Teladoc Health, Inc. (TDOC-US)
Healthcare Services
2/27/2022

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Short / $41.20 PT / 42% downside

SHARE PRICE	2/25/22	$70.74
AVG DAILY VAL ($M)		374.3
BASIC SHARES		160,469
+ STOCK OPTIONS		2,518
+ RSU & PSU'S		2,962
DILUTED SHARES		165,949
MARKET CAP ($M)		11,739.3
- CASH		896.0
+ DEBT & LEASES		1,247.4
+ PREFERREDS		0.0
+ MINORITY INTEREST		0.0
+ PENSION LIABILITY		0.0
ENTERPRISE VALUE		12,090.7

SITUATION: *Factors that attract me to the idea*

Teladoc (TDOC) offers a technology platform that enables patients to access telehealthcare services via mobile devices, personal computers, and a variety of video conferencing tools. Its current portfolio of services covers medical subspecialties from non-urgent, episodic needs like flu and upper respiratory infections, to chronic, complicated medical conditions like cancer and congestive heart failure.

TDOC is an intriguing short for the following reasons:

1. Pending LVGO writedown – In November 2020, TDOC paid ~45x sales to acquire Livongo Health (LVGO) at $14.4B. Despite their shares trading near all-time highs, TDOC paid $13.9B of the consideration in cash. In their 10-K filed in February 2022, TDOC announced an upcoming planned writedown related to LVGO. The charge could range from **$800M to $4B**.

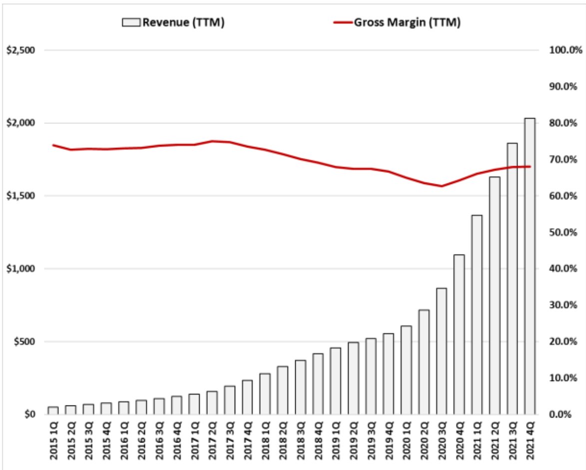
2. No more easy market share gains – In recent years, TDOC has significantly benefitted from the pandemic combined with a first-mover advantage in telehealth. Recently, however, we are seeing their membership growth stagnate. While they are still expecting double-digit revenue growth, membership growth is expected to be low single-digits, which **implies aggressive price hikes are required to get to guidance**. Membership growth is the key driver of long-term growth; they can only squeeze so much growth out of the same pool of members.

3. Still not cheap – Despite shedding nearly 70% in market value over the past year, TDOC still trades ~5x forward sales. While this looks reasonable for a company expecting to grow sales ~20% in the near-term, once we factor in their stagnating membership on expectations for 3-5 year growth, it becomes a "busted growth" story and a 5x multiple is not warranted.

INVESTMENT CASE: *Thesis support*

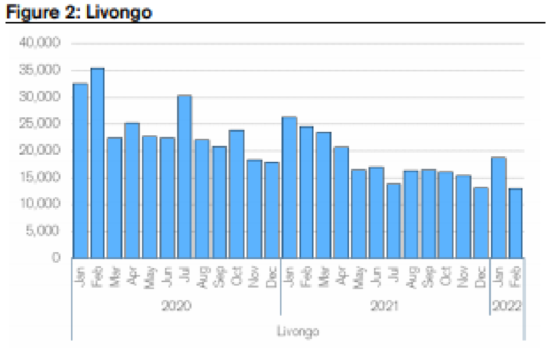
1. No sustainable competitive advantage – While the telemedicine industry experienced significant growth during the pandemic, it has very few barriers to entry. This can clearly be identified through the presence of multiple competitors without notable pricing power, and low customer switching costs. To launch a competing product, new entrants would simply need to license a technology, set up an outsourced tech support, and sign up doctors/providers to their new business.

   While TDOC benefitted from first-mover advantage, that is not a sustainable competitive advantage. They do not possess any sort of advanced, proprietary technology that would insulate them from new competitors – their core platform is unpatented and they have historically underspent on R&D. Their **platform is not differentiated**, and it is only a matter of time before competition arrives.



2. Lack of operating leverage - As seen in the chart on the right, throughout their history gross margins seem to have an inverse relationship with sales volumes. This implies TDOC is taking negative gross margins on incremental visits, presumably to prioritize their position in the market. Perhaps more importantly, it indicates **TDOC has no pricing power**, just as we would expect in an industry with no barriers to entry.

Figure 2: Livongo



Source: SensorTower; As of February 13, 2022

3. Massive overpayment for LVGO – TDOC bid on LVGO at an outrageous valuation – even if LVGO performed exceptionally, it would have been very difficult to justify their synergy projections. LVGO has not performed exceptionally; we can observe consistently declining app trends as seen on the right. The acquisition was a case study in value destruction.

4. No evident path to profitability – TDOC's valuation exploded during the pandemic, largely from an inflow of retail and generalist investors. The appeal was that it offered exposure to a growing secular trend (remote healthcare). The core model has never been profitable, however, and I cannot model a realistic path to breakeven given the variable nature of their operating expenses. As this becomes more and more apparent, casual investors will begin to liquidate.

WHAT MATTERS: *Key questions & controversies*

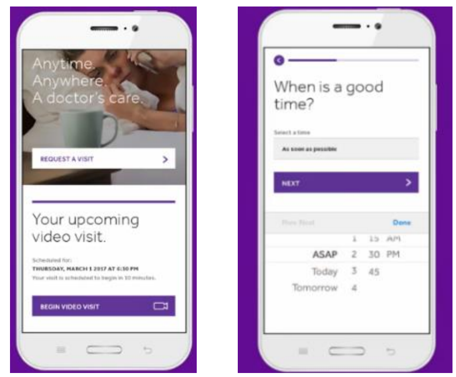
What is the real LT growth profile given the outlook on membership growth?
Despite guiding for a 25-30% sales CAGR between 2021-2024, management is expecting just 1-5% growth in membership:

Membership growth is the long-term driver of organic growth. Is it realistic to accept management's forecast of 25% annual compounding increases in revenue per member?

Relative to their history, this type of sustained double-digit increase would be outside the norm. Unless they are expecting a massive uptick in utilization (visits per user), this would **imply aggressive price hikes**, which TDOC may struggle to achieve given the low switching costs discussed above.

Is there anything actually keeping people on this platform, or are they waiting to be displaced?
Some TDOC bulls have mentioned the superior technological offering put forth by TDOC. After reviewing several walkthrough videos of their website and app, I think their UI is generally pretty good (screenshots on the right), but it could be very **easily be replicated** by a team of developers. I have not seen any proprietary, "secret sauce" on their platform that creates a differentiated offering.

As mentioned, TDOC does not maintain any patents around their core technology platform – only trademarks. Assuming the UI and functional capabilities can be fully replicated by a new entrant, the only remaining challenge would be getting customers and doctors to switch.



Theory aside, are competitors actually entering the space in the near-term? Are there any other threats?
Several competing telehealth platforms have stepped up investment in recent years: American Well Corporation (AMWL), Included Health, and Accolade, Inc., among others. The biggest threat to TDOC, however, is if insurers decided to set up their own telehealth platforms en masse. Cigna (CI) began this trend when they acquired MDLive in February 2021. United (UNH) is the largest private insurer in the US, and they are actively considering acquiring a competing telehealth solution.

VARIANT VIEWS: *Preliminary thoughts*
IMO the prevailing view is that telehealth is a growing market and TDOC is the only pure-play vehicle to invest in this theme. While I agree with the idea that telehealth is a large, fragmented, and underpenetrated market, I think the competitive dynamics are often overlooked. There are very low barriers to entry, and at this point there is no clearly superior service offering. TDOC is currently the most popular, not because they offer the best service, but because they were first movers. TDOC's leading position in the market should not be conflated with a quality, "moat-like" business.

VALUATION: *Potential upside/downside*
TDOC trades on a multiple of forward sales. While the multiple has reached as high as the mid-teens, it currently trades ~5x NTM sales. Using 3Y projections of sales, I arrive at the following up/downside valuations:

UPSIDE SCENARIO	
REVENUES (2024)	3,450
EV/SALES	5.5x
EV ($M)	**18,975**
NET DEBT	1,515
MARKET CAP ($M)	**17,460**
FDSO	166
PRICE / SHARE	**$105.18**
% UPSIDE	*+48.7%*

DOWNSIDE SCENARIO	
REVENUES (2024)	2,850
EV/SALES	2.0x
MARKET CAP ($M)	**5,700**
NET DEBT	1,515
MARKET CAP ($M)	**4,185**
FDSO	166
PRICE / SHARE	**$25.21**
% DOWNSIDE	*-64.4%*

EXPECTED VALUE	
UPSIDE PRICE	$105.18
PROBABILITY	20%
DOWNSIDE PRICE	$25.21
PROBABILITY	80%
EXPECTED VALUE	**$41.20**
% DOWNSIDE	*-41.8%*