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Coinbase: It's worth owning some COIN

A lot happened this week. Bitcoin hit new ATH's and crypto is showing signs of market rotations. Our current views on the crypto market are the following:

- Crypto bull market cycle intact
- Bitcoin valuations haven't peaked
- Macro picture mixed but favorable
- Crypto cooling off would be healthy
- Institutions more cautious on crypto
- Signs of retail money entering picture
- Still favor buying GBTC over spot Bitcoin
- Still see Ethereum outperforming Bitcoin
- Size leadership shifting to retail midcaps
- Exchange tokens to DeFi sector rotation

We want to give folks a sense what we're seeing in the market broadly but we're not going to go into the above this week. Instead, we're going to focus our note on our thoughts about the Coinbase public offering.

Coinbase (COIN) went public via a direct listing on Wednesday. This was the most highly anticipated crypto industry offering of the year.

In some senses, it went very well. The company technically traded up ~30% from the reference price of \$250 and closed at \$332 on the day. During the day, COIN shares hit a high of \$429 giving the company a market cap that briefly surpassed the \$100B mark.

But in another sense, I think the COIN offering tells us something else very interesting about the market – institutions may be getting more cautious on crypto for now. Why do we think this? A few reasons:

- COIN futures were trading north of \$600 on the offshore crypto exchange FTX just before the official pricing was set in the high \$300 range – we think this says crypto native investors were very bullish buyers of Coinbase with a lot of euphoria leading into the listing
- Crypto stocks sold off and the GBTC premium widened on Wednesday – we think this says institutional investors were raising capital from existing crypto holding to reallocate towards Coinbase instead of putting new money to work
- Compared against the arguably blow out quarter we saw in Q1, sell-side analysts are forecasting lower ~~more~~ numbers though the balance of the year – we think this says either the company gave analysts conservative guidance (if that still happens these days) or The Street thinks Coinbase will lose share or thinks the crypto market has peaked
- Using Wall Street consensus estimates, institutions are pricing COIN like a traditional exchange stock at the high end of the valuation range, which sounds like investors are paying up for growth on the surface but once you factor in relative growth it implies COIN looks like a cloud stock – we think it shows institutions are very bearish about that growth continuing
- Even the Mad Money host, Jim Cramer, admitted on CNBC that he sold half his Bitcoin holdings on Wednesday – we think this was also signaling bearishness on crypto prices to the Wall Street retail crowd

In last week's note, we reserved from giving a recommendation on COIN, but we'll now offer our opinion on the stock (although we are not formally covering the stock):

- We think investors should have some Coinbase (COIN) exposure at current levels given it's the largest publicly traded pureplay crypto stock and we remain bullish on the crypto market long term
- We don't mean this harmfully, but we're not yet ready to accept that Wall Street has best sense for forecasting crypto markets given past performance and we're not reading too much into the signal yet
- We think Wall Street forecast of Coinbase having lower but sustained growth after Q1 may signal a bullish counter trade where consensus is implying that Bitcoin will be steady, and we are not yet at the top of the bull market
- We're seeing signs that we're at the phase of the cycle where new retail investor money is entering crypto in a larger way (i.e. XRP & DOGE moves as of late) and if we're on the edge of more retail crypto trading, Coinbase seems likely to still be the place to go for now
- When we look at the bull & bear case for buying COIN, we think it favors the bull side for now, as we'll discuss

With any asset, there are always reasons to invest and reasons not to invest. We believe the bull and bear case for Coinbase in many institutional investors' minds could be the following:

Bull Case:

1. **Bull Market:** Coinbase could grow revenue simply by maintaining share with their current customer base who will grow trading volumes and assets along with the overall market as crypto continues higher
2. **Internet 2.0:** Coinbase could be riding a wave of secular growth with crypto being the next era of internet innovation which changes the way information, value, products, and people flow across the globe
3. **Business Mix:** Coinbase could grow revenue due to their shift towards higher growth segments such as alt coins, and custody services
4. **New Services:** Coinbase could increase revenue by offering and growing additional services such as borrowing & lending or staking by leveraging their existing base of \$223B assets on the platform, making those assets more spendable with credit cards, and leveraging their existing base of 56M user (6.1M monthly transacting) to enter traditional markets with assets such as tokenized stocks
5. **Operating Execution:** Coinbase could continue its track record of successful execution by leveraging its leading market position and strong balance sheet to transition the business
6. **Sustainable Growth:** Coinbase could successfully transition from being viewed by the market as a cyclical crypto pureplay to more traditional fintech with lower business volatility, a lower risk premium, and higher multiples
7. **Investor Euphoria:** Coinbase could become a 2.0 version stocks like Zoom, which saw investors paying 125x forward price to sales (!!!) during the COVID "stay at home" growth phase, if crypto has another 2017 run

Bear Case:

1. **Bear Market:** Coinbase may be about to see its business decline, crypto markets may be near their top and that would mean trading fees, assets, customers, and revenue in general would decline drastically as a result
2. **Market Potential:** Coinbase is in an industry that has seen crypto exchange volumes exceeding legacy exchange volumes which may mean growth is near its TAM and crypto may be in a massive speculative trading bubble that will see volumes materially flatten or decline
3. **New Competition:** Coinbase will have slower growth or lose customers to existing crypto exchanges offering more innovative products, fintech retail brokerages offering crypto, new institutional-focused crypto exchanges targeting the next wave of sophisticated funds, and legacy investment houses with entrenched relationships
4. **Pricing Erosion:** Coinbase will come under fee pressure from emerging CeFi and DeFi competitors who will force them to lower pricing to maintain share, leading to slower revenue growth even if crypto continues growing
5. **Operating Risk:** Coinbase is in a position where it needs to invest aggressively to transition its core business model away from trading which could crush the ~60% margins reported in Q1 far lower than other exchanges and the company could be in trouble if it mismanages cash flows by overinvesting before a bear market
6. **Regulatory Risks:** Coinbase is exposed to regulatory risk and some of the altcoin assets it lists or wants to list could be deemed securities by the SEC which could harm its growth prospects
7. **AOL Dot.Com 2.0:** Coinbase is largest and most successful crypto company to become public to date but it could be like AOL which was an early winner but later replaced by better businesses

Our View:

1. **Bull/Bear Cycle:** We remain bullish on crypto and reiterate our FY 2021 forecast from Jan-21 which calls for BTC, ETH & the total crypto market to reach \$100k, \$10k, and \$5T, respectively. Our forecasts imply the crypto market could be ~125% higher in Q4-21 vs. Q1-21. Wall Street consensus calls for lower Coinbase financials vs. Q1 21 through the balance of the year. If we're correct, street consensus estimates could be materially wrong
2. **Crypto Opportunity:** We continue to maintain the view that crypto is the next wave of the web, as we've written about extensively. Imagine looking at an email company during the early days of the internet and saying: *"my god, more emails are being sent than post office letters, no one can read all this, it must be spam, it must be a bubble, I'm not investing"* It seems obvious today most wouldn't think that, and making the decision to invest or not with that view would be a mistake, but things aren't always obvious at the time. Crypto payment volume is already on pace to exceed credit cards with ~85% being between exchanges – let that sink in
3. **Growth vs. Competition:** We certainly see new competition coming into Coinbase's market. But that has almost always been the case since it was launched in 2012. And the Company has managed to maintain its market share, especially in the U.S. until now. We think the latest shifts to embrace more coins outside BTC & ETH were smart. We forecast alts rising much faster than Bitcoin over the next 9 months and that could lead to more trading and more assets on the platform generating higher fees. We view the growth in institutional customers over the last few quarters as encouraging. We think the increased market mix towards institutions will grow the pie of custody services vs. self-hosted wallets used by retail, which could generate higher fees. We've been able to observe the backlog of institutional clients over the prior quarters first-hand based on the time we've seen it take for new folks to get accounts set up with the exchange due to high demand. But if we had to guess, we think COIN caters more to a plain vanilla customer base and new more sophisticated competitors that are entering the market vying to service the next wave of crypto fund strategies. But we think this will take some time. In the meantime, we think on the retail side Coinbase maintains a strong lead with the 56M registered users, that's higher than most fintechs and digital banking apps. Although only a portion are monthly today, we think as the market rally continues, more retail money, which we think has been largely on sidelines vs. institutions this cycle to date, will enter the market and Coinbase will be the easiest place to go. From there, having those customer relationships will be valuable for selling other services in a rapidly maturing market
4. **Lower Fees vs. More Services:** We think on the retail side Coinbase maintains a strong lead with the 56M registered users, that's higher than most fintechs and digital banking apps. Although only a portion are monthly today, we think as the market rally continues, more retail money, which we think has been largely on sidelines vs. institutions this cycle to date will enter the market and Coinbase will be the easiest place to go. From there, having those customer relationships will be valuable for selling other services in a rapidly maturing market. This could boost revenue growth even in the lower pricing
5. **Operating Outlook:** We think that it is still to be seen if Coinbase can successfully transition its business away from transaction fees and towards other services, but we're optimistic, and if it comes out on the other side as dominate for the next era of crypto, the price will be higher even if it temporarily kills margins
6. **Business Sustainability:** We think its way to early to say if Coinbase will be the AOL of the crypto era, but we think for now and over the foreseeable year or longer, the business will still have a strong market position. We think the U.S. regulatory environment is increasingly moving in Coinbase's favor. We think if Coinbase can transition to a more diversified fintech market, the street will give it more credit for future growth
7. **Investor Perception:** Comparing crypto exchanges to traditional exchanges feels somewhat like comparing websites to newspapers. We think Coinbase should be viewed closer to a cloud play. We think if crypto gets moving higher COIN could see multiple expansion as many cloud stocks did during the wave of COVID growth

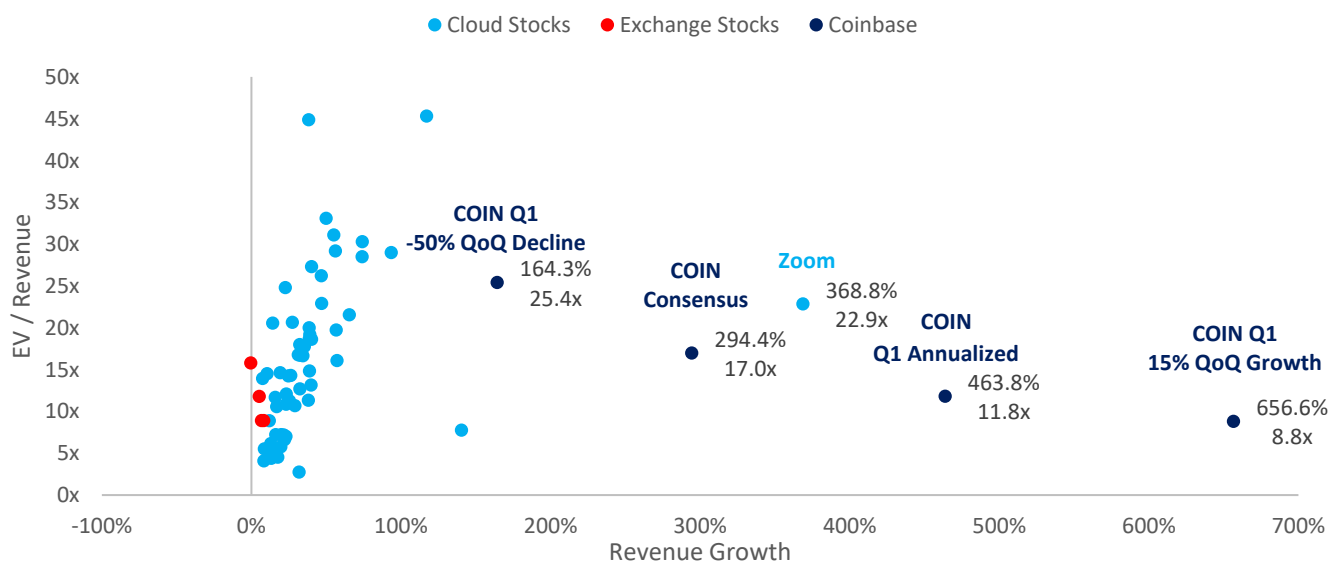
Now that we've weighted the bull and bear case, let's look at some possible scenarios for Coinbase's valuation below:

- Coinbase consensus numbers are correct for FY 21
- Coinbase can put up similar numbers as Q1 for rest for the year
- Coinbase can manage to grow revenue 15% QoQ (50% higher Q4 vs. Q1)
- Coinbase revenues fall -50% QoQ in a bear market (-85% lower Q4 vs. Q1)

	Wall Street Consensus	Coinbase Q1 Annualized	Coinbase Q1 15% QoQ Growth	Coinbase Q1 -50% QoQ Growth
Revenue FY 2020A	\$1,277	\$1,277	\$1,277	\$1,277
Revenue FY 2021E	\$5,037	\$7,200	\$8,988	\$3,375
<i>Growth</i>	294%	464%	604%	164%
Closing Price (4/15/21)	\$328.50	\$328.50	\$328.50	\$328.50
Fully Diluted Shares (M)	261.30	261.30	261.30	261.30
Market Capitalization (M)	\$85,837	\$85,837	\$85,837	\$85,837
Cash & Equivalents (M)	\$1,062	\$1,062	\$1,062	\$1,062
Total Debt Outstanding (M)	\$379	\$379	\$379	\$379
Enterprise Value (M)	\$85,154	\$85,154	\$85,154	\$85,154
<u>EV / Revenue</u>	<u>16.91x</u>	<u>11.83x</u>	<u>9.47x</u>	<u>25.23x</u>

Source: Fundstrat, Company Reports, Bloomberg, Analyst Reports

Based on the YoY revenue growth vs. implied EV/ Revenue multiples below, it seems to imply that institutional investors are possibly being overly bearish about giving Coinbase credit for its growth:



Source: Fundstrat, Bloomberg

Even if crypto markets take a ~90% dive by end of the year and Coinbase quarterly revenues fall 50% QoQ into that, the company would today be trading at a ~25X revenue multiple and would have still generated 165% YoY growth – doesn't that deserve to be trading like a high growth cloud stock?

We understand that future performance is all that matters but if that happened does the market think that's the end of Coinbase growth or is the market just pricing Coinbase like a super cyclical stock that's hyper-sensitive to near-term growth?

Peloton P/S



Zoom P/S



Source: YCharts

Maybe Coinbase is a fad stock like Peloton (devoted riders please forgive me) or something that's perhaps transformative (in the eyes of some) like Zoom? If either are the case, what could happen to the Coinbase multiple if the crypto market sees further bullish growth?

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