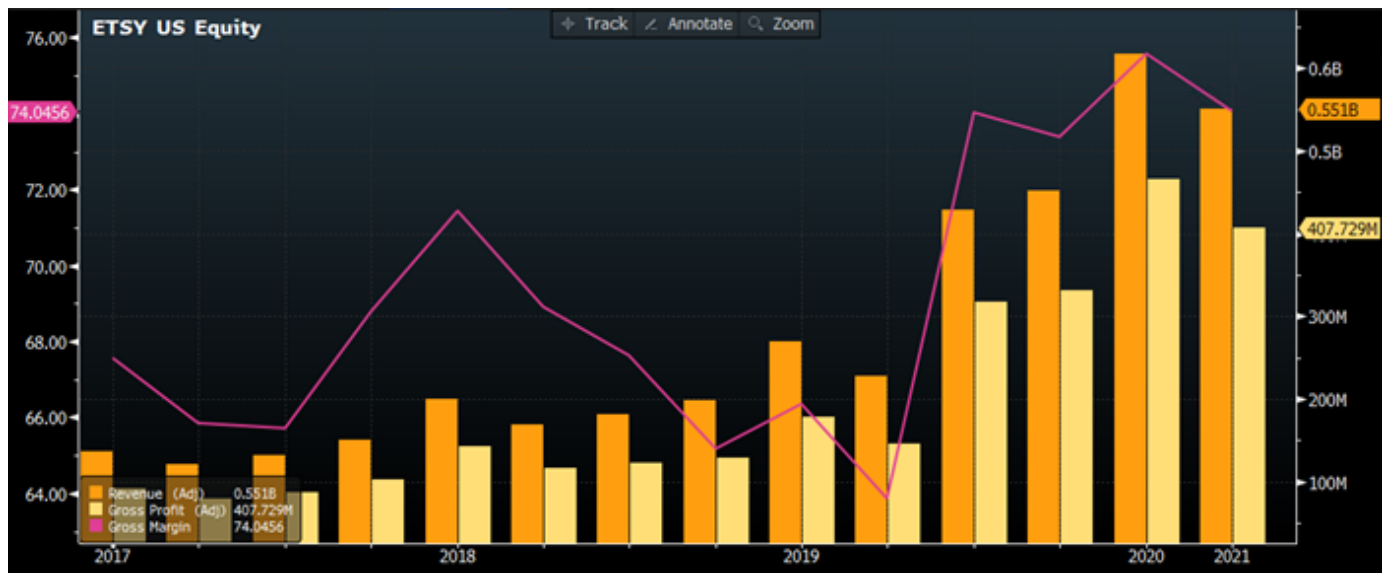


Figure 1: Etsy's Quarterly Financials. The purple line is the gross margin, the dark orange bars are the Revenues, and the pale yellow bars the gross Profit. All are quarterly, in \$ millions.

#### 4. Revenue Growth:

Revenues are generated by charging sellers 3.5% of sales, and charging \$0.20 per listing. In 2018 there were 60 million products listed on their website, and a 2021 First quarter revenue of \$550.7 million (+140% from last year) has caught many investors attention. The political lobbying on the behalf of artists and its fair prices make it a very appealing choice for a creative looking to monetise their skills. Trustpilot.com's statistics on website reviews are displayed in the first table (pg 2). Etsy has the highest positive ratings, and lowest negative ratings meaning it is best thought of. Please note: this study obviously falls victim to sample size issues as well as volunteer biases, and is not specific to artists (this data does not appear to exist).

Figure 1 shows the increase in Quarterly Revenue since 2017 in orange. It is important to recognise the stable (13% range) purple profit margin between 64-76%, while revenues increased by 300%. This is particularly important because expanding companies often lose margin as costs growth exceed revenue growth until their internal investment bears fruit. The fact that Etsy has a stable and high margin shows that it is investing into the revenue generation areas of the company, and management is making the correct decisions regarding R&D.

To recognise this, please see Figure 2, showing the relationship between Total R&D spending, Revenue and stock price. The correlation between R&D spending and Revenue is 0.9891, meaning that company investment flows into generating revenue, and therefore profits. This is supported by the 0.955530928 correlation between R&D spending and the stock price. This shows that the increases in Revenue are sustainable and costs are increasing at a similar rate. Quarterly revenues doubling in 2020 caused the stock price to double twice, to 4x its starting yearly price. This

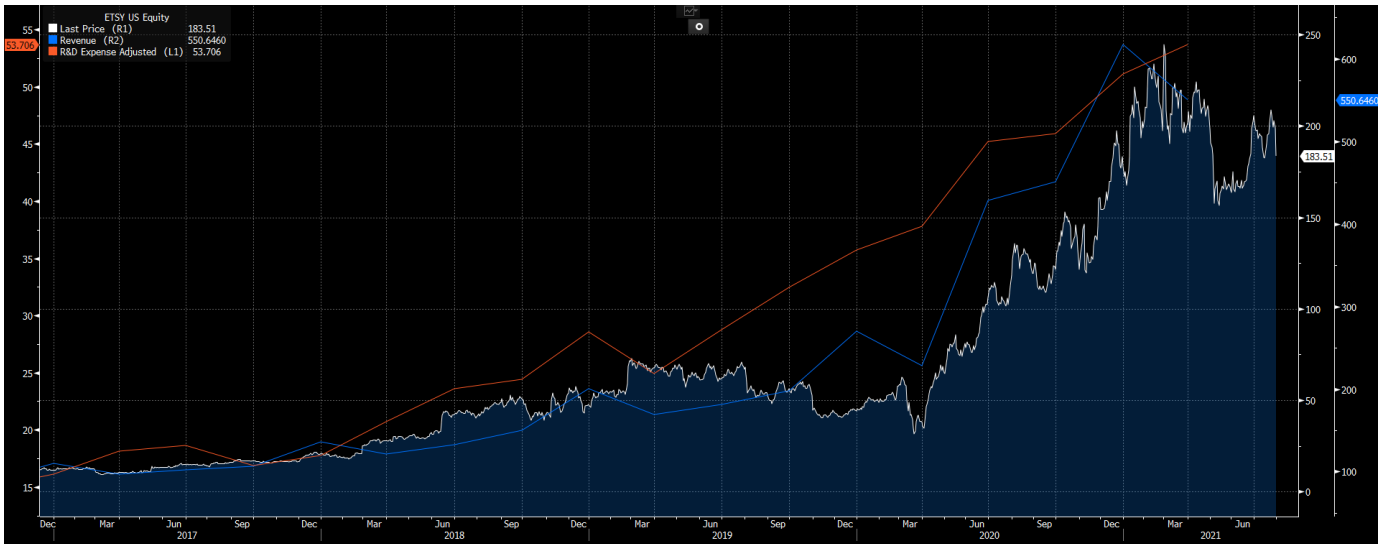


Figure 2: Line is the R&D costs, and bar chart represents Revenues. Both are quarterly, and in \$millions. Shows the graph of stock price against Revenues. The correlation (on quarterly data) is 0.949632987.

increase in valuation pushed its P/E ratio to 52. Despite this, the four most recent quarterly reports have exceeded EPS expectations by \$0.27 on average. By this standard, and a Q2 expectation of 0.63, an EPS of up to \$0.9 should not be a surprise. This is obviously assuming that analysts continue to be wrong by the same factor.

One interesting expense incurred in 2017 shows that management is willing to take on large costs when they see opportunities. The acquisition of reverb.com, the second hand music retailer, in 2019 gave Etsy some extra \$242.4 million in merchandise sales, 4.9% of its total that year. At a cost of \$275 million, it is easy to see that this was a savvy investment and is helping drive strong revenues for Etsy.

The cash acquisitions of Depop and Elo7 (Brazilian online marketplace) for \$1.6 Billion and \$217 Million both occurred in 2021 and many details are not yet fully disclosed. There is no reason to think that Etsy will not maximise these investments potential as they have with Reverb. Depop, with its 30m users, 90% of which are below 26, is the 10th most visited website among gen-Z consumers so is a logical move for Etsy. Etsy has experience catering for niche clients, (artists and musicians) so the needs of the climate aware, young people who use Depop will be respected; both parties will profit. Depop also diversifies Etsy's portfolio into Europe, while Elo7 provides exposure to more consumer markets. Elo7 was described by Etsy CEO Josh Silverman as "the Etsy of Brazil", and the 1.9m currently active buyers are projected (by ETSY) to grow 26% by 2024.

## 5. Technical Analysis:

Figures 3 and 4 shows the relentless rise of Etsy's stock price.

Log charts are useful to place relative gains into context (successive doubling is linear on a log chart), and to make long term analyses. Over the short term, when a stock has experienced heightened valuations and extended rises, log charts can be a good way to look at wide ranging prices. Etsy stock has experienced a 700% increase from \$34 to \$260, meaning those initial double digit moves would be invisible. Looking on the log graph we can easily see the long term trendlines. For any interested readers, TSLA and BTC both have interesting long term setups when looking on their log charts.

The lower trendline has been touched three times, indicating an upwards Elliot wave pattern, and there is pattern alternation in the corrections. The 2017 correction is of type ABC, and the 2019-2020 correction is of type WXY. These indicate that the 5th wave has just ended, having reached the upper trendline for the 8th time.

In Figure 4, the only trendline present from Figure 3 is the middle line. This is important because of the increased volume of trading done at/around this line. The Grey circles in Figure 4 show spikes in volume which correspond to breaks or bounces from this trendline. Traders have been placing importance on this line, and momentum is behind the stock upwards over the long term (moving average crossovers).

The Elliot wave correction (ABC with an abcde triangle (not labelled - too small) in wave B) occurring since March 2021 took price from the upper trendline to the middle line. This was followed by a bounce and retest, with no previous lows being broken, showing that upwards moves are still likely.

Two possibilities from a technical perspective are:

1. Break the middle trendline, and a fall down to the lower line. Price would be falling to the high double digits here, in an ABC or WXY Elliot wave correction.
2. Price could extend above the upper trendline, or spend time between the middle and upper lines. This is the scenario I believe will occur, because of the bullish short term technicals you can see in Figure 4. Here, the 5th wave since May 2020 would be extended and a new technical high may be created. In 2018-19, price spent 74 weeks above the middle trendline, the 2020-21 trend has been above 54 weeks, so any price rise may continue until Nov 2021.



Figure 3: Log graph of Etsy stock weekly bars 2017-2021.



Figure 4: Log graph of Etsy stock with Elliot wave analysis post-covid crash, 2020-2021.

## 6. Risks:

### **ETF Holdings in a Crash:**

The institutional ownership of Etsy is high at 86% (Vanguard, Blackrock, T.Rowe Price all own more than 1,000,000 shares), according to Nasdaq. This strong institutional involvement is good, due to the acceptance of risk they take. However, in the event of a crash they will be obligated to sell, as most of these hold Etsy as part of their Exchange Traded Funds. Vanguard's 'VO - Vanguard Mid-Cap ETF' owns 851,020 shares (according to ETF.com), in the event of a wide scale selling event where 40% of VO owners sell, about 340k shares will be offered. This is a very rough calculation, but the large ETF ownership is not a positive indicator for Etsy, as the price of the stock depends largely on the ebbs and flows of the wider market. This is evidenced by the almost 60% dip from March 2019 to March 2020, with 52% occurring during the March 2020 crash, out-falling the S&P by 22%, and falling roughly inline with the Nasdaq.

**Crash Risk:** Etsy's heightened valuation (P/E of 53) gives it much further to fall in the event of a crash. For it to fall to a P/E of 19,8 (the long term average P/E of the S&P 500 according to currentmarketvaluation.com) the price will have to undergo a 62% drop. This would correspond to a price similar to the supporting trendline in Figure 3, around \$70. In the event of a market panic, it is not unreasonable to believe Etsy would fall to these levels very quickly.

**Competition Risk:** The main competitor that should concern Etsy is Amazon. Etsy has a strong moat with: respect from artists, incentives regarding lobbying and fair prices to fight off most competition. this means Big Cartel, Ebay and Shopify cannot replicate many of Etsy's best features for sellers. This said, Amazon has such huge amounts of capital available that, if it felt the need, it could smother Etsy. It could do this by offering better incentives and including artistic discussions in its already extensive lobbying program. This would motivate artists to migrate from Etsy to Amazon Handmade, sealing the fate of Etsy and the E-Commerce industry as a whole.

**Recession:** The effect of a reduction in buying power would be felt especially hard by Etsy. The closest comparable event to this, Ebay during the 2008 crash shows how Ebay stock fell by 70%, and revenues were stagnant for 3 quarters. For a new, high growth company, stagnation is deadly as investors lose patience. Especially during a double digit stock price loss. Any macroeconomic downturn would be felt especially badly by young people, and foreign countries with debt denominated in USD. Depop and Elo7 would have large losses in this scenareo.

## 7. Second Quarter 2021 Results

The 4/8/21 release gave several interesting points. Etsy marketplace GMS over the period was \$2.8 billion, up 14.2% year-over-year, and Revenues grew 23.4% YoY. Numbers of habitual buyers (6 purchases totaling more than \$200) rose 115% YoY, showing that the company is not over-charging for their services (costs are relayed to customers). Reverb is concentrating on international expansion.