FEATURE

Grubhub Shares Could Slide 25% as Competition Grows

The meal-ordering service is facing more competition and higher costs. That's a recipe for indigestion.

By VITO J. RACANELLI
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Amazon.com and UberEATS are poised to take market share from Grubhub. *John Kuczala for Barron's*

Grubhub, the online food-ordering service, has enjoyed strong revenue and profit growth since 2013, helped by its first-mover advantage. But new rivals, including some with deeper pockets, are entering the business, and threaten to nibble away at the company's lucrative niche.

At the same time, Chicago-based Grubhub is facing rising delivery expenses as it seeks to expand beyond the country's most densely populated urban markets. The combination of increased competitive and cost pressures could damp financial results, and send the stock (ticker: GRUB) down over 25% in the next year or so. Grubhub went public in April 2014 at $26 a share. Some analysts see the shares sliding to $25, or lower, from a recent $34.51.

Grubhub's Web and mobile platform matches diners with neighborhood restaurants for prepared-food delivery. The company has signed up more than 50,000 eateries in 1,100 U.S. cities, and boasts 8.2 million active users. Grubhub charges restaurants 15% to 30% of an order tab for a listing, and roughly 15% more for delivery. Consumers also pay a $2 to $3 delivery fee.

Grubhub recently reported 2016 revenue of $493 million, up 36% year over year. Earnings rose 30%, to $49.6 million, or 58 cents a share, based on generally accepted accounting principles, or GAAP, although they missed estimates in the fourth quarter by two cents a share on an adjusted basis. Revenue is expected to rise 26% to 34% this year, to $620 million to $660 million, while earnings could come in at 78 cents on a GAAP basis.

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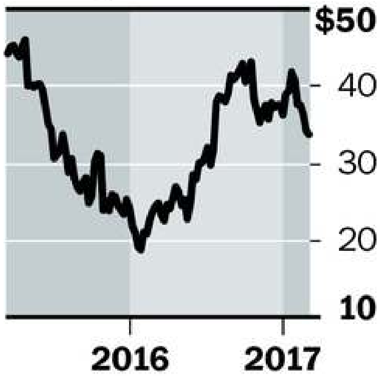
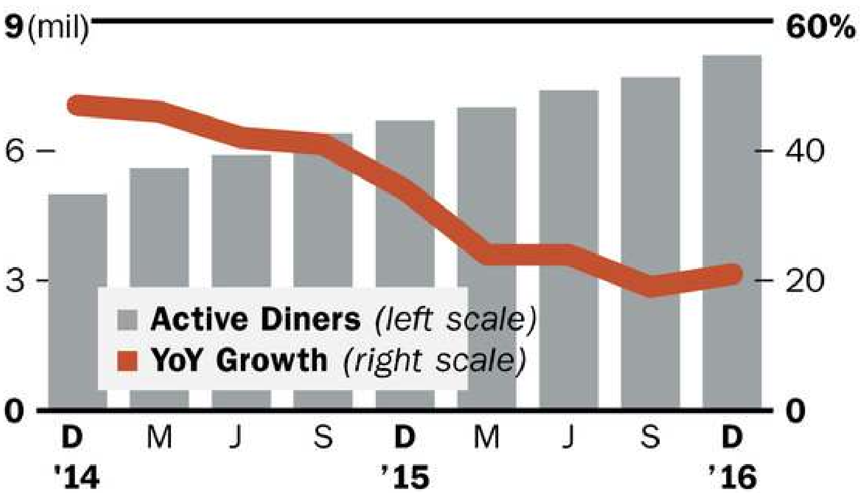
GAAP figures include stock-based compensation, which *Barron's* has long argued should be recognized as a business expense. On a non-GAAP, or adjusted basis, analysts expect Grubhub to earn $1.08 a share this year, up from last year's 89 cents.

GrubHub
(GRUB - NYSE)
Weekly close on Mar. 16



Recent Price	$33.74
52-Week Change	38%
Market Value (bil)	$3
2016 Revenue (mil)	$493
2016 Net Income (mil)*	$49.6
2016 EPS*	$0.58
2017E EPS*	$0.78
2017E P/E	43

*Based on GAAP E=Estimate



Sources: Bloomberg; MSUSA; company reports

Grubhub trades for 44 times this year's GAAP estimates, a lofty multiple that leaves little room for error. But the company's rapid growth rate and continued success are by no means assured.

To the contrary, certain business metrics, while still robust, have been steadily deteriorating. Active diners—consumers who used the service at least once in the past 12 months—rose 21% in the fourth quarter, down from 34% growth in the year-earlier quarter, and 47% growth in the final quarter of 2014. Similarly, average daily order growth fell to 21% last year from 75% in 2013. As Grubhub expands and competition encroaches, growth rates are likely to slow further.

UBER TECHNOLOGIES' UberEATS and Amazon.com 's (AMZN) Amazon Restaurants have joined the online-ordering fray, and could be Grubhub's most formidable competitors. Both charge rates similar to Grubhub's but have better delivery capability. UberEATS already has an army of drivers and Uber customers across the U.S.; Amazon Restaurants doesn't charge Amazon Prime members for delivery currently. Both could steal market share by offering discounts to restaurants and consumers. Indeed, restaurants list on multiple platforms, and consumers can easily toggle among ordering apps.

Howard Penney, an analyst at Hedgeye, an independent research firm, expects Uber, Amazon, and smaller order-and-delivery outfits, including PostMates and Yelp Eat24, to cut into Grubhub's market share, estimated at a market-leading 10% to 15% of the current delivery market.

Some 70% to 75% of Grubhub's orders comes from New York and Chicago, cities where restaurants typically handle their own deliveries. As the company looks to grow elsewhere, a delivery infrastructure will become more important—and potentially costly. In the past two years, Grubhub spent $155 million to buy four delivery companies, including LAbite.com, to service second- and third-tier markets such as Los Angeles, Boston, and Philadelphia. That is a tacit acknowledgment that delivery—a low-margin business that management intentionally had avoided—is going to be an important future capability.

Grubhub said in its fourth-quarter earnings call that delivery investments will "approach a de minimis level" by the end of 2017. That's a "strategic mistake," says Penney, as it underestimates the cost of building delivery capacity outside of major cities.

Moreover, order frequency is likely to be lower outside New York and Chicago, where having prepared food delivered is common, says James Cakmak, an analyst at Monness Crespi Hardt. Yet the company will have to maintain a basic delivery presence, regardless of order frequency.

Grubhub also is planning to increase its national TV advertising this year. The company recently issued guidance of $165 million to $190 million for 2017 adjusted earnings before interest, taxes, depreciation, and amortization, up from $145 million last year, noting that the wide guidance range builds in flexibility on promotional activity. In other words, it might have to spend more on marketing than in the past.

The Bottom Line

Grubhub shares could fall to $25 in the next year or so from a recent $34.51. With growth slowing, the company deserves a P/E of 20 to 25, not today's 44.

Longer-term, Cakmak sees Grubhub's revenue growing in line with e-commerce generally, at a rate of about 15% a year. Given such growth estimates, a P/E multiple of 20 to 25 seems more appropriate than the current valuation. Even if applied to adjusted earnings estimates for 2017, that would suggest a stock price of $22 to $27. The Wall Street consensus probably hasn't incorporated Grubhub's rising promotional and delivery spending into its estimates.

Grubhub declined to make CEO Matt Maloney available for comment. The company says that order frequency trends are stable to up, and that its delivery capability will allow it to service restaurant chains.

Sam McBride, an analyst at New Constructs, an independent stock-research concern, thinks Grubhub investors' main hope is that the company will be acquired, although the current valuation could discourage buyers. A potential acquisition doesn't seem like a reason to buy the stock, however. With growth trends slowing and costs expected to rise, Grubhub is more likely to give investors indigestion than a meal-ticket to fatter gains.

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sarah de luca 2 days ago

Well, we're quite glad d that we didn't follow the advice in your last July's article. So instead, as Chicago burb residents we became consumers of GRUB's services rather than its business owners. We find it strange that Barron's wouldn't provide a link to that prior story, as you so often (and refreshingly do) for many other review pieces.

My general take here is that the competition you now speak of surely was there as well last July, and surely GRUB's multiples were equally unappetizing at that time?

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