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INTRINSIC VALUE ASSESSMENT OF

STAMPS.COM (STMP)

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Introduction

Stamps.com is a leading provider of Internet-based mailing and shipping solutions both in Europe and the U.S. The company offers customers the possibility to print postage approved by the United States Postal Service (USPS), requiring only a PC and a printer.

The firm operates under multiple brands like Stamps.com, Endicia, ShipWorks, ShipStation, or Metapack and offers its services both to individuals, small businesses, and large corporations.

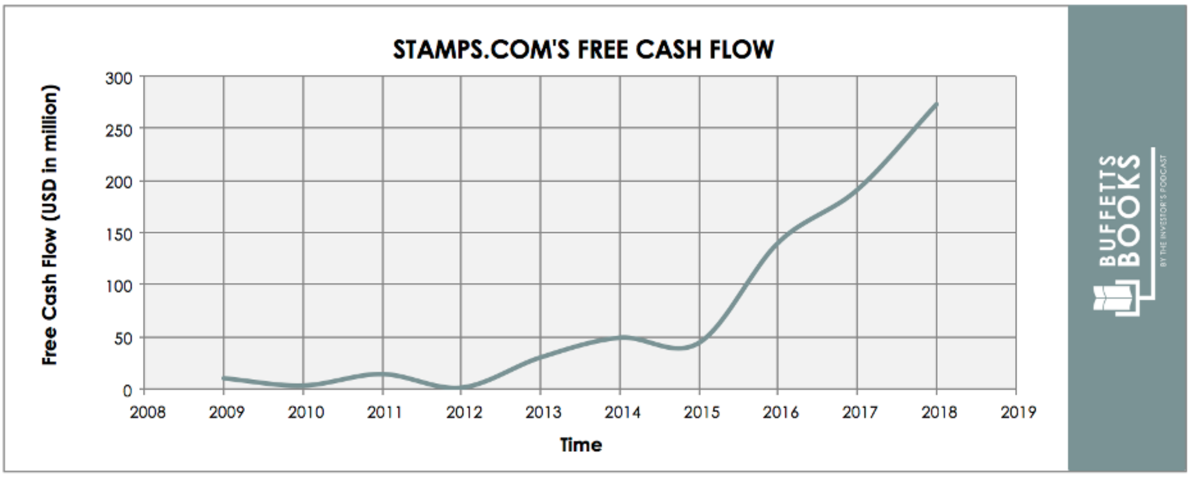
Stamps.com has managed to grow revenue dramatically from $10 million in 2009 to $273 million in 2018. During this time, EPS rose from $0.38 to $8.99, and book value increased from $4.82 to $36.95 – an annual increase of 41.6% and 25.1% respectively.

Due to these very high growth rates, Stamps.com used to be a darling of Wall Street, trading as high as $285 only one year ago. But then the company experienced a double blow in 2019. Firstly, its exclusive relationship with USPS via Negotiated Service Agreement (NSA) was ended. Three months later, USPS also announced its intention to renegotiate the NSAs from existing resellers, thus also cutting this indirect relationship between STMP and USPS.

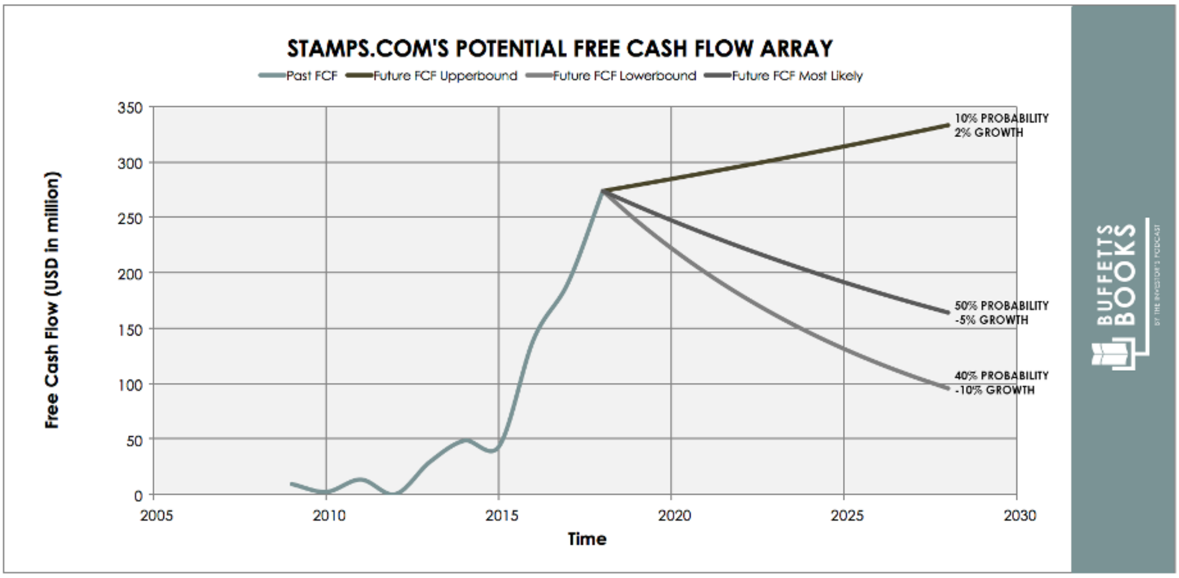
Both issues are highly problematic for Stamps.com since they strongly affect the core of its business model. As Stamps.com has already drastically reduced its earnings and revenue guidance, the stock dropped like a stone and trades for currently $46.33. Is Stamps.com now a bargain worth buying or are the risks for its business models too great?

The Intrinsic Value of Stamps.com

To determine the value of Stamps.com, let's start by looking at the company's history of free cash flow. The free cash flow is important because it represents the company's ability to retain earnings and grow the business. Most importantly, it demonstrates a return on the principal that might be invested into the ownership of equity of the business. Below is a chart of Stamp.com's free cash flow over the past years.



The growth in free cash flow surely looks impressive – but due to multiple recent obstacles, this growth cannot be expected to continue in the next years. In fact, even a drop in free cash flow seems highly likely. We will, therefore, use a very conservative estimate for Stamps.com's future cash flows.



Each line in the above graph represents a certain probability for occurring. We assume a 10% probability for the upper band to be 0% annually, and for the most likely scenario, we estimate an annual decline of 7%, which we assign a 50% probability. The worst-case scenario could be a contraction of 15% every year, that is considered quite possible. We estimate the probability of that to happen to be 40%.

Assuming these growth rates and probabilities are accurate, Stamps.com can be expected to give a 23.7% annual return at the current price of $46.33. Now, let's discuss how and why those free cash flows could be achieved.

The Competitive Advantage of Stamps.com

Stamps.com possesses some unique advantages that should allow it to be successful in the future:

- **Leading Provider.** Stamps.com remains by far the leading provider of internet-based shipping solutions. This position could also give Stamps.com clout when dealing with the USPS. While there are other USPS-approved PC postage services like EasyPost and Pitney Bowes, Stamps.com offers a superior user interface and a larger number of features.
- **Sticky business.** Stamps.com's churn rate (the percentage of subscribers that are discontinuing their subscriptions) in the latest quarter was a very low 2.9%. This indicates that customers tend to stay loyal and seem to be satisfied with the offer from Stamps.com.
- **Chances due to canceled USPS deal.** One must bear in mind, that Stamps.com decided to cancel the NSA with USPS, not the other way around. While the risks of this move are obvious, it also gives Stamps.com new possibilities, since it is no longer bound by this rather restrictive agreement. Now Stamps.com can do more deals and agreements with other players.

Opportunity Costs

When looking at various investment opportunities on the market today, let's compare the expected return of Stamps.com to other ideas. First, one could invest in the ten-year treasury bond, which is producing a 2.04% return. Considering the bond is completely impacted by inflation, the real return of this option is likely only around 1%. Currently, the S&P 500 Shiller P/E ratio is 29.75. As a result, the US Stock market is priced at a 3.36% yield. If one were to invest in the S&P500, they might purchase a low-cost ETF to take advantage of this return.

Macro Factors

The mailing and shipping business is vast and will only grow more important in the future. While Stamps.com is a leading provider of Internet-based mailing and shipping solutions in the U.S. and Europe, this large business attracts multiple competitors. Users have many other ways to use the services of USPS, and there are also many other private carriers, package manifesting systems, and enterprise software solutions that offer easy mailing and shipping systems.

Until recently, the NSA with the USPS gave Stamps.com a huge advantage over these competitors. It remains to be seen, how successful Stamps.com can operate without this competitive advantage. The market might also experience a major disruption in the future if, for example, Amazon delivers much or even all of its shipping itself.

Risk Factors

Several risks might limit the growth prospects of Stamps.com:

- **End of NSA with USPS.** In February 2019, the company announced that it ends its exclusive relationship via Negotiated Service Agreement (NSA) with the U.S. Postal Service. As a result of the company drastically decreased its sales and earnings targets and lowered its guidance. This is especially problematic because many of Stamps.com's customers were lured by its favorable USPS prices due to the NSA. No longer able to offers such cheap prices, Stamps.com may lose both customers and see a drop in its margins.
- **Renegotiating of NSAs between USPS and its resellers**. In May 2019, the USPS announced its intention to renegotiate its existing NSAs with its resellers. This might also threaten the indirect relationship of Stamps.com with the USPS using these intermediate companies.

- **Amazon's aggressive expansion into the shipping market**. Amazon is both friend and foe for Stamps.com. The deliveries of Amazon's postage accounted for a whopping 88% of Stamps.com's revenue. This makes Stamps.com very dependent on Amazon, which is especially risky since Amazon explores several ways to deliver its goods itself – thus no longer relying on Stamps.com's services.

- **Goodwill**. Stamps.com's impressive growth was at least partly realized by multiple acquisitions. As a result, the company has currently $385 million goodwill on its balance sheet, which is more than half of its market capitalization. If this huge amount of goodwill has to be written down in the future, earnings can easily become negative. On the positive side, Stamps.com's debt level seems sustainable and does not yet raise a red flag.

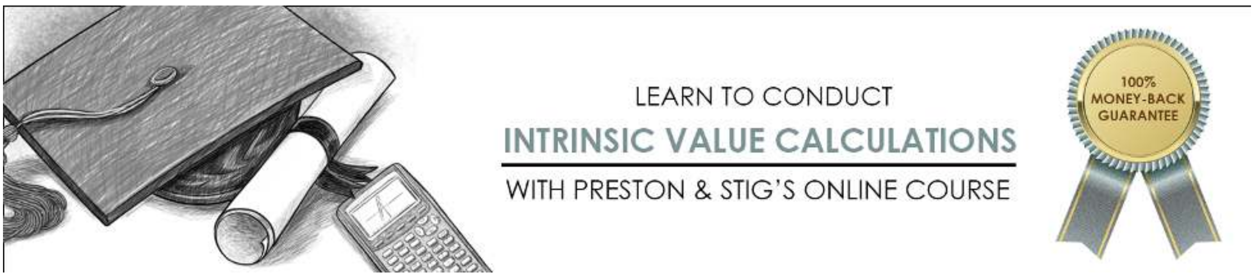
Summary

Stamps.com is an intriguing company. On the one hand, its historical performance has been breathtaking and has included very high growth rates in revenue, earnings, free cash flow, and book value. The company is an important player in a vast global market that can be expected to remain relevant for the foreseeable future.

On the other hand, its whole business model has been completely turned upside down by the cancellation of the NSA with the USPS and the renegotiation of the NSAs between the USPS and its resellers. Obviously, this makes Stamps.com's future path highly uncertain and the business in five years will probably look very different from the one today.

Although risky, the decision to cut the relationship with the USPS also holds interesting opportunities for Stamps.com. While the USPS remains relevant, its numbers and influence have been declining for years. Doing "business as usual" with the USPS would therefore also have carried risks for Stamps.com.

At this point, it is quite hard to determine if this is a bargain or a value trap. If Stamps.com manages to prosper within the new business environment, this stock could offer vast returns of 23.7% annually. If not, things can go downhill very fast. Before investing in Stamps.com, investors are well-advised to investigate the company in more detail.



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