BEHIND THE NUMBERS
Quality of Earnings Analysis

Jeff Middleswart
jmiddleswart@btnresearch.com

Bill Whiteside, CFA
bwhiteside@btnresearch.com

www.btnresearch.com

September 25, 2023

DoorDash, Inc. (DASH)
Earnings Quality Review

We are initiating earnings quality coverage of DASH with a 2- (Weak) rating.

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

DoorDash has considerable liquidity with over $4 billion in cash and securities and no financed debt. However, its cash flow, earnings, and Adjusted EBITDA depend on adding back a growing stock-compensation figure. DASH is losing money on a GAAP basis but is beating forecasts for non-GAAP EPS. We see several low-quality sources of non-GAAP EPS that exceed the 21-cent earnings beat DASH reported for 2Q23. There are also some key operating risks with the business model that investors should watch:

- Adding back share compensation is not only the primary reason DASH has positive non-GAAP earnings but also the only reason it has positive adjusted EBITDA. On existing stock awards, there is still $2.5 billion that is unexpensed with stock compensation already costing $312 million in 2Q23 ***(See below for details)***.

- Stock compensation as a percentage of sales has risen from 10% to 14.5% - helping non-GAAP EPS further. Sequentially this jumped from 11.3% of revenues to a more normal 14.6% in 2Q23 – adding 18 cents to non-GAAP EPS.

- Interest income is excluded from adjusted EBITDA, but not non-GAAP EPS. This is cash income that is being generated as DASH sits on its IPO cash from 2020. The question is can interest income grow at anything close to recent rates as it jumped from $1 million to $28 million y/y in 1Q23, adding 7 cents to EPS and from $4 million to $34 million y/y in 2Q23, adding 8 cents to EPS.

- Deferred Contract Costs are another EPS driver. These are sales commissions and the costs to onboard a merchant to the system, which are capitalized and amortized over time. The difference between costs paid and what is amortized into income is about $7-$9 million in most quarters which is about 1.8-2.2 cents in higher EPS. 2Q23 saw a $4 million jump y/y giving DASH 2.6 cents vs. 1.6 cents:

	2Q23	2Q22	1Q23	1Q22
New Costs	$25	$10	$17	$13
Amortization	$15	$4	$10	$6
Net Change	$10	$6	$7	$7

- Adjusted EBITDA and non-GAAP EPS also add back litigation and regulatory settlement items as one-time. Much of this relates to classing its drivers as independent contractors and not as employees. Both the government and the company's own Dashers have been filing legal challenges examining this so it does not appear to be one-time in nature but a persistent risk. DASH has already agreed to payouts in some cases and is also being investigated over payroll taxes. In the 2Q23, this added 13 cents to non-GAAP EPS and $49 million to adjusted EBITDA. This has been about 5 cents for several quarters before 2Q23, so the last quarter saw 8 cents of non-GAAP growth. ***(See below for details)***

- DASH is gaining some EPS by holding down advertising growth. Advertising was down in 2022 vs. 2021 to $1.1 billion from $1.2 billion on a 35% increase in revenue. In 1Q23, advertising was up $51 million y/y likely back to 2021's run-rate on a 40% increase in revenue y/y. In 2Q23, advertising was only up $25 million against a 33% y/y jump in revenue. If it should have been closer to $50 million in 2Q, this added 6 cents to EPS. Advertising likely needs to rise as DASH deals with more competition and expands its offerings.

- Revenue has several components that may change relating to incentives offered to customers and Dashers. Items like a free delivery to get a customer to order or a higher payment to Dashers during peak hours are netted against revenue along with tips paid to Dashers and the net proceeds paid to merchants. Competition may force these incentives/payouts to increase. DASH also benefits from inflation as the payment from the restaurant is computed off the total order value. The thing to keep in mind is if DASH books $3-$4 in revenue on a $40 order, there are enough potential pressures to see how that could become $2-$3 instead on the same order. ***(See below for details)***

Adding Back Stock Compensation Is Skewing Several Metrics

DASH adds back stock compensation in several areas of its results. The stock compensation is also continuing to rise rapidly. Without this growth, we would argue that DASH's actual profitability and growth are more subdued. It certainly is diluting EPS. It should be obvious that without adding back stock compensation, DASH would not be profitable:

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22	4Q21
GAAP EPS	-$0.44	-$0.41	-$1.73	-$0.77	-$0.72	-$0.48	-$0.46
Share Comp/Share	$0.80	$0.59	$0.72	$0.65	$0.63	$0.37	$0.39
Non-GAAP EPS	$0.49	$0.23	-$0.68	-$0.06	$0.09	$0.00	-$0.01

- There are more charges being added back than just share compensation for non-GAAP EPS.

- In 4Q22, DASH had a $305 million write-down of an investment in a grocery delivery platform that impacted both GAAP and non-GAAP EPS by 82 cents.

- Against the high share compensation figure, DASH is seeing dilution as a headwind to EPS Growth:

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22	4Q21
Share count	388.7	390.4	371.4	384.8	364.0	349.2	336.8
y/y count change	6.8%	11.8%	10.3%	13.1%	8.7%	6.5%	n/a
NonGAAP EPS	$0.49	$0.23	-$0.68	-$0.06	$0.09	$0.00	-$0.01
Dilution headwind	-$0.03	-$0.03	-$0.04	-$0.02	-$0.01	n/a	n/a

We want to point out that share compensation increased as a percentage of sales and the change between 1Q23 and 2Q23 played a big role in the large non-GAAP EPS beat:

	2Q23	1Q23	4Q22	3Q22	2Q22	1Q22	4Q21
Share Comp % Rev.	14.6%	11.3%	14.7%	14.8%	14.4%	8.9%	10.2%

- In 2Q23, share compensation bounced up to $312 million from $231 million in 2Q22 and $230 million in 1Q23. That 450bp increase is adding about 25 cents per quarter to non-GAAP EPS.

- Sequentially, the move from 11.3% to 14.6% from 1Q23 to 2Q23 added 18 cents to DASH's non-GAAP EPS, and the company beat forecasts by 21 cents.

The Adjusted EBITDA is a key metric that DASH touts and gives guidance for the next quarter and full year. The only other guidance is for Marketplace Gross Order Value – which is the total value of all placed orders including taxes, tips, and consumer fees, excluding orders through Drive and StoreFront. There are some other other items in here as well that we will discuss below in more detail:

DASH EBITDA	**2Q23**	**1Q23**	**4Q22**	**3Q22**	**2Q22**	**1Q22**	**4Q21**	**3Q21**
GAAP Loss	-$172	-$162	-$642	-$296	-$263	-$167	-$155	-$101
Depreciation/Amortization	$128	$123	$111	$118	$81	$59	$49	$41
Interest Income/Exp.	-$34	-$27	-$16	-$9	-$4	-$1	$0	$0
Taxes	-$9	$17	-$17	-$5	-$9	$0	$2	$0
Normal EBITDA	-$87	-$49	-$564	-$192	-$195	-$109	-$104	-$60
Share Compensation	$312	$230	$268	$251	$231	$130	$133	$125
Other Income/Exp.	$4	$1	$305	$2	$3	-$5	-$1	$1
Legal, tax, regulatory	$49	$19	$19	$14	$15	$24	$11	$17
Transaction/Restructuring	$1	$3	$87	$12	$47	$14	$8	$2
Impairment	$0	$0	$2	$0	$0	$0	$0	$1
Adjusted EBITDA	$279	$204	$117	$87	$101	$54	$47	$86

- Again, we want to point out that DASH has negative EBITDA if it does not add back share compensation.

- It also would seldom have positive free cash flow if all the share compensation was paid in cash. It has improved, but still is not a great picture:

	2Q23	**1Q23**	**4Q22**	**3Q22**	**2Q22**	**1Q22**	**4Q21**
Cash from Ops	$393	$397	$23	$199	$165	-$20	$167
Capital Spend	$82	$81	$96	$100	$79	$71	$70
Free Cash Flow	$311	$316	-$73	$99	$86	-$91	$97
Stock Compensation	$312	$230	$268	$251	$231	$130	$133

It is worth pointing out that DASH still has unrecognized stock compensation expense of $2.4 billion from prior plans that it expects to expense over the next 2.55 years. Plus,

there is another $123 million unexpensed stock pay for the CEO that should flow through income over 1.82 years. DASH also allocates the bulk of stock compensation to management and research staff. On the positive side, those are likely more highly paid individuals who would continue to take stock compensation even if the stock price is impaired for a period of time.

One additional positive we will point out here is the interest income. DASH simply doesn't burn much cash. Free cash flow with the stock compensation is positive. The company has one sizeable acquisition, which it bought with $2.8 billion of stock. It has no financed debt and just over $4 billion in cash. Its largest liabilities are gift cards and other prepaid revenues from merchants and customers. So it has investors excited that it is repurchasing shares and, based on the status quo, can afford to do that.

Understanding What Helps and Hurts Revenue

DASH talks often about the value of all the orders placed with its system. It is growing at a fast clip even after Covid leading to the common cheer that "DASH is still in the early innings of its business growth." We do not have a problem with how DASH reports revenue. In many ways it is conservative. However, there are several mechanisms in place that could change and impact revenue and/or earnings:

- **The easiest one is inflation equals growth for DASH.** The deals with merchants specify that DASH will be paid a percentage of the total dollar amount of the order. When a hamburger used to cost $6 and now it costs $9 – DASH enjoys 50% revenue growth on that order. That can be offset by people trading down or ordering less. The $18 steak that is now $28 may become the $9 burger, or there may be fewer orders per customer overall. DASH does not give much insight into how this is impacting operations. In our view, 2022 and 2023 have likely benefited from inflation, but it's unclear if some of the offsets are becoming bigger headwinds.

- Revenue at DASH is reported on a net basis meaning the total amount collected from the customer is netted against what is paid to the restaurant and paid to the driver. Tips and Incentive Fees are also in play at times:

    - A customer may pay $40 for an order, which covers $28 in food and taxes with $26 sent to the restaurant net of a $2 fee to DASH, a $7 delivery fee with most of

that going to the driver, and a $5 tip which fully goes to the driver. In this example, $40 may net out to $3-$4 to DASH.

- DASH may offer a full refund to the customer if the food arrives cold and two hours late. That would be -$40 netted against revenue too.

- DASH may offer coupons to customers – buy $200 in a gift card and get $250 in DASH orders. That -$50 would be netted against revenue as it is used. Or, there may be a merchant special – order two pizzas from X with no delivery fee tonight. DASH would still have to pay the driver and remit the cost of the pizzas. It may also offer new customers no delivery fees for the first order or existing customers may get a discount on their 20th order.

- Drivers may also earn incentive fees to ensure DASH can meet heavier customer demand at peak meal times. Instead of paying a driver $4-$5 for a delivery, it may rise to $7-$10 in some cases. That too is netted against revenue.

- Drivers are normally paid weekly. However, DASH does allow them to be paid faster but charges them by paying a lower percentage. Instead of $100 in 4 days, DASH may give them $90 today. That $10 would boost revenue.

When we look at all the give-and-take issues here, we think DASH has already seen some sizeable changes to its business model since going public. There was a period when restaurants were staying open entirely on take-out and delivery food. There were plenty of unemployed people to be drivers and others being paid to stay home. The perfect storm to grow the business was probably Covid.

Without Covid, there is still a good base of heavy users of the service who may not be overly price sensitive. Think of the guy at a lake house who still uses satellite TV for $150/month. We think investors should keep in mind that businesses like this tend to grow by having to chase the more marginal customers. These may be people who order once every six weeks instead of three times per week. It may be people who only order from one restaurant or will only place orders for $25 or less. These people may not be as profitable and tougher to bring on board.

Merchants would have similar issues. They no longer require delivery to stay open. Anecdotally, restaurant owners we know have said they are more likely to have individuals pick up their own food than use a delivery service now vs. 2021.

Plus, there is more competition. Uber and Lyft drivers likely lost business during Covid and switched to DASH. Other food delivery companies exist including Uber Eats. Plus, people have returned to work and students to school. Every relationship between DASH and customers, merchants, and drivers was all in DASH's favor with other parties begging to work with DASH. That's just not the case anymore.

The company is still too new to really attack them on much of this as some of the data is not available from DASH. However, we would be concerned with:

- The amount of pay to the driver going up – the result of higher gas prices, drivers playing DASH against Uber and other similar businesses and watching their phone apps to take the highest fees available – airport drive pays $11, delivering Italian food pays $7 both are needed in 10 minutes. That would shrink net revenue to DASH.

- Driver incentive fees needing to rise and possibly allowances paid for car expenses, payroll taxes, etc. This could be the result of simply not having driver growth keep up with order growth. Higher fees to drivers, regardless of how it occurs – would reduce revenue growth.

- Merchants' fees going down and any upfront payments going away. Many restaurants may not be seeing this type of business as material to their top line these days. They may also get pitched by competitors to switch or use another one exclusively. We could see merchants complaining that they used to make $4 on a $28 order, and were still making $2.50-$3 when that same order was done with DASH, but now with inflation, the same order sells for $40 and they only make $1.50-$2.00 with DASH because DASH's fee rises on the higher food cost.

- We're not going to make a macro-call on inflation, but there are several points here to keep in mind:

    - Does this result in lower tips to drivers which hurts their pay prompting them to demand higher delivery fees? Right now, tips have no impact on DASH's revenue but higher payouts to drivers would.

    - Does inflation cause customers to order less frequently and/or trade down to lower the total purchase price? Remember, DASH gets paid a percentage of the total price price so losing last year's $20 steak to a $9 burger hurts.

- Do customers notice a rising delivery fee and tip and determine they can save $12-$13 if they just pick up the food themselves on the way home? The merchant saves money too with that system and the customer may order more as he has $12 in his pocket.

Our conclusion is the revenue recognition is conservative. The company gets paid rapidly via credit cards and thus cash comes in fast and it can entice merchants and drivers with fast payment. We cannot time how quickly some of the changes in the marketplace could impact DASH. We just want to illustrate the risk of making $3-$4 on a $40 order may become $0 when that same $40 order now costs $55. Or, if competition causes driver costs to rise, and now DASH makes $2-$3 on an order, that also cuts profits quickly. Raising merchant fees or delivery fees can also turn the merchant and customer into competitors who don't need delivery.

Litigation is Not a One-Time Item for DASH

In the Adjusted EBITDA table above, litigation has been a recurring cost every quarter. Normally, it was less than $20 million per quarter, but jumped to $49 million in 2Q23. This was added back to non-GAAP EPS too for $0.13. When it was $19 million in 1Q23, this was only 5 cents of non-GAAP EPS. So this is another 8-cent jump in 2Q23, against the 21-cent beat. The key to us is this cost is not going away and it consumes cash. This probably should not be added back to Adjusted EBITDA or non-GAAP EPS.

The biggest area of concern is that DASH classifies its delivery drivers as independent contractors. Its ordering system claims that DASH operates as an agent not a principal between the consumer and the driver. As independent contractors, DASH can avoid paying parts of payroll taxes, unemployment insurance, health insurance, maintaining the drivers' cars, or making sure drivers have auto insurance. It may also have a tough time policing the number of hours a Dasher actually works – especially if the Dasher works for Uber, Uber Eats, DoorDash, and Lyft at the same time.

Governments like to be paid and there have already been several lawsuits regarding the independent contractor status. Changes to this classification could result in higher operating costs to DASH as well as payment of retroactively assessed taxes. This is coming from not only governments but from drivers themselves:

- In January 2022, DASH agreed to pay $100 million to drivers in California and Massachusetts over independent contractor classification. The original deal was increased from $41 million to $100 million.

- At that time DASH had over 35,000 drivers seeking further arbitration against the company for additional payments.

- DASH bases its independent contractor status with governments on legislation known as AB-5 in California from 2019 that better defined independent contractor status and had carve-outs that further supported DASH's classification.

- That still does not stop other governments and municipalities from investigating further and seeking to challenge DASH in court. After AB-5, San Francisco began challenging DASH based on violation of labor laws. In 2023, California's Employment Development Department assessed DASH for certain payroll taxes for drivers.

- In 2020, AB-5 was expanded to add more carve-outs for DASH. In 2021, a court ruled that all of the new carve-outs were unenforceable. DASH won on appeal earlier this year, and that is now being appealed to the state supreme court.

- Other states and cities are writing new laws or challenging old ones as they relate to independent contractor status.

This is not just DASH. There are several other companies that operate in a similar manner and are growing. That catches the attention of other competitors and the government. Rules get changed when old loopholes are exploited in a huge way. When REITs were set up, they were required to have only passive income. However, there were three or four small companies that were allowed to operate as "Paired-REITs" and could have the operating company and the REIT. One of these was a horse track that only operated part of the year and didn't even utilize the structure.

However, Wall Street became involved and discovered that these would be great acquisition vehicles in 1995-96. Paying no taxes on passive and operating income was a huge edge over the traditional REIT and taxable operator model. The Paired REITs were acquired and then used to make numerous deals – outbidding many other players with the lower cost of capital. The law was changed in 1998 – about 2 years after the bubble started.

We do not have any additional insight into how this plays out. We do think DASH has already shown that legal costs are a regular part of doing business. Also, we think these laws may continue to change in ways that could alter DASH's cost of operating. Our view is investors should remain very mindful of the risks and closely watch any future developments.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

Disclosure

Behind the Numbers, LLC is an independent research firm structured to provide analytical research to the financial community. Behind the Numbers, LLC is not rendering investment advice based on investment portfolios and is not registered as an investment adviser in any jurisdiction. All research is based on fundamental analysis using publicly available information including SEC filed documents, company presentations, annual reports, earnings call transcripts, as well as those of competitors, customers, and suppliers. Other information sources include mass market and industry news resources. These sources are believed to be reliable, but no representation is made that they are accurate or complete, or that errors, if discovered, will be corrected. Behind the Numbers, LLC does not use company sources beyond what they have publicly written or discussed in presentations or media interviews. Behind the Numbers does not use or subscribe to expert networks. All employees are aware of this policy and adhere to it.

The authors of this report have not audited the financial statements of the companies discussed and do not represent that they are serving as independent public accountants with respect to them. They have not audited the statements and therefore do not express an opinion on them. Other CPAs, unaffiliated with Mr. Middleswart, may or may not have audited the financial statements. The authors also have not conducted a thorough "review" of the financial statements as defined by standards established by the AICPA.

This report is not intended, and shall not constitute, and nothing contained herein shall be construed as, an offer to sell or a solicitation of an offer to buy any securities referred to in this report, or a "BUY" or "SELL" recommendation. Rather, this research is intended to identify issues that investors should be aware of for them to assess their own opinion of positive or negative potential.

Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them may have a position in, and from time-to-time purchase or sell any of the securities mentioned in this report. Initial positions will not be taken by any of the aforementioned parties until after the report is distributed to clients, unless otherwise disclosed. It is possible that a position could be held by Behind the Numbers, LLC, its employees, its affiliated entities, and the accounts managed by them for stocks that are mentioned in an update, or a BTN Thursday Thoughts.