

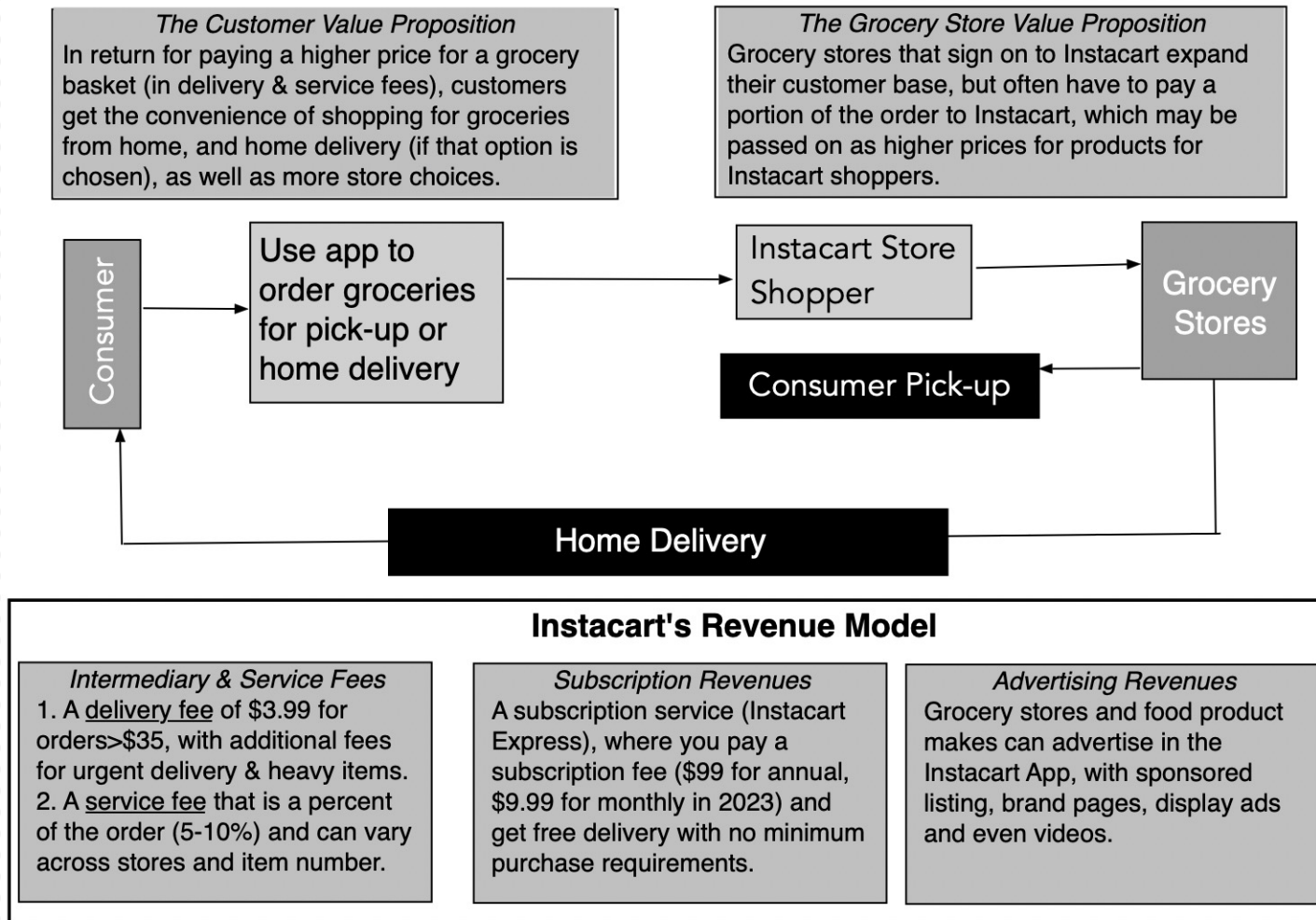
# THE (INSTA) CART BEFORE THE (GROCERY) HORSE: A COVID FAVORITE'S REALITY CHECK!

The Pandemic gives... And it takes away!

# A Long-awaited IPO

- After years of lead in, Instacart has finally filed for a public offering of its shares, with estimates that it will be aspiring to raise about \$600 million from markets, at a pricing of about \$9-\$10 billion for its equity.
- Coming in the same week that ARM is also filing to go public, but with an estimated pricing of \$55-\$60 billion, it is an indication of how much the ground has shifted under Instacart since the heady days of 2020, when Instacart was viewed by some Americans as the only thing that stood between them and starvation.
- At that time, there were some who were suggesting that the company could go public at \$30-\$40 billion, but reality has caught up with both the company and investors, and this IPO represents vastly downgraded expectations for the company's future.

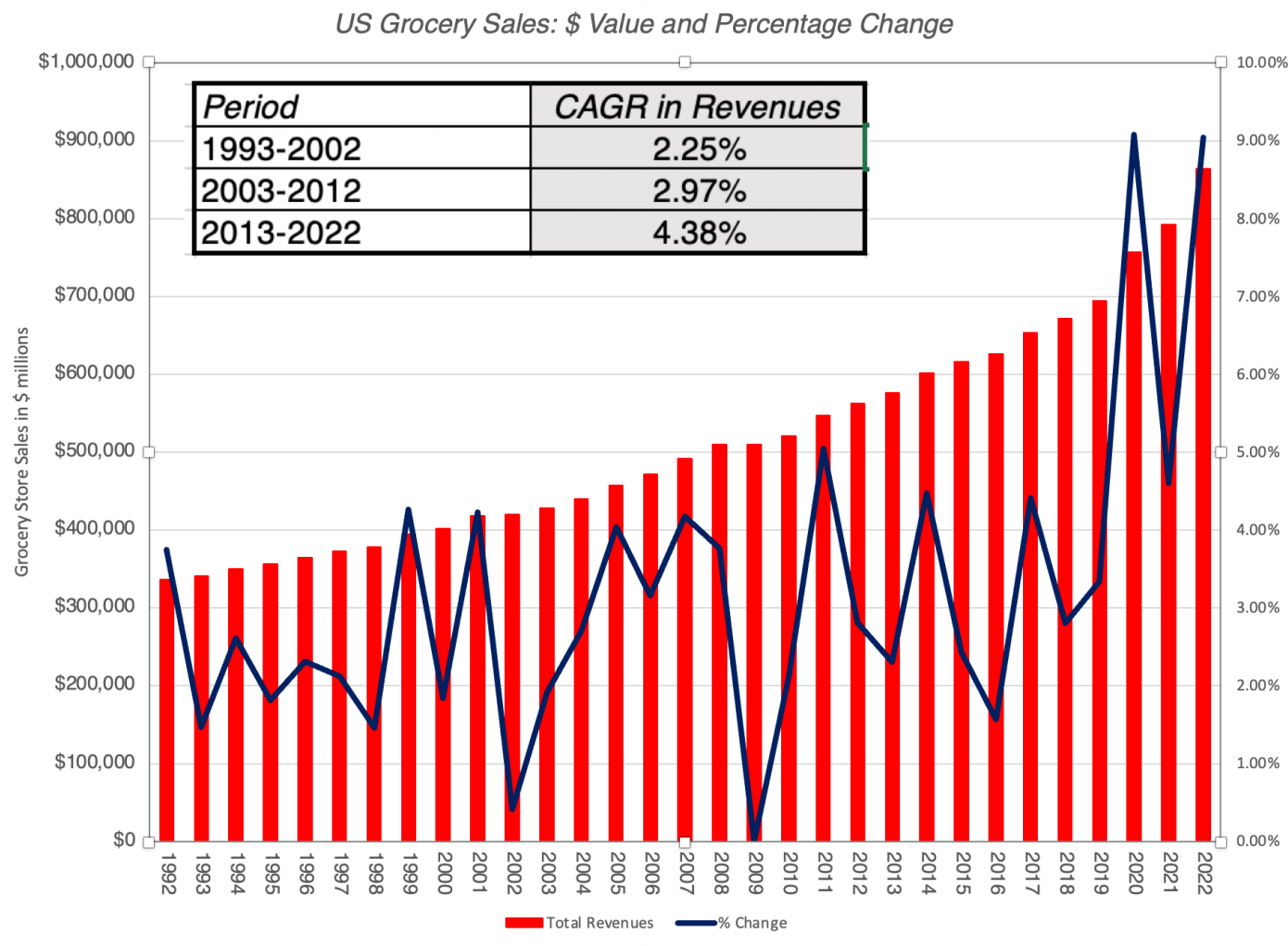
# The Instacart Business Model



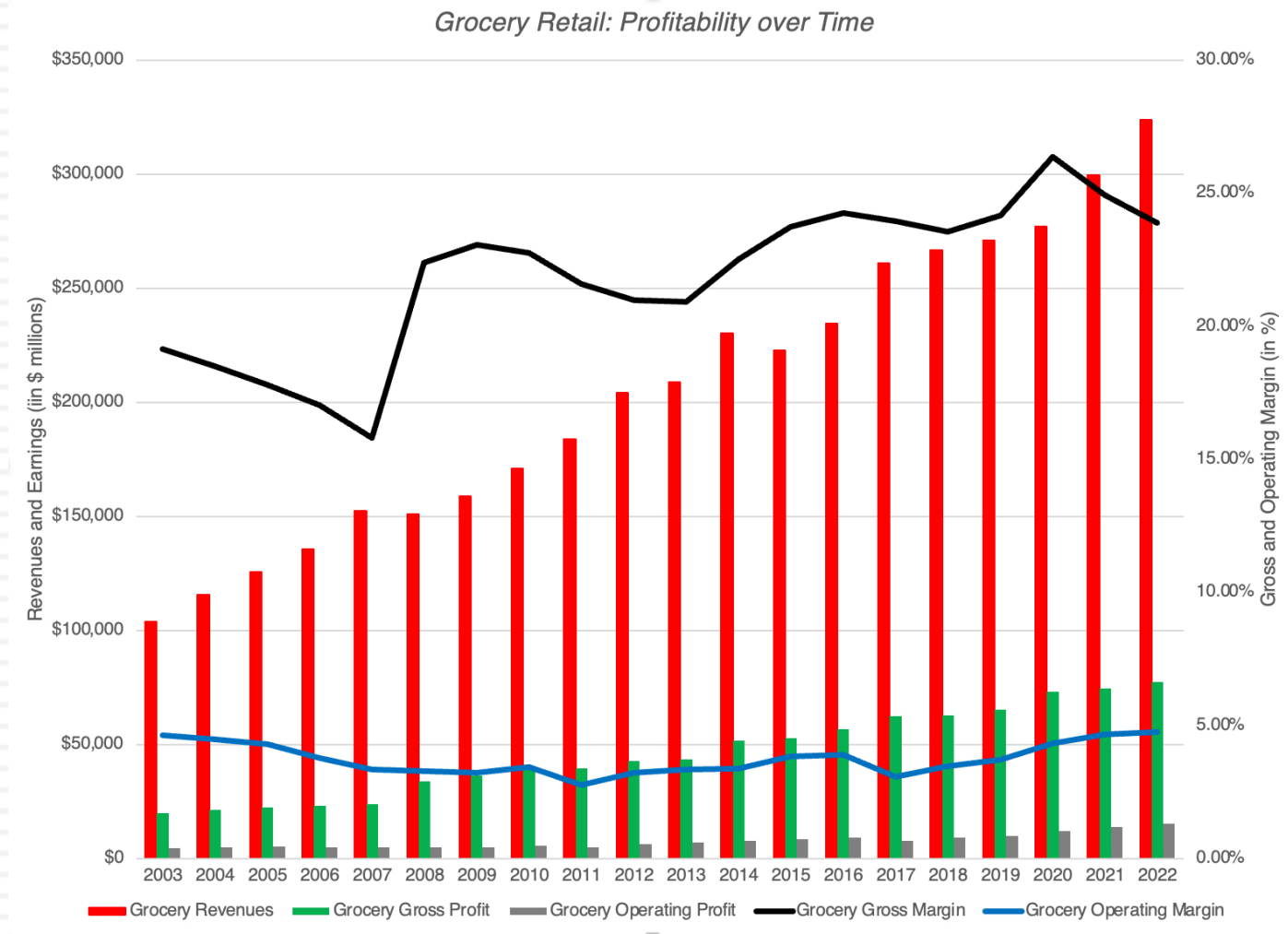
# The Business, in steps

- In the first, I will look at the grocery business, both in terms of growth and profitability of grocery stores, since even though Instacart is an intermediary in the business, it will be affected by grocery business fundamentals.
- In the second, I will examine the forces that are pushing consumers to online grocery shopping, and why I believe that the ceiling for that growth is much lower than it is than in other areas of retailing.
- In the third, I will focus on how the competition to Instacart, within the online grocery retail space, is shaping up, and the consequences for its market share.
- In the final, I will examine the operating costs faced by Instacart, especially in the content of how the fee pie will be shared by the company with its shoppers and drivers.

# 1a. The Grocery Business – Slow Growth

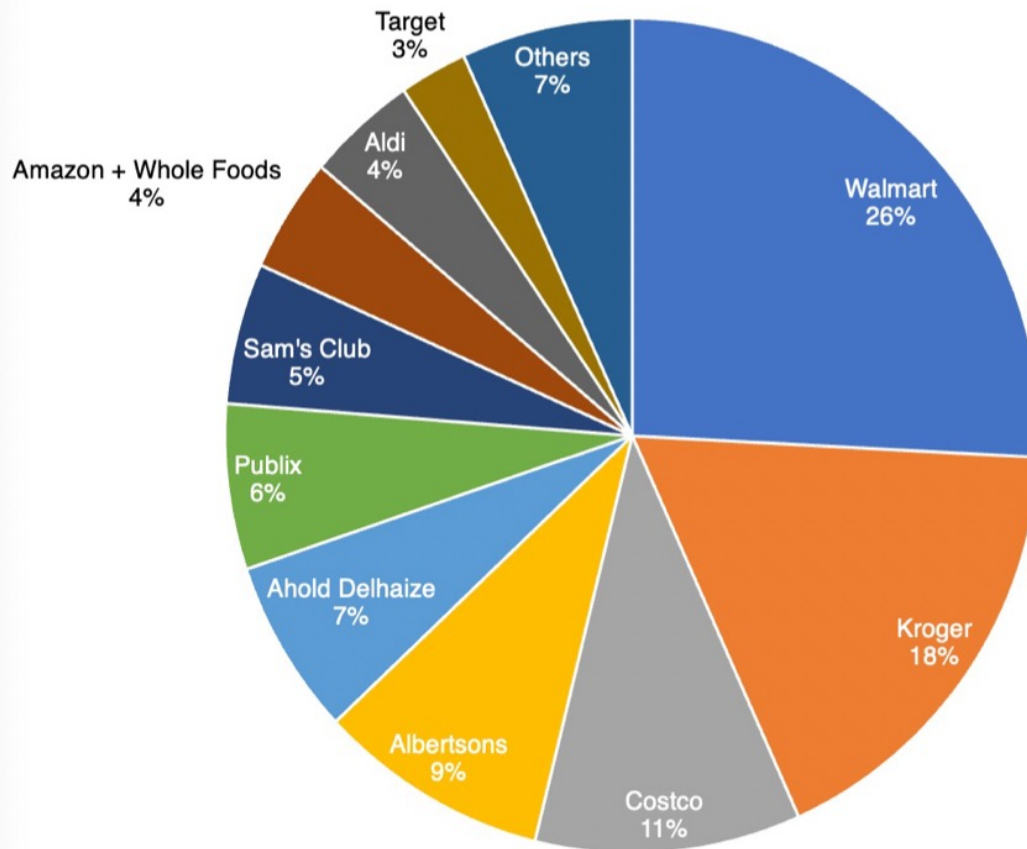


# 1b. And low profit margins...



# 1c. And concentrated market share...

*US Grocery Market Share in 2022*



**1. Increasing market share to big-name retailers:** Walmart, Target and Amazon have all increased their share of the grocery business, with Walmart (Target) getting close to 56% (21%) of its total revenues from groceries in 2022.

**2. Big-box club retailers wedged into the business:** Costco, Sam's Club and BJ's acquired significant stakes in the grocery business, with Costco and Sam's Club getting more than 60% of their revenues from groceries.

**3. Conventional grocers consolidated:** The conventional grocery store chains, faced with increased competition, consolidated with Kroger and Albertson's becoming the lead grocers.

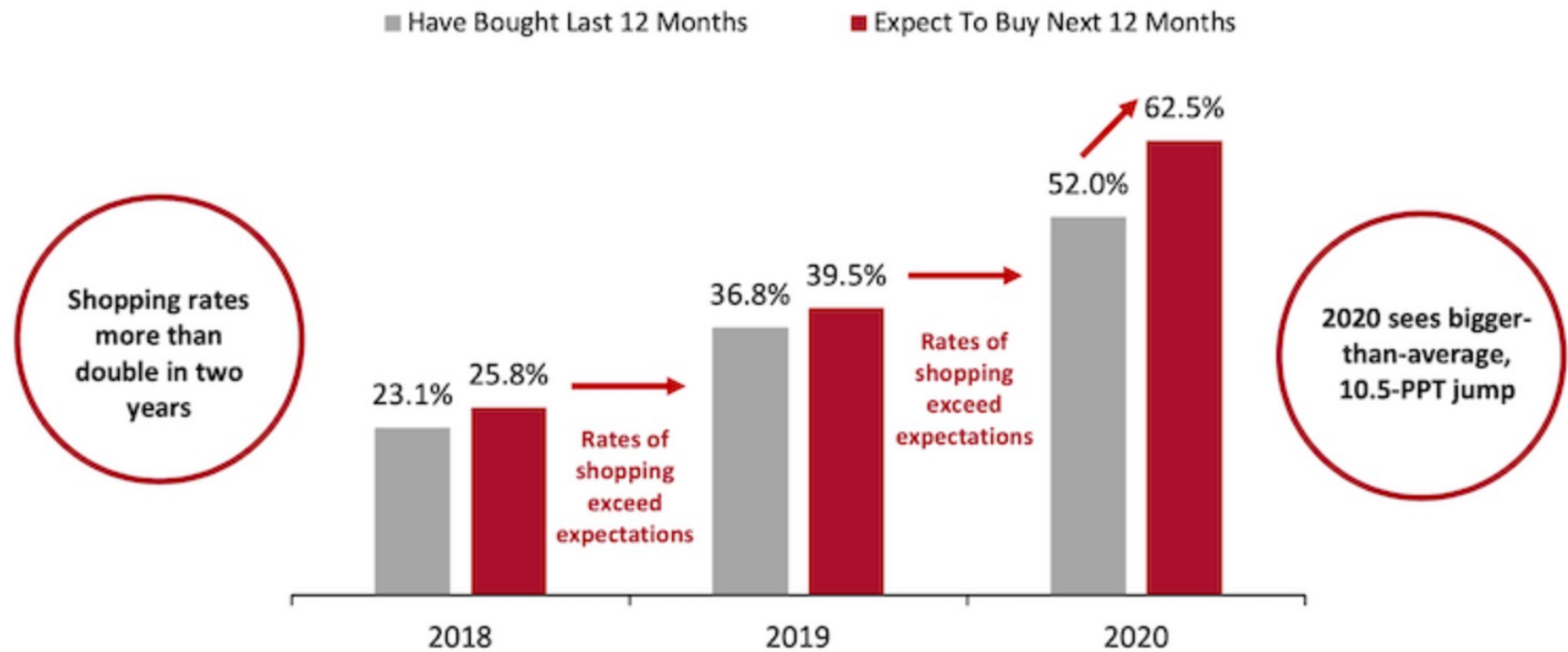


## 2. Online Grocery Shopping

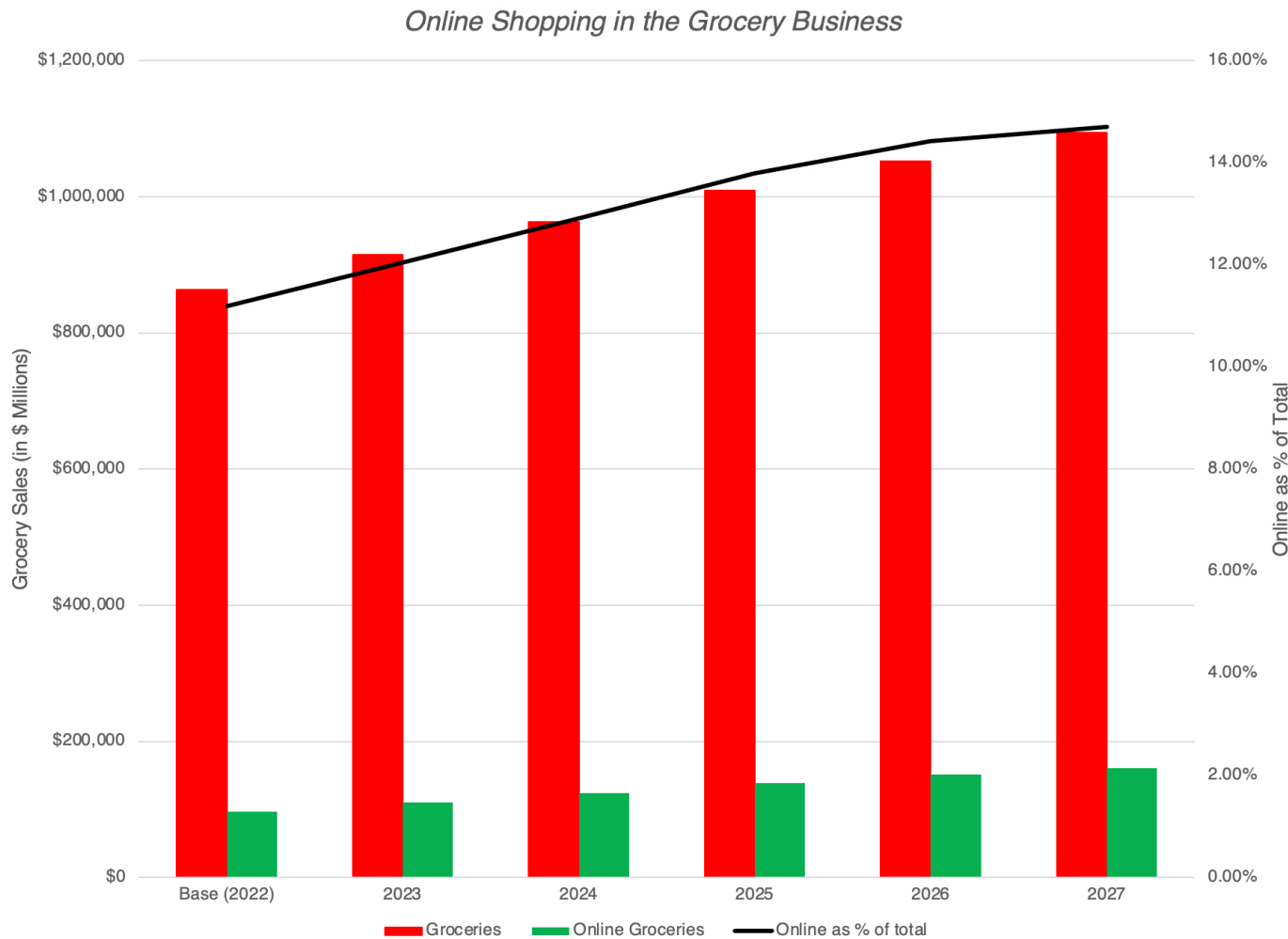
- Customers tend to favor a specific grocery store (or at most, a couple of stores) for most of their grocery needs.
  - One reason for that is familiarity with store layout, since knowing where to find the items that you are looking for can make the difference between a 10-minute trip to the store and a 30-minute trip.
  - Another is location, with customers tending to shop at neighborhood stores, for much of their needs, since groceries do not do well with long commutes back home.
- Second, for non-processed food, meats and produce, being able to see and touch items before you buy them is part of the shopping experience, with pictures of the same product operating as poor substitutes.
- For these reasons, grocery retail remained almost immune from the disruption wrought on the rest of brick-and-mortar retail, at least in the United States.



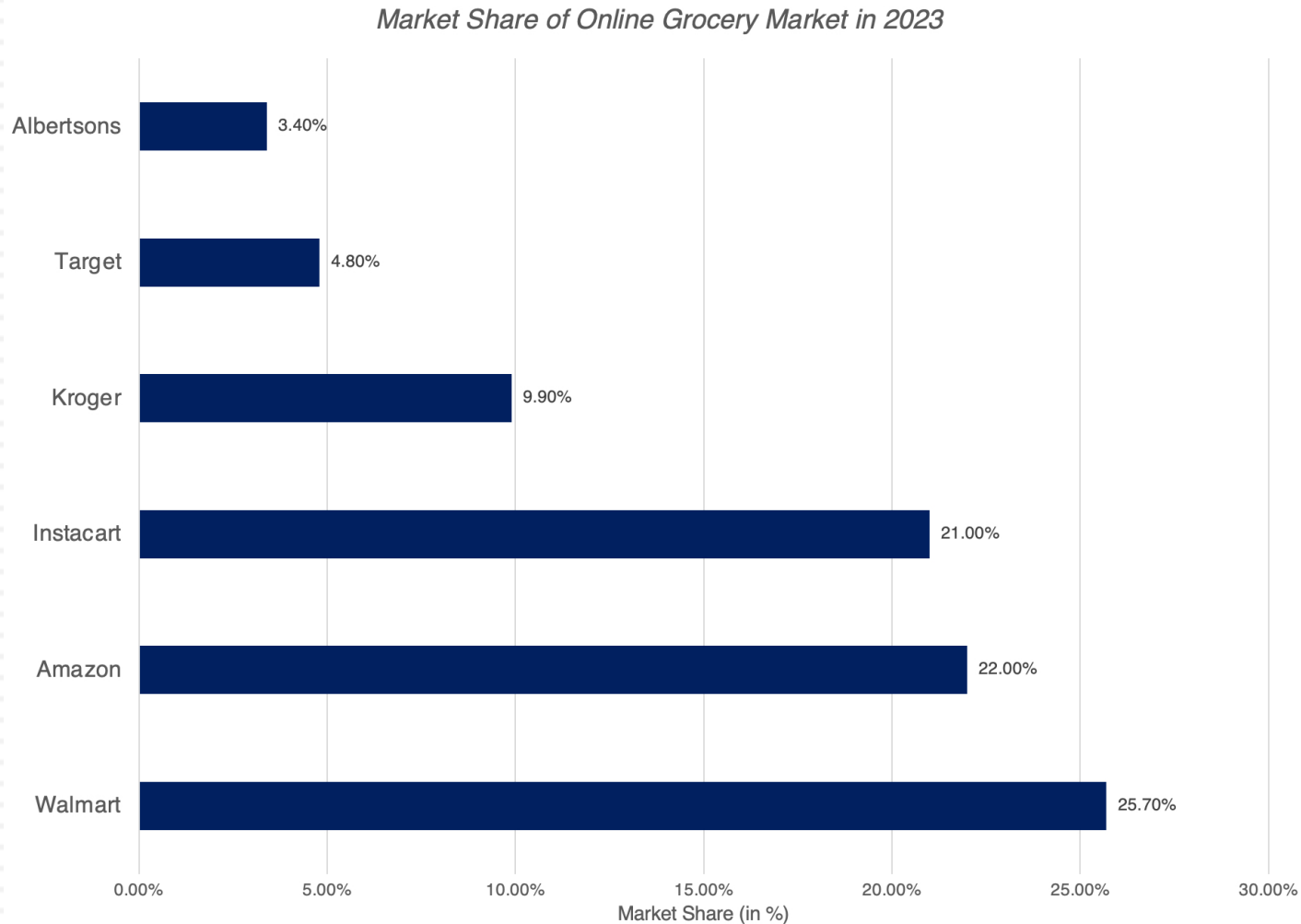
# The COVID Effect



# And the Easing of that Effect



# 3. The Competition



## 4. Operating Economics

- By far, the biggest cost that the company faces in hiring and paying thousands of shoppers and drivers to operate its system. Like ride-sharing companies, the question of how Instacart categorizes these workers, and the resulting costs, will determine what it will be able to generate as operating profits:
  1. Pay versus Commission: Instacart has traditionally paid its shoppers based upon the batches of work done (with a batch including shopping, packing and loading a customer order) and payments for deliveries made, with tips from customers accruing as additional income. In effect, that makes almost all of these expenses into variable costs, rising and falling with revenues, reducing risk to the company but also economies of scale, as it gets bigger.
  2. Independent contractor versus Employee: Instacart has argued that the shoppers and drivers who work for it are independent contractors, rather than employees. That distinction matters because an employee categorization will open up Instacart not only to additional costs (social security, health care etc.) but also to legal liability, for employee actions. In 2023, Instacart paid \$46.5 million, to settle a California lawsuit on this count.
- As a company built around a technology platform, Instacart also has significant spending on R&D, as well as on customer support services.

# The Instacart IPO: Prospectus Pet Peeves

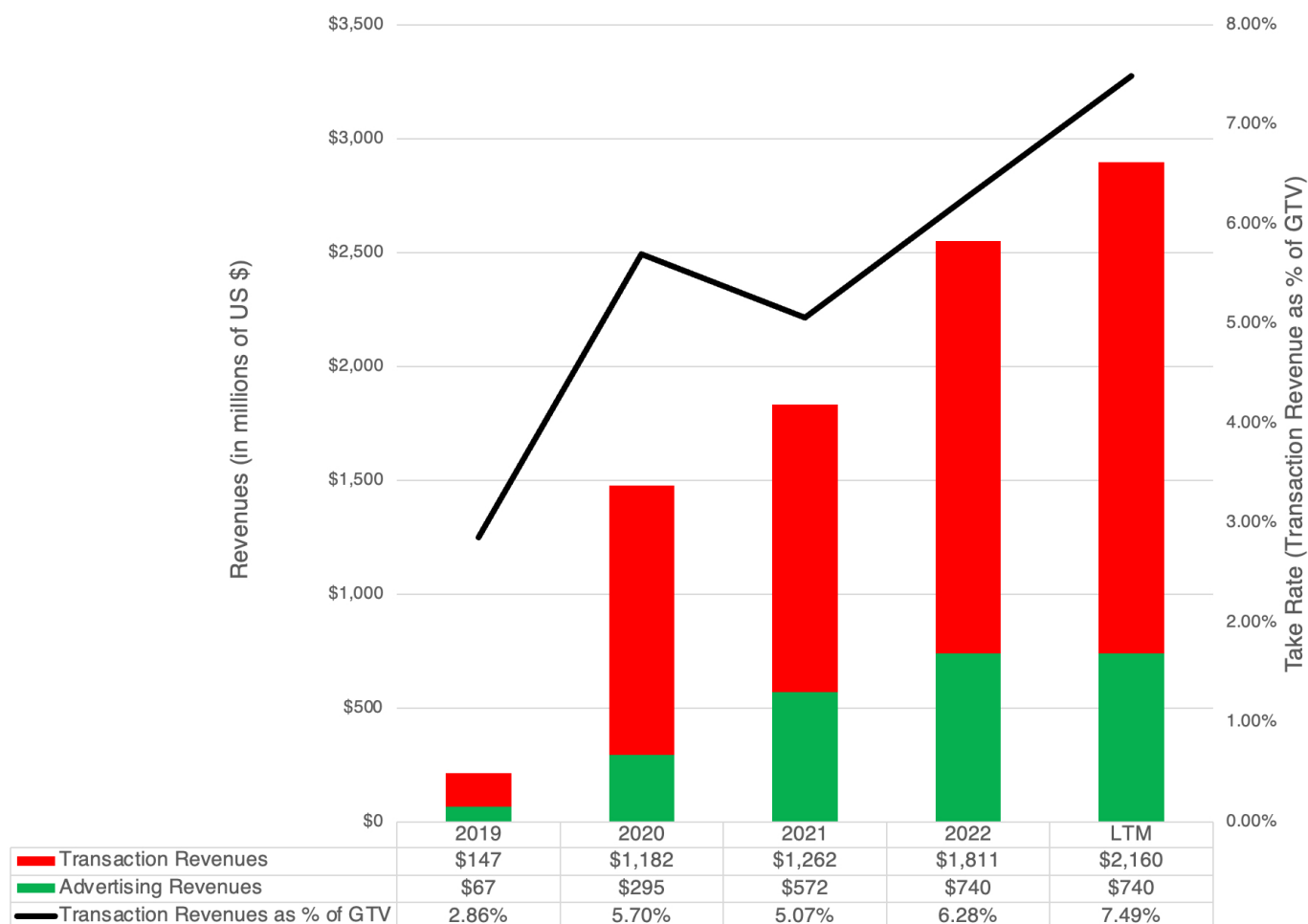
1. Disclosure Diarrhea: Prospectuses have become more and more bulky over time, with Airbnb's 2020 listing including a prospectus that was 350 pages long. With appendices, Instacart's prospectus stretches on to 416 pages.
2. "Tech" and AI: In common with many other companies that have gone public in the last decade, Instacart is quick to label itself a *technology company*, when the truth is that it is a grocery delivery company that uses technology to smooth the ride. In keeping with the times, the prospectus mentions AI multiple times, I counted *32 mentions of AI* in the prospectus, and I remain skeptical that AI will (or should) alter grocery shopping in fundamental ways.
3. Adjusted EBITDA: Needless to say, Instacart plows right ahead and not only adds back stock-based compensation but makes a host of other adjustments (see page 126 of prospectus). Since Instacart makes money without these adjustments, they only draw attention away from that good news.
4. Share count shenanigans: On page 19 of the prospectus, Instacart headlines that its share count will be 279.33 million shares, but counting excluded shares (including RSUS) together, you get an ignored share count of 43.62 million, which brings the total share count to 322.94 million shares.

# Instacart: Financial History

	<i>2019</i>	<i>2020</i>	<i>2021</i>	<i>2022</i>	<i>LTM</i>
Number of orders (in millions)	49.7	171.5	223.4	262.6	263.20
GTV (\$ million)	\$5,144	\$20,736	\$24,909	\$28,826	\$29,407
Revenues (\$ million)	\$214	\$1,477	\$1,834	\$2,551	\$2,900
COGS (\$ million)	\$232	\$598	\$608	\$720	\$729
Gross Profit (\$ million)	-\$18	\$879	\$1,226	\$1,831	\$2,171
Operating Expenses (\$ million)	-\$434	\$954	\$1,312	\$1,769	\$1,767
Operating Profits (\$ million)	-\$454	-\$75	-\$86	\$62	\$404

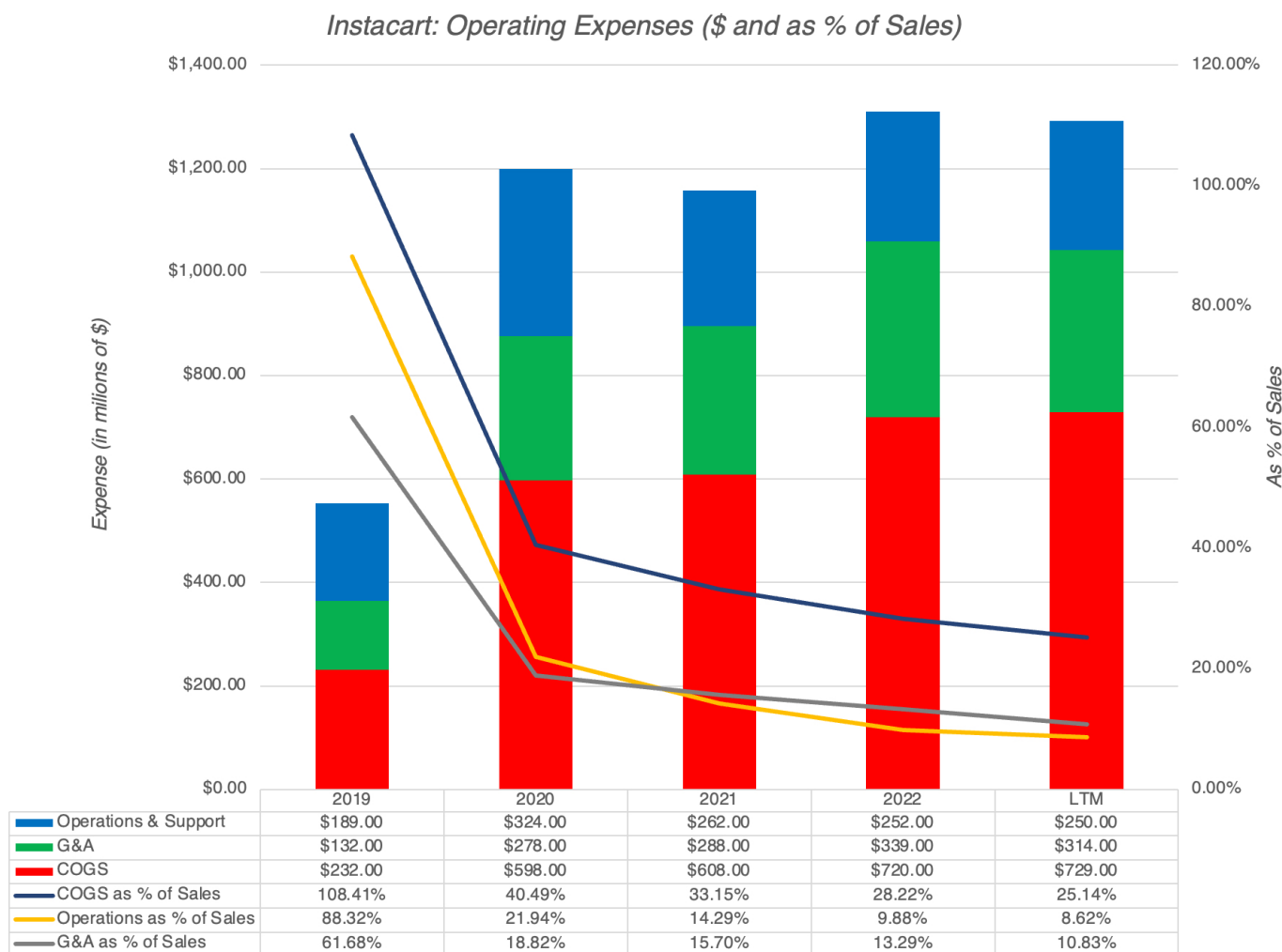
# a. Take Rate

*Instacart: Revenue Breakdown and Transaction Take Rate*

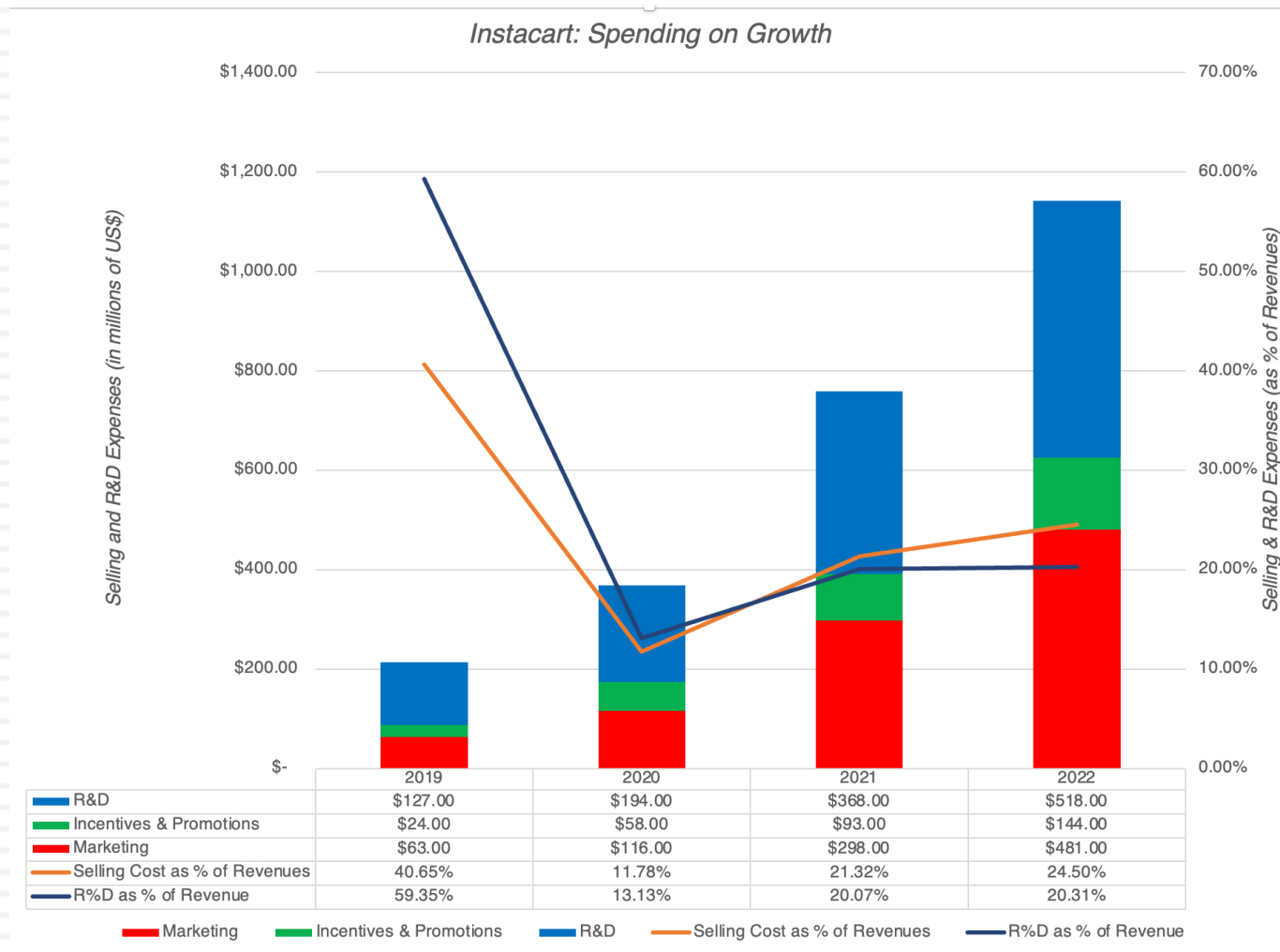




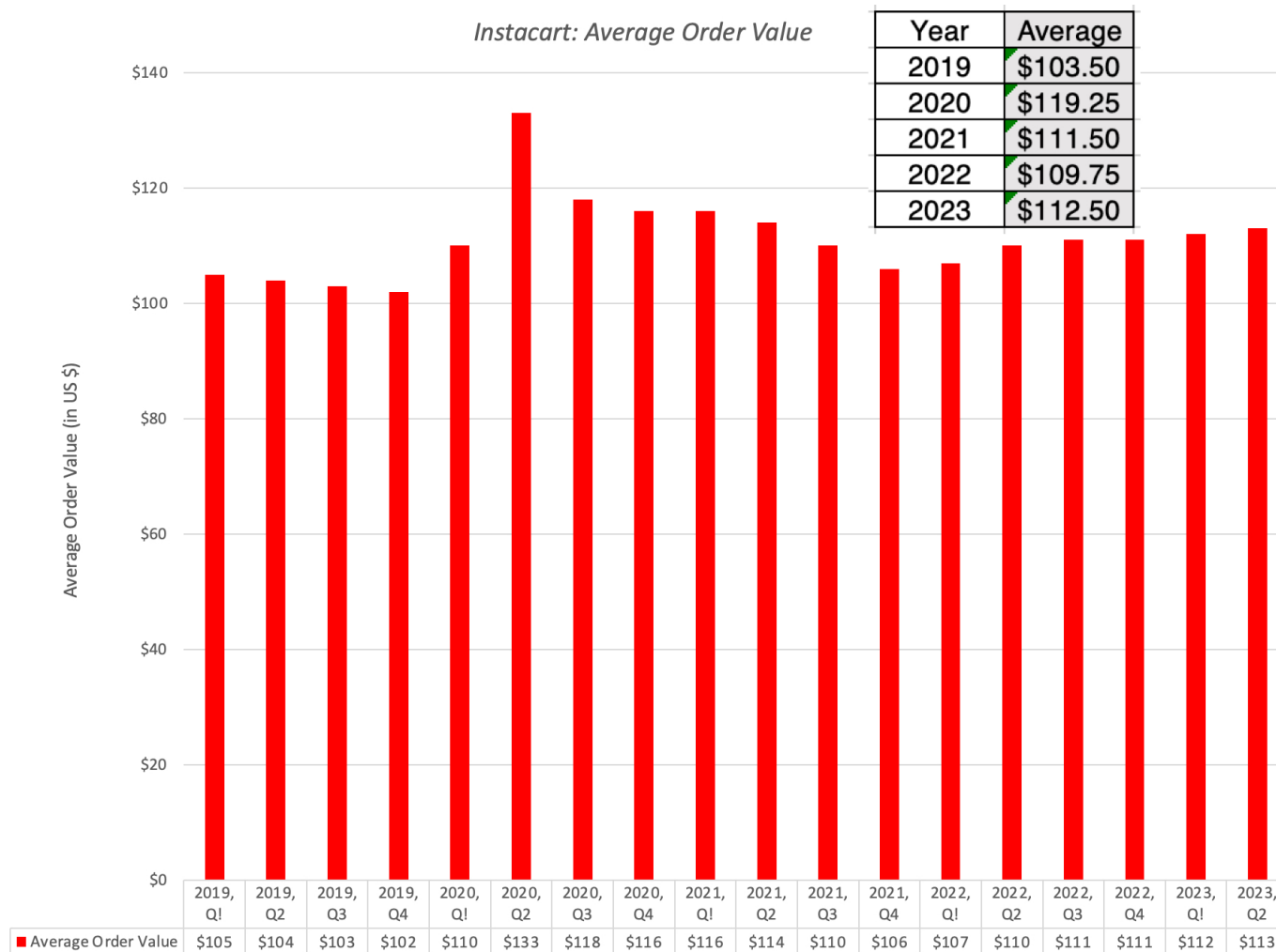
## b. Operating Expenses



## c. Customer Acquisition and Reinvestment



## d. Unit Economics – Order Size



## And by cohort...

Cohort	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>	<i>Year 5</i>	<i>Year 6</i>
<i>2017</i>	1.00	1.73	1.74	3.00	3.26	3.52
<i>2018</i>	1.00	1.49	2.42	2.67	2.81	
<i>2019</i>	1.00	2.18	2.36	2.43		
<i>2020</i>	1.00	0.95	0.85			
<i>2021</i>	1.00	1.29				
<i>2022</i>	1.00					

# My Instacart Valuation Story...

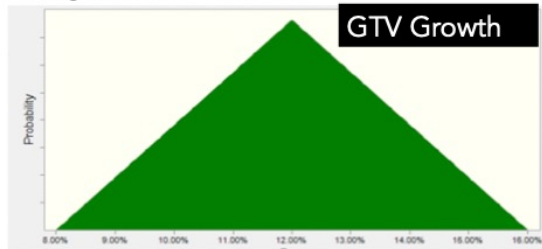
1. Growth: To estimate transaction revenues, *I will assume that gross transaction value on the platform will track growth in online grocery retailing, which seems to have settled into a compounded annual growth rate of about 12%, for the next five years. I will assume that Instacart will maintain its market share of the online grocery market, in the face of competition, but only by cutting its fees and accepting a take rate of 6%, by year 5, down from 7.5% in the trailing 12 months. Advertising revenues, though, are assumed to keep track with gross transactions on the platform.*
2. Profitability: Drawing on the company's history of delivering economies of scale on cost of goods sold and operations support, I will assume that the company will be able to improve its operating margins over time to 25%. The tensions between Instacart and its shoppers, as well as push back from grocery stores, will keep a lid on these margins and prevent further improvement, and I expect Instacart's expenses for its shoppers to increase over time, as it is forced to treat them as employees (rather than independent contractors).
3. Reinvestment: As user growth levels off, I expect the company to revert to its capital-light origins, and spend far less on acquiring customers, as well as on R&D. This allows me to assume that the company will be able to deliver \$3.13 in revenues, for every dollar invested, roughly matching the global industry average.

Instacart					Jan-04				
<b>The Story</b>									
Instacart went from start-up to star status in 2020, as COVID shuttered people, and the company was positioned for success. While that increased Instacart's profile as well as online grocery retail, the online surge has slowed, especially on the delivery front, and competition has picked up. We assume that online grocery share will grow its share of overall sales, but at a slower rate. To maintain its market shares, Instacart will have to cut its take (and margins) to compete with the big online players. Economies of sale will allow operating margins to improve over time and Instacart will have to invest in technology and acquisitions to deliver on growth.									
<b>The Assumptions</b>									
	<i>Base Year</i>	<i>Years 1-5</i>	<i>Years 6-10</i>	<i>After year 10</i>	<i>Link to story</i>				
GTV and Growth	\$28,826	12.00%	decreases to	4.00%	Instacart will grow with online grocery				
Take Rate (Revenues as % of GTV)	7.49%	Moves to		6.00%	Reduced take rate, in response to				
Operating margin (b)	13.93%	Improves to		25.00%	As company scales up, operating margins				
Tax rate	0.00%	15.86%	Moves to	25.00%	Global/US marginal tax rate, after NOLs				
Reinvestment (c )		3.13	Reinv Rate =	44.44%	Low capital intensity business, with				
Return on capital	-31.40%	Moves to		9.00%	Competitive advantages in near term, but				
Cost of capital (d)		11.00%	Moves to	9.00%	Cost of capital decreases as company bec				
<b>The Cash Flows</b>									
	<i>GTV</i>	<i>Take Rate</i>	<i>Transaction Revenues</i>	<i>Ad Revenue</i>	<i>Total Revenue</i>	<i>Operating Margin</i>	<i>EBIT (1-t)</i>	<i>Reinvestment</i>	<i>FCFF</i>
1	\$32,285.12	7.34%	\$2,371	\$829	\$3,200	15.04%	\$404.89	\$67.41	\$337.48
2	\$36,159.33	7.19%	\$2,602	\$928	\$3,530	16.14%	\$427.41	\$73.65	\$353.76
3	\$40,498.45	7.05%	\$2,853	\$1,040	\$3,893	17.25%	\$503.69	\$80.42	\$423.27
4	\$45,358.27	6.90%	\$3,128	\$1,164	\$4,292	18.36%	\$591.00	\$87.75	\$503.25
5	\$50,801.26	6.75%	\$3,427	\$1,304	\$4,731	19.47%	\$690.76	\$95.68	\$595.08
6	\$56,084.59	6.60%	\$3,700	\$1,440	\$5,140	20.57%	\$793.04	\$87.12	\$705.92
7	\$61,020.04	6.45%	\$3,935	\$1,566	\$5,501	21.68%	\$894.44	\$74.92	\$819.52
8	\$65,413.48	6.30%	\$4,120	\$1,679	\$5,799	22.79%	\$991.10	\$59.30	\$931.80
9	\$69,076.63	6.15%	\$4,248	\$1,773	\$6,021	23.89%	\$1,078.96	\$40.76	\$1,038.20
10	\$71,839.70	6.00%	\$4,310	\$1,844	\$6,155	25.00%	\$1,153.99	\$20.01	\$1,133.98
Terminal year	\$74,713.29	6.00%	\$4,483	\$1,918	\$6,401	25.00%	\$1,200.15	\$533.40	\$666.75
<b>The Value</b>									
Terminal value	\$	13,335							
PV(Terminal value)	\$	4,959							
PV (CF over next 10 years)	\$	3,619							
Value of operating assets =	\$	8,578							
- Adjustment for distress	\$	214			Probability of failure =			5.00%	
- Debt & Minority Interests	\$	682							
+ IPO Proceeds	\$	616			Based upon early news stories. May change as final offering details are set.				
+ Cash & Other Non-operating assets	\$	1,838							
<b>Value of equity</b>	<b>\$</b>	<b>10,135</b>							
- Value of equity options	\$	652							
Value of equity in common stock	\$	9,483							
Number of shares		322.94			Includes shares outstanding after IPO as well as RSUs.				
Value per share	<b>\$</b>	<b>29.37</b>			Offer price \$30				

Aswath Damodaran

### GTV Growth

Triangular: Peak = 12%, Min = 6%; Max = 18%



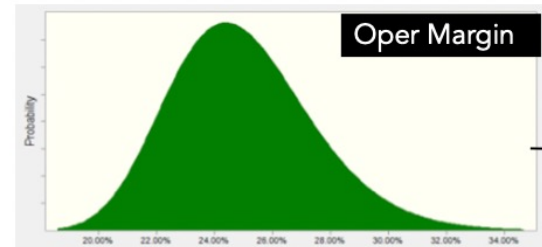
### Take Rate

Uniform: Min = 4.5% Max = 7.5%



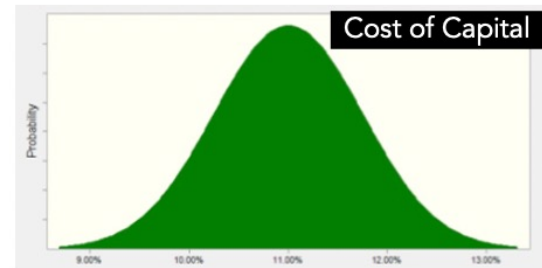
### Operating Margin

Log Normal: Mean = 25%, Std Dev = 3%



### Cost of Capital

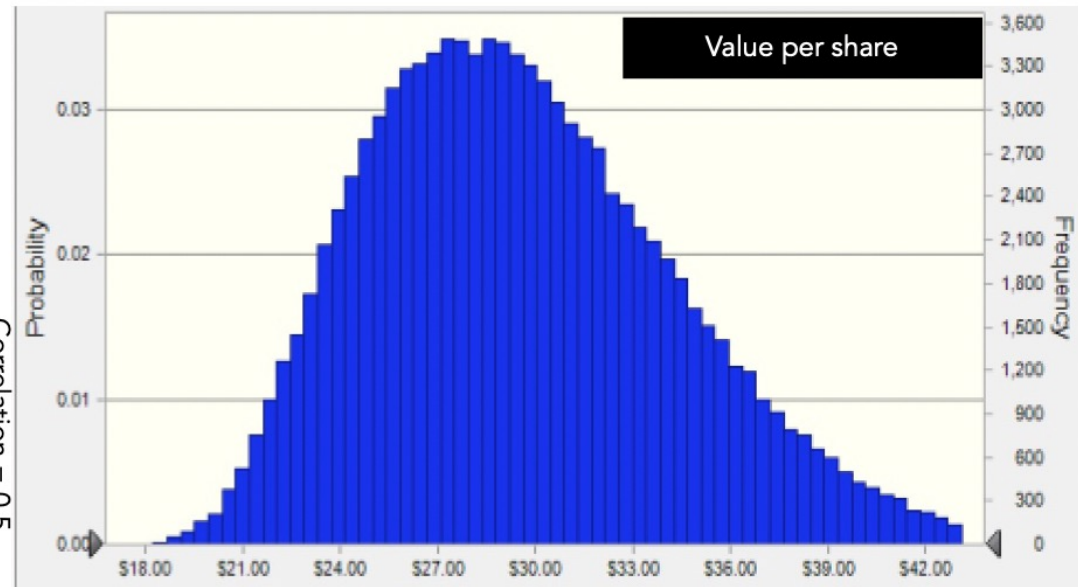
Normal: Mean = 11% Std dev = 0.75%



Correlation = 0.25  
Correlation = 0.5

### Instacart Value/Share in September 2023

Across 100,000 Simulations



Percentile	Value per share
0.00%	\$17.42
10.00%	\$23.80
20.00%	\$25.38
30.00%	\$26.68
40.00%	\$27.91
50.00%	\$29.13
60.00%	\$30.40
70.00%	\$31.84
80.00%	\$33.63
90.00%	\$36.16
100.00%	\$56.97



# The Offering: A Pricing Game

- IPOs are priced, not valued, notwithstanding the lip service that everyone involved in the process, including VCs, founders and bankers, pays to valuation.
- The difference between valuing and pricing is that while the former requires that you grapple with business questions on growth, profitability and reinvestment, the latter is based on how much investors are paying for peer group companies, a subjective judgment, but one made nevertheless. In keeping with this theme, I compared the proposed pricing for Instacart against the pricing of its peer group.

<i>Company</i>	<i>Market Cap</i>	<i>EV</i>	<i>GTV</i>	<i>Revenues</i>	<i>EBIT</i>	<i>EV/GTV</i>	<i>EV/Sales</i>	<i>EV/EBIT</i>
Airbnb	\$ 93,280	\$86,101	\$63,200	\$ 9,088	\$1,956	1.36	9.47	44.02
Doordash	\$ 32,640	\$29,359	\$65,200	\$ 7,687	\$ (969)	0.45	3.82	NA
Instacart	\$ 9,300	\$ 7,886	\$28,626	\$ 2,900	\$ 404	0.28	2.72	19.52

# An Offering Preview

- A Risk Averse Offering: The fact that Instacart is going public is perhaps a sign that the market is thawing, but this IPO has been swaddled in safety blankets to prevent a market backlash. In addition to pricing the company conservatively (as you can see from the value estimate in the last section), Instacart lined up high-profile cornerstone investors including Norges Bank, TCV, Sequoia, D1 and Valiant to buy up to 60% of the offering, providing a floor on the price.
- Mood and Momentum: The ARM IPO offering on September 14, which saw the company's stock price, which was offered at \$51, open for trading at \$56.10 and closed the day at \$63.59.
  - If that mood spills over into this week, I expect Instacart's IPO to pop on its opening day as well, and it is no surprise that the offer price was reset to \$30 in the aftermath.
  - There is of course the possibility that Instacart gets a chilly reception for its offering, either because the market mood has already turned (ARM is back down to \$56 per share) or because Instacart does not have the AI hook that might have induced investors to jump on its bandwagon.

# The VC Game

VC Round	Date	Equity Pricing	Investor	Compounded Annual Return		
				% Return on IPO Price	S&P 500	Vs S&P 500
Seed 2012	2012	\$75	Khosla, Canaan, Y Combinator	55.02%	13.04%	41.98%
Series A	2013	\$75	Sequoia	61.96%	11.28%	50.68%
Series B	2014	\$930	Andreessen Horowitz	29.16%	11.04%	18.12%
Series C	2015	\$4,153	Kleiner Perkins, Valiant	10.60%	12.31%	-1.71%
Series D	2017	\$5,778	Sequoia, Y Combinator	8.26%	12.39%	-4.13%
Series E	2018	\$6,274	Coatue, Glade Brook	8.19%	10.92%	-2.73%
Series F	2018	\$9,279	D1, Tiger Global	0.05%	14.22%	-14.18%
Tender Offer	2020	\$14,445	D1	-13.65%	10.33%	-23.98%
Series G	2020	\$15,004	DST Global, General Catalyst	-14.74%	7.88%	-22.62%
Series H	2020	\$18,720	Valiant Peregrine, D1	-20.80%	-1.14%	-19.66%
Series I	2021	\$39,000	Fidelity, T.Rowe Price, Sequoia	-51.17%	19.20%	-70.37%
IPO offer		<b>\$9,300.00</b>				

# Bottom Line: There is no smart money

- The notion that there is smart money, i.e., that there is an investor group that is somehow wiser, more informed and less likely to act emotionally than the rest of us, and that it earns higher returns than the rest of us, is deeply held.
- In my view, it is a mirage, since every group that is anointed as smart money ultimately ends up looking average (in terms of behavior and returns), when all is said and done.
- It happened to mutual fund managers decades ago, and it has happened to hedge funds and private equity over the last two decades.
- For those who are holding on to the belief that venture capitalists are the last bastion of smart money, it is time to let go. While there are a few exceptions, venture capitalists for the most part are traders on steroids, riding the momentum train, and being ridden over by it, when it turns.