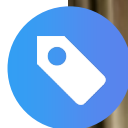


HEDGEYE

# PTON - Short

Overvalued With Competition  
Accelerating

March 17, 2020



Hedgeye Retail

Brian McGough

Jeremy McLean

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Please submit questions\* to  
**qa@hedgeye.com**

\*Answered at the end of the call

- 1 There is a viable business in connected cycling, but TAM is too small**

Peloton owns a defensible core concept in connected cycling, but the TAM is too small to justify the valuation especially with competition ramping at all different price points to take their fair share. That limited TAM has driven PTON to move investments away from the core where the competitive moat is much weaker or nonexistent. Margins and returns in these other business will be very low to the point it means PTON may never earn money while it invests to grow outside the core. The TAM growth was fueled by the early private investment rounds looking to garner a big valuation on the IPO. For the most part the market has seen through it, but there is still a lot of downside in the stock when it becomes a clear reality.
- 2 Digital Only is not the opportunity people think it is**

Streaming fitness content is a commodity. There is essentially no differentiation in the various product offerings. That means comparable content can be found on YouTube for free or as part of Prime video. This is why Peloton saw significantly stagnated growth in digital only subs leading them to cut the price by 33%, offer a 30day free trial, and plug money into a new marketing campaign in December. Due to the trial the 2Q(Dec) number was irrelevant, but with the help of the price cut and Covid home exercise interest, growth needs to go parabolic in 3Q, or the digital only bull case is nil. You have to believe in tens of millions of subscribers and hope pricing wont crash to want to get long PTON on the digital only opportunity. Watch out if Amazon gets serious, or Netflix gets going, on digital streaming content.
- 3 Numbers were bound to slow, in a recession they could plummet**

We expected 2Q and 3Q of this year to be the best selling periods the company every had by far, and we think the best it ever will have in terms of new equipment and new connected fitness subscribers. 3Q will likely be the peak of adoption (added subs). Ending subscriber growth has slowed for 6 straight quarters, and guidance signaled a slowdown again in 3Q20. We think by 4Q, growth rates will underperform and the fact we are most likely heading into a recession means that slowdown will be amplified further. On our revised TAM and share estimates the core cycling business could be worth about \$3bn over the long term if the company executes. However with the company losing money, seeing slowing revenue metrics, and burning cash, we think there is much more downside in this environment. Punchline PTON is worth \$6 to \$12 per share.

# Retail Position Monitor

BEST IDEAS - LONG			Trend	Tail	BEST IDEAS - SHORT			Trend	Tail
Active Longs			Mkt. Cap (\$MM)		Active Shorts			Mkt. Cap (\$MM)	
DLTR	Dollar Tree	\$15,861	✓	✓	HBI	Hanesbrands	\$3,037	x	x
GIL	Gildan	\$2,916	✓	✓	KSS	Kohls	\$3,086	x	x
NKE	Nike	\$104,016	✓	✓	PTON	Peloton Interactive	\$6,245	-	x
DOL-CA	Dollarama	\$8,258	✓	✓	FL	Foot Locker	\$2,474	x	x
RH	RH	\$1,786	✓	✓	OXM	Oxford Industries	\$664	x	x
LONG BIAS					SHORT BIAS				
CPRI	Capri	\$1,443			RL	Ralph Lauren	\$5,281		
BURL	Burlington Stores	\$8,730			WSM	Williams-Sonoma	\$2,756		
FIVE	Five Below	\$3,183			BBY	Best Buy	\$14,828		
ADS-DE	Adidas	\$38,352			DKS	Dick's Sporting Goods	\$1,862		
PUM-DE	Puma	\$8,295			BBBY	Bed Bath and Beyond	\$773		
TPR	Tapestry	\$3,169			VFC	VF Corp	\$21,994		
AMZN	Amazon.com	\$840,876			JWN	Nordstrom	\$2,675		
UAA	Under Armour	\$4,157			CRI	Carter's	\$2,817		
ELY	Callaway	\$769			SHOO	Steve Madden	\$1,838		
LOW	Lowe's	\$55,638			SIG	Signet Jewelers	\$553		
GES	Guess?	\$491			GOOS	Canada Goose	\$1,631		
VVV	Valvoline	\$2,640			RVLV	Revolve	\$608		
ORLY	O'Reilly Automotive	\$22,443			GPS	Gap Inc	\$3,113		
LB	L Brands	\$3,221			TGT	Target	\$46,985		
OLLI	Ollie's Bargain Outlet	\$2,459			GOLF	Acushnet	\$1,726		
DECK	Decker's Outdoor	\$3,116			KTB	Kontoor Brands	\$1,509		
RECENTLY REMOVED: Thesis and/or Price Changed					RECENTLY REMOVED: Thesis and/or Price Changed				
REAL	RealReal	\$560			W	Wayfair	\$2,867		
CHWY	Chewy	\$9,674			KTB	Kontoor Brands	\$1,509		
BME-GB	B&M European Value Retail	\$3,324			TJX	TJX	\$49,780		
SFIX	StitchFix	\$1,254			PVH	PVH Corp	\$2,973		
					M	Macy's	\$2,073		
					COLM	Columbia Sportswear	\$4,039		

Hedgeye's "bench" represents Hedgeye's outlook on companies currently under Hedgeye's review, or for which timing is not right for greater coverage. Hedgeye may or may not provide further commentary on any or all companies represented on the bench and representation of a company on the bench does not forecast whether Hedgeye will or will not issue any additional material on that company

# Financial Summary

## Peloton Interactive (PTON)

		3Q20	FY2020	FY2021	FY2022	FY2023	FY2024
Connected Fitness Subscribers	Hedgeye	868	926	1238	1509	1734	1927
	Consensus	848	929	1468	2166	3043	4078
Revenue	Hedgeye	\$549	\$1,577	\$1,812	\$1,964	\$2,064	\$2,003
	Consensus	\$479	\$1,544	\$2,260	\$3,215	\$4,199	\$5,256
EBIT Margin	Hedgeye	-10.1%	-15.1%	-17.6%	-17.6%	-16.5%	-15.6%
	Consensus	-12.2%	-15.6%	-13.0%	-9.2%	-5.0%	-0.6%
EPS	Hedgeye	-\$0.19	-\$0.81	-\$1.10	-\$1.18	-\$1.15	-\$1.02
	Consensus	-\$0.19	-\$1.01	-\$1.04	-\$1.05	-\$0.73	-\$0.20

# What is it?

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# It Is NOT An Everything Company

But it thinks it is everything under the sun.





# The Core Concept is Solid, The Rest is a Money Pit

Bringing the experience of a studio cycling class to the home at a reasonable price was a great idea.

This is a home streaming cycling service company, selling the associated hardware...



Bike = Engaging, Good Value, Competitive Moat



Others = Less Engaging, Lower Value, Weak Moat

By most accounts the heavy users are big fans of the bike and the classes. It's relatively inexpensive for active users, convenient, engaging, and brings all the benefits of exercise.

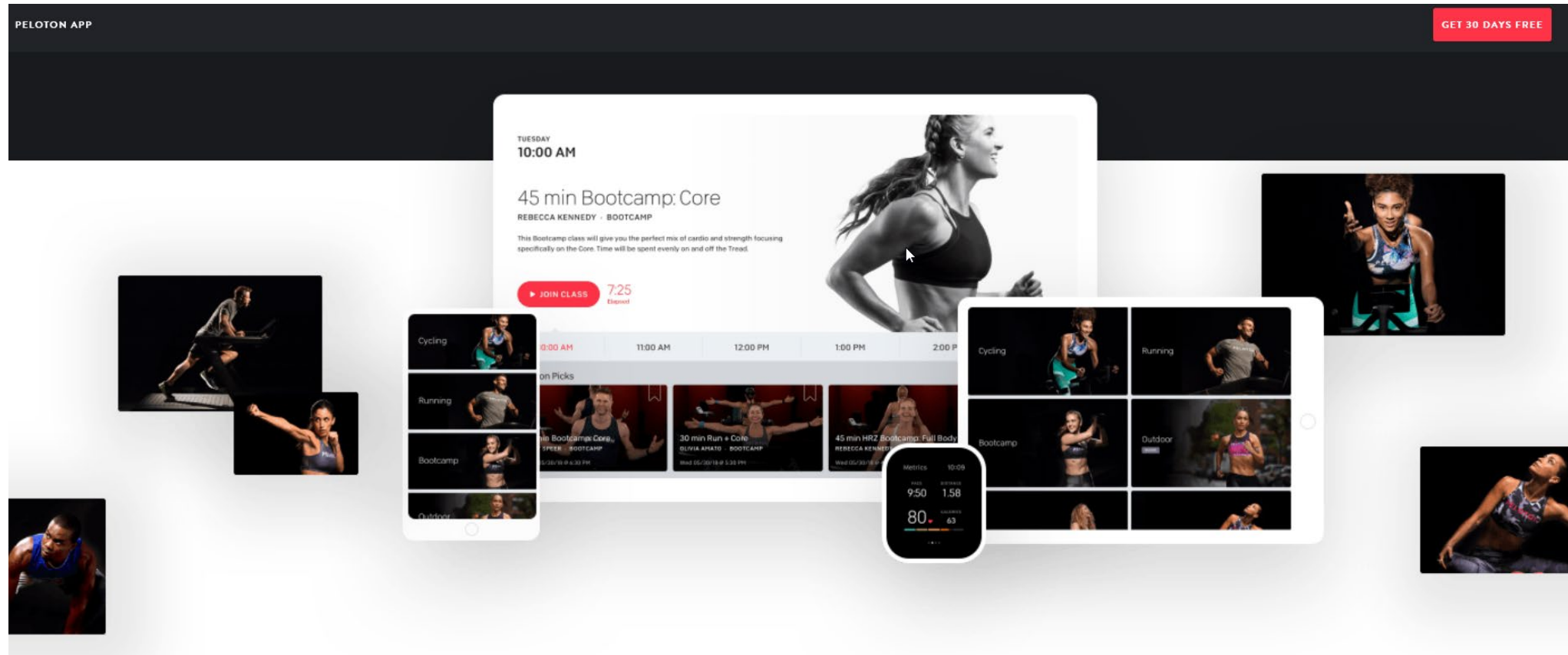
For frequent users the utility of a class for \$39 a month at their convenience is a fantastic proposition. Classes cost on average \$15-25 across the country. In NYC the costs are roughly \$35 per session so it offers even more utility.

# Digital Only - The Uber Bull Case?

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# We Think Bulls See the Opportunity as Being Digital Only



Most investors seem to understand that there is unlikely to be ~10mm households that will join connected fitness buying a piece of equipment. The pricing is too big a hurdle.

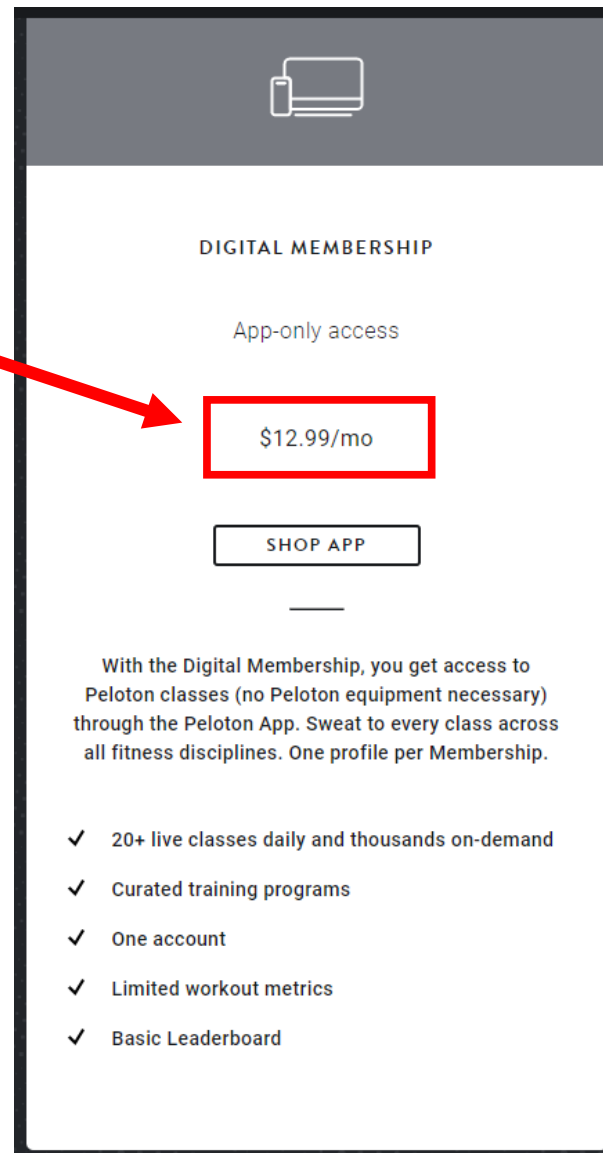
Yet there seems to be a perception that Peloton digital only could be the next Netflix.



# But We're Already Seeing Problems With Digital Only - Price Cut

Know a friend who would love Peloton Digital? Let them know this all-new experience is available for \$12.99 a month through June 30 only. After that, our monthly subscription rate will increase to **\$19.49** (for new Members only).

Digital only subscription was 'launched' in June 2018 at \$19.49/month. It has already been reduced to \$12.99 in December 2019. In Digital only you are competing against every streaming content company in existence including many free or ad supported models (like Youtube). The differentiation here is nil, switching is easy, and therefore **there are no profits to be made.**



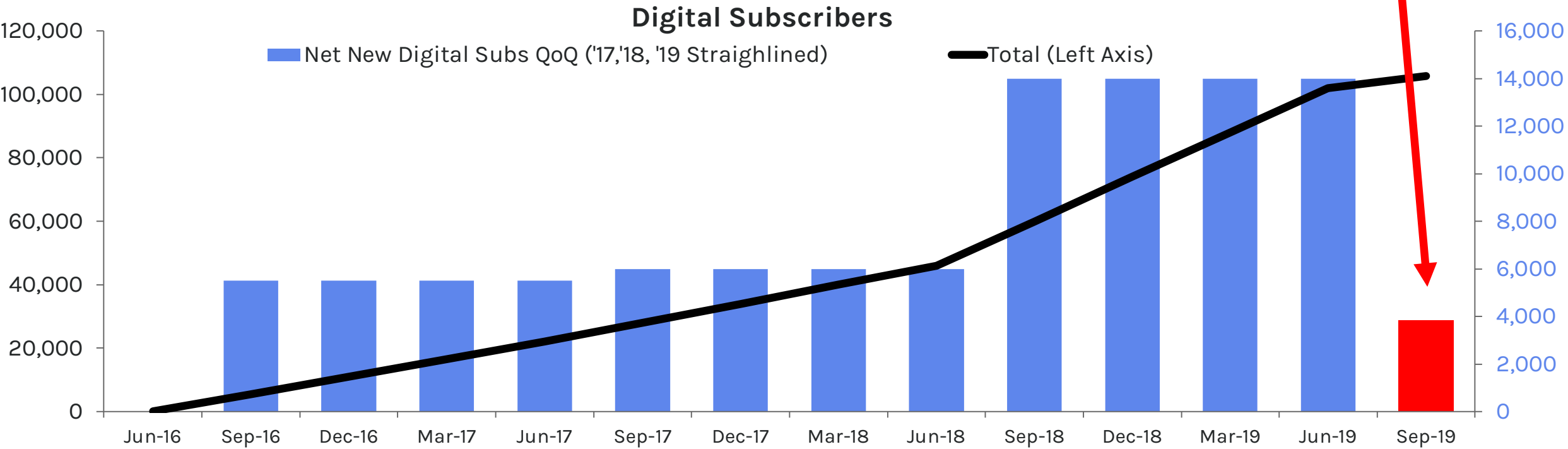
If this was such a compelling market opportunity and value proposition, this would not be necessary.

Digital only would make PTON purely a content company, which means value/differentiation would be quality of content. That would mean higher costs on instructors, studio, production. Costs that are too high to incur when competitors and copycats can easily replicate the digital only streaming offers.

An exercise content platform (think exercise specific YouTube) would make PTON irrelevant in this channel.

# No Growth - This is Why the Digital Price Was Slashed

Peloton Blog implies “launch” in June 2018 (or that’s when it was promoted), lets look at sub growth rate...



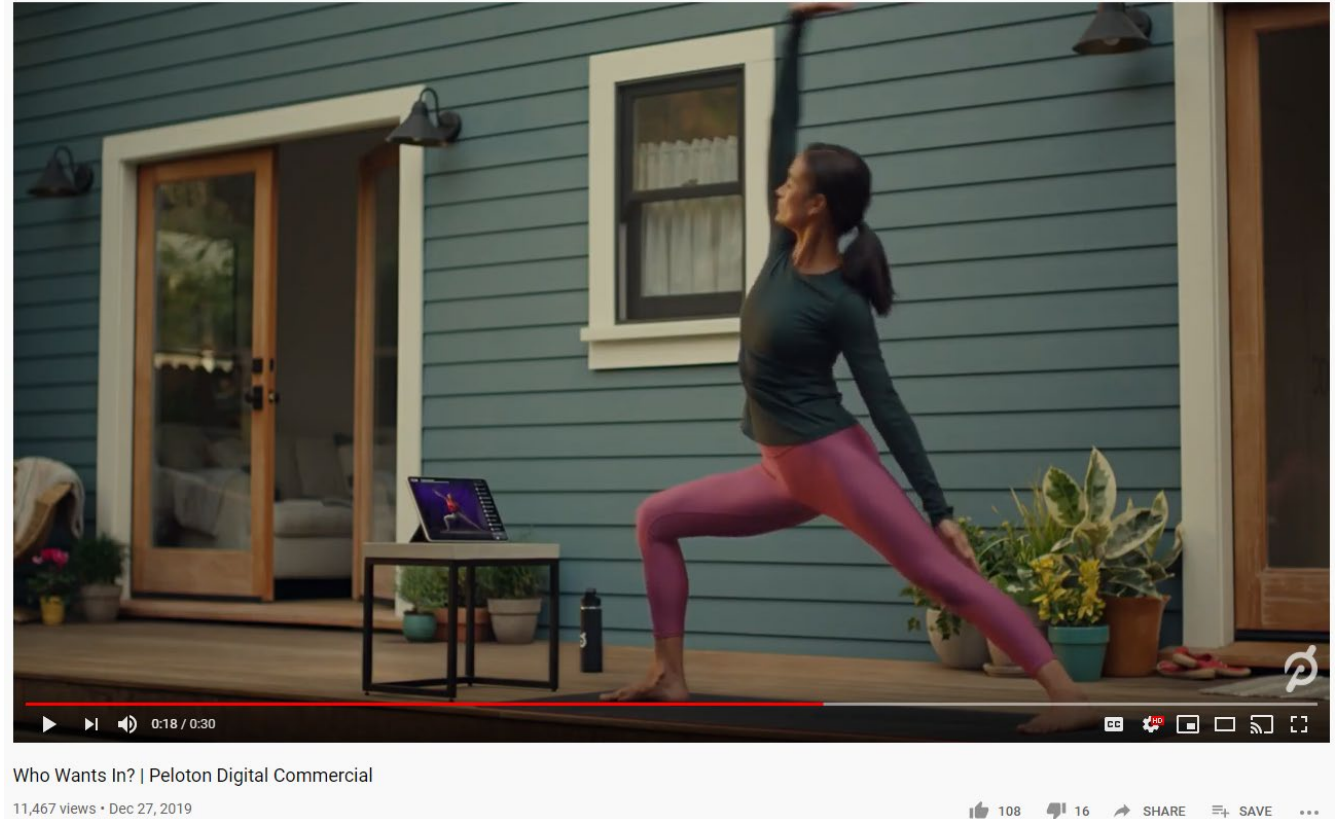
Text of PTON Shareholder letter: **We ended the quarter with 105,856 Digital Subscribers**

As of June 30, 2019, we had approximately 102,000 Peloton Digital Subscribers... This compared to approximately 46,000 and 22,000 Peloton Digital Subscribers as of June 30, 2018 and June 30, 2017, respectively. - PTON S-1

We suspect the original pricing was set for breakeven, we doubt the company makes money per sub on digital. Which is why PTON doesn't disclose a Digital Only Customer Acquisition Cost. It's fake TAM, no material profits to be made.

# The New Marketing Campaign and Free Trial

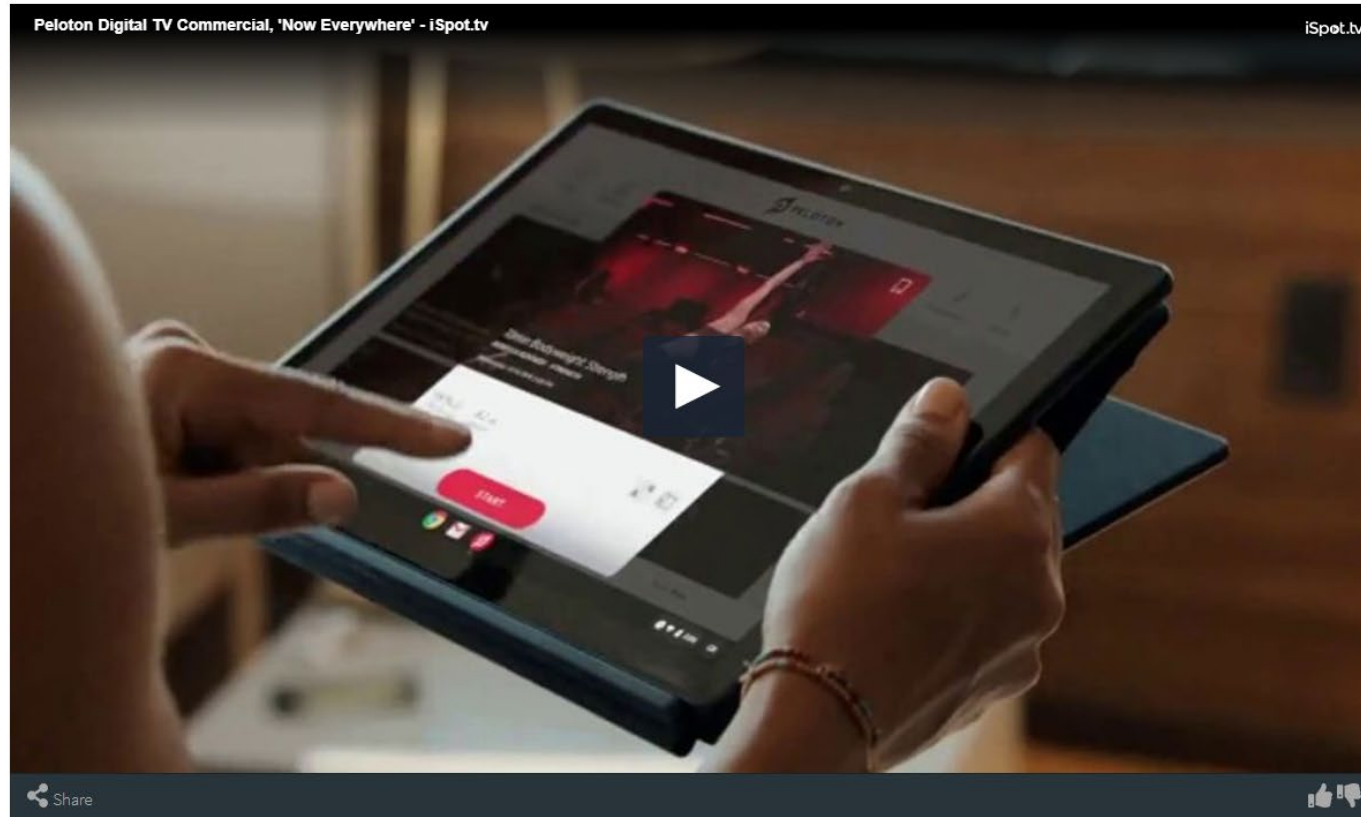
Alongside the Digital Only price cut Peloton also introduced a 30day free trial. This is one of the reasons we don't know the real sub additions for 2Q20. At the end of December is also started a new marketing campaign heading into the big New Year's resolution season.



We suspect these actions will have a material benefit to digital only subscription additions. COVID-19 is likely also helping sub additions, at least for the potential of new trials while people are self quarantining for a month or so. Though, most of those won't be in final 3Q number since they likely have been added in March.

# Though It Also Had a Marketing Campaign in '18

Commercial From Dec '18



## Get Full Metrics On This Ad

10 days of access across the site

 [Unlock Metrics](#)

### Media Measurement

National Airings	10,072
↳ First Airing	
↳ Last Airing	1/28/2019
Creatives	3
Recently Aired On	Ridiculousness on MT
Est. Spend	
TV Impressions	
↳ National	
↳ Local	
↳ VOD/OTT	

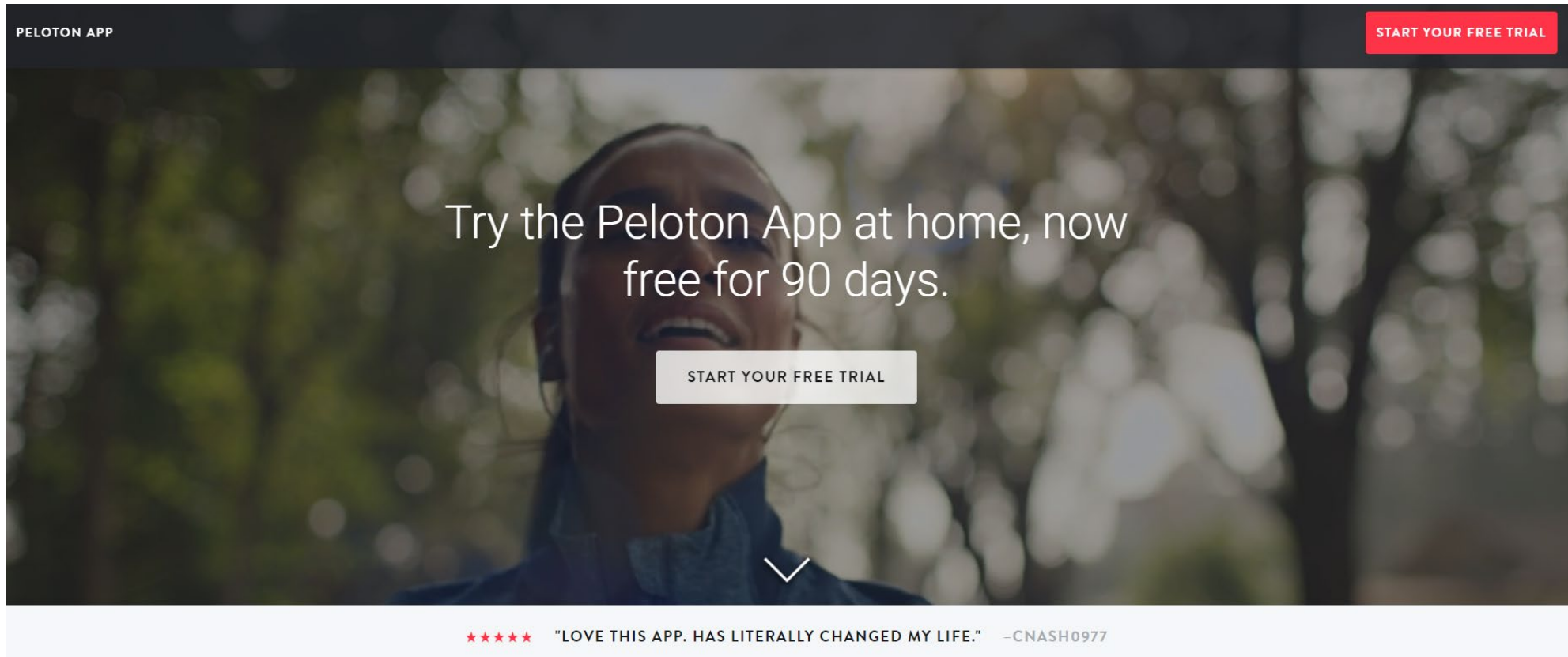
### Attention & Performance Analytics

Attention Score	
↳ Industry Avg.	93.8
Earned Online Views	
Social Impressions	
Sentiment	82% positive
Engagement Rating	4.0
Industry Share of Voice	

Keep in mind its likely about 30-50% of additions happen in the March end Q.



# Peloton Just Went to 90 Day Free Trial



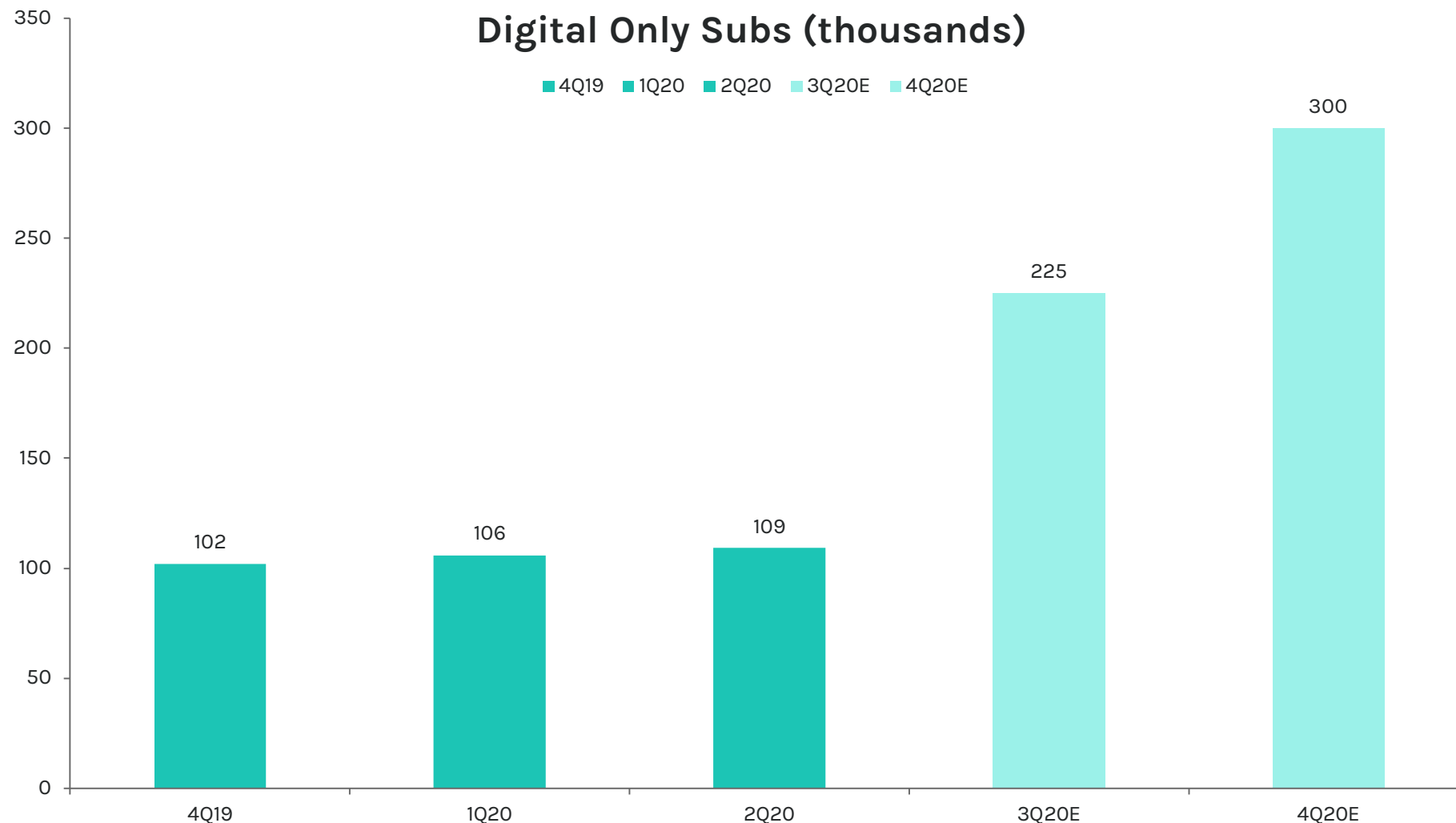
Why 3 months after doing 30 day free trial, do you expand to a 90day free trial? It doesn't seem like you would do that if you're product is in demand and conversion is high.

Could it be nobody wants to pay for it? Peloton is trying to get people hooked, seems unsuccessful so far.



# The Important Number, New Digital Subs

With the price cut this number needs to go up big, or the bull case on digital is punk.



Perhaps the connected fitness slowdown will be so notable the digital won't matter, but this seems like a very important number this Q for the long term bull case.

Digital only needs to go parabolic with a massive jump with the price cut.

For context, connected fitness just added about 150k subs in 1Q, if Digital cant do at least in that range after the price cut, the big 4Q awareness spike, and the marketing campaign, something is wrong.

We're unable to get a good read from our survey as Ns are too small.

# The Odd Management Thoughts on Digital Only

## Justifying Pricing

On the last call the CFO twice reiterated that the pricing of digital only (\$12.99) is for one user only, vs connected fitness (\$39) is for a household. She was seeming to justify the price difference. Yet the company should know that people will share, there are no protections to limit to one user, and there is no evidence of the company trying to enforce this.

Yet the CEO said this on the last call referring to using digital on a different bike: *“it's on a dramatically inferior bike and **an inferior experience because you don't get all the interconnectivity and the leaderboard**”*

Therefore, we can deduce that the price variance is NOT about user quantity, but rather the value of the product. Of course management has to be cautious about signaling digital as being much lower value than the connected fitness product, since that would signal to investors the lack of opportunity in this market. **Streaming fitness without some other service is a commodity.**

You also had the CEO state “you can count on one hand the number of people” that switched from connected fitness down to digital. Again showing the significant lower value of the product, otherwise why would you pay 3x for connected.

Yet the CEO also believes a full body bootcamp workout is the best one can get. So digital only is less valuable, but bike is limited in quality of workout.

## Digital A Marketing/Pipeline Tool

*“Over time, Peloton Digital has become an incredibly powerful lead generation tool for us as well.”*

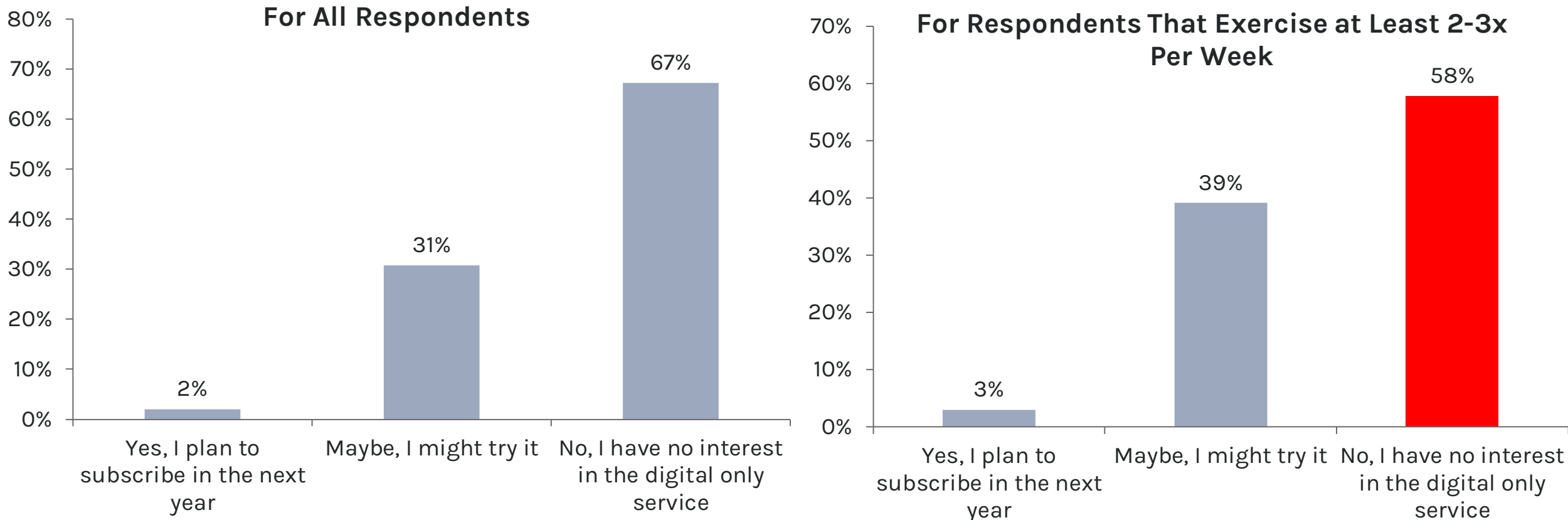
*“Obviously, we've seen some marketing from some of these other pure hardware players trying to take advantage of our content. To the extent that they get any traction, which we haven't seen, and they are becoming digital subscribers, we would celebrate that because it is an introduction into our ecosystem.”*

To think that digital subs are a pool to sell bike's is ridiculous. There is large barrier in price to converting people from one to the other. Not to mention that digital subs are a fraction of connected fitness growth, so if conversion numbers were that good, the pool would rapidly empty.

# Interest in Digital Only for Non-Subscribers of C.F.

HEDGEYE

Would you consider subscribing to Peloton's app based digital only service for \$12.99/month?



Going by households, if 60% have people that actually exercise, and only 40% are interested, you are down to ~25mm digital subs as you're total US addressable market, with lots of competition and no switching costs.

This survey was filled just last week (ie in the middle of the COVID scare).

# Is the Digital Only Opportunity Priced In?

Let's assume we're wrong on digital, people do want/stay with it, and there is some price integrity vs competition.

What would you have to believe on digital only to buy it here?

	Low	Mid	High
Subs (mm)	5	10	15
Gross Profit Per Sub	\$50	\$100	\$110
Gross Profit (mm)	\$250	\$1,000	\$1,650
SG&A (mm)	\$500	\$650	\$750
Profit (mm)	-\$250	\$350	\$900
Multiple	NA	10.0 x	12.0 x
Long Term Value (mm)	\$0	\$3,500	\$10,800

You have to believe that Peloton penetrates around half of the potential market to justify the value it was at a few months ago.

And that is likely 5-10 years down the road.

SG&A may be high on this, but the company is already at \$726mm in TTM Op Ex.

# Competition is Closing In Fast

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# Competition Ramping In Everything...

- More competitors in Live Fitness
- More competitors in Equipment
- More competitors in Connected Fitness
- More competitors in Digital Only (watch out for the big guys)



# Live Fitness Concepts Booming

Live fitness will not be going away. Many concepts will die, but some will thrive, and people will try them.



**BARRY'S**



**XPONENTIAL**  
FITNESS

CLUB  PILATES®

 pure barre®

**STRETCH**  
  
**LAB**

ROW  HOUSE

  
CYCLE BAR

**AKT**

  
YOGASIX

  
**Orangetheory**®  
FITNESS



# Equipment Competition

## Horizon Bike Copying the Design With Easy Digital Only Integration



\$699.99



The Wellness Company

\$399.99

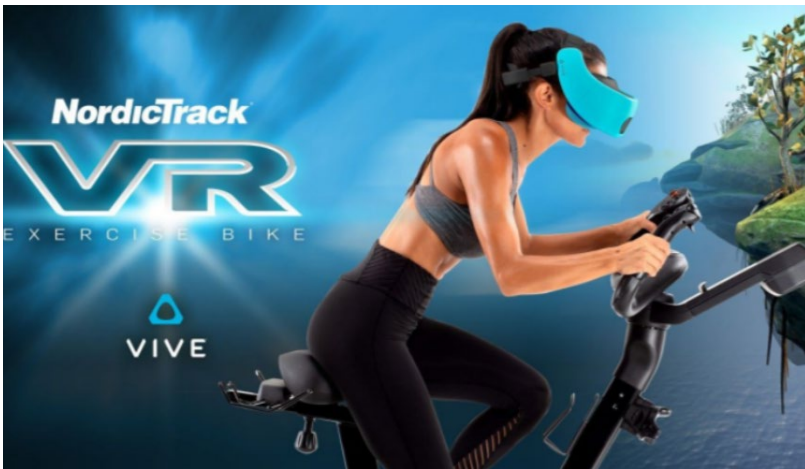




# Connected Fitness Competition

HEDGEYE

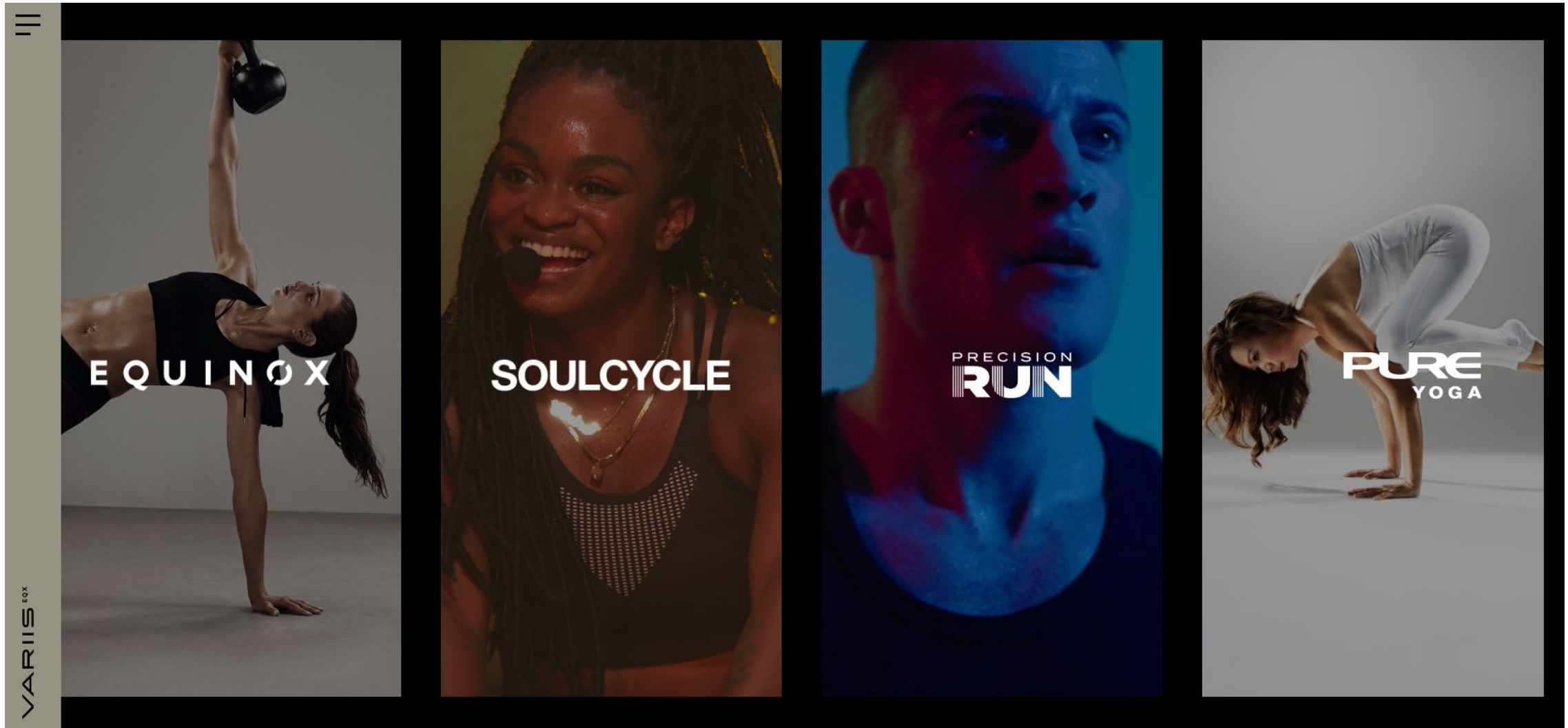
We think this will end up looking like the meal kit space, 2 or 3 winners that rapidly run out of TAM



# The Equinox/SoulCycle Launch

HEDGEYE

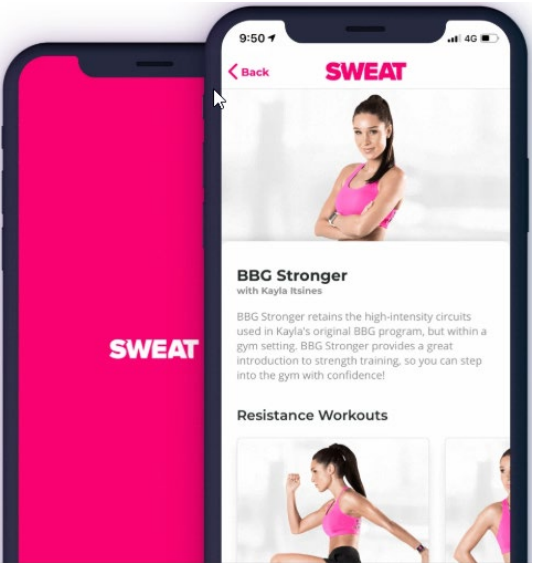
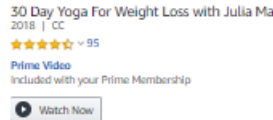
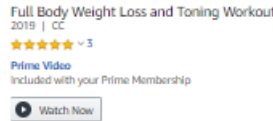
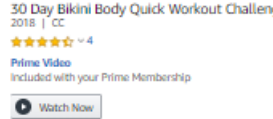
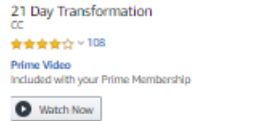
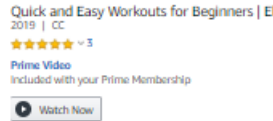
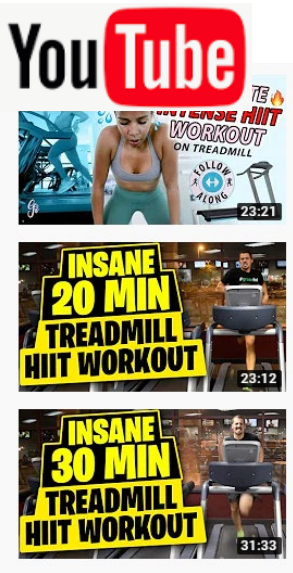
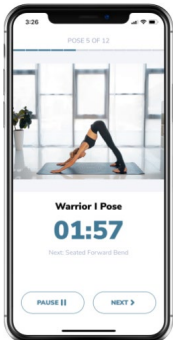
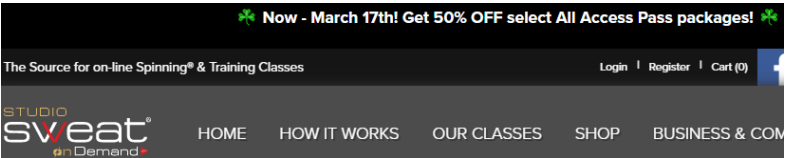
\$2500 bike and \$40 a month. Equinox is going at the high-end consumer, a real risk to PTON share





# Digital Only Competition

Social distancers will only pick Peloton?



So why do we assume people pick Peloton in their time of #socialdistancing ?

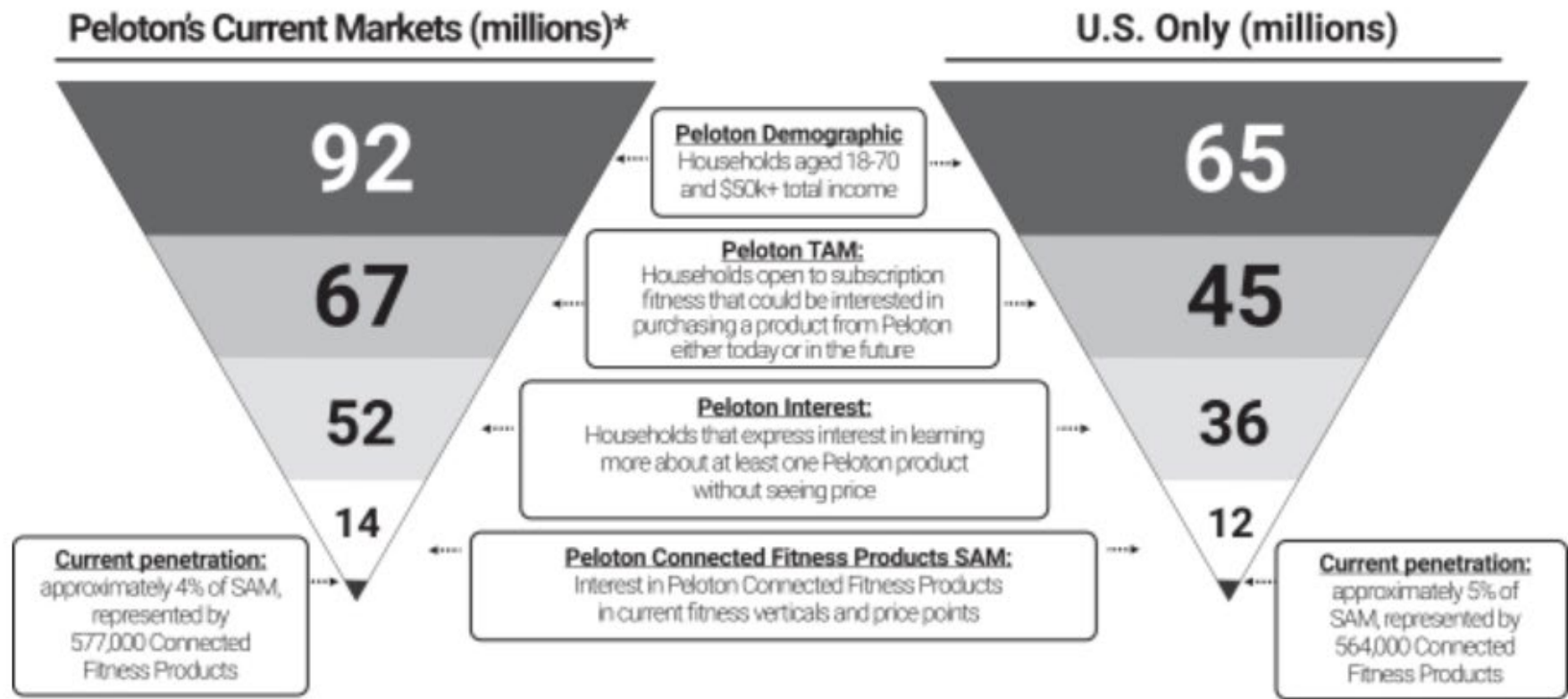
# Addressable Market Overstated

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# Company's Total Addressable (& Serviceable) Market



PTON estimates TAM of 67mm households of which 45mm are in the US. The Servicable Addressable Market (SAM) is estimated at 14mm globally and 12mm in the US. So ~7% penetrated.

That's \$50,000 in income.

Fastest growing customer segment is below \$75,000 in household income.

62mm people in the US and 183mm globally have gym memberships. – IHRSA.

5mm treadmills and 3mm stationary bikes sold in 12 months ended Mar. 2019 – IHRSA.

\* Represents our total addressable market within our current and announced markets—the United States, the United Kingdom, Canada, and Germany.

# How We Break Down the TAM (US)

## Propensity to Spend

US Households	128,500,000
% With Home Broadband Internet	84%
Households With Broadband Internet	107,940,000
% Willing to Spend \$20+ on sub, and \$1800+ on equipment	5.0%
<b>Addressable Market</b>	<b>5,397,000</b>

## Income, Exercise, Interest

US Households	128,500,000
% With Home Broadband Internet	84%
Households With Broadband Internet	107,940,000
Income Bracket	\$75k+
Workout frequently	a least once a week
Willing to Spend on Gym Membership	at least \$11/mo on sub
Tried Spin Class, Soul Cycle, X-fit, Orange Theory or Flywheel	
% on Survey Meeting Criteria Above	6.1%
<b>Addressable Market</b>	<b>6,611,325</b>

We see the market as being around 6mm households in the US. Given the competition and PTON as the first mover, 30-40% would be an ambitious market share. That’s 1.7mm to 2.4mm Connected Fitness Subs. We’ll come back to this on valuation.

# Idea of Shifting to Home Workouts is Unlikely

We have heard the bull case of “at home fitness becoming long term trend.”

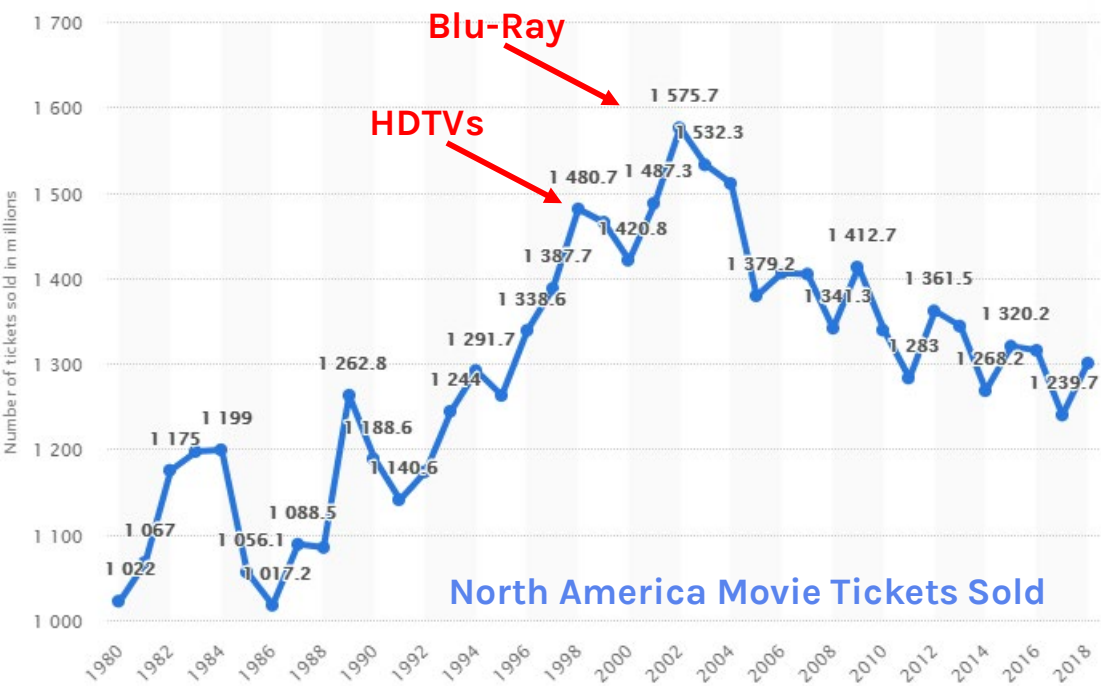
Exercise at home has been around forever (literally).

Consuming fitness content at home has been around for roughly 4 decades.

The only thing that is new, is the quality of trying to replicate an in-person experience.

The best comparable we can think of is Movie Going.

Technology has made at home movie watching closer to the in-person experience, but...



Movie going didn't fall off a cliff, only down ~15% from levels when major home viewing innovations came.

Since people are unlikely to consume more exercise content (ie not workout more hours), we would have to see a big dropoff in live exercise for the big TAM to be possible. We think too many people will want to feel the real thing, just like many people still go to the movies.

If all the consumer wanted was at home fitness, gyms would not exist today.

The equipment cost is a real barrier to many. And the success of fitness concepts suggests that people like to workout in a live setting.



# What is Real vs “Fad”?

Some of these customers just try everything, then switch. Peloton needs to keep innovating.

Some people just try the new thing... They tried yoga, they tried crossfit, they did spinning, pilates, they do peloton, and they will move on to the next thing when it hits.

Exercise concepts and equipment have always been a “fad” type business. Like the new diet or the new cool shoes.

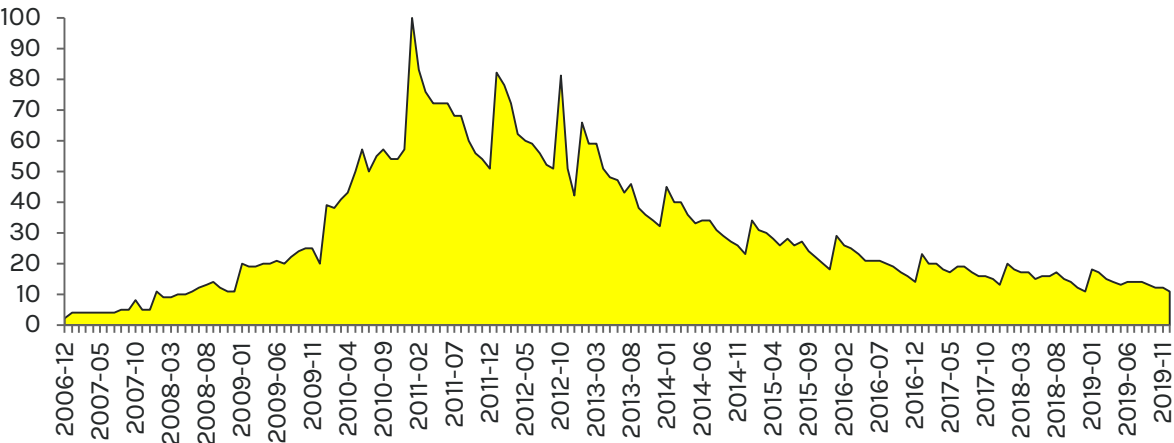
Remember Jazzercise, Tae Bo (1mm videos), Bowflex Home Gym, Thighmaster, Aerobics, Shake Weights (2mm units at \$20), Ab Slide, Wii Fit, Pilates, EasyTone shoes, Medicine balls, Kettleballs, Power Plates, Pole Dancing....



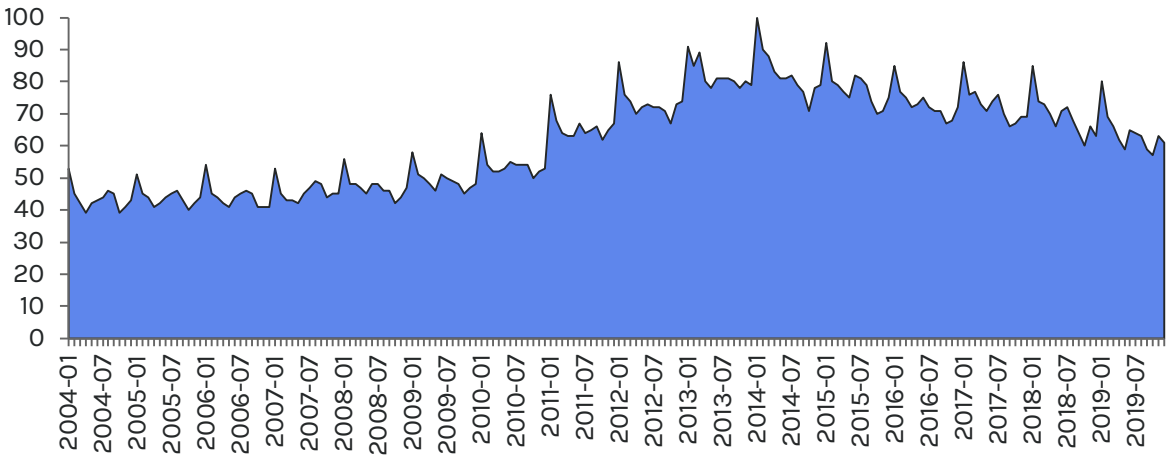
# Nothing Stays At The Peak in This Industry

Cycles of other popular workout fads/trends

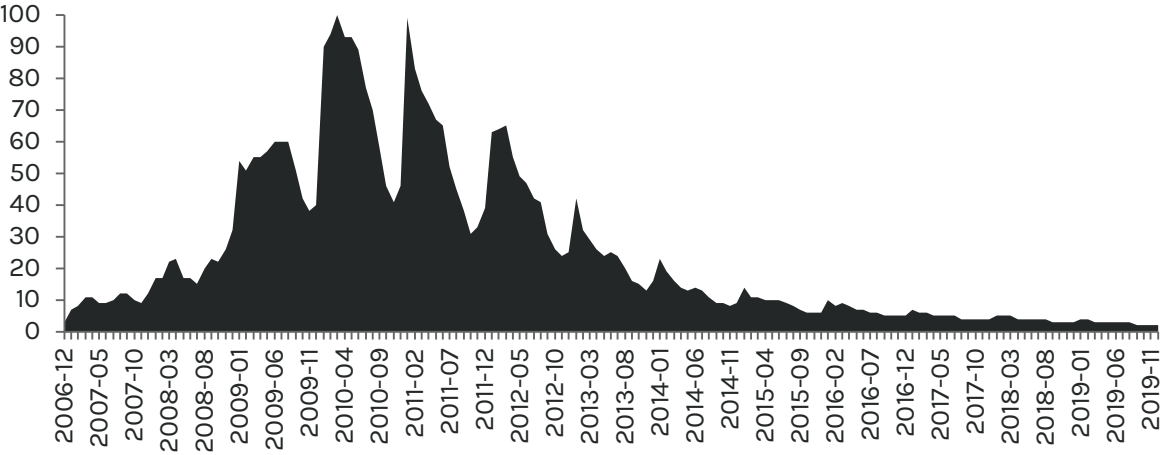
Zumba Interest



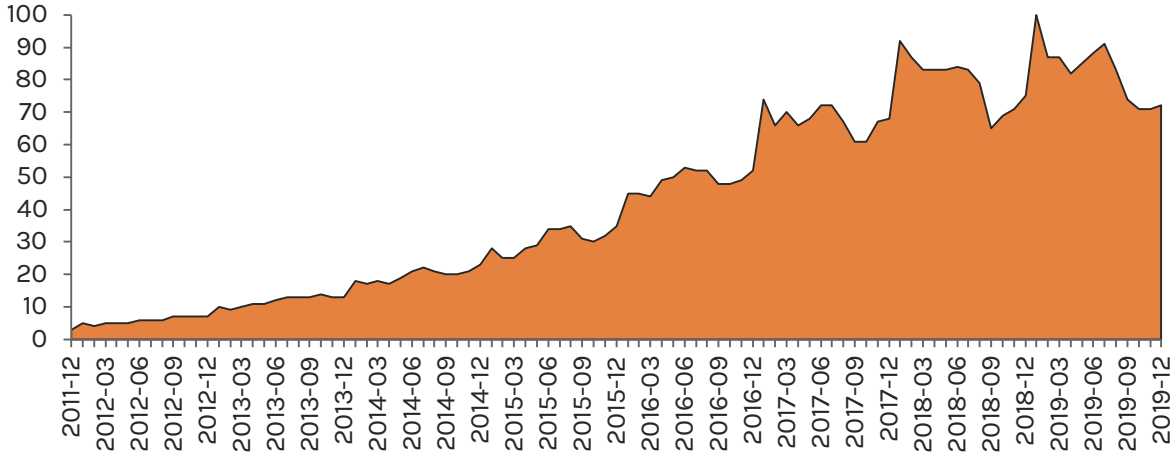
Yoga Interest



P90x Interest



Orange Theory Interest



# Where could PTON settle out?

Some other massive fitness trends suggest real limitations with street at 5.2mm PTON C.F. subs in 5 years

P90x sold about 5mm copies.

Crossfit has about 13000 gyms globally with let's say 200 average members... that's about 2.6mm users.

At the peak Zumba had about 15mm active members

At its peak, the leader in high end fitness equipment (Technogym) was worth about \$2.5bn

Yoga had about 35mm people at the peak in the US (many of which don't pay)



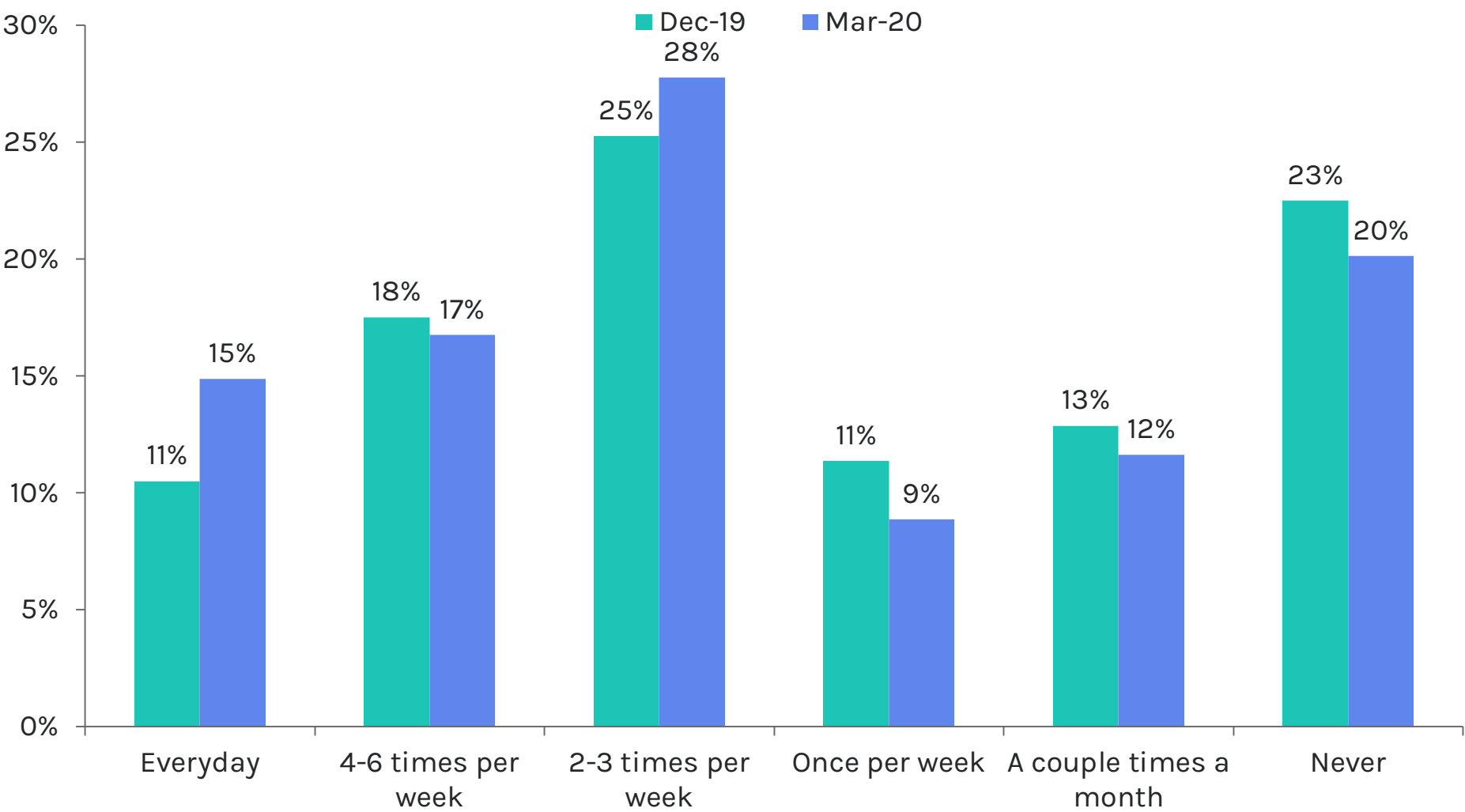


# TAM Survey Insights

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# Exercise Frequency

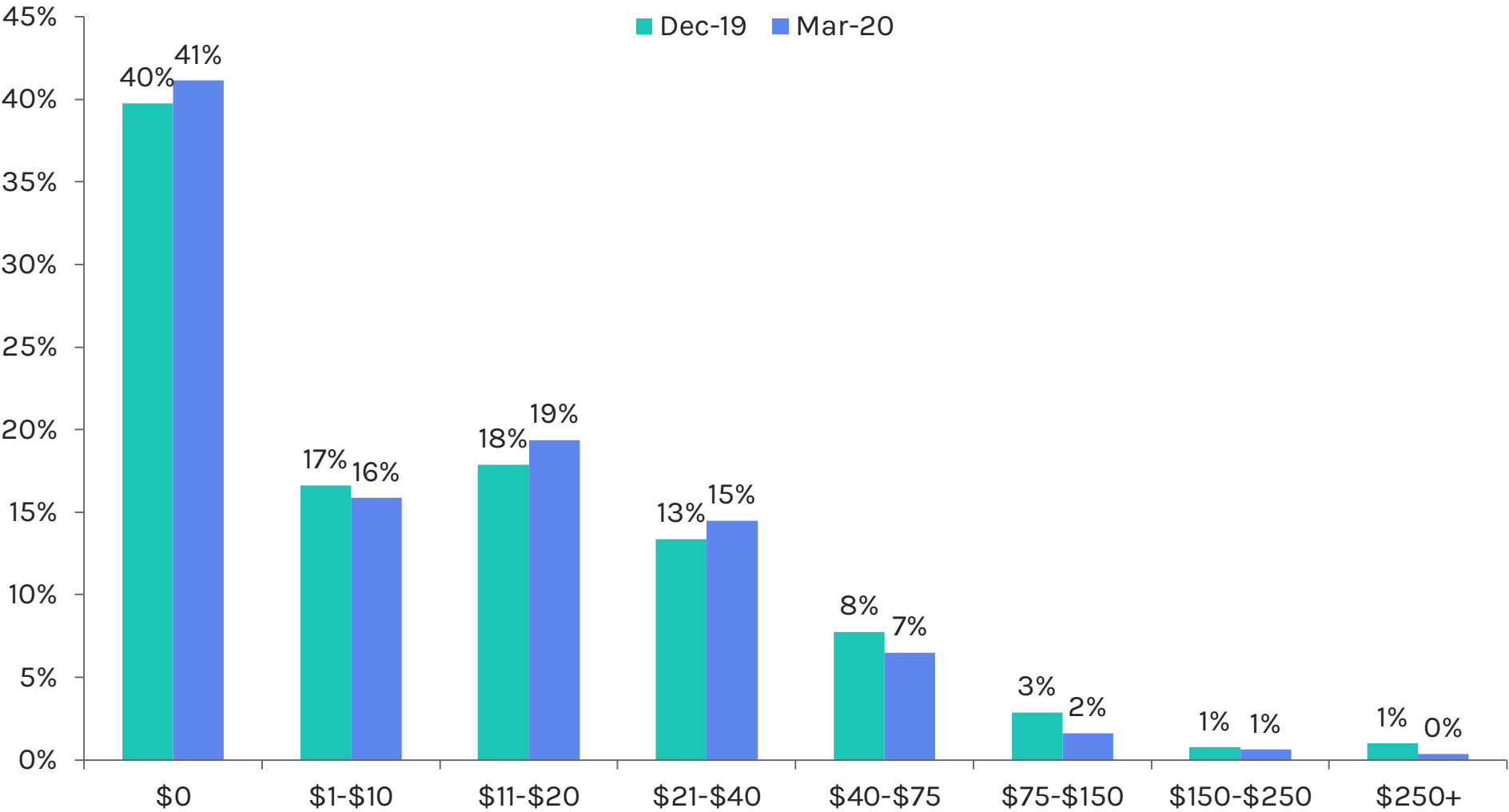


“How often do you exercise?”

Slight up tick implied in exercise frequency.

Perhaps just sampling error but would make logical sense given the time of year the survey was executed. People try to increase exercise in Jan and continue as long as they are able. Likely workout less in the holiday season.

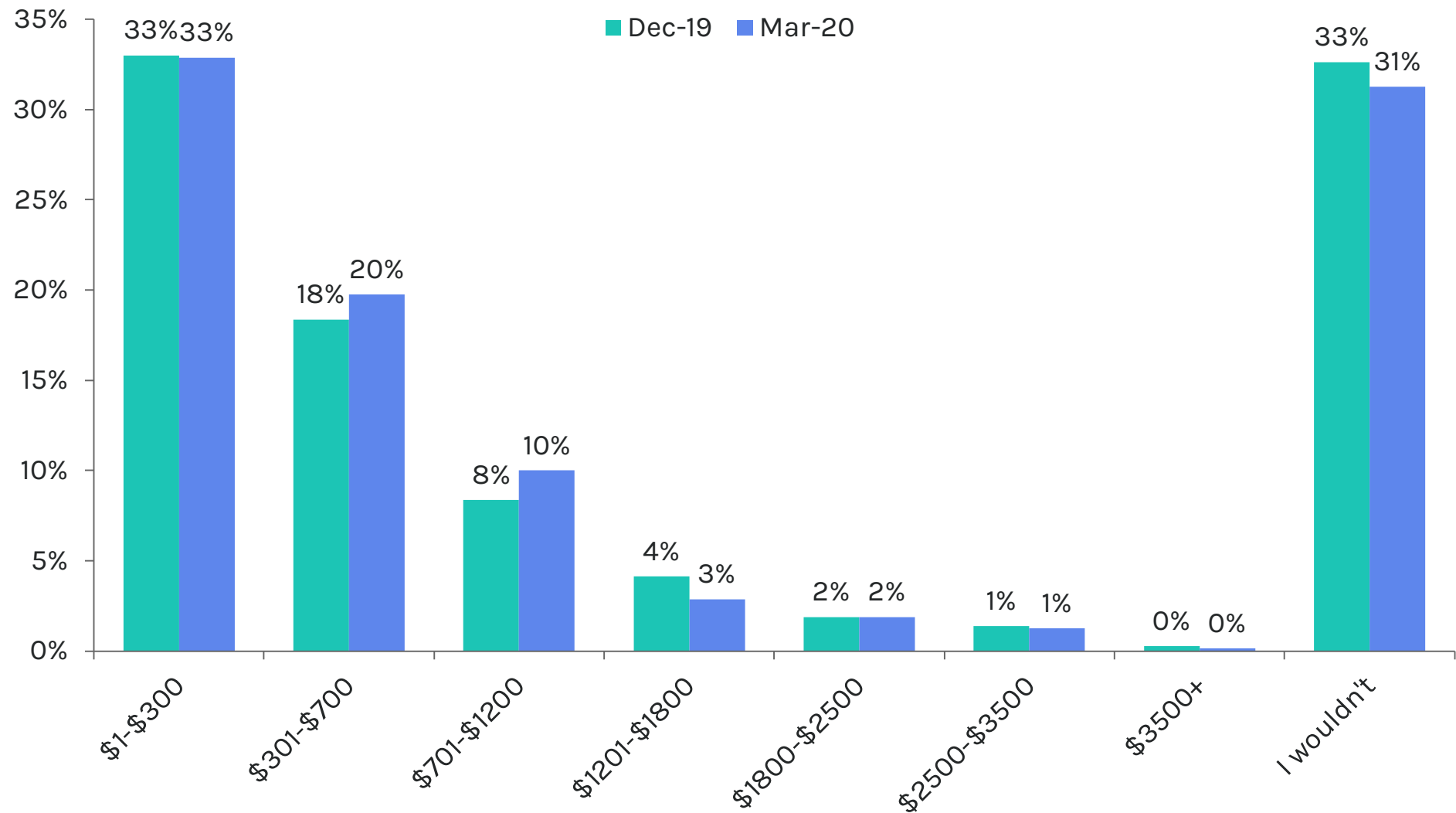
# Membership Propensity to Spend



“How much are you willing to spend PER MONTH on all of your exercise/fitness memberships whether a digital service from home or at a gym/fitness center?”

Overall similar results, perhaps a slight shift towards lower end of price spectrum.

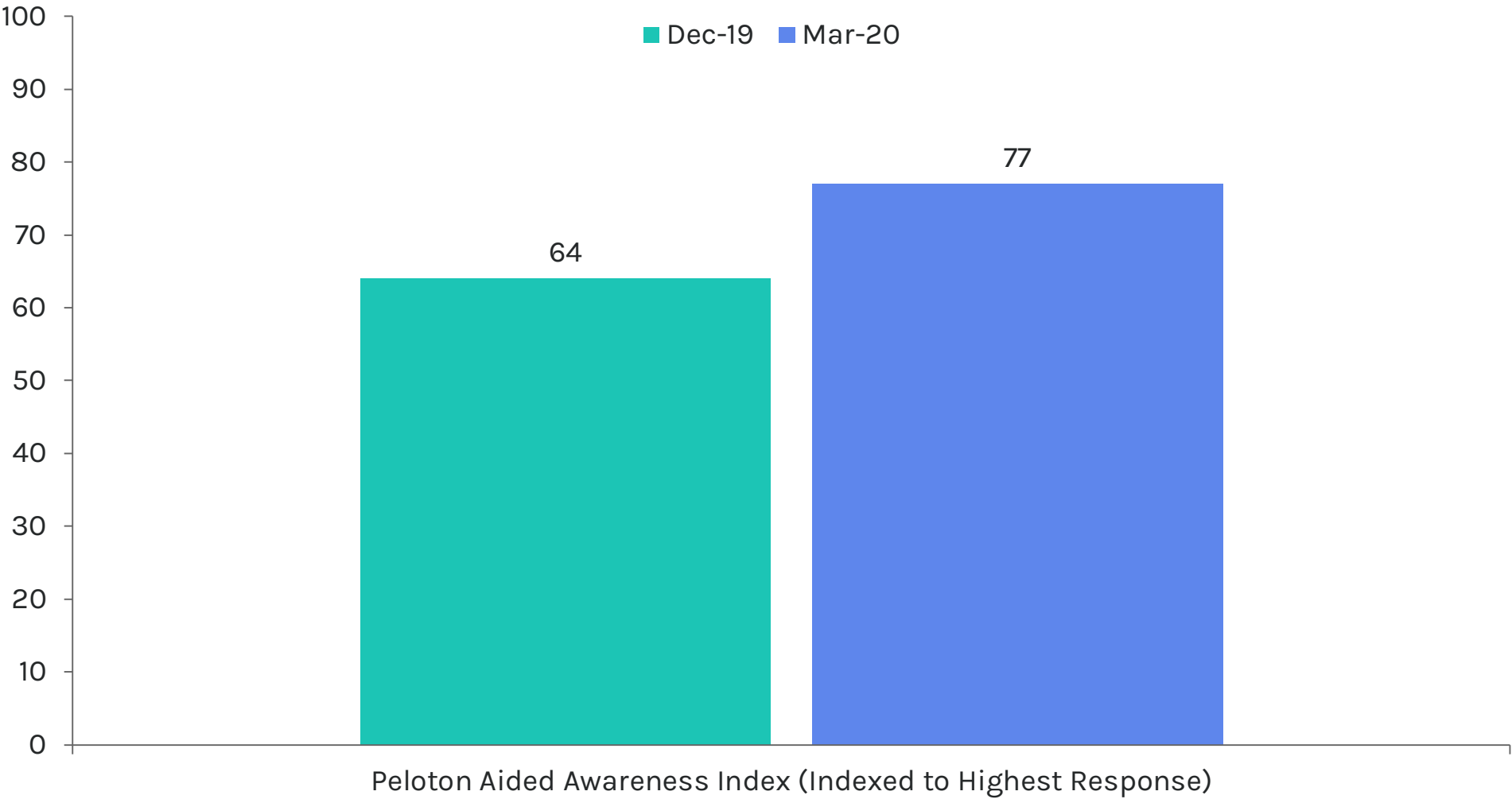
# Equipment Propensity to Spend



“How much are you willing to spend on a single exercise stationary bike or treadmill?”

Overall similar results, perhaps a slight shift towards lower end of price spectrum.

# Awareness Index

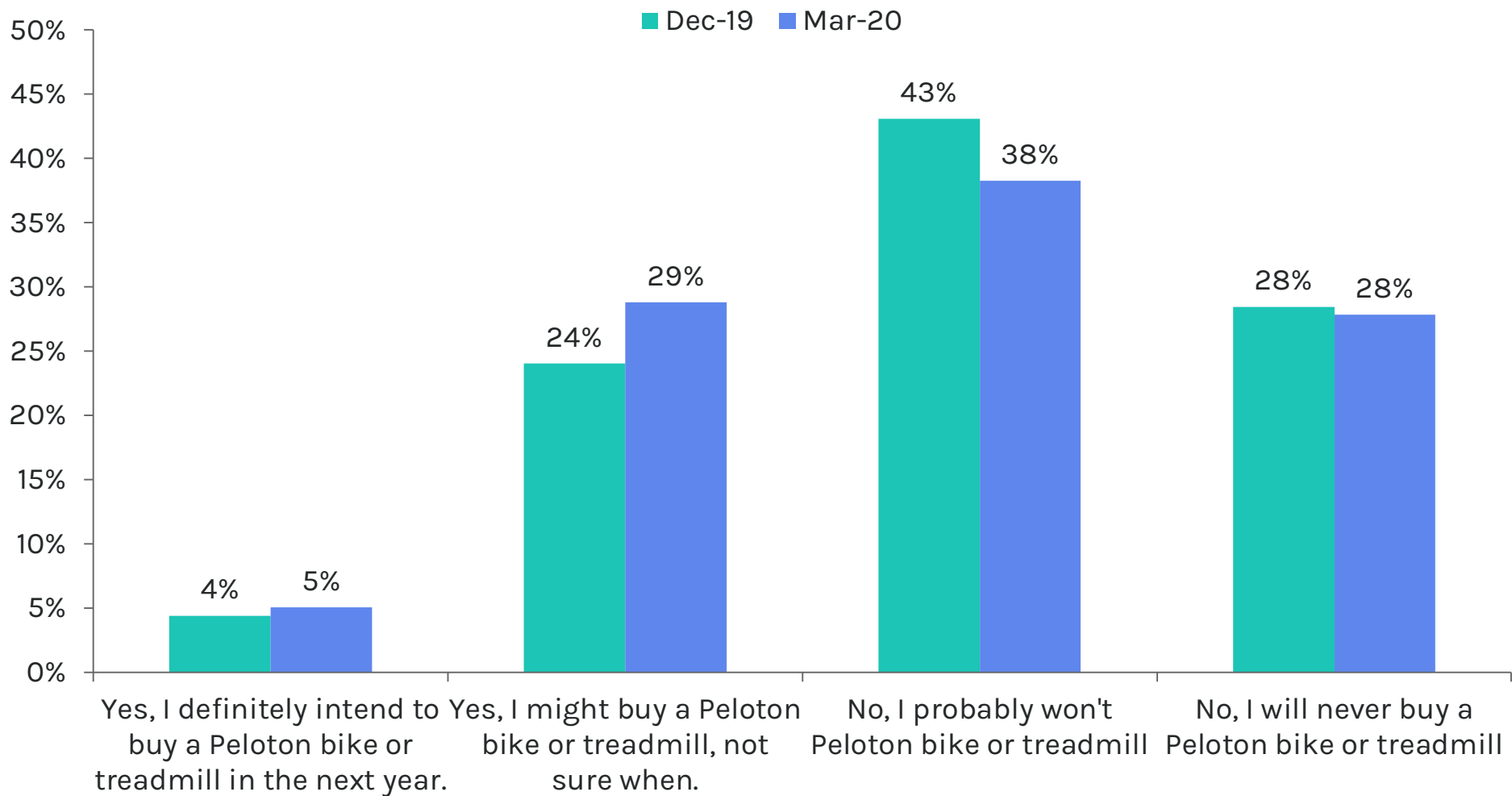


“How much are you willing to spend on a single exercise stationary bike or treadmill?”

Overall similar results, perhaps a slight shift towards lower end of price spectrum.



# Peloton Equipment Purchase Intention



“How much are you willing to spend on a single exercise stationary bike or treadmill?”

Overall similar results, perhaps a slight shift towards higher likelihood to purchase.

Surprisingly similar “never percentage”

# Recession Risk

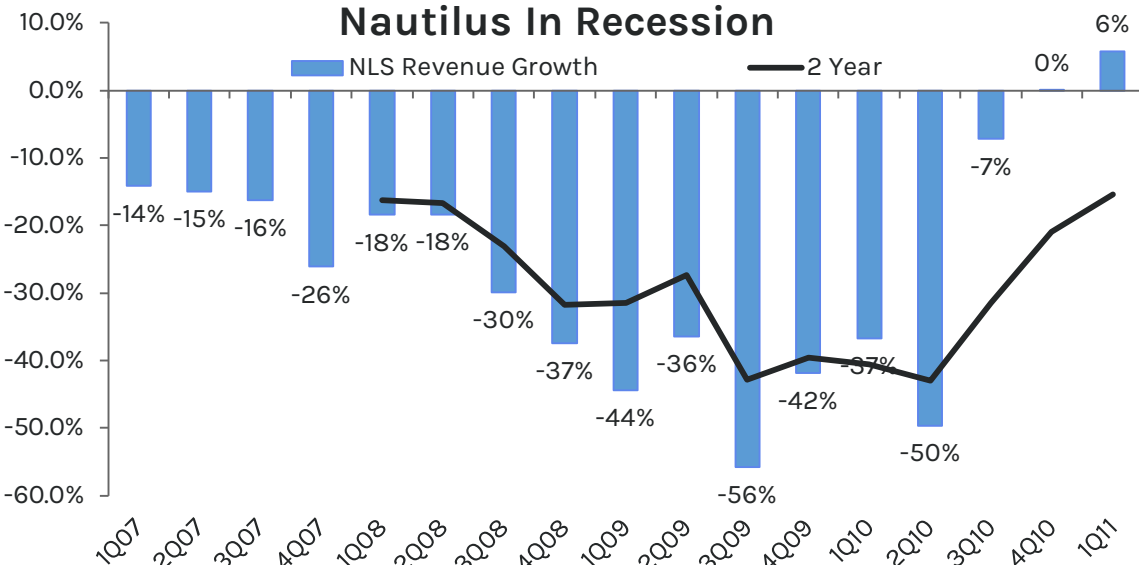
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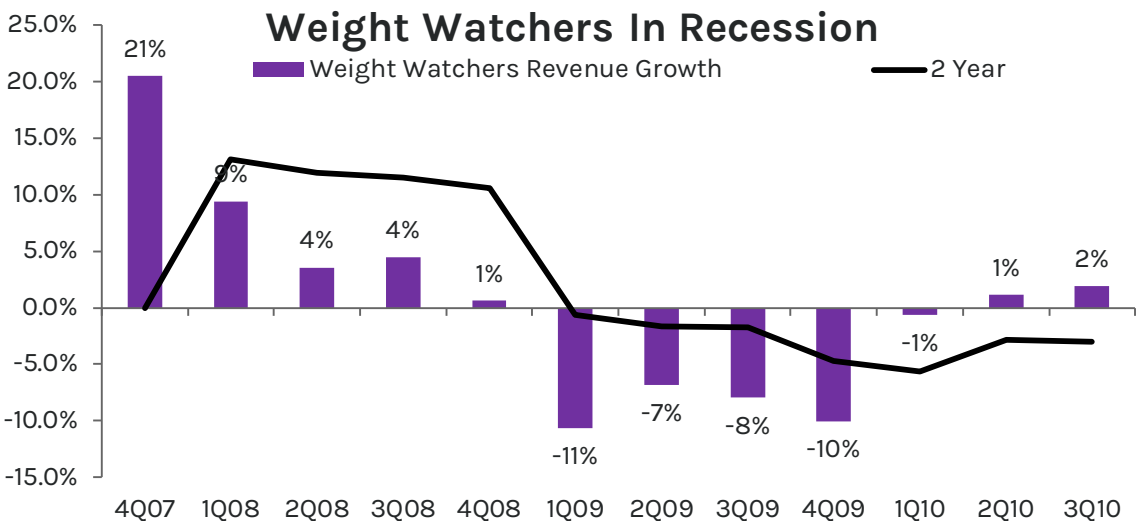
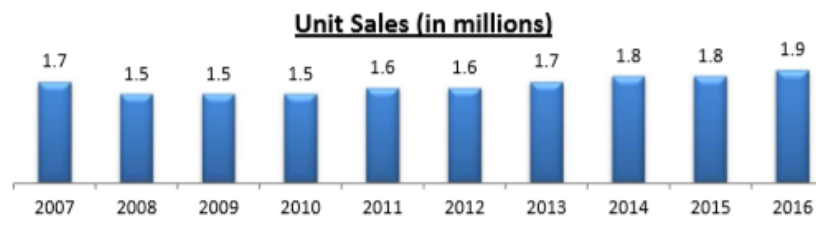
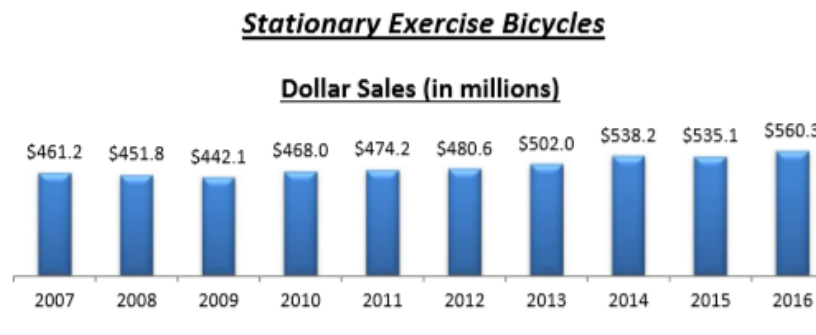
# This Business is Cyclical, Recession Risk is Real

HEDGEYE

CEO Foley Pre-IPO interview: "It's essentially a recession proof category" (fitness spend increased in '08 '09)



**Wrong!!!**



Bulls argue that there will be a trade down to Peloton in a recession. It is cheaper than attending spin classes.

However, consumers cut back on large purchases even when it can be financed.

There are many ways to exercise for nearly no cost after all.

# Vertical Integration is VERY Risky for This Model

This is an at home indoor cycling stream content and hardware brand that...

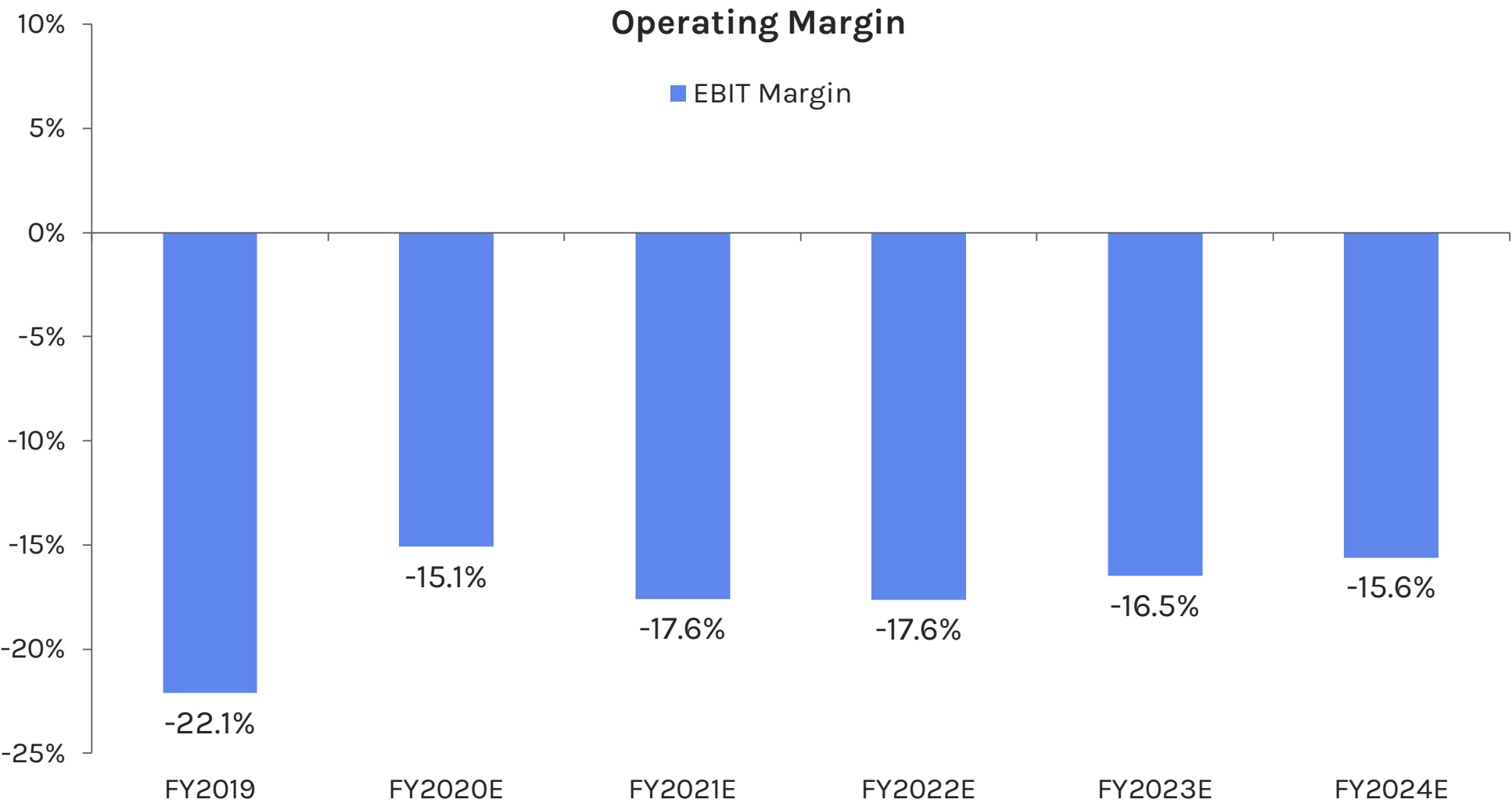
- Has over 200 software engineers on its team (but only 32 content generators, ie instructors).
- Owns a bike manufacturing operation in Taiwan.
- Has a base of 76 stores and growing.
- Has a new HQ with ~\$30mm in rent (and 16 year lease).

What happens when revs slow to a halt (as we often see in fitness), and/or you hit a recession?



# No Profits In Sight With Current Strategy

Companies with this type of earnings profile have nearly no bottom in a recession.



We don't think the model as it is being run today chasing TAM and going rapidly outside the core can be profitable.

# This Isn't Built for Weak Consumer Environment

Peloton's CFO said of the hundreds of Key Performance Indicators (KPIs) only **engagement, subscriber growth and churn** really matter.

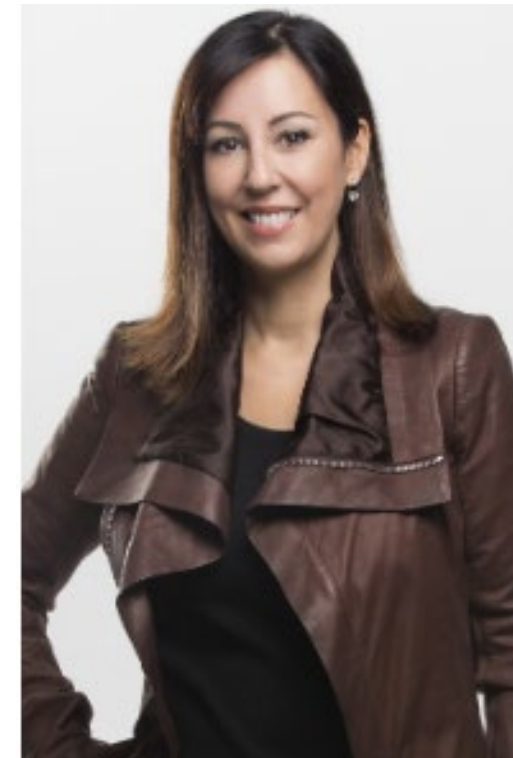
Not costs, margins or cash flow? Perhaps return on invested capital?

The CFO joined in April 2018 with an eye to take the company public. Her background is in capital markets origination and she succeeded in maximizing the IPO price.

"I look at WeWork and I have so much sympathy."

"For us, it's growth—not at all costs—but growth is 100% our priority. If your opportunity is massive, you should just grow as fast as you can." – Jill Woodworth

Apparently, there is at least some consideration for costs – the company reportedly abandoned plans for a Super Bowl ad. Though, not sure the core football fan is the customer here when holidays and January have passed.

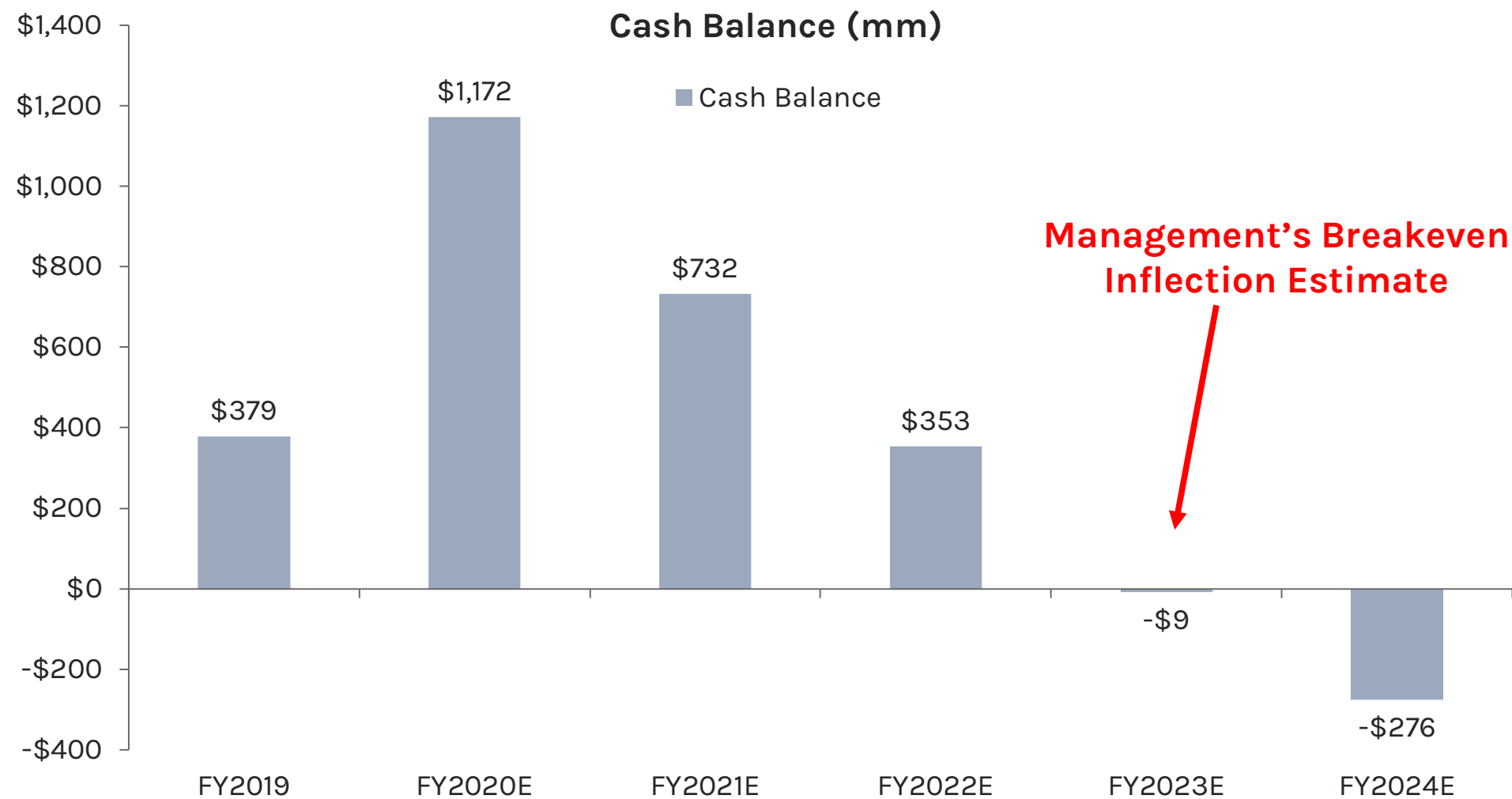


CFO Jill Woodworth

We recognize that this is a company focused on growth, but someone (at least the CFO) should care about costs and margins. That hyper focus on revenue growth pervades the decision making at the company with store openings, purchasing manufacturing, building everything themselves, building expensively.

Woodworth has experience with IPOs, not running startups for long term health. Hence the focus on growth metrics for valuation.

# Cash Burn – Run Out Before Break Even?



The company is investing heavily and losses are high.

With a vertical model, as revs slows profits can get worse.

Running out of cash and having to tap capital markets again is a real possibility within 3-4 years.

# Valuation





# Recession Valuation

As growth slows, this could look a lot like Wayfair or Blue Apron, so let's compare to W today

Recession Downside	
Wayfair EV	\$4,250
NTM US Sales	\$9,400
Wayfair Sales Multiple	0.45 x
PTON NTM Sales	\$1,715
Implied PTON EV	\$776
PTON Cash	\$1,130
PTON Equity Value	\$1,906
PTON Shares	280
Share Price	<b>\$6.81</b>

**~70% downside**

Virus spread = recession and the negative impact from recession will be much greater than any positive impact from people self quarantining.

The COVID bull case does have the issue of delivery time. People might want to trial a Peloton now to substitute their normal studio/gym workout. But delivery is typically 2-3 weeks, longer if seeing a demand spike. People might not get their bike by the end of their social distancing.

# Valuation On Run Rate Subs/Contribution Margin

## Valuation Summary - Out Year Target

Subscription Price	\$39
Annual Revenue Per Sub	\$468
US Sub Contribution Margin	68%
Annual Contribution Per Sub	\$318
US Subscriber Target (mm)	1.9
Intl Sub Contribution Margin	58%
Intl Subscriber Target (mm)	0.45
US Subscriber Contribution Dollars (mm)	\$605
Intl Subscriber Contribution Dollars (mm)	\$122
Gross Profit/Bike (at 80% of Today)	\$850
Bikes Per Year 6Yr Replacement Cycle (mm)	0.39
Bike Replenishment Gross Profit Dollars (mm)	\$333
Overhead/SG&A (mm)	\$550
Run Rate EBITDA (5+ Years Out)	\$510
Discount Rate	10.0%
Present Value at 5 Years Out	\$317
Multiple	10.0x
<b>Enterprise Value</b>	<b>\$3,166</b>
<b>Equity Downside</b>	<b>-49%</b>

We think there is a viable business with the bike streaming service.

With relatively bullish assumptions, we can get to \$2-\$3bn in value.

This is what it could be worth with several years of strategy change and execution that we don't see happening.

Since our last deck we have taken down the target market share given new entrants in high end connected fitness.

**Punchline is we think PTON is worth \$6 to \$12 per share**

Please submit questions\* to  
**qa@hedgeye.com**

\*Answered at the end of the call

# Appendix

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# Management Background

Many of the executives worked together at Barnes & Noble

CEO John Foley: formerly President of eCommerce at Barnes & Noble before PTON founding.

CFO Jill Woodworth: Managing Director of JP Morgan. Investment banker at Morgan Stanley.

President & Director William Lynch: CEO of Savant Systems (luxury smart home technology company). CEO of Barnes & Noble and oversaw the Nook.

Chief Operating Officer Tom Cortese: CEO of Proust.com, online social media and memory sharing company.

Chief Technology Officer Yony Feng: Senior Platform Engineer at Ticketfly, Software Engineer at Skype and Cisco.

Chief Revenue Officer Tim Shannehan: VP of Sales at IMG and Inspirato.

Chief Supply Chain Officer Jon Adey: COO and EVP of Retail Sales at Savant Systems, Barnes & Noble MD of Nook Hardware.

# How We Got Here

## Peloton Timeline

Company founded in 2012.

First Peloton pop up store in Short Hills mall Nov 2013.

Bike launched in 2014.

The company raised \$550mm at a \$4.2bn valuation last year (2018).

It raised \$994.7mm total before going public.

Dual class structure. CEO has 6% of the class B stock, with 20-1 voting power.

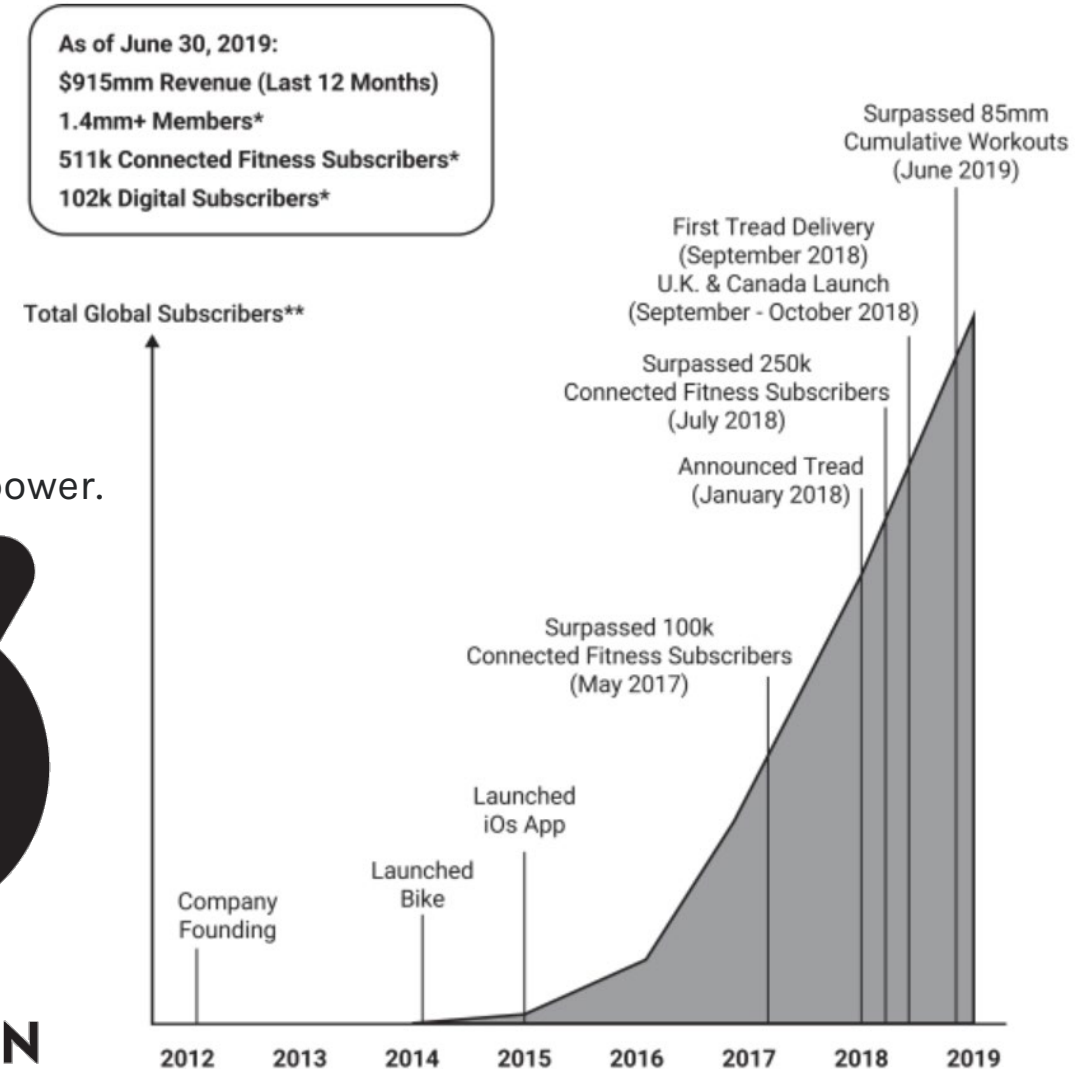
At the IPO price it was valued at \$8.1bn.

Management is talking breakeven by 2023.

### How it all started

Founded in 2012, Peloton brought top talent together in its Silicon Alley headquarters to create a new concept in fitness. We loved cycling but had a hard time finding a workout that consistently fit our schedules, and our at-home workouts never felt quite up to par. So, we set out to create a world-class indoor cycling studio experience on your time, and in the comfort of your own home.

So Why Not Stick With That?



# The IPO Debacle

Perhaps the size of the deal was too much to handle in a tough IPO tape.

Shares were priced up at \$29 after the range during the roadshow was \$26-29. CEO Foley says they left some money on the table.

Was to open trading at \$24-\$25.

Nasdaq got on the phone.

Deal cut, opened at \$27.

Sold off as low as \$21 in the following months.

The stock did rally all the way back peaking just under \$37.



# Key Products/Numbers/Metrics

New Hardware Expected: Cheaper Tread, Rowing Machine

## Hardware



Bike: \$2,245 plus  
\$250 installation



Tread: \$4,295 plus  
\$300 installation



Bike Essentials:  
\$159

Tread Essentials:  
\$229



## Subscriptions

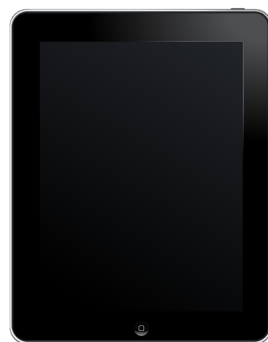
### CONNECTED FITNESS MEMBERSHIP

Full access to the Peloton experience  
with seamless integration with your  
Peloton equipment

\$39/mo

*Requires Peloton Bike or Tread*

Digital Only Single Account:  
\$12.99/mo



## Operational

Adjusted GP Per Connected Fitness Device:  
\$1,063

Adjusted CAC Per Connected Fitness Sub  
\$1,057 (\$5 Net)

FY2019 Monthly Avg Churn  
0.65%

'19 Lifetime Value of Connected Fitness Sub  
\$3,593

Connected Fitness Subscribers  
562,774

Digital Subscribers  
105,856

2019 Hardware Revenue  
\$719mm

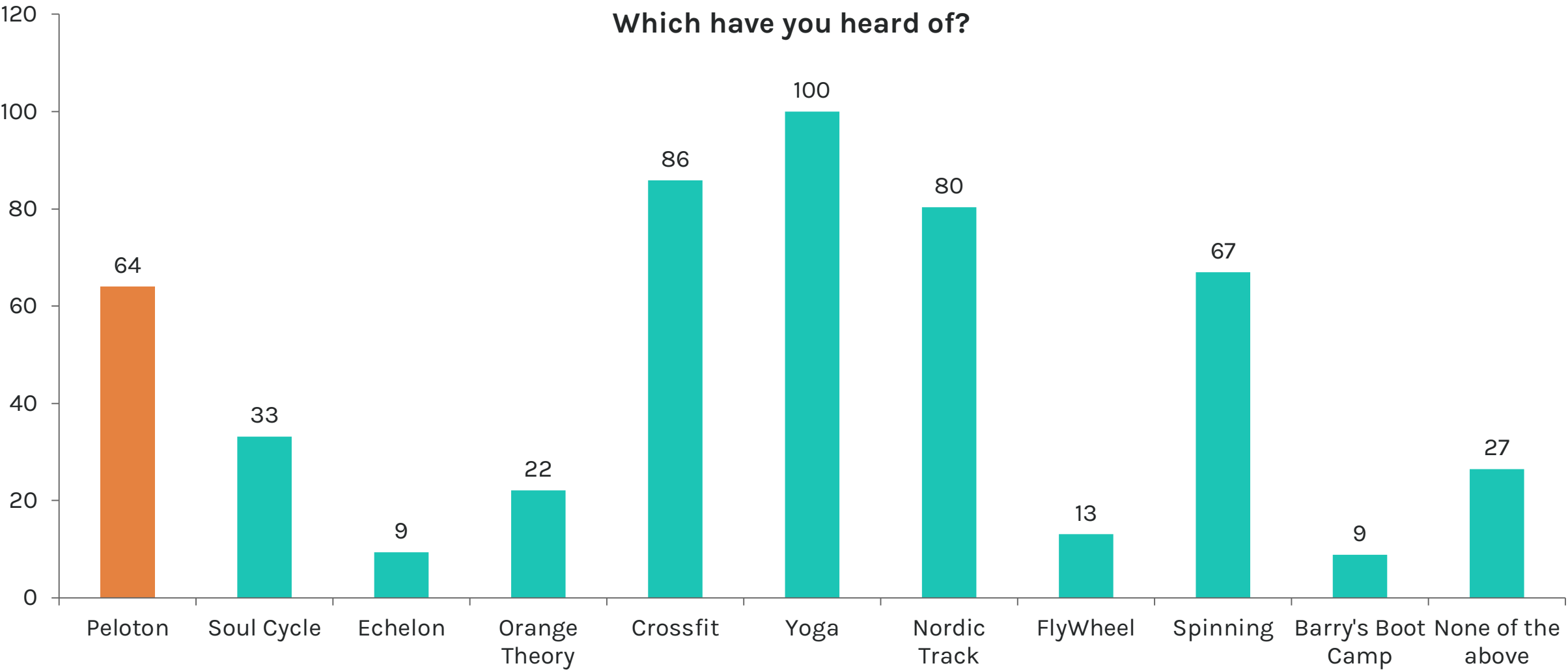
2019 Subscription Revenue  
\$181mm

2019 Subscription Gross Margin  
42.7%



# Survey: Aided Awareness Index

US General Population (online) – Indexed to Highest



# Don't Worry, The CEO Says Peloton is Profitable

Question: "Are you profitable?"

Answer: "We are profitable, weirdly. It's a beautiful business model. Um, our investors are happy. Um, yes."



Peloton CEO John Foley: We're 'Weirdly Profitable' For A Growing, Young Company | CNBC

8,293 views • May 23, 2018

49 5 SHARE SAVE ...

Maybe he meant gross margin or contribution margin is positive?

Looking back we can't reconcile his statement with the company's earnings with the S-1 showing significant adjusted EBITDA losses for each year disclosed.

A year and a half later, for the IPO the company is talking about breakeven in 2023.

# PTON Bought a Factory, Why?

**Manufacturing capacity is the last thing a company like this needs to own.**

Peloton acquired Tonic Fitness Technology, one of its two Taiwanese bike manufacturing partners, for \$47.4mm last quarter. Tonic makes treadmills, ellipticals, rowing machines, and cycling machines. Peloton is planning substantial expansion plans to be finished in 2020.

CEO Foley said, “We aren't in China meaningfully, and are very comfortable with Taiwan, but this gives us more transparency into our upstream supply chain ... So we have more optionality if we find ourselves in the position of considering stateside manufacturing.”

Tonic previously had 300 employees making 300 to 400 bicycles per day, as it scaled up and invested in the facility the number of employees has been reduced to 200 while the output has almost doubled to 600 bicycles.

Peloton also acquired Gossamer Engineer and its staff of 16. The team previously worked with Facebook to develop the Portal video chat device.

*“A brand-new fitness facility... that is going to be, we believe, one of the best, if not the best manufacturing facility for fitness equipment in the world.”* PTON 1Q20 CC



The question is Why? We think it is to increase production and have more control over supply as well as launch the rower.

There should have been much better options to increase production that required less capital and less long term operational risk.

**magtonic**  
good to be you

# Few Durable Goods Brands Have a Chain of Stores

The Peloton store concept is akin to Tesla, Tempur-Pedic or a single appliance brand. There are few retailer concepts with such low frequency of shopping as Peloton. In contrast to mattresses or appliances a household most likely would only have one Peloton machine. Peloton has also chosen a strategy of the most expensive malls. Tesla has recently looked to close stores.

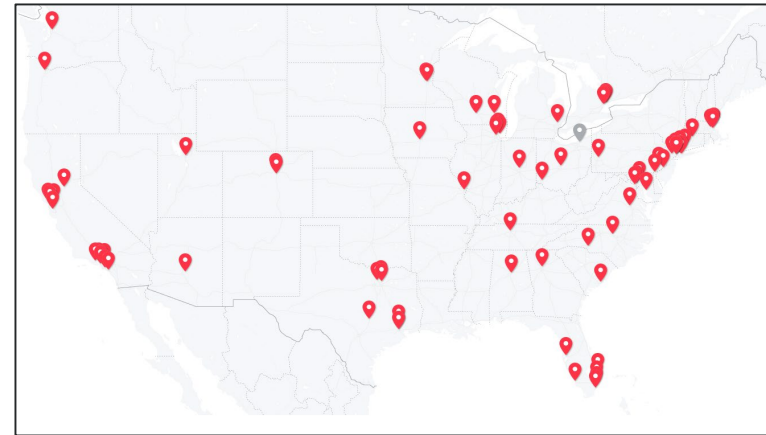
Tesla has 80 gallery/dealerships in the US.

Tempur-Pedic has 57 US stores.

**Peloton has 76 stores in the US**, 6 in Germany, 9 in the UK, and 7 in Canada.

NordicTrack closed all 300 stores in 1998.

The rents are between 11-13% of sales at these malls. Showrooms are 2-3,000 sq. feet while the company also has some microstores at 2-300 square feet.



Peloton's locations are primarily in A malls with a couple of street locations. These are malls with low occupancy costs and high rents.

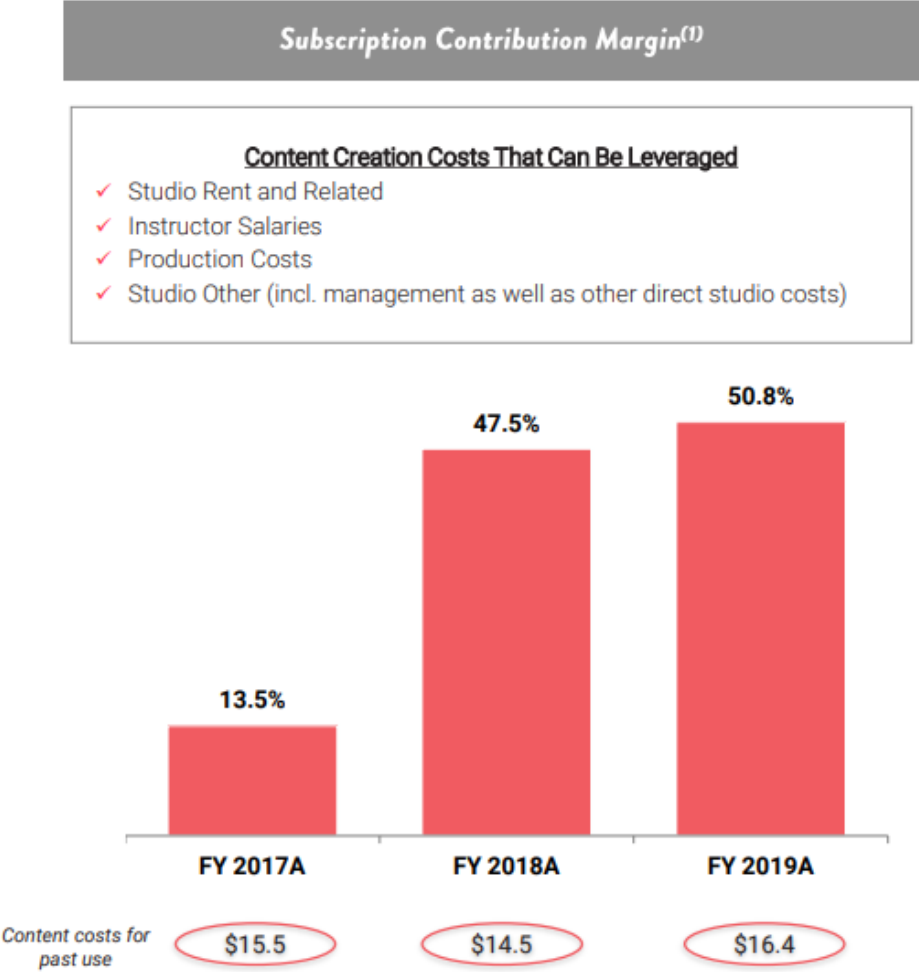
Peloton has \$785mm in operating lease obligations. That includes its expensive HQ.



# Past Music Use Costs Have Been (Will Be) Ongoing

The National Music Publishers Association (NMPA) sued Peloton for \$150mm for copyright infringement.

NMPA president David Israelite said, “It is frankly unimaginable that a company of this size and sophistication would think it could exploit music in this way without the proper licenses for this long, and we look forward to getting music creators what they deserve.”



Peloton excludes the costs of past music payments from its contribution margin, but the costs seem ongoing.

There is no visibility when the payments for past content use end.

Its possible these costs actually head higher as some lawsuits are ongoing.

# Music Can't Be Leveraged, Could Easily Go Higher

Music is the largest variable cost of subscription revenue (~23%).

Peloton is in a worse position than streaming services like Spotify. In addition to paying royalties to music right holders it also has to pay “public performance rights” because it is considered a live concert.

The same percentage YY would confirm that music costs are variable.

The cost of past content use has been \$15.5mm in 2017, \$14.5mm in 2018, and \$16.4mm in 2019. That represents underpayment for past use and most likely represents higher future music costs as the company settles with the music industry that has held out for higher payment rates.

If the contracts on are on a per stream basis, given Peloton is seeing higher adoption and higher engagement, music costs could actually deleverage.

	'18 from '17	'19 from '18
Increase in music costs	\$ 10.9	\$ 23.1
Increase in subscription revenue	\$ 48.0	\$ 101.0
Music cost growth as a % of incremental revenue	23%	23%

Our industry checks indicate that a low 20s% for music costs is likely correct and that if anything the risk is in costs going higher as a % of revenue, not likely to go down.

Music is critical to the value proposition to the consumer and cant be replicated vs getting rights to use it.

# Peloton Churn Definition Breakdown

Why does Peloton present the number this way?

Why use a monthly number? Well it looks so much smaller than a quarterly number, doesn't it?

This is either cancelled subs coming back, or bikes being sold to someone else. Including reactivations understates the real churn and ignores CAC for reactivations.

## Average Net Monthly Connected Fitness Churn

We use Average Net Monthly Connected Fitness Churn to measure the retention of our Connected Fitness Subscribers. We define Average Net Monthly Connected Fitness Churn as Connected Fitness Subscriber cancellations, net of reactivations, in the quarter, divided by the average number of beginning Connected Fitness Subscribers in each month, divided by three months. This metric does not include data related to our Digital Subscribers who pay a monthly fee for access to our content library on their own devices.

Why not just use the quarterly beginning subscriber base? Well if your subscriber count is growing, using the average of the months increases the denominator, reducing the calculated churn.

Why ignore the digital subs? We suspect churn in this subscriber base is much higher, evidenced by the lack of growth this quarter.

# And the Lifetime is Already Down Over a Third

## ATTRACTIVE CONNECTED FITNESS SUBSCRIBER LIFETIME VALUE

Connected Fitness Subscriber Lifetime Value	FY 2019	
	Monthly subscription price	\$39.00
		×
	Subscriber LTV months	154
		×
	(Subscription Contribution plus content costs for past use) divided by Subscription Revenue <sup>(1)</sup>	59.8%
	<b>LTV per Connected Fitness Subscriber</b>	<b>\$3,593</b>

Implied by  $1 / 0.65\%$   
Average Net Monthly  
Connected Fitness Churn

If you valued the company on the average customer life from the S-1, your valuation should be down ~40% already, not counting how much worse churn will get from here.

	Q2 2020	FY 2020
<b>CONNECTED FITNESS SUBSCRIBERS</b>	680,000 - 685,000 88% YoY growth at midpoint	885,000 - 895,000 74% YoY growth at midpoint
<b>AVERAGE NET MONTHLY CONNECTED FITNESS CHURN</b>	<1.05%	<1.05%
<b>TOTAL REVENUE</b>	\$410 - \$420M 58% YoY growth at midpoint	\$1.45 - \$1.50B 61% YoY growth at midpoint
<b>GROSS MARGIN</b>	39% - 40%	41% - 42%
<b>ADJUSTED EBITDA</b>	\$(70) - \$(65)M (16.3%) margin at midpoint	\$(170) - \$(150)M (10.8%) margin at midpoint

LTV Months Implied at ~95  
Down 38% YY !!!



# It's Even Worse When Converting to Annual Properly

	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20E	4Q20E
Avg Monthly Churn Quarter	0.62%	0.50%	0.97%	0.61%	0.52%	0.49%	0.55%	0.85%	0.50%	0.52%	0.68%	0.79%	0.90%	0.74%	1.10%	1.10%
Basic Q Churn	1.9%	1.5%	2.9%	1.8%	1.6%	1.5%	1.7%	2.6%	1.5%	1.6%	2.0%	2.4%	2.7%	2.2%	3.3%	3.3%
Average Subs					115,562	146,102	193,339	231,778	261,312	319,673	409,749	484,156	536,988	637,390	790,003	898,500
Start					107,708	123,416	168,788	217,889	245,667	276,957	362,388	457,109	511,202	562,774	712,005	868,000
Lost					1,803	2,148	3,190	5,910	3,920	4,987	8,359	11,474	14,499	14,150	26,070	29,651
Added					17,511	47,520	52,291	33,688	35,210	90,418	103,080	65,567	66,071	163,381	182,065	90,651
End				107,708	123,416	168,788	217,889	245,667	276,957	362,388	457,109	511,202	562,774	712,005	868,000	929,000
Quarterly Churn					1.7%	1.7%	1.9%	2.7%	1.6%	1.8%	2.3%	2.5%	2.8%	2.5%	3.7%	3.4%
Annual Churn TTM								12.1%	12.3%	10.7%	10.6%	11.7%	14.2%	13.4%	14.5%	16.5%

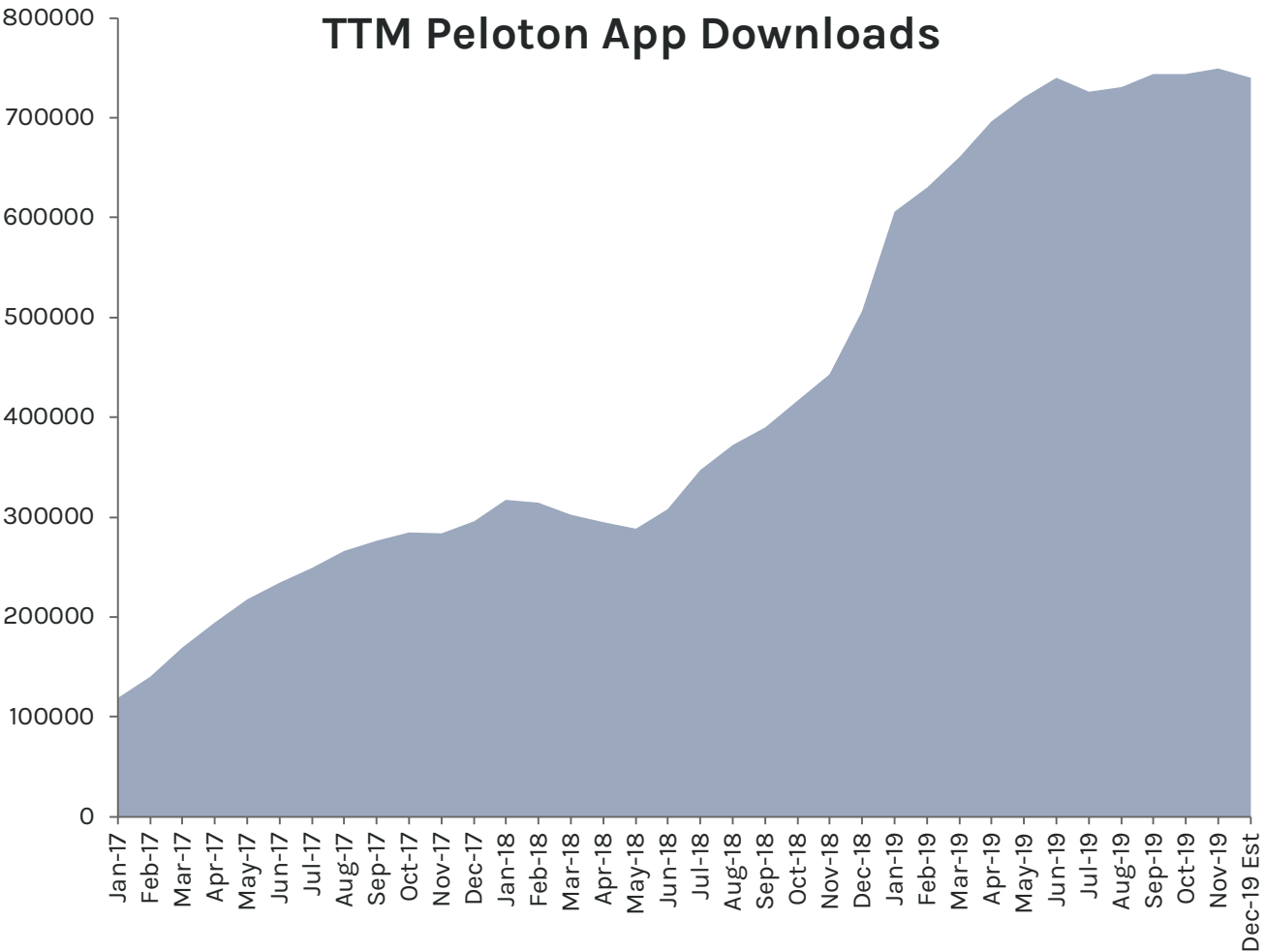
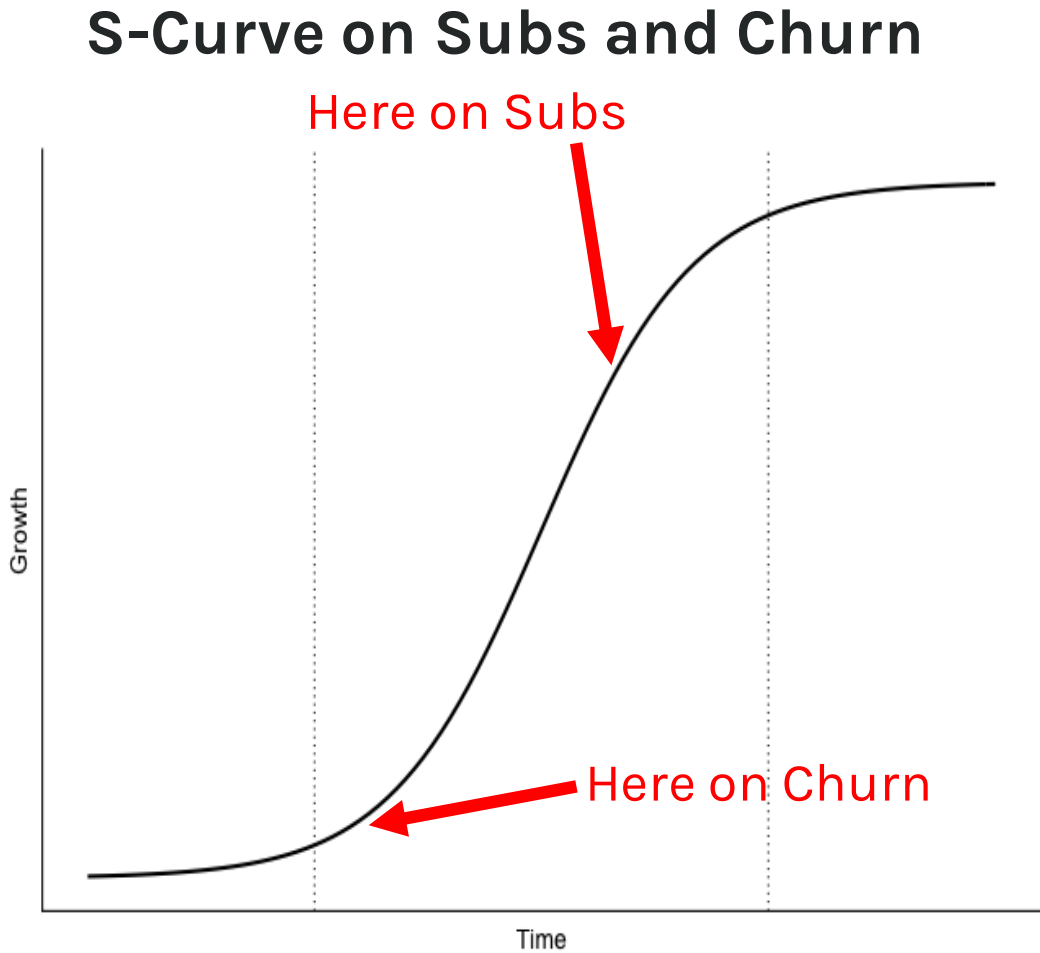
Street Forecasts on End Subs

## Churn Analysis Math

Taking the monthly number and converting it to quarter results and TTM annual churn.

# Peak Interest and Adoption Happening Now

Are we past peak on the S Curve? App Downloads already appear to be slowing.



# Annualized Lifetime Actually Trending to Less Than Half the Implied IPO Value

## S-1 Implied Numbers

2019 Monthly Churn	0.65%
x 12 Months	7.80%
Customer Lifetime	12.8 years

## 2020 Estimated Numbers

Monthly Guidance	1.00%
2020 Estimated Annualized Churn	16.83%
Customer Lifetime	5.9 years

Using where the churn is likely to end up at year end based on estimates and guidance, we get to a 5.9 year customer life. Less than half the number implied on the IPO.

# Segmentation: The Advertising Imagery is Very Elitist

Every person in a Peloton ad is in great shape, lives in a beautiful home, and makes their bike the centerpiece.

Estimated to spend \$108.7mm in 2017, \$141.9mm in 2018 according to Nielsen, and \$112.6mm YTD through November.

In the past month Peloton has aired TV ads 26,148 times, ranking #6 with spending at #34 nationally.

Awareness is very high at 67% as of April, likely much higher after the holiday ad buzz.





# Bowflex in Contrast... “If I Can You Can”



If you take a look at Bowflex's "If I can, you can" marketing campaign you can see a good example of an inclusive and inspiring ad. But this is not what Peloton's marketing has been like. It has not been targeting people who haven't exercised, most likely because it's a high price point.

None of these people would ever be featured in a Peloton add. And Peloton riders workout in front of a large window with the shades drawn.

We're not saying one is better or worse, just that they are clearly segmenting the addressable market.

# Some Figures on Gym Memberships

January is the best month for new gym memberships, but most people quit soon after.

12% of all new gym memberships occur in January. - IHRSA

80% of gym memberships go unused. - IHRSA

The average income of a gym member is \$75,000. - IHRSA

According to a 2012 study, 80% of gym members that join in January quit within 5 months. 14% quit by the end of February.

50% of all new gym members quit within 6 months. - IHRSA

In 2018 the average gym membership in the US was \$58 per month. - Statistic Brain

40% of gym members enroll in group exercise classes.

The two most popular pieces of equipment in a gym are treadmills and strength training machines. - IHRSA

# The Rower Is Likely Next

Tonic Fitness recently filed a patent application for a high tech indoor rowing machine.

Tonic has been developing with Body Alive a rower with magnetic resistance.

United States Patent Application	20190201740
Kind Code	A1
Robert; Tilman ; et al.	July 4, 2019

INDOOR ROWER

Abstract

An *indoor rower* has a frame, a rolling assembly, and a winding assembly. The frame has a beam having a first end and a second end. The rolling assembly is disposed adjacent to the second end of the beam and has a rotatable wheel hub and a cable coiled around the wheel hub. The cable has a first cable end fastened to the wheel hub and a second cable end connected to a handle. The winding assembly has a first pulley set disposed adjacent to the first end of the beam, a second pulley set disposed at the second end of the beam, and an elastic cord coiled around the wheel hub, the first pulley set, and the second pulley set. The elastic cord has a first cord end being stationary and a second cord end being fastened to the wheel hub.

Inventors:	Robert; Tilman; (Troisvierges, LU) ; Wu; Mu-Chuan; (Tainan City, TW)				
Applicant:	Name	City	State	Country	Type
	Robert; Tilman	Troisvierges		LU	
	TONIC FITNESS TECHNOLOGY, INC.	Tainan City		TW	
Family ID:	67057920				
Appl. No.:	15/860860				
Filed:	January 3, 2018				



Peloton’s interest in a rowing machine is likely to head off competition in a “better full body workout” than capturing the existing base of participants that would be attracted to its entry. The largest hurdles for rowing include the general lack of familiarity and educating consumers on how to operate the machine correctly

For more information, contact us at:

**sales@hedgeye.com**  
**(203) 562-6500**