



## **The RealReal Research (10/17/19)**

**Description:** The RealReal, Inc. operates an online marketplace for consigned luxury goods. It offers resale product categories, including women's, men's, kids', jewelry and watches, as well as home and art products. The company was founded in 2011 and is headquartered in San Francisco, California.

**Ticker:** REAL

**Price:** \$21.75

**Market Cap:** \$1.85B

**Performance:** +8.75% From IPO Price of \$20 in late June, 2019

**Dividend Yield:** N/A

### **Analysis**

REAL is a unique ecommerce play when compared to an eBay, Etsy, and Amazon. The company sells preowned luxury goods but takes it a step further by providing authenticity of the products being sold by actually examining them themselves. This is where they differentiate themselves in comparison to the names previously mentioned in order to provide more trust and transparency for the customer.

According to studies, the personal luxury goods market is expected to rise from \$294B in 2018 and grow to between \$362B-\$412B in 2025, according to Bain.

Luxury goods retain value over time as a result of their enduring desirability and durability, making them particularly well-suited for resale. In addition, the total addressable market of luxury products in U.S. homes potentially available for resale, including men's and women's apparel, handbags, shoes, watches, jewelry, high-end

furniture and art valued below \$250,000, is approximately \$198B according to Frost & Sullivan. This is the space that REAL is operating in and, at the moment, don't face too much competition.

Moving on to the business, REAL has grown their gross merchandise value (GMV) from \$492M in 2017 to \$710M in 2018.

Halfway through 2019, they have grown their GMV to \$452M vs. last year's \$321M during the same time frame – marking a 40% gain. The company expects to finish the year with \$974-988M in GMV which would be a 38.5% gain Y/Y.

|                  | Three Months Ended                         |               | Six Months Ended |               |
|------------------|--|---------------|------------------|---------------|
|                  | June 30, 2019                              | June 30, 2018 | June 30, 2019    | June 30, 2018 |
|                  | (In thousands, except AOV and percentages) |               |                  |               |
| GMV              | \$ 228,487                                 | \$ 162,954    | \$ 452,603       | \$ 321,332    |
| NMV              | \$ 164,782                                 | \$ 115,916    | \$ 325,320       | \$ 229,263    |
| Number of Orders | 505  | 359           | 1,003            | 715           |
| Take Rate        | 36.6%                                      | 35.5%         | 36.0%            | 35.3%         |
| Active Buyers    | 492  | 352           | 492              | 352           |
| AOV              | \$ 453                                     | \$ 453        | \$ 451           | \$ 449        |

In addition:

- Trailing twelve months active buyers reached 492,440, up 40% year over year.
- Orders reached 504,820, up 40% year over year.
- Average Order Value was \$452.61 compared to \$453.32 in the second quarter of 2018.
- Take Rate increased 110bps year over year to 36.6%.
- GMV from repeat buyers was 83.1% compared to 82.9% in the second quarter of 2018.

What is shocking to CUBE out of these stats is the take rate. The take rate is what the company retains as a percentage of the proceeds received as payment for its consignment service. For example, if someone sells their Gucci bag for \$1,000, REAL takes \$366 on that sale. We find this number staggering considering Etsy is around 15% and eBay is around 10%. As more competition enters the market, we believe this number can see a huge leg lower in order to remain competitive.

In addition, consignors may decide it's worth listing on a less niche marketplace like that of eBay simply to save more than 25% on their sale. Furthermore, if consignors are as upset as they are with the policies as the reviews we've seen, then they may look to list elsewhere to also avoid the headache.

Some more stats from the quarter:

- Total Revenue increased \$24.0M to \$71.0M, up 51% Y/Y
- Consignment and Service revenue increased \$18.5 million to \$60.7 million, up 44% Y/Y
- Direct Revenue increased \$5.5M to \$10.3M, up 114% Y/Y
- Gross Profit increased \$15.3M to \$46.1M, up 50% Y/Y
- Adjusted EBITDA was \$(20.9M) or (29.4%) of total revenue.
- GAAP basic and diluted net loss per share was (\$2.83)
- Non-GAAP diluted net loss per share was (\$2.50). Assuming the pro-forma share count is the outstanding common shares immediately after the IPO, Non-GAAP diluted net loss per share was (\$0.28).
- Free cash flow was (\$32.1M)
- At the end of the second quarter, cash, cash equivalents and short-term investments totaled \$66.7M. Inclusive of the IPO net proceeds, pro-forma cash balance was \$387.6M at the end of the second quarter.
- Expects EBITDA for 2019 to come in around (-25%) to (-24%).

|   | Three Months Ended June 30, |             | Six Months Ended June 30, |             |
|---|-----------------------------|-------------|---------------------------|-------------|
|   | 2019                        | 2018        | 2019                      | 2018        |
| Revenue:                                |                             |             |                           |             |
| Consignment and service revenue         | \$ 60,713                   | \$ 42,178   | \$ 116,950                | \$ 83,177   |
| Direct revenue                          | 10,263                      | 4,807       | 23,281                    | 10,267      |
| Total revenue                           | 70,976                      | 46,985      | 140,231                   | 93,444      |
| Cost of revenue:                        |                             |             |                           |             |
| Cost of consignment and service revenue | 17,200                      | 12,349      | 33,147                    | 23,926      |
| Cost of direct revenue                  | 7,726                       | 3,857       | 18,652                    | 8,134       |
| Total cost of revenue                   | 24,926                      | 16,206      | 51,799                    | 32,060      |
| Gross profit                            | 46,050                      | 30,779      | 88,432                    | 61,384      |
| Operating expenses:                     |                             |             |                           |             |
| Marketing                               | 11,715                      | 9,276       | 23,448                    | 18,910      |
| Operations and technology               | 34,320                      | 22,997      | 65,865                    | 44,329      |
| Selling, general and administrative     | 25,355                      | 14,377      | 47,674                    | 27,901      |
| Total operating expenses                | 71,390                      | 46,650      | 136,987                   | 91,140      |
| Loss from operations                    | (25,340)                    | (15,871)    | (48,555)                  | (29,756)    |
| Interest income                         | 610                         | 81          | 1,015                     | 165         |
| Interest expense                        | (380)                       | (526)       | (511)                     | (723)       |
| Other expense, net                      | (1,706)                     | (1,279)     | (1,987)                   | (1,387)     |
| Loss before provision for income taxes  | (26,816)                    | (17,595)    | (50,038)                  | (31,701)    |
| Provision for income taxes              | 59                          | —           | 59                        | —           |
| Net loss                                | \$ (26,875)                 | \$ (17,595) | \$ (50,097)               | \$ (31,701) |

Growth of 50% this year has been great and hasn't really slowed down too much from REAL's 55% revenue jump from 2017 revs to 2018. Investors will definitely be putting a lot of emphasis on the GMV and the revenue as the rest of REAL's metrics are abysmal.

The company is nowhere near profitability and I truthfully believe it will be a long time before the company turns a profit. EBITDA margins are -30% and the company expects that to be around -25% by year's end and the company is bleeding cash at a pretty alarming run rate of well over \$100M a year.

Another reason for concern is that “operations and technology” includes the costs to authenticate the goods that are being sold. These numbers make up a massive amount of revenues to the tune of 47% vs. last year’s 53.2% of sales. While this is heading in the right direction, this is alarming and makes me very concerned at how capable the company is at being profitable.

Another reason is that while revenue did grow 50% Y/Y, cost of revenues grew 61.5% thus pushing gross margins for the year down 200 bps to 63%. If we cut out marketing expenses and assume that all the traffic to the site came from word of mouth, the company still would not be able to operate profitably and would still be in the red by around \$25M halfway through the year. If the cost to authenticate the products was actually included in cost of goods sold, I believe the Street would be even less bullish on the company because when it comes to high growth names that’s one of the most cared about margins because investors believe it is a tell for how well they can scale their business. If competition enters the space as we all should expect, marketing costs should only rise to remain competitive.

At a take rate of over 36%, how much more can REAL squeeze out of their transactions before sellers realize it is far too much and decide to increase their prices to compensate for the fee, and scare away buyers?

As new entrants come into the market, what will happen to REAL’s margins then? How fast will top-line growth give? How much of a moat does REAL have? In other words, what’s preventing another company from copying this business model and commoditizing the platform?

At this point in time, I don’t see any easy way for REAL to turn around their business and return any kind of capital to shareholders.

At a \$1.85B valuation, REAL is trading at around 6x sales which is one of the more expensive ecommerce names as ETSY trades around 9x sales, EBAY trades at 3x sales, Jumia (JMIA) trades at 2x sales, Farfetch (FTCH) trades at 2x sales, Chewy (CHWY) trades at 2x sales, and AMZN trades at 3x sales. What ETSY, EBAY, and AMZN have on REAL are actual margins aside from just gross profit. JMIA, who is growing but has terrible financials, is only able to garner 2x forward sales right now and even CHWY with their growth is only able to garner the same 2x multiple. In addition, AMZN acquired Souq, an Arabic ecommerce platform, for \$580M paying only 2x the annual revenue of approximately \$300M. On a peer to peer ecomm basis, REAL is trading at a pretty steep valuation here.

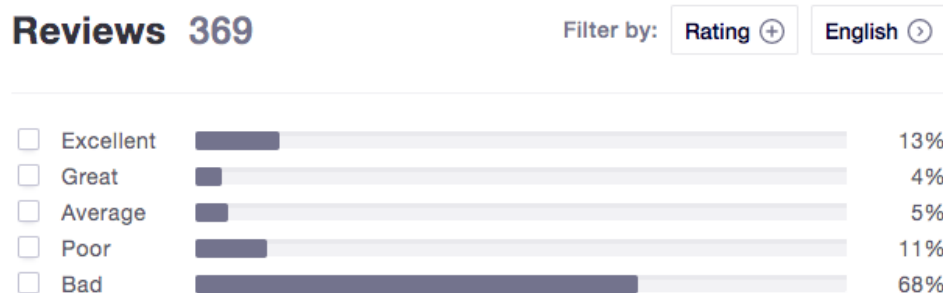
What are some risks aside from the financials?

1. Friction for consignors. Existing luxury resale models often require consignors to spend a significant amount of time and energy dropping off items at physical locations or self-listing on peer-to-peer platforms.

2. Growing competition from more trusted companies that have the ability to scale their business more efficiently
3. Sensitivity to economic cycles
4. Lack of trust for buyers due to the pervasiveness of counterfeit luxury goods and inconsistent authentication standards, buyers can be hesitant to purchase pre-owned luxury goods.
5. Abuse from customers with regard to returns from items either not being authentic, more damaged than advertised, and returned after using for one-time events

After taking a step away of from the financials, I figured it would be best to analyze the reviews and just when I thought the financials were tough to look at the reviews were even worse.

On TrustPilot, nearly 2/3 of the users have left a 1/5 star with many saying that they wish they could give it a 0/5. The average rating is a 1.8 on 369 reviews.



Yelp has a 2.5/5, BestCompany has a 1.5/5, SiteJabber has a 2.9/5, and the BBB has a 1.25/5 star rating.

Many of the reviews revolve around being charged extra, delivering fake items, failure to refund money for greater than displayed damage on goods, awful customer service, improper sizing listings, amongst many other things.

Overall, this is simply a name I can't get behind. Not only do the financials worry me but so do the reviews and I have genuine concerns as to why the company is not able to at least breakeven with a 36.6% take rate with virtually no competition. If the economy does in fact hit a rough patch, people will be looking to save their money and not spend it on used luxury goods. While income inequality in the country has only gotten worse, I do not believe REAL is the home for high net worth individuals, who may not feel a recession as

much, to shop. I believe they prefer to buy new luxury goods without any of the headaches consumers seem to be dealing with at REAL.

For the foreseeable future, REAL will rely on secondary equity offerings and debt to keep things afloat as the cash burn is simply way too high at this point and with all of those complaints it seems REAL will also have to hire some headcount to deal with all of the customer inquiries.

While I'd like to say a company would come in and take them out, seeing Amazon only willing to pay 2x sales for Souq does not make me very confident. If sales growth at REAL slips under the 30% mark, investors will really start to wonder when they'll get their capital back, if ever, and at that point shares may correct themselves big time.

With no moat, no free cash flow, no earnings, no EBITDA, weakening margins, etc. this investment is just too risky to take on for CUBE's risk appetite. In addition, the general market has not been kind to companies with these types of financial statements, especially as of late.

## Technical Analysis



Right now, shares of REAL seems to be nearing overbought on the RSI, MFI, and Wm%R indicators. The stock was recently unable to break the level it dropped at in August of \$23.75. REAL is currently floating in between fibbonaci levels with the next area of support being \$19.28 and the next level of resistance being \$25.49. CUBE believes a move to the downside is more probable not just from a fundamental standpoint as we mentioned earlier but also from a technical standpoint due to the overbought metrics.