

Valuing Peloton

Peloton Interactive (PTON), a well-known unicorn in the connected fitness space, had gone public with a market capitalization of over \$8.0 billion. In the weeks following its public debut, PTON's stock price had fallen by over 25%. Taylor Knox, a stock analyst and enthusiastic Peloton subscriber, must determine the fundamental value of Peloton's shares, as well as identify and evaluate the key risks associated with its innovative business model.

Case Questions:

- What are the key elements of Peloton's business model? Which aspects of the business model are the most appealing? Which aspects are the most troubling?
- Using the information provided in Table A and Exhibit 6, how many subscribers will Peloton have as of November 8, 2026? In your analysis, make the following assumptions:
 - Peloton has 511,000 subscribers on November 8, 2019.
 - Peloton subscriber cancellations in each 12-month period are calculated based on the number of Peloton subscribers at the end of the 12-month period (see the revenue build template).
 - All new Peloton subscribers join at the beginning of each 12-month period.
- Conduct a discounted cash flow (DCF) valuation of Peloton as of November 9, 2019. What is the value of a share of PTON? Please perform a DCF for the following two scenarios:
 - *Scenario 1:* assuming the 'Historical Performance' metrics in Table A are expected to hold in the future.
 - *Scenario 2:* assuming the 'Analyst Expectations' metrics in Table A are expected to hold in the future.
- What does your analysis imply about PTON's current stock market valuation?
- In what ways do subscriber cancellations pose a risk (or not) to Peloton's business model? Would you recommend that Knox invest in the stock at the current price of \$23.46? Why or why not?

Hints & Assumptions:

- In your analysis, use the projected number of subscribers to determine Peloton's aggregate future cash flows.
- A 'revenue build' template has been provided to you. This spreadsheet includes a schedule on how to forecast the total End-of-Period subscribers each year.
 - See Exhibit 6 for forecasts for subscriber additions.
 - CFP revenue is a function of 'new gross joins' and the price per unit sold. In 2019, the average price per unit is \$2,395 (accounting for both bikes and treads). Assume that the average price per unit will rise with 2% inflation per year.
 - Subscription revenue is a function of End-of-Period (EOP) subscribers. The monthly subscription price in 2019 is \$39. Assume that this price will rise with 2% inflation per year.

- Do not worry about forecasting revenue for the ‘Peloton Digital Subscribers’ (subscribers without a fitness product). Per the case, there were 102,000 of these subscribers in 2019, however as noted in the footnote (a) on page 3, the revenue from these subscribers is offset by marketing costs. As such, we will assume a zero impact to free cash flow.
- A DCF template has also been provided to you.
 - Cost of goods sold has *fixed* components (which do not fluctuate with revenue) and *variable* components (which fluctuate with revenue).
 - Variable CFP costs can be derived from information in Table A. In the table, the CFP gross margins are provided for the two scenarios. For example, under the ‘historical performance’ scenario, the CFP gross margin is 43%. Variable CFP costs are thus 57% (1-43%) of CFP revenue each year.
 - Variable subscription costs are 28% of subscription revenue each year (page 3 of the case).
 - Fixed media production costs are \$53 million in 2019 and will increase with 2% inflation each year.
 - Marketing costs (subscriber acquisition costs) are variable costs and are a function of ‘New Gross Joins’. Subscriber acquisition cost are outlined in Table A (and the per-subscriber amount will increase with inflation).
 - R&D costs are fixed in nature; the 2019 amount is provided in the Income Statement (Exhibit 2) and will increase with inflation.
 - G&A costs are fixed in nature; the 2019 amount is provided in the Income Statement (Exhibit 2) and will increase with inflation.
 - Assume a 25% marginal tax rate.
 - See Exhibit 6 for capex and depreciation forecasts.
 - Assume that the company makes an investment in net working capital (NWC) equal to .3% of sales (sales * .003) each year.
 - Use the Gordon growth method for terminal value; assume that the company’s FCFs grow at 2% in perpetuity after 2026
 - The company’s WACC is 12%.

Case Submissions:

The assignment is due at the beginning of class on Thursday, October 3. Please submit a written memo (two pages maximum) plus appendices that summarizes your findings in PDF format on Blackboard. Include all relevant spreadsheets and tables in the PDF (do not upload your Excel file to Blackboard). Please use the following format:

Date: October 3, 2024
From: Team Member 1, Team Member 2, Team Member 3, Team Member 4 and Team Member 5
To: Scott Abrams
Re: Valuing Peloton

**Note: If you inadvertently submit a wrong file to Blackboard, you can resubmit the correct file before the deadline.*