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An Equity Note

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What's Inside:

➢ *4 Reasons 1stDibs (DIBS) is De-Risked At The Current Price*
➢ *DIBS's Marketplace Disintermediation*
➢ *The Trolley Dilemma For DIBS Sellers*
➢ *MO Portfolio Trade Updates*

Companies Mentioned:

➢ *1stDibs (DIBS)*

Equity Note: 1stDibs (DIBS) De-Risked, Disintermediation, and The Trolley Dilemma

1stDibs (DIBS) is the leading online marketplace for luxury design items. You can read my latest write-up on the company here.

In March, I noted that DIBS's stock price was "*approaching stupid levels here*."

That was at $8/share. Today, the stock trades at ~$5.60/share or 35% lower than March's "stupid level."

There *are* reasons for this price decline, most notably higher inflation on non-discretionary items like food/gas and rising interest rates. Such price hikes reduce consumers' ability to spend on discretionary things like luxury design (DIBS's primary market). While higher interest rates handicap long duration/unprofitable businesses.

Plus, DIBS checks nearly every box for what the market (currently) despises most:

➢ Online/digital business
➢ Currently unprofitable
➢ Retail
➢ New IPO

This year, DIBS will face continued macro headwinds and will likely print its worst quarterly FCF loss since going public. It's chart looks worse than a Tiger Cub's PnL statement.

However, at a $63M EV, **nearly all the company's future risk is embedded in the current price.**

Four factors give me confidence to make that claim:

➢ **A fortress balance sheet**
➢ **Highly flexible business model**
➢ **Existing GMV leverage**
➢ **Long-term shift to online commerce**

 Chop wood, carry water…

In this note, we'll unpack each of the above. Finally, we'll discuss the most prominent red flag for most potential investors: **Marketplace Disintermediation.**

We'll examine Disintermediation from both sides of the marketplace and use The Trolley Dilemma to solve the Seller-side problem.

Let's get after it.

Reason 1: DIBS's Fortress Balance Sheet

DIBS has ~$161M in cash on its balance sheet with no debt, giving the company a $63M Enterprise Value.

The company burned ~$7M in cash between 2020-2021 and is on pace to burn $25M this year (annualizing Q1 2022 of -$6M burn).

Here's the good news. DIBS could burn $25M/year for the next ***six years*** without needing to tap financial/debt markets.

But DIBS *can't* burn money for the next six years. Investors aren't hungry for cash-burning growth. They want profits, and they want them now.

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Investors are funny.

2021: "I don't care if you lose money in the short-term. You're capturing a huge TAM and today's investments will reap tomorrow's rewards."

2022: "I swear to God if you don't print a profitable FCF figure this quarter I will sell every single share I have."

3:20 PM · May 26, 2022 · chirr.app

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Why is this important?

First, this year's cash burn doesn't (read: shouldn't) matter, which is good because it'll be an ugly print.

Second, DIBS's strong cash position allows it to grow *through* difficult times. Rosenblatt can invest while other managers retreat and freeze investments and/or hiring. Who knows, maybe they even buy a competitor if things get *terrible*.

Reason 2: Asset-Light, Highly-Flexible Business Model

DIBS's strong balance sheet is made possible by its asset-light and highly-flexible business model. The company doesn't buy products from sellers. It simply connects supply and demand with a tax on the exchange (read: revenue).

Asset-light businesses can more easily shift from "growth mode" to "survival mode" than other fixed-cost heavy operations. For example, DIBS doesn't have lease obligations or fixed interest payments to consume cash.

Instead, DIBS has complete control over its main cash drain, Sales & Marketing (SG&A).

Historically, DIBS plowed cash into SG&A to get more buyers on its platform, which is what it should do. New DIBS customers are profitable from the *first* order. Moreover, DIBS's most mature buyer cohorts generate ~4.5x LTV/CAC.

But remember, the market doesn't care about any of that stuff. It only wants to know if DIBS can survive the next 12-18 months.

Think of DIBS's SG&A spending like a bathtub plug. The tighter the plug, the less the water drains. And in DIBS's case, the more cash it keeps.

Reason 3: Existing Gross Merchandise Value (GMV) Leverage

DIBS possesses tremendous revenue growth leverage within its *existing* GMV base.

Let's review a couple of terms. First, **Platform GMV** means the cumulative dollar value of all products listed on DIBS's platform. GMV represents the total dollar value of items sold by sellers through DIBS.

DIBS had ~$14B in Platform GMV as of 2021.

During Q1 2022, the company generated $117M in GMV or $450M+ on an annualized run-rate basis.

In other words, the company captures ~3% of its current Platform GMV.

DIBS doesn't need additional supply to generate higher revenues. It can grow from increased orders from existing customers, which should happen over time as buyers become more trusting in the DIBS platform.

All of this potential growth comes at little-to-no incremental cost.

Reason 4: Long-Term Shift in Consumer Spending Habits

Finally, it's essential to step back and ask yourself, "*will more people buy luxury design items online in 5-10 years than they do today?*"

Our bet is that the answer remains "**yes.**"

DIBS operates in a nearly $130B TAM with a sub-5% online adoption rate. It offers consumers/sellers a significantly better experience online versus in-person. Moreover, nobody competes with DIBS at its average price point (compared to AMZN, ETSY, or eBay).

This means DIBS will capture a good portion of the shift from offline to online luxury design commerce.

Now let's shift to one of DIBS's most significant risks: **Marketplace Disintermediation**

How DIBS Can Avoid Marketplace Disintermediation

Marketplace Disintermediation occurs when both parties of an online marketplace leave to exchange goods/services off-platform.

A great example of Marketplace Disintermediation is nannying. Care.com is an online marketplace connecting nannies and families.

That sounds like a great idea, right? However, think about nannying as a job to be done. What do families want?

They want to hire **one** nanny. And they want to **keep** that nanny as long as they can.

On the other hand, nannies desire a stable income and a good family.

A good outcome for both parties results in a meaningless marketplace as neither side needs its service.

I like how venture capital firm NFX defines Disintermediation (emphasis added):

> *"Disintermediation is a vulnerability that mostly applies to Marketplaces and Market Networks. **It happens when**, after initially connecting through a marketplace or market network product, **users take future transactions off the product and transact directly.** This is a significant problem because retention leading to repeat purchase is the name of the game in most transactional networks."*

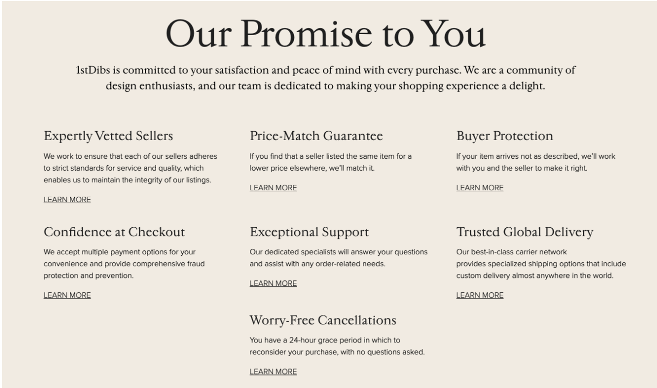
DIBS faces similar Disintermediation issues. A buyer can find an artist she loves, message them on DIBS's platform, and then conduct future business outside DIBS's marketplace via the seller's personal website, etc.

However, DIBS reduces Disintermediation on both sides of its marketplace (buyers and sellers). Let's see how they do it.

Reducing Buyer Disintermediation

DIBS reduces Buyer Disintermediation by offering various incentives and benefits from buying on the DIBS platform. These benefits include:

- Buyer Protection
- Price-Match Guarantee
- Trusted Global Delivery
- Exceptional Customer Support
- Worry-Free Cancellations



In other words, a buyer might not get those benefits if she buys off-platform from an independent seller. These benefits *really* matter when you're buying $100K+ items online.

Going off-platform might save the buyer a few hundred (or even thousands of) dollars. But is it worth losing Buyer Protection, Price-Match Guarantee, and a Trusted Global Delivery logistics system?

Reducing Seller Disintermediation

I've thought about the problem of Seller Disintermediation since I discovered DIBS. It's a much more challenging problem to solve than Buyer Disintermediation for a few reasons.

First, sellers have good reason to engage with buyers off-platform. They don't pay DIBS's marketplace fee and can foster more personal relationships with buyers.

Second, it allows sellers to cross-sell other pieces to the same buyer, again, without DIBS's cost.

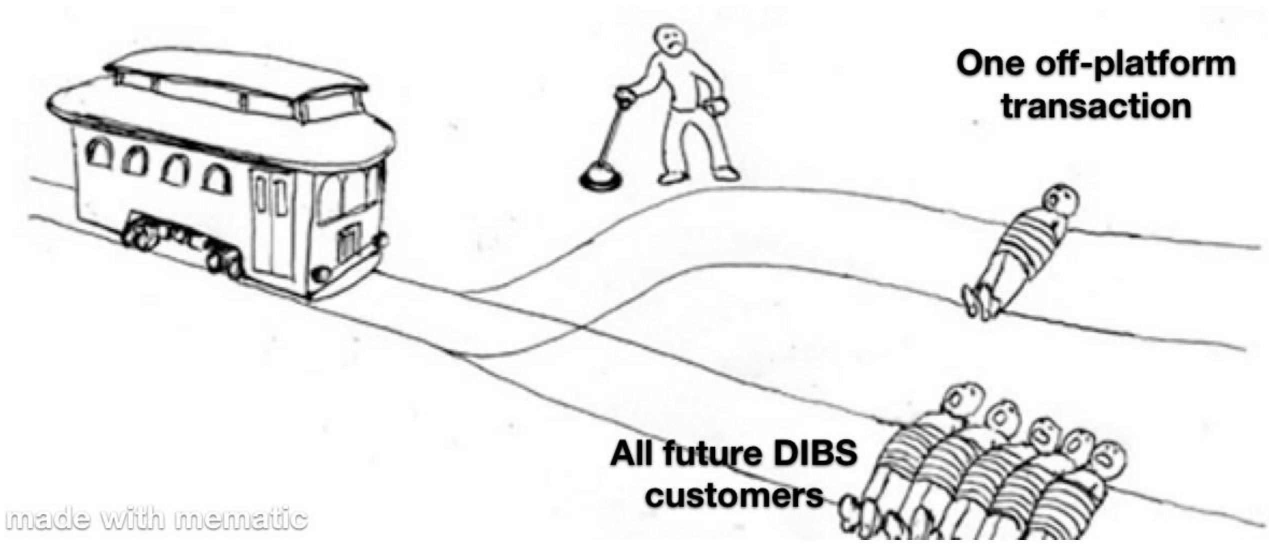
Yet, the more I thought about the problem, the more it reminded me of the [Trolley Dilemma]**,** which asks, **"do you sacrifice one life to save 5 others?"**

Sellers face a similar problem.

DIBS will **permanently ban** any seller that engages/transacts off-platform for a piece listed on the DIBS platform.

The question sellers then face is, "**do I sacrifice all future DIBS customers to save money on this one customer?"**

We can visually represent this below.



One study replicated the Trolley Dilemma with mice. Participants had to choose: **"Shock one mouse to save five other mice or do nothing and shock five mice."**

83% of participants shocked one mouse to save the other five.

What does this mean for DIBS sellers? Over time, sellers *should* do the rational thing and sacrifice one off-platform customer for more DIBS customers (i.e., more revenue) in the future.

Additionally, the decision to stay on-platform becomes easier as DIBS onboards more active buyers, further simplifying the seller's Trolley Dilemma.

Speaking of simplifying things, let's discuss DIBS's current valuation proposition.

DIBS Is Now A Binary Bet

DIBS is so cheap you can throw away your valuation models. The company is now a binary bet.

Suppose you believe that Rosenblatt can guide DIBS through the short-to-medium term headwinds while having enough cash on the other side to invest in growth.

In that case, the stock price a few years from now will be significantly higher than today.

However, if you *don't* think that happens, you should value DIBS on its net cash balance. Which again, isn't too far from the current price! Hence the de-risked nature of the bet.

DIBS still has a broken chart. We'll wait for technicals to firm up before entering.

I'm buying more DIBS at these levels in my IRA.

Portfolio Updates

Buys

- **BOUGHT** Starter Long in Vista Energy (VIST)
- **BOUGHT BACK** Remaining Russell 2000 (RTYM2022) Short
- **BOUGHT BACK** Remaining Nvidia, Inc. (NVDA) Short

Sells

- **SOLD** Remaining US Dollar (DXM2022) Long