

McIntire Investment Institute

At the University of Virginia



Short Pitch: Dollar Thrifty Automotive Group (NSDQ: SFLY)

shutterfly.

Prepared by Jon Haas | October 7, 2010

Outline

- Company Overview
- Stock Analysis
- Thesis Points
- Catalysts
- Risks
- Recommendation
- Q&A

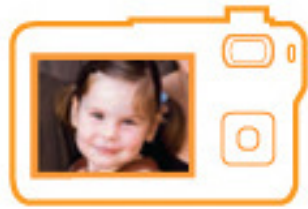


Company Overview

- Internet-based social expression and personal publishing site that provides a full range of personalized photo-based products and services
 - Personalized Products and Services (PPS) – photo books, greeting cards, stationary, etc...
 - Prints – 4x6 and larger photo prints
 - Commercial Print Services – B2B printing for marketing industry
- Free membership, photo storage and sharing - revenue from sale of products
- Founded in 1999, IPO in 2006
- 519 employees, 850 temps during peak period
- HQ in Redwood City, CA



Basic Business Model



Take pictures



Upload them
to shutterfly.com



Turn them into cards,
photo books and gifts



No Profit

Upload



Profit – 66%

- Products
- Shipping Premium
- Advertising

Prints - 33%

Commercial Print Services - 2%



Fundamentals

- Price (10/7): 25.81
- Market Cap: 703.86M
- 52-wk: 13.76-27.17
- Beta: 1.41
- Trailing P/E: 99.65
- Forward P/E: 45.28
- PEG: 3.44
- Diluted EPS: 0.26
- RoE: 3.52%
- Quick Ratio: 6.28
- OCF: 47.14M
- Levered FCF: 12.25M
- Short Ratio: 15.50
- SFLY does not pay dividends



SFLY 52-Week Performance



Misperception

The Street seems to believe Shutterfly will benefit from increased demand from a recovering economy and integration with social media outlets, resulting in improved quarterly performance that will boost annual earnings.

However, Shutterfly will have a hard time meeting lofty earnings expectations and, in the long run, will be unable to survive in a competitive, unprofitable, and unsustainable industry.

Thesis Points

1. Industry analysis shows poor prospects for demand, profitability
2. Shutterfly lacks a competitive advantage
3. Unrealistic earnings outlook requires extraordinary efforts to meet expectations



Thesis #1

Industry analysis shows poor prospects for demand, profitability

Industry: Online Digital Photo Services

- Online publishing and printing services
 - Products vary from photo albums to mugs to business cards
- Revenue from sale of items, shipping premiums, advertising on site



Porter's Five Forces



Industry Rivalry = HIGH

- Numerous direct competitors
- Little product differentiation
- Compete entirely on price, rely on promotions
- Little new market share to capture – must win from competitors



FREE Business Cards

- 250 full-color business cards
- 42 designs to choose from

3 Easy Steps!

[Get Started](#)

TANYA'S DAY SPA
TINA RAE
27 SWAN STREET
TULSA, OK 74106
1-555-555-5555

FREE SHIPPING
ON ORDERS OF \$25 OR MORE

Use code **FS25FALL10** by 10/31.

[Shop and save now](#)



FREE SHIPPING
ON ORDERS OF \$30+

Enter code **SHIP30**

[See special offers](#)



Power of Buyers = **MEDIUM-HIGH**

- Will purchase based almost fully on price
 - Easy to price shop on the internet
- Little brand loyalty – easy to get pics up to different sites
- Can use website without actually spending \$



Power of Suppliers = **MEDIUM**

- Photo company (i.e. Fujifilm) supplies photofilm

FUJIFILM

- Special items produced by 3rd parties

Threat of New Entrants- **HIGH**

- Literally anyone can enter the industry
 - Get a loan
 - Start a website
 - Contract out printing
 - Advertise
- Large players competing in parts of SFLY's business (explained shortly)
- Counter: economies of scale lower costs



Threat of Substitutes- **HIGH**

- Online photo printing
 - facebook
 - photo printing
 - photo bucket
- In-store photo printing
 - CVS pharmacy
 - Walgreens
- In-store kiosks
 - Walmart
 - photo (online)
 - photo
- Home photo printing
- Specialty photographers



Conclusion:

- Incredibly competitive industry
- Many new entrants, strong substitutes
- Wholly price-based competition

- Not good for Shutterfly!!!



Thesis #2

Shutterfly lacks a
competitive advantage



What Could the CA Be?

- Features
 - Technology
 - Ease of use
 - Storage, speed
- Quality
 - Photo quality
 - Product quality
 - Bang per buck



Does Shutterfly Differentiate on Features?

Rank	#1	#2	#3	#4	#5	#6	#7	#8	#9	#10
	Snapfish	SmugMug	Kodak Gallery	Shutterfly	York Photo	Clark Color	PhotoWorks	Walgreens Photo Center	Winkflash	myPhotopipe
■■■■ Excellent ■■■□ Very Good ■■■□ Good ■□□□ Fair □□□□ Poor										
Service and Site Features										
	Upload Video	✓	✓							
	Film Printing	✓		✓	✓	✓	✓			
	Webware Editing Tools	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Free Online Album Sharing	✓	✓	✓	✓	✓	✓	✓	✓	
	Group Rooms	✓	✓		✓	✓		✓	✓	
	High Resolution Downloads	✓	✓		✓	✓		✓		
	Additional Upload Application	✓	✓	✓	✓	✓	✓	✓	✓	✓
	Unlimited Online Storage	✓	✓	✓	✓	✓	✓	✓	✓	
	Inactive Account Expiration	1 year	1 Year	1 year	never	1 year	1 year	1 year	1 year	never
	Order Online-Pick up Same Day at Store	✓		✓				✓		
	Photo Gifts	✓	✓	✓	✓	✓	✓	✓	✓	✓
	FREE - Initial Purchase Offers	✓		✓	✓	✓	✓		✓	✓
	Pre-Pay Discounts	✓			✓	✓	✓			
	Money Back Guarantee	✓			✓	✓	✓		✓	
	Prompt Photo Delivery	✓	✓		✓	✓	✓	✓	✓	✓
	Photo Organizing Application		✓	✓	✓	✓	✓	✓	✓	✓



Ease of Use

- Pro: Shutterfly is easy to use
 - Many reviews praise “very simple photo editor”
- Con: So is everyone else
- Uploading 10 pics took \approx 6 min
 - Compare that to Facebook
- But, very easy to create/save/order items



Integration

- Can share pics from SFLY to FB, Iphone, not other way
- Just acquired Wink
 - Take pics from Computer, Fbook, Shutterfly, Flickr
 - Make 2x6 photo strip
 - Ship anywhere for \$2.50
- Adapting to times
- But, who needs this?
 - Can just share using initial source
 - The person with photos on their iPhone is not the person who wants to share photos offline

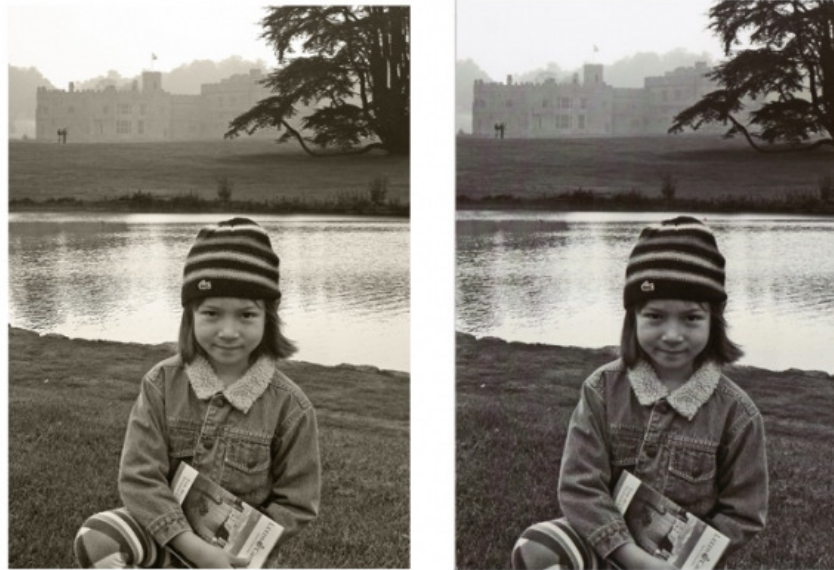


Photo Quality



“**Sunset:** This picture was dark comparatively. With many of the top services, you are able to see the sun-kissed cheeks of our models, but Shutterfly’s print was a little dark. The sunset in the background looked good but we felt that there was just a little too much red in the exposure and it cast a shadow on the models.”

Photo Quality



“**Black and White:** On its own, Shutterfly’s black and white image looked good and seemed to avoid the usual pitfall of too much yellow, but as soon as we started to compare it to the prints from other companies, there was a distinct red tone to the picture. The picture isn’t bad, but compared to some others, it seems to have too much red.”

Photo Quality



“**Aerial:** We felt that Shutterfly’s aerial photo was its best. They managed to take a cloudy skyline and clean it up to really “pop.” However, to do this, they needed to use a significant amount of yellow. Although we like how the photo turned out, the processing made damp and dreary London look like a sunny day in California.”

No Differentiation

shutterfly.com

Sign in | Sign up | Help

Free shipping on orders \$30+, Promo Code SHIP30

My Shutterfly My pictures Share Community Store

Photo Books Cards & Stationery Prints Calendars Photo Gifts Home Décor Occasions Special Offers

hip, hip holiday
INTRODUCING OUR 2010 HOLIDAY COLLECTION
GO AHEAD, SNEAK A PEEK

Get started ▶

FREE SHIPPING
ON ORDERS OF \$30+
Enter code SHIP30
See special offers

Photo Books Cards & Stationery Share

We're falling for fall designs A show of cards Share what's happening

CVS Photo pharmacy

Welcome Guest | Order Status | Shopping Cart (0 items) | Sign In | Sign Up

Home Upload Photos Manage Photos Shop Products Specials Passport Photos My Projects

Why Pay For Shipping?

Over 7,000 Locations

Choose From Express Prints, Photo Books, Cards and Calendars and Pick Up Your Order In-store in About an Hour

Sign In or Join Now

50 FREE Prints When You Join! OR Shop As Guest

FREE Shipping. ALWAYS.
Have your order shipped to any CVS/pharmacy for FREE*

Fall Prints Sale
Buy 60 4x6 Express Prints Get 20 FREE

Save \$2 on Passport Photos Now!

Video & Photo DVDs
Enjoy your home movies and digital images and video on TV!

Walgreens photo

Log in to access your profile or register

photo home my photos prints gifts cards share Shop Walgreens

Visit our Customer Service Center Photo Cart

Need a little inspiration?

50 for \$5 4x6 prints
thru Saturday, October 9

Get coupon code

Welcome
New to the Photo Center?

Create Account

Already registered?
Username
example@walgreen
Password

PRINTS IN AN HOUR at your local Walgreens

Get a FREE Purse Book! 20% OFF Photo Gifts Posters

Walmart Photo

Photo Center FIND Photo Cart

New Customer? Start Here | Sign In | Photo Center Overview | Help

Home Shop My Photos My Projects Tips & Ideas

97¢ Shipping
to your home on all photo gifts*

Shop Now

Why Join Walmart?

- Unlimited Free Long-Term Storage*
- Share Photos and Albums with Friends & Family
- Print photos in 1 Hour
- Over 100 Photo Gifts
- Free shipping to your store with site to store

Sign In Create Account

Create Gifts Order Prints Share View & Edit Upload

Create Over 100 Great Photo Gifts

Browse Our Store

1-Hour Prints & Gifts

Blankets
Cards
Collage Gifts
Memory Books
Mugs
Prints
See All Products



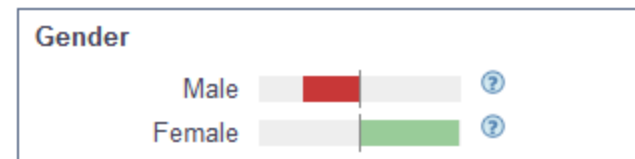
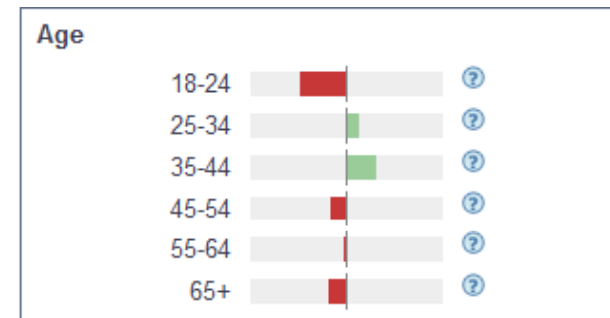
Price and Turnaround

Rank	#1	#2	#3	#4	#5	#6	#7	#8	#9	#10
	Snapfish	SmugMug	Kodak Gallery	Shutterfly	York Photo	Clark Color	PhotoWorks	Walgreens Photo Center	Winkflash	myPhotopipe
<ul style="list-style-type: none"> ■ ■ ■ ■ Excellent ■ ■ ■ □ Very Good ■ ■ □ □ Good ■ □ □ □ Fair □ □ □ □ Poor 										
Pricing										
4 x 6	\$0.09	\$0.19	\$0.09	\$0.15	\$0.08	\$0.08	\$0.19	\$0.12	\$0.08	\$0.19
5 x 7	\$0.79	\$0.79	\$0.99	\$0.99	\$0.79	\$0.79	\$0.99	\$1.59	\$0.25	\$0.99
8 x 10	\$2.99	\$1.99	\$3.99	\$3.99	\$2.99	\$2.99	\$2.99	\$2.99	\$1.49	\$1.89
Photo CD (DVD)	\$9.49			\$9.99	\$2.99	\$2.99		\$2.99	\$9.95	
Volume Discounts	✓			✓		✓	✓			
Shipping										
USPS	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
2-Day Delivery	✓	✓	✓	✓	✓	✓	✓	✓		✓
Overnight Delivery	✓	✓	✓	✓	✓	✓	✓	✓		✓
Average Delivery Time of Prints	2-3 Days	3-5 Days	3-10 days	4-8 days	3-5 Days	3-5 Days	2-5 Days	3-5 days	3-5 Days	3-5 Days
Canada	✓	✓	✓	✓	✓	✓	✓		✓	✓
International	✓	✓	✓	✓	✓	✓	✓		✓	



Conclusion

- Everything Shutterfly does, its competitors do
- Also, they do it cheaper and faster
- Its “unique” offerings don’t add much value
- Site traffic shows gap between users and customers, demographics
 - Not popular with older, younger consumers
- 25-30% view single page



Thesis #3

Unrealistic earnings outlook requires
extraordinary efforts to meet
expectations

Remember...

- Trailing P/E: **99.65**
- Forward P/E: **45.28**
- PEG: **3.44**

Recommendation Summary*	
Mean Recommendation (this week):	1.8
Mean Recommendation (last week):	1.8
Change:	0.0

* (Strong Buy) 1.0 - 5.0 (Sell)

Recommendation Trends				
	Current Month	Last Month	Two Months Ago	Three Months Ago
Strong Buy	6	6	6	6
Buy	3	3	3	3
Hold	4	4	2	2
Underperform	0	0	0	0
Sell	0	0	0	0



Analyst Consensus Estimates

- 1Q 2010: \$ (0.18)
 - 2Q 2010: \$ (0.22)
 - 3Q 2010 est: \$ (0.25)
 - 4Q 2010 est: \$ 0.94
 - FY 2010 est: \$ 0.32
 - FY 2011 est: \$ 0.57
- Analysts are giving SFLY approx. 20% growth yoy per quarter
 - Looked at geometric growth rates, regressions, CAGR
 - I gave them 12% growth yoy for Q1-Q3, 15% Q4
 - Im being really nice ...
unsustainable business model
+ increased competition and substitutes



FY 2010

	Q1 2010	Q2	Q3 (est)	Q4 (est)	FY 2010 (est)
Net Revenue	\$ 45,742	\$ 46,807	\$ 45,354	\$ 150,727	\$ 288,630
CoGS	\$ 22,578	\$ 23,179	\$ 22,677	\$ 58,030	\$ 126,464
Gross Profit	\$ 23,164	\$ 23,628	\$ 22,677	\$ 92,697	\$ 162,166
Operating Expenses:					
Tech&Dev	\$ 12,169	\$ 12,477	\$ 12,246	\$ 14,621	\$ 51,512
Sales & Marketing	\$ 10,157	\$ 11,311	\$ 10,432	\$ 21,554	\$ 53,453
SGA	\$ 8,801	\$ 9,620	\$ 9,071	\$ 14,470	\$ 41,962
Total OpEx	\$ 31,127	\$ 33,408	\$ 31,748	\$ 50,644	\$ 146,927
EBIT	\$ (7,963)	\$ (9,780)	\$ (9,071)	\$ 42,053	\$ 15,239
Interest Expense	\$ (21)	\$ (21)	\$ (21)	\$ (21)	\$ (84)
Interest and other income, net	\$ 242	\$ 194	\$ 227	\$ 151	\$ 813
Income Tax Expense	\$ (3,011)	\$ (3,722)	\$ (3,457)	\$ 16,451	\$ 5,334
Net Income	\$ (4,731)	\$ (5,885)	\$ (5,408)	\$ 25,731	\$ 10,635
Basic EPS	\$ (0.18)	\$ (0.22)	\$ (0.20)	\$ 0.94	\$ 0.35
Diluted EPS	\$ (0.18)	\$ (0.22)	\$ (0.20)	\$ 0.94	\$ 0.35

27.27M shares outstanding



FY 2011

	Q1 (est)	Q2 (est)	Q3 (est)	Q4 (est)	FY 2011 (est)
Net Revenue	\$ 51,231	\$ 52,424	\$ 50,797	\$ 173,336	\$ 327,788
CoGS	\$ 25,616	\$ 26,212	\$ 25,398	\$ 66,734	\$ 143,960
Gross Profit	\$ 25,616	\$ 26,212	\$ 25,398	\$ 106,602	\$ 183,828
Operating Expenses:					
Tech&Dev	\$ 13,832	\$ 14,154	\$ 13,715	\$ 16,814	\$ 58,516
Sales & Marketing	\$ 11,783	\$ 12,057	\$ 11,683	\$ 24,787	\$ 60,311
SGA	\$ 10,246	\$ 10,485	\$ 10,159	\$ 16,640	\$ 47,531
Total OpEx	\$ 35,862	\$ 36,697	\$ 35,558	\$ 58,241	\$ 166,357
EBIT	\$ (10,246)	\$ (10,485)	\$ (10,159)	\$ 48,361	\$ 17,470
Interest Expense	\$ (21)	\$ (21)	\$ (21)	\$ (21)	\$ (84)
Interest and other income, net	\$ 256	\$ 262	\$ 254	\$ 173	\$ 946
Income Tax Expense	\$ (3,904)	\$ (3,995)	\$ (3,871)	\$ 18,920	\$ 6,115
Net Income	\$ (6,107)	\$ (6,249)	\$ (6,055)	\$ 29,593	\$ 12,217
Basic EPS	\$ (0.22)	\$ (0.23)	\$ (0.22)	\$ 1.09	\$ 0.41
Diluted EPS	\$ (0.22)	\$ (0.23)	\$ (0.22)	\$ 1.09	\$ 0.41



Conclusion / Catalyst

- Even with a “nice” growth estimate, Shutterfly will have a hard time meeting earnings estimates
- Missing earnings = not good for share price
- This is what will drag the stock down to a more reasonable price
- Looking for further decline long-term – no competitive advantage, decreasing demand, too many substitutes

Risks

- Increased income, job security → increased leisure travel → more vacations → more photos
- Improved functionality with phones, social media boosts profits
- Increases in demand for B2B photo services
- Very liquid, cash-laden

Recommendation

- Initiate a short position at 1%
- Scale up depending on earnings results, P/E movement
- 3Q earnings call is October 27



VAR

- Sam Odio – Photos Product Manager, Facebook
- Toptenreviews.com
- Direct use of Shutterfly, competitors, substitutes
- More to follow



Any Questions?

Thank you for being a great audience!

