

PAI: How to Think About Marketing in the Post COVID-19 World – Retail Deep Dive – PAI Series – 3 of 3

May 14, 2020

BOTTOM LINE: Following the onset of Covid-19, it has not been surprising to see the strength in eCommerce, but what has caught us by greater surprise has been the boon lower priced media – particularly on FB – has been toward that acceleration. We have spoken to several agencies that are focused on the DTC-native eCommerce segment. Their advertisers indicated that beginning early/mid April, they were seeing multiple successive days of record spend at prices down 30-40% post-Covid vs pre-Covid. Beyond the benefits of lower eCPMs, this has been accompanied by higher conversion rates as well – driving record ROAS for this cohort of advertisers. We have not touched base with any gaming advertisers, but based on FB's comments on their 1Q20 eps call, suspect this is likely driving a further boom. Notably, we have heard about pricing increases though early May on FB in the HSD/LDD range, though pacing still well below pre-Covid 19 levels. Our interpretation is this is more a reflection of firming up of the auction at FB, though it is having a slight negative impact on this cohorts' ROAS.

Looking at a broader set of eCommerce and retail advertisers, we wanted to do a deeper dive via PAI to talk about some of the trends seen through April relative to March and to review a few interesting developments and things that stood out to us during the 1Q20 eps season.

- **Long term changes** - while there has been a clear pull forward of e-Commerce demand as a result of Covid-19, we are hard pressed to not view much of this as structurally changed consumer behavior.
- **Table stakes is getting your online strategy right – yesterday** - if you have not had a cohesive online eCommerce strategy – you better figure one out in a hurry.
 - “Brick and mortar only retailers have lost their only channel, the street, if these businesses are going to survive, its mission critical to get online” – Harley Finkelstein, SHOP COO
- **Some pull forward in demand likely** - so be mindful of overextrapolating growth into 2H – ETSY was the most deliberate in their commentary on this front – having spoken for an extended period of time about the benefit from customers purchasing masks.
 - “We sold over 12 million face masks in the month of April alone. In fact if face masks were a standalone category, it would have been the second biggest category on Etsy in the month of April.” Josh Silverman, ETSY CEO
- **GOOG PLAS** – as we mentioned in PAI and a few call outs in this note, we've received questions as to why this was rolled out now and some believe it is a defensive move vs. AMZN. While this may be part of it, given Covid-19 changes, GOOG's TAM in the space has increased by 4-5x in our view. To the extent the world better categorizes their product catalogs, it can have meaningful positive impacts for other advertising players who would benefit. We lived through this firsthand at Yahoo, and it should not be hard for them to capitalize on the opportunity.
- Some of the quotes that turned our head this earnings season are as follows:
 - “And so in many ways what the situation is doing is it's accelerating the catalyst for people to move from wholesale businesses to direct consumer businesses and move from businesses that traditionally were only brick and mortar to being more in a brick and click sort of model. So pleased to see that and we think that will continue.” – Harley Finkelstein, SHOP COO
 - “The number of consumers making a purchase for the first time from any Shopify merchant grew 8% between March 13 and April 24 compared with the previous 6 weeks. Over that same period, the number of consumers purchasing from a Shopify merchant they've never shopped at before grew by 45% over the 6 weeks leading up.” – Amy Shapero, SHOP CFO
 - This post COVID world is what we're building for and we have shifted accordingly. Shopify's world view has not changed. Our conviction that merchants need to be able to sell to their buyers wherever they may be

Michael Levine

212-514-4682
Michael@pvtl.com

Amazon (AMZN)

RATING: BUY
Target Price: \$2,700.00

Price (5/12/20): \$2,367.92

Alphabet (GOOG)

RATING: BUY
Target Price: \$1,575.00

Price (5/12/20): \$1,348.33

The Trade Desk (TTD)

RATING: BUY
Target Price: \$345.00

Price (5/12/20): \$292.36

Snap (SNAP)

RATING: BUY
Target Price: \$21.50

Price (5/12/20): \$16.77

Pinterest (PINS)

RATING: HOLD
Target Price: \$22.00

Price (5/12/20): \$16.61

Twitter (TWTR)

RATING: HOLD
Target Price: \$32.00

Price (5/12/20): \$28.20

Facebook (FB)

RATING: HOLD
Target Price: \$225.00

Price (5/12/20): \$205.10

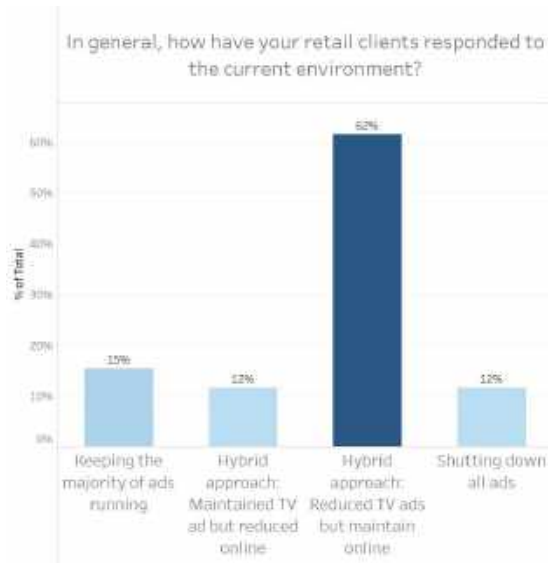
remains as true today as it was a decade ago.” – Harley Finkelstein, SHOP COO

- I think that this is going to be an inflection point for e-commerce and I think that inflection point is going to be meaningful and lasting as much as many of us are really native to online and have been shopping online for years and shop online for many, if not most of our purchases, it's still a very large segment of the economy that shops offline and I think this is a moment when a lot of people are suddenly turning online and discovering that it's really convenient and it works really well for them and I think that that could create some very lasting behavior changes and I think that in that world people aren't going to want to remember 5,000 or 10,000 or 50,000 brands and I don't think they only want to shop in one or two places.” – Josh Silverman, ETSY CEO
- “We believe this period has certainly and permanently accelerated e-commerce adoption in our category. We are seeing not just robust new customer acquisition, but also strong repeat trends from both long-term loyal and recently added new customers.” – Michael Fleisher, W CFO
- “We're definitely seeing an increase digitization of small business, the everyday entrepreneurs who maybe weren't online, didn't have a presence or even had one and needed to get it refreshed in an environment where everyone is finding and discovering things online is absolutely a tailwind for the sector at large. And so we are leaning in with our marketing spend.” – Andre Low Ah Kee, GDDY COO

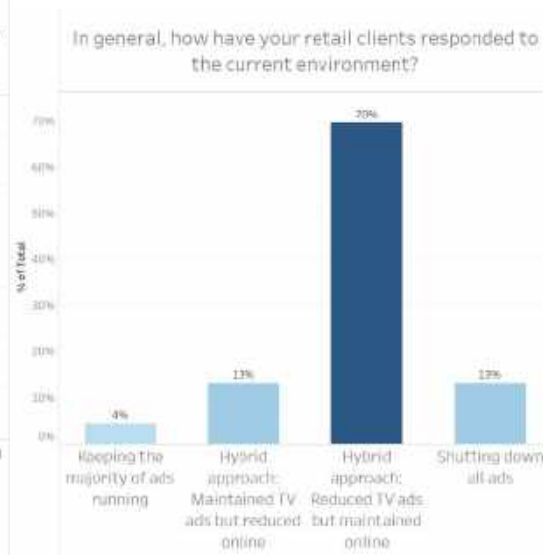
To the extent Internet advertising have not been as tuned into earnings from these names, we thought these summarized some consistent and poignant themes. Economic dislocations have a tendency to identify new winners and new losers so we think this is a fascinating point in time.

In terms of reactions and changes we have seen from the PAI respondent set (skews heavily towards ecommerce and retail), we thought we would provide some interesting vignettes in the exhibits attached:

Exhibit 1: How have retail clients responded?



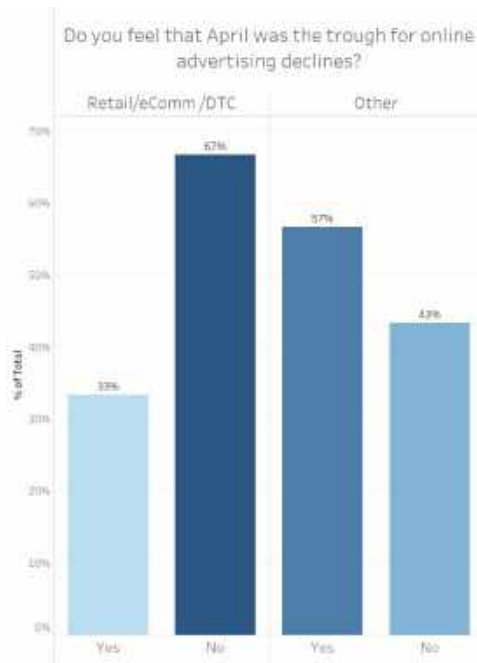
Source: PAI April 2020



Source: PAI March 2020

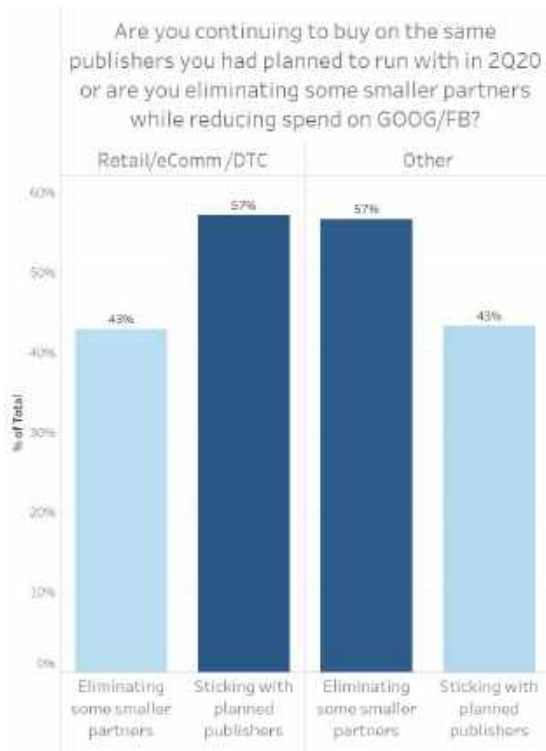
Pivotal Take: The key difference between the results from April vs. March was the change in the percentage of respondents keeping the majority of ads running, which rose from 4% in March to 15% in April, coinciding with a decline in the percentage of people taking a hybrid approach with reduced TV ads but maintaining online. As we've stated, we believe the March read of PAI likely captured people in their most negative outlook.

Exhibit 2: Trough for online ad declines



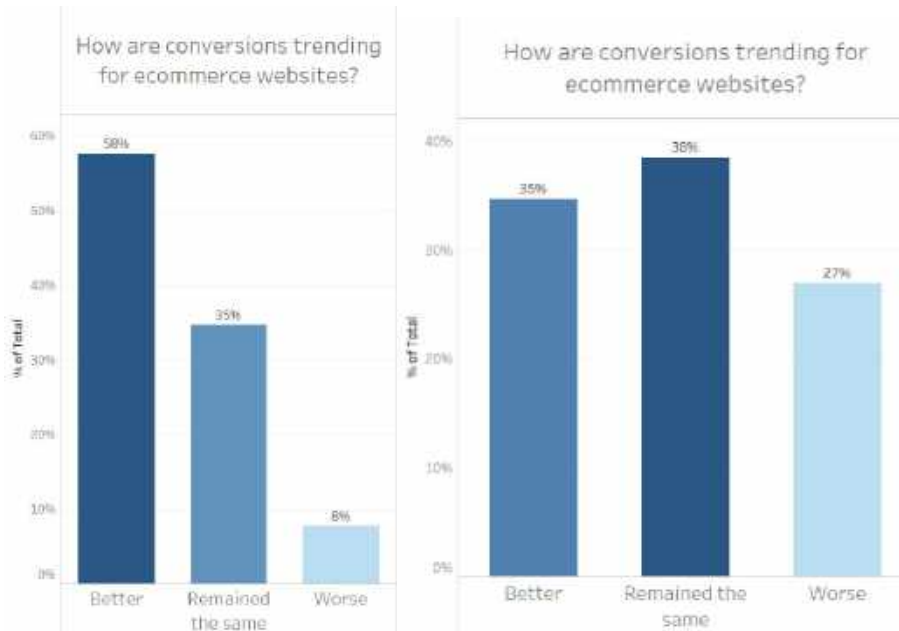
Source: PAI April 2020

Exhibit 3: Sticking with planned publishers or eliminating some smaller partners



Source: PAI April 2020

Exhibit 4: eCommerce conversions – April vs. March



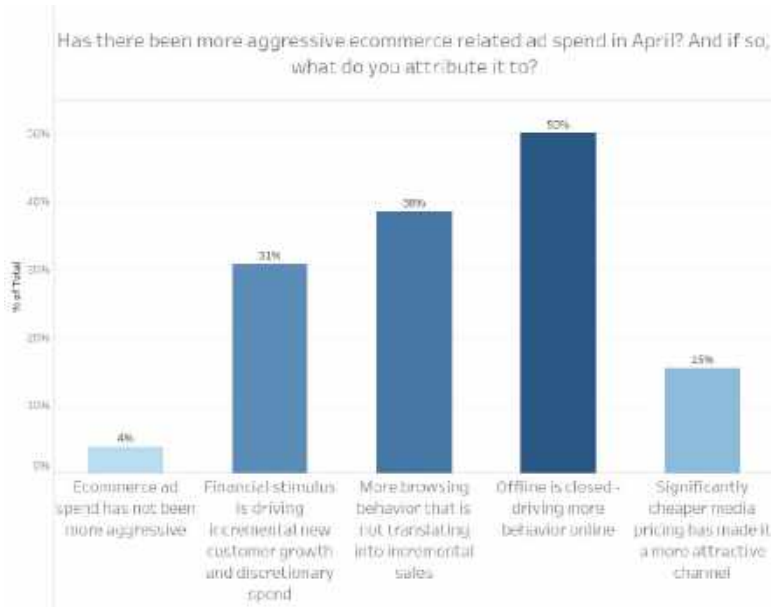
Source: PAI April 2020

Source: PAI March 2020

Pivotal Take: Our data points to significantly better conversions in April vs. March, with the “better” bucket up 23%, the “remained the same” bucket down 3% and the “worse” bucket down 19%. We will be intrigued

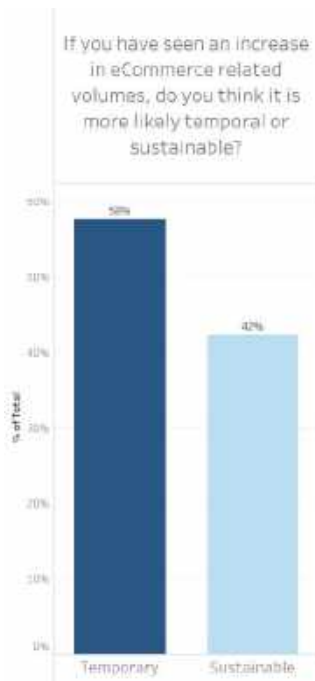
to see how May shapes up as we would suspect the shoppers will continue to be there, but are curious to see how higher prices impact ROAS.

Exhibit 5: eCommerce spend



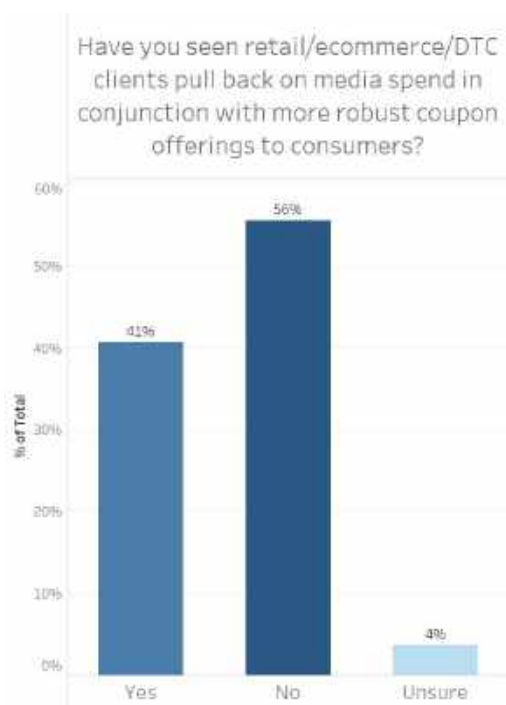
Source: PAI April 2020

Exhibit 6: Is the increase in eCommerce spend sustainable?



Source: PAI April 2020

Exhibit 7: MARCH DATA – media spend and coupon offerings



Source: PAI March 2020

Pivotal Take: A significant percentage, 41% of respondents have seen retail and eCommerce clients pull back on media spend in conjunction with more robust coupon offerings to customers. We believe many of these companies will need to turn over inventory in order to stay in business.

On SHOP's 1Q20 earnings call, COO Harley Finkelstein stated that "merchants are eager to mobilize, implementing discount codes at levels usually seen during the holiday shopping season."

Exhibit 8: MARCH DATA – Please elaborate on the actions retail clients are taking to weather the storm and prepare for summer and fall seasons.

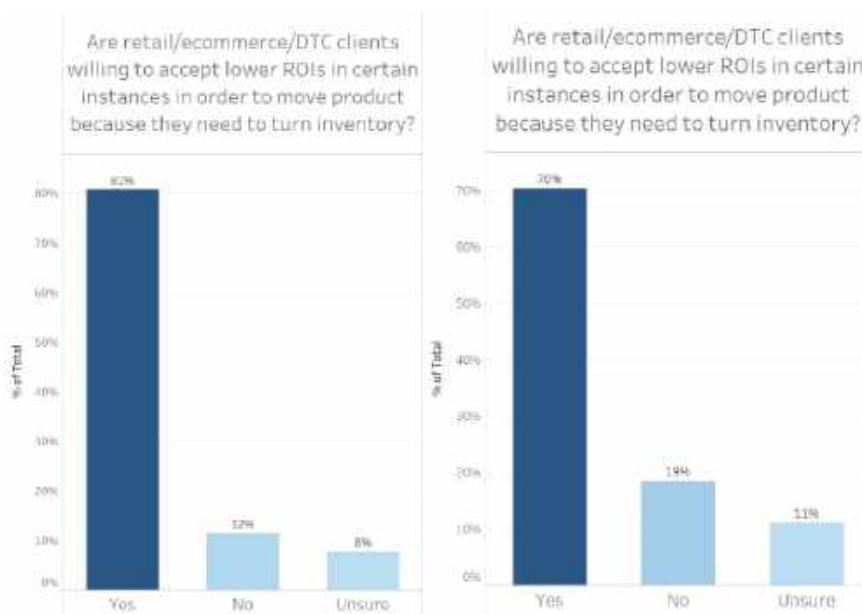
- "Ramp up or pull forward any ecommerce-related initiatives to bolster revenues while majority/all physical locations are closed. Develop dedicated 'restart' plans for when the restrictions are lifted."
- "Pulling back budgets and reducing experimentation with channels that have less defined baselines demonstrating success down to the revenue level."
- "Pulling back budget significantly.. planning varying scenarios of strategy for both media, merchandising and related sales programs"
- "There is a great focus on core customers and retention. Most media spend historically is intended to acquire customers, or move them to different product categories or lines of biz. Right now, it's all about retention. Nobody is thinking of acquisition."
- "Mostly baby steps re: changes and wait and see"
- "I am assuming most of our retail clients are restructuring their debt currently and have no idea what they're ability to market will be in the 2nd half of 2020"
- "Pausing or trying to cancel media contracts"
- "My retail clients are currently saving as much money as they can now in order to keep the business afloat in hopes of rehiring furloughed employees when things return to normal."
- "Retail clients are focusing all efforts to digital driving to e-tail experiences for the now and foreseeable future"
- "My Retail clients have maintained spend levels while revising messaging in market to focus on curbside pick-up options and revised store hours. My eCommerce clients have reduced budgets"

to align with reduced inventory levels and increased shipping times. They have not provided any coupons as they tend to focus on higher-priced products (electronics).”

- “Keeping their on-line presence so when consumers are ready to start spending money again they have the awareness of their brands.”
- “Retailers like Target and Walmart are thriving given they can weather the storm thru grocery. Nordstroms and Macy’s are going to struggle in this economy”
- “Retail clients are taking this time to research their customer and find new ways to communicate with them”
- “Actions depend on the product and it’s importance to daily life. Not a great time for luxury categories with amount of layoffs.”
- “Many of our retail clients are only advertising at the bare minimum return on investment at this time. They are trying not to drive people from wanting to go to their stores. Their own websites are getting more traffic and direct conversions.”
- “Once stores open, more spend will come back to kick-off w/media support”

Source: PAI March 2020

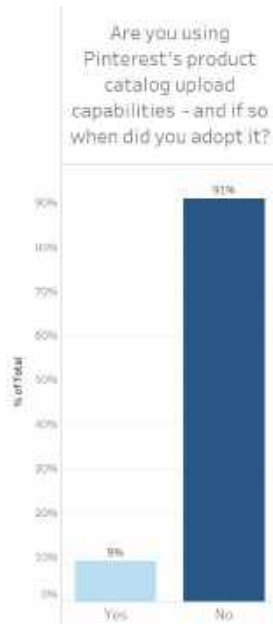
Exhibit 9: ROI – how does it impact advertiser behavior?



Source: PAI April 2020

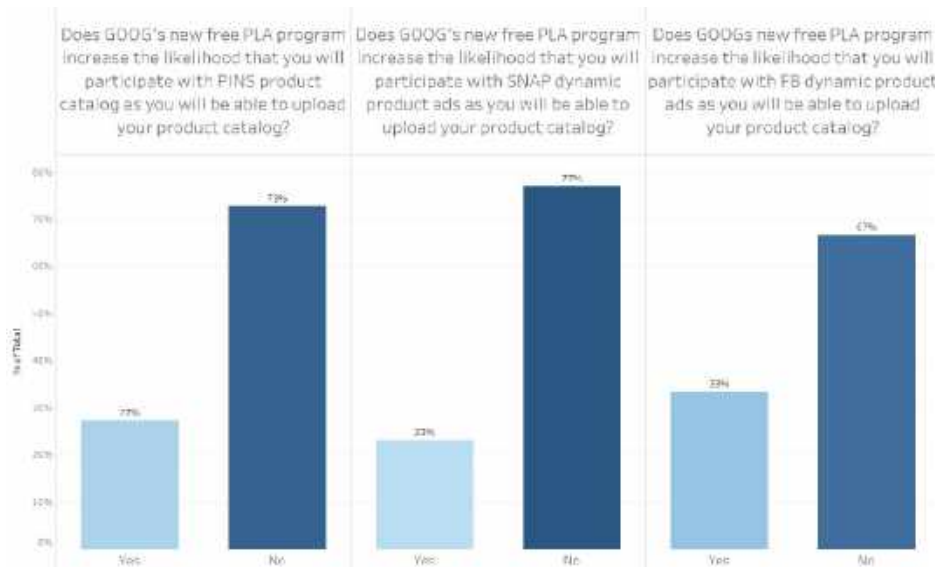
Pivotal Take: This is the one concerning point we saw, and are still unconvinced that there could be some element of retail advertisers – particularly larger offline players – who may be holding their noses in order to push product.

Exhibit 10: Pinterest product catalog upload



Source: PAI April 2020

Exhibit 11: Google's new PLA program



Source: PAI April 2020

Pivotal Take: We think GOOG free PLAs could be a game changer for moving forward ecommerce adoption across the online advertising ecosystem. We recognize that this is early days given the program just rolled out, but we think this is less about a defensive move by GOOG and could have far ranging implications.

Appendix: Important Disclosures

Analyst Certification

I, Michael Levine, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company and their securities. I further certify that I have not received and will not receive direct or indirect compensation related to specific recommendations or views contained in this research report.

Legal Disclaimers

Pivotal Research Group LLC is an independent equity research company and is neither a broker dealer nor offers investment banking services. Pivotal Research Group LLC is not a market maker for any securities, does not hold any securities positions, and does not seek compensation for investment banking services. The analyst preparing this report does not own any securities of the subject company and does not receive any compensation directly or indirectly from investment banking services.

Stock Ratings

Pivotal Research Group LLC assigns one of three ratings based on an expectation of absolute total return (price change plus dividends) over a twelve month time frame. The ratings are based on the following criteria:

BUY: The security is expected to have an absolute return in excess of 15%.

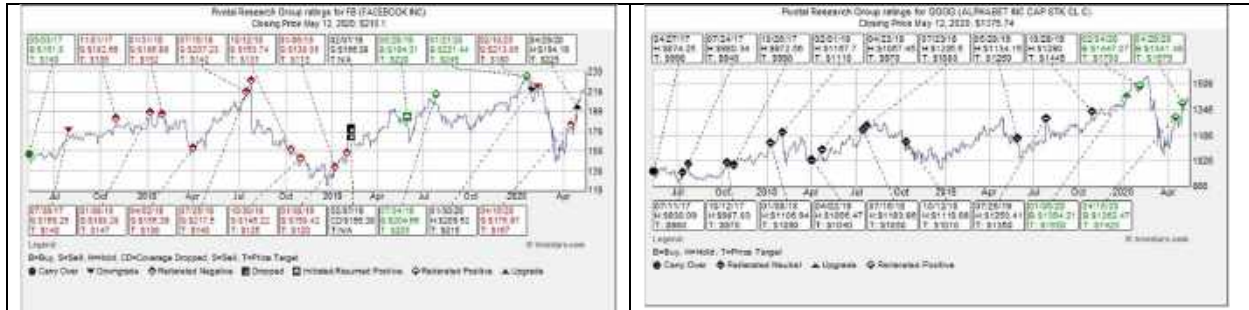
HOLD: The security is expected to have an absolute return of between plus and minus 15%.

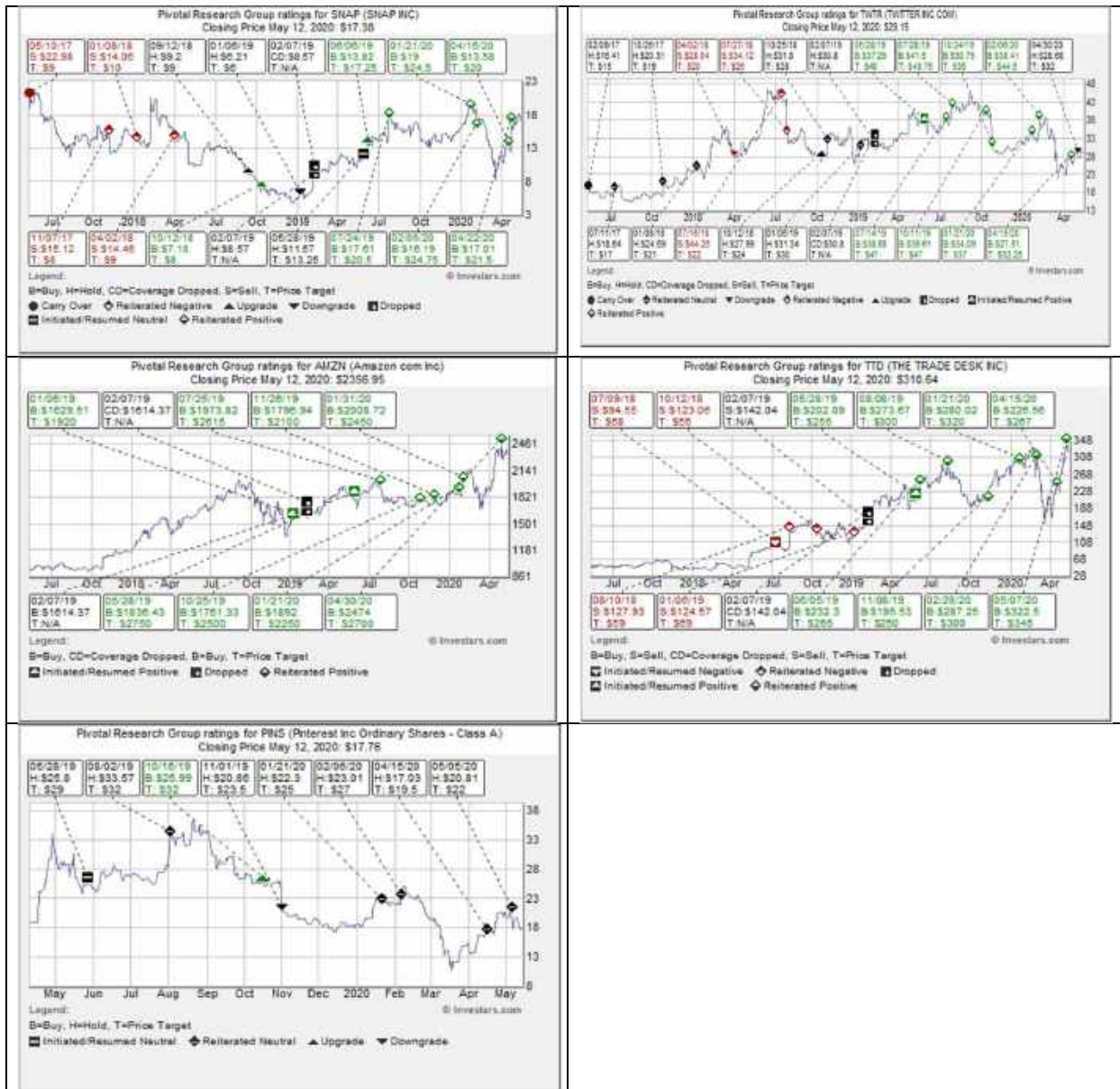
SELL: The security is expected to have an absolute return less than minus 15%.

Ratings Distribution

Pivotal Research LLC currently provides research coverage of 35 companies, of which 63% are rated BUY, 34% are rated HOLD, and 3% are rated SELL. Our company does not offer investment banking services. This data is accurate as-of 5/13/20.

Price Chart and Target Price History





Other Disclaimers

Information contained in this report has been prepared from sources that are believed to be reliable and accurate but are not guaranteed by us and do not represent a complete summary or statement of all available data. Additional information is available upon request. Furthermore, information and opinions expressed are subject to change without notice and we are under no obligation to inform you of such change.

This report is has been prepared solely for our institutional clients. Ratings and target prices do not take into account the particular investment objectives, financial and/or tax situation, or needs of individual investors. Investment decisions should take into account all available information, not just that which is contained in this report. Furthermore, nothing contained in this report should be considered an offer or solicitation by Pivotal Research Group LLC to buy or sell any securities or other financial instruments. Past performance is not indicative of future performance and estimates of future performance contained in this report are based on assumptions that may not be realized.

Material in this report, except that which is supplied by third parties, is Copyright ©2020, by Pivotal Research LLC. All rights reserved. No portion may be reproduced, sold, or redistributed in any form without express written consent of Pivotal Research Group LLC.

Commission Sharing Arrangements

Pivotal Research Group LLC has commission sharing arrangements (CSA) with numerous broker-dealers. Please contact Jeff Shelton at 212-514-4681 for further information.

Additional Information Available Upon Request