A Work Project presented as part of the requirements for the Award of a Master Degree in Finance from the NOVA – School of Business and Economics.

Farfetch – Where Disruptive Innovation Meets Luxury Fashion

Maria Enes (33814) & Cláudia Pinheiro (33963)

A Project carried out on the Master in Finance Program, under the supervision of:

Professor Filipa Frade de Castro

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Abstract

The present Equity Research serves the purpose of performing a valuation of Farfetch, the leading technology platform for the global luxury fashion industry.

The valuation was performed considering the company's bulls – it belongs to an expanding market; it follows the market trends; it disrupts the market – and its bears – it might not sustain high take rates in the future; the possible negative effect of its mergers and acquisitions strategy; Brexit.

After analysing the company and the market, a Discounted Cash Flow model was built. Our final recommendation is a Buy, with a price target of $16.98.

Keywords: Disrupt, Future, Luxury, Technology.

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FARFETCH LIMITED

COMPANY REPORT

LUXURY FASHION

3RD JANUARY 2020

STUDENT: MARIA ENES & CLÁUDIA PINHEIRO

33814@novasbe.pt & 33963@novasbebe.pt

Farfetch

Where Disruptive Innovation Meets Luxury Fashion

We are initiating coverage of Farfetch with a Buy recommendation and a $16.98 price estimation. In our view, the company is a buy for several reasons:

(1) The luxury personal goods market growth (5% Compounded Annual Growth Rate (CAGR) until 2025) and the **shifting to online** (25% of the overall market in 2025). Currently, Farfetch's market share represents 1% of the overall market, existing plenty of space to grow;

(2) Emerging markets. China, the market chosen by Farfetch to make two great investments – JD.com and CuriosityChina - is predicted to represent 45% of the industry's revenue in 2025;

(3) Highest take rate when compared to its competitors (30% VS 9.7% Competitors' average);

(4) 10x more Stock Keeping Units than its closest competitor (Yoox Net A Porter);

(5) Strong Partnership Relationship. 98% of its partners entered in an exclusive contract and it was able to retain 100% of its top brands;

(6) New Guards Group and Stadium Goods acquisitions. We believe these will drive the number of active consumers growth (~30% CAGR until 2025), increasing the Marketplace Gross Merchandise Value (54.7% of growth from 2018 to 2019).

Valuation/Risks - Our target price is based on a DCF model explained in the valuation section. Company bears are related to the take rate pressure, M&A strategy's risk and Brexit.

Company description

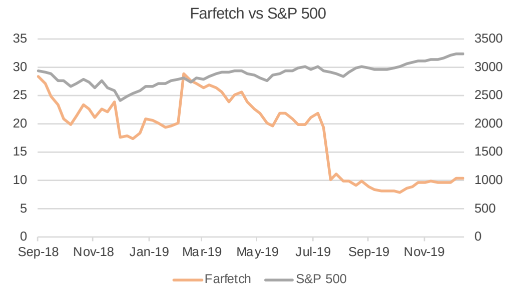
Farfetch Ltd. is the leading luxury digital marketplace. It connects shoppers from 190 countries with 1,022 brands and designers. Apart from the marketplace, it provides its sellers white-label e-Commerce services through Black & White Solutions – empowering its online presence.

Recommendation:	**BUY**
Price Target FY20:	**$16.98**
Price (as of 3-Jan-20)	**$11.11**

Bloomberg: PX_LAST

52-week range ($)	6.65 – 28.29
Market Cap ($ thousand)	3,103,520
Outstanding Shares (thousand)	299,857

Sources: Bloomberg; Capital IQ



Source: Bloomberg

(in $ thousand and %)	FY2017	FY2018	2019E
Revenues	386,016	603,299	1,074,334
Operating Costs	(299,260)	(471,766)	(708,944)
EBITA	(90,846)	(165,978)	(265,221)
NOLLAT	(88,637)	(94,363)	(173,366)
GMV	909,763	1,407,699	2,318,448
Growth		54.7%	64.7%
Net Profit Margin	-24%	-28%	-31%

Source: Company data and Analyst's Projections (2019)

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Executive Summary

Company Overview Farfetch Limited, the first Portuguese unicorn, describes itself as the leading technology platform for the global luxury fashion industry. It offers luxury brands and retailers from all over the world a high-reach marketplace and solutions to improve its online presence.

Bulls and Bears The company follows the market and keeps investing to take advantage of it. It is battling with the industry giants knowing that luxury fashion is being driven by the online presence of highly regarded brands, by acquiring companies on the high-growing Chinese consumption market, on the active and streetwear market segments, and by nurturing relationships with its partners.

Performance Analysis Despite its losses that mostly come from the strong investment in demand generation, the company has been performing well for the past years. It is both highly liquid and solvent, has low leverage, has minimum inventory risk and its revenue has been constantly growing at rates above 50% in the previous years.

Competitive Landscape Farfetch does not have direct competitors due to its unique business model. However, it has several companies with whom competes indirectly (other online luxury fashion retailers).

Revenue The firm has four main sources of revenue: Platform Services Revenue (Marketplace), mainly driven by Active Consumers, Number of Orders per Consumer, Average Order Value and Take Rate; Platform Fulfilment Revenue (Black & White Solutions); Brand Platform Services Revenue (New Guard's Marketplace) and In-Store Revenue (Browns, New Guards, and Stadium Goods).

Our Recommendation To perform a valuation of the company, we built a DCF model. Through it, we got to a share price of $16.98. Our final recommendation is a buy.

Glossary

- Active Consumers – a consumer that has made a purchase on the Marketplace within the last 12-month period;
- Average Order Value – the average value of all orders placed on the Marketplace excluding value-added taxes;
- Brands – brands with whom the company has direct relationships;
- Farfetch Black & White – comprehensive modular white-label business to business e-commerce solution for brands and retailers;
- First-party sales – sales on the marketplace of inventory directly purchased by Browns store;
- Gross Merchandise Value (GMV) – the total dollar value of orders processed;
- Number of Orders – total number of consumer orders placed on the Marketplace, gross of returns and net of cancellations, in a particular period;
- Digital Platform Fulfilment Revenue – revenue from shipping and customs clearing services that the firm provides its consumers, net of consumer promotional incentives;
- Platform Order Contribution – gross profit after deducting demand generation expense, which includes fees that the company pays for marketing channels;
- Retailers – boutiques and department stores with whom the firm has a direct contractual relationship to display and sell the products in the marketplace.

Investment Thesis

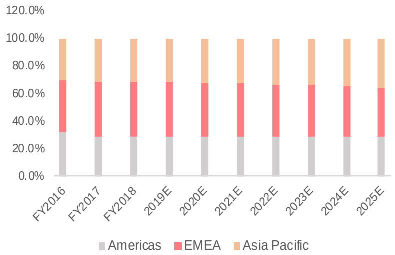
Luxury Market Opportunities & Shifting to Online

Overall, the luxury market grew 5% in 2018 with personal luxury goods being the most representative segment in the industry – reaching $290.51 billion in sales. Shoes and jewellery were the core products, representing 7% of the total personal luxury goods sales. Also, casual and streetwear categories experienced a jump in 2017 because of the increasing importance of younger buyers and workplace casualization.

Along with these trends, the market is accelerating its transition to online - the online luxury shopping represented 10% of all luxury sales in 2018 which is equivalent to a 22% growth ($27 billion of sales). In the forecasted years, the luxury market is expected to continue growing at an annual rate of 3% to 5% and the online channel to represent 25% of the market's value.[1]

We believe that both luxury and e-commerce market growths are going to enhance Farfetch's ability to attract and retain consumers contributing to an active consumers CAGR of 35.8% until 2025. Also, Farfetch has a market share of $3.1 billion which represents approximately 1% of the overall personal goods luxury market – there is enough space to grow in the market.

Emerging Markets – The Chinese Market Luxury Consumption



Graph 1 - Chinese Luxury Consumption Impact on Asia Pacific Revenue Stake

The demand for luxury fashion is global. In previous years, America and Europe accounted for almost two-thirds of sales in the global personal luxury goods market. Over the next decade, emerging markets like China, the Middle East, Latin America and Eastern Europe are expected to drive the luxury goods market, with Chinese consumers representing 46% of the market in 2025.[1]

To secure this growth opportunity, Farfetch expanded its business in China by entering in a partnership with JD.com, one of the two massive online retailers in China, and with the CuriosityChina's acquisition, supporting our view that China will detain a higher stake of the company's revenue in the future (graph 1).

Farfetch Strategies to increase its Market Share

Farfetch is working to become a winner in the luxury fashion online market. On one hand, it is currently the leading technology platform and has no direct competitors due to its business model. The company operates without inventory risk, contrarily to similar luxury online retailers like Yoox Net a Porter[2], having

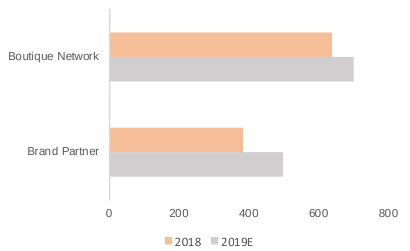
[1] All this data was collected from Claudia D'Arpizio, Federica Levato, Filippo Prete, Elisa Del Fabbro, and Joelle de Montegolfier, *LUXURY GOODS WORLDWIDE MARKET STUDY*, FALL–*WINTER* (BAIN, 2018).

[2] Company's Form F-1 – Registration Statement

335,000 Stock Keeping Units (SKUs) on its marketplace in 2018 (ten times more than its closest competitor). On the other hand, the company keeps following the market trends by adding new sections to its platform like jewellery and watches, and by speaking to its millennial customer base with the acquisition of Stadium Goods and New Guards Group – these are brands of the future that sell streetwear and activewear.

These growth drivers together reflect our view for the future Platform GMV – 37.8% CAGR until 2025.

Strong Partnership Relationship



Graph 2 - Number of Partners in 2018 and 2019 (third quarter)

As of December 31, 2018, Farfetch had 1,022 luxury sellers on its marketplace, of which 640 were retailers and 382 were brands that sell directly on the platform (graph 2).

Due to the company's effort to build a strong connection with its partners, 98% of the retailers entered an exclusive relationship with the company. Additionally, in the last three years, Farfetch has retained all its top 100 retailers.

Recently, Prada picked Farfetch as the only online retailer holding the rights of the exclusive distribution of *Linea Rossa*, popular in the 1990s and early 2000s for its aesthetics. It entered as well into a partnership with Chanel through Farfetch Black & White Solutions.

These facts boost our belief that the company is leveraging up its relationship with some of the most well-known brands and it has been able to keep its existing luxury partners loyalty – a competitive advantage that is aligned with the predicted revenue growth.

Data and Market Insights

One of the advantages of working with Farfetch is that the company provides its partners with rich consumer data sets and algorithms that can lead to operational efficiencies. This process generates critical insights that allow boutiques/brands to operate following their clients' needs in terms of the most relevant products, pricing strategies and inventory management. Also, Farfetch buying experts provide tailored perspectives on industry trends and new season launches.

Farfetch Store of the Future

Farfetch wants to build the *Farfetch Store of the Future*, one of the most important moves of the company. It is a modular platform that enables the design of technological solutions to humanize the retail experience, delivering personalization to customers and empowering store staff. This will enhance what Farfetch is doing with luxury fashion – revolutionizing how people buy luxury goods and disrupting traditional offline markets.

Risks

Take Rate

Farfetch is currently charging high prices to brands and retailers due to not having any direct competitors so far and also due to the high proposition value it offers (beyond being an intermediary, it offers services) – its take rate has been rounding 30% over the years, a high value considering its similar companies and the overall marketplace business.

However, the future is uncertain and direct competition might come up, forcing the company to charge lower prices and losing competitive advantage.

M&A Strategy

As previously mentioned, one of the company's strategies to increase its market share is to follow market trends. One way to achieve this is with the acquisition of brands that fit in that vision.

The company has acquired three businesses in the last fiscal year (2019) for almost $1 billion in total. Although these can be smart acquisitions, they can also prove to be bad investments – it is proved that more than once acquirers overpay for the companies due to an overestimation of the synergies that come with the merger of the two companies.

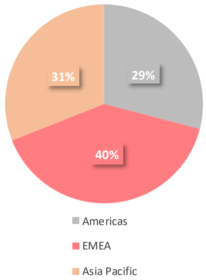
In addition, investors are starting to turn its back on the company (when the company announced New Guards Group acquisition, the share price fell by almost 40%). For a company that has not yet shown to be profitable, spending so much money to grow inorganically can result in a market's bad reaction.

Brexit

By being a marketplace, Farfetch's sales won't probably be that affected, since the company operates all over the world - the only thing that is on the British territory is, in fact, its headquarters.

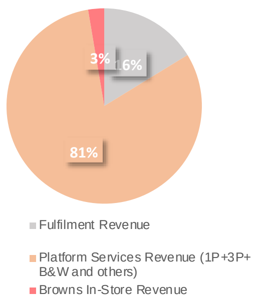
However, the company's CEO claimed that Brexit can impact talent acquisition. Being a company that has embarked on the path of technology disruption, not being able to attract the best people to follow that path can cause a slowdown.

Company Overview



Graph 3 - Revenue per Geography as of December 2018

Farfetch Limited, founded in June 2007 by the Portuguese entrepreneur José Neves, is a global luxury digital marketplace that sells luxury fashion goods like women, men and kids wear, accessories and bags from various boutiques and brands around the world (graph 3). The company believes it is reinventing how consumers discover and engage with luxury fashion, so it keeps investing in its platform developments to deliver the highest-quality experience. In December 2018, there were approximately 1.3 million active consumers from 190 different countries. Farfetch's shares are traded in the New York Stock Exchange since 2018 when the company became public with a share price of $27.



Graph 4 - Revenue per Segment as of December 2018

Apart from the primary application – the Marketplace Platform - the company offers other services (graph 4) - Black & White Solutions, Seller Tools and *Farfetch Store of the Future*. Farfetch Black and White Solutions was created to help other businesses developing and expanding their online presence, inventory management, and global logistics. Seller Tools aims to provide Farfetch's partners (retailers and brands) operational efficiencies – end-to-end management of the online selling experience and an integration platform built to deliver a retail solution. Lastly, *Farfetch Store of the Future* reflects the company's vision – to disrupt the luxury industry with a platform that will connect both the online and offline retail worlds.

Moreover, Farfetch acquired Browns (physical store) in 2015, to obtain insights and a better understanding of the luxury fashion market.

We estimate that Farfetch will reach $1 billion in revenue in 2019, which will grow at a 43.5% CAGR until 2025.

Business Model

Farfetch started its activity by empowering the online presence of designers without any e-Commerce, to currently be working with some of the most well-known brands such as Gucci, Alexander McQueen, and Burberry.

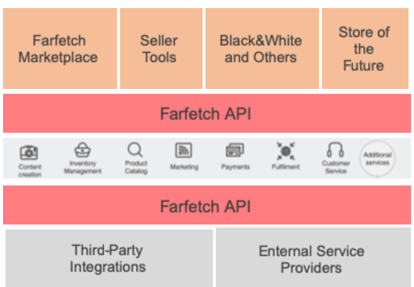


Figure 1 - Farfetch Business Model

In its marketplace, the company generates <u>third-party revenue</u> through commissions derived from negotiations with other retailers, <u>first-party revenue</u> that results from luxury goods directly purchased by Browns and then sold online, and <u>fulfilment revenue</u> - includes the provision of shipping services, packaging materials, and credit card processing. Apart of the marketplace, the company generates <u>revenue through services</u> rendered to its sellers, including Farfetch Black and White Solutions; through <u>physical stores</u> – Browns, Stadium Goods and New Guards Group; and lastly, <u>Brand Platform Revenue</u> (New Guards Operations less of in-store revenue, Farfetch marketplace and other authorized e-commerce websites) (figure 1).

Unlike typical retailers, Farfetch differentiates itself because it has no physical inventory, which allowed the company to grow faster, due to not having inventory risk.

The Marketplace

Figure 2 illustrates how the marketplace works.

Starting with the production step, content is created (sellers send the sample of the products for photography) and then exposed in the marketplace. Farfetch generates demand with its marketing strategies. When customers place the order and proceed to the payment, the seller receives the order, prepares it for delivery in Farfetch packaging and in 3 to 4 days, the client receives it. Lastly, Farfetch follows up the order to provide, if necessary, customer service and uses Farfetch Access to evaluate customer satisfaction.

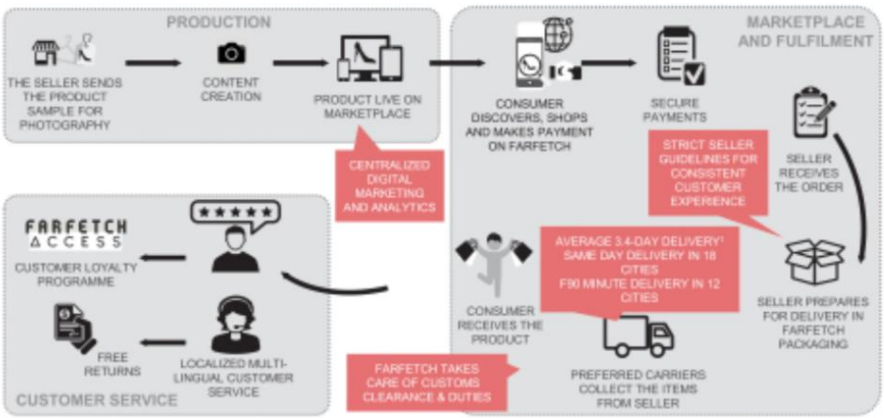
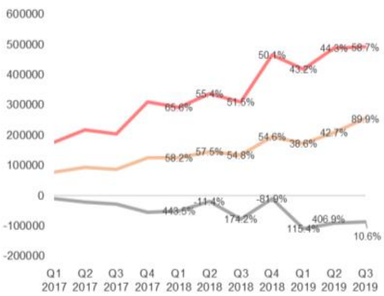


Figure 2 - Farfetch Marketplace Model

Performance Analysis

Operating Performance

Both Farfetch's revenues and GMV have been growing around 50-60% in homolog terms in the past years (graph 5), making it a high-growth company. However, it hasn't shown yet to be profitable – its Loss after Tax has been growing at a higher pace than its Sales. This is evident by the comparison between Gross Margins of around 50% and negative Net Profit Margins of 20-50% - explained by the company's investments in terms of Demand Generation Expense and Technology Expense. The company spends in these categories from one-quarter to one-third of its revenue generated in a year. This is concerning investors – Condé Nast, the parent of Vogue, GQ and Vanity Fair, has dropped its stake in the company (6%



Graph 5 - GMV, Revenue and Loss After Tax of the Farfetch's equity) (Peixoto 2019). However, the company believes it is going to achieve breakeven by 2021, through some cost efficiencies (Fernandez 2019) - it was stated that it was its goal to decrease the Demand Generation Expenses in percentage of Adjusted Revenues, and it has. However, we don't agree with 2021 to be the breakeven point (our estimated breakeven year is 2025). In terms of returns, the Annual Economic Profit in percentage of Revenues[3] in the last three disclosed years has been always around negative 30% - the company is investing more than it is gaining from it. We expect that those investments returns will realize in the period between 2019 and 2021.

Activity Efficiency

Table 1 - Cash Conversion Cycle

	FY2017	FY2018
Days Sales of Inventory	65	67
Days Sales Outstanding	0	0
Days Payables Outstanding	131	102
Cash Conversion Cycle	-67	-35

The company has a negative Cash Conversion Cycle (CCC) (table 1) when it comes to its store that has improved from 2017 (-67 days) to 2018 (-35 days). This negative ratio comes from the fact that the company receives from the consumer in the moment of the sale but pays the suppliers on average 117 days after it receives the inventory, never holding it for more than two months.

However, when it comes to the main business – the marketplace - the inventory goes straight from the brand/retailer to the consumer – the brand/retailer has the Farfetch containers in which it puts the product(s) sold and ships directly to the consumer.

Capital Structure and Liquidity

Farfetch's capital structure consists mainly of equity, debt in form of capital leases (from 2019 on, due to the IFRS 16) and excess of cash. The company doesn't usually issue regular forms of debt (bonds, loans, etc.) and, when it does, it repays the full amount in about one year – it happened from 2016 to 2017. This is related to the fact that the company is a high-tech company – most of its assets are intangible, which means that the company does not have collateral to provide to lenders. However, the company's net debt is negative and very high – it detains a lot excess of cash, causing the Debt-to-Equity ratio to be negative and around 100%. This high value of Excess of Cash is reflected on the liquidity ratios of the company (table 2) – from 2016 to 2018, the company went from a Cash Ratio of 168% to a ratio of 216% , meaning that if the company had to pay its current liabilities right now, it would have the capacity to pay it twice. The Working Capital Ratio is also high, as can be seen in table 2. Additionally to be highly liquid, it is also highly solvent – the firm has a sustainable capital structure to finance its activity (table 3). Finally, the company is independent towards its creditors – the Financial Autonomy Ratio was twice what banks consider to be healthy in 2016

Table 3 - Liquidity

Liquidity	FY2016	FY2017	FY2018
Current Ratio	202.3%	290.5%	302.9%
Cash Ratio	167.8%	246.3%	216.0%

Table 2 - Solvency

Leverage	FY2016	FY2017	FY2018
Gearing Ratio	-3.2	0.0	0.0
D/E Ratio	-105.3%	-94.8%	-91.5%
Solvency Ratio	94.3%	238.9%	257.5%
Fin. Auton. Ratio	48.5%	70.5%	72.0%

[3] We chose this ratio to measure the company's return based on the article Dodd, M. and Rehm, W. (2005). *Comparing performance when invested capital is low*. [online] McKinsey & Company. Available at: https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/comparing-performance-when-invested-capital-is-low.

and almost third times it in 2017 and 2018 (table 3).

Mergers & Acquisitions

Acquisitions can be a powerful tool to accelerate revenue growth. This strategy is vital when we refer to software or online services platforms, extremely dependent on the growth rate.

Farfetch seeks to acquire and invest in other companies or technologies to complement or even expand its brand and products. It is possible to observe the company's acquisitions during the past years in table 4.

Table 4 - M&A Activity

(US $ thousands)

Company	Year	M&A type	% Acquired	Deal Value	%Cash	%Equity	% of Contingent Consideration
Browns Limited	2015	Acquisition	100%	31,781	28,5%	38,1%	33,5%
iMall Holdings Limited	2015	Acquisition	100%	4,609	2,47%	79,0%	18,5%
Laso Co Limited	2015	Acquisition	100%	3,544	100%		
Fashion Concierge UK Limited	2017	Acquisition	100%	2,183		100%	
Style.com	2017	Acquisition	100%	12,411		100%	
JD.com	2017	Merge					
Curiosity China	2018	Acquisition	100%		cash&equity		
Stadium Goods	2019	Acquisition	100%	250,000	cash&equity		
Top Life	2019	Acquisition	100%	50,000	100%		
New Guards Group	2019	Acquisition	100%	675,000	50%	50%	

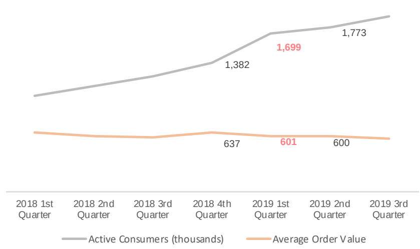
For the forecasted years, we have considered the most recent acquisitions - Stadium Goods and New Guards Group - because the synergies created with both acquisitions are not reflected yet on Farfetch's annual financial statements.

Possible Future Outcomes

<u>Stadium Goods</u>

Stadium Goods is the world's premier sneaker and streetwear marketplace. This company, which will continue independent as part of the deal, sells deadstock products (rare and limited-edition sneakers and streetwear) online and in a brick-and-mortar store in New York.

In terms of market share, this acquisition will help Farfetch to expand to one of the major fashion markets – sneakers ecosystem – and to access the second-hand market which is attracting more and more sneaker fanatics and collectors.



Graph 6 - Stadium Goods impact on the Number of Active Consumers and the Average Order Value

Also, this acquisition is predicted to impact the company's revenue through increasing the number of active consumers and the Average Order Value (AOV) growth (graph 6) - from the 4th quarter of 2018 to the 1st quarter of 2019, AOV grew approximately 23%.

<u>New Guards Group</u>

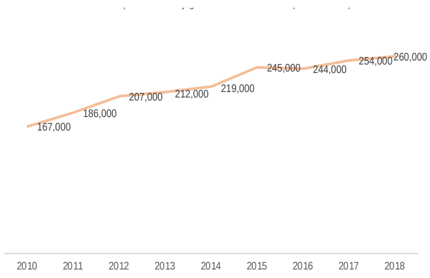
New Guards Group (NGG) is an Italian contemporary luxury fashion production and distribution holding company, founded in Milan. It owns brands like Off-White and Supreme which dominate the mainstream fashion (streetwear brands). The company believes that this acquisition will complement the Stadium Goods' one.

Farfetch is expecting to attract millennials due to NGG alternative and sportive fashion design and to generate higher revenue directly through the new layer – “Brand Platform” – with an expected GMV of $156,678 million by the end of 2019.

After analysing how the company operates, how it has been performing and what it is doing in terms of M&A, it is necessary to understand the market, the main trends and the competitive landscape.

The Market

Luxury Fashion Market Overview

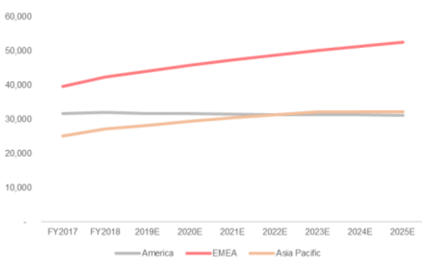


Graph 7 - Value of the Personal Luxury Goods Market Worldwide (in $ thousand)

The Luxury Fashion Market is characterized by products which price, quality and aesthetics differ from “normal” brands. According to the definition, luxury brands price offerings belong to the most expensive products of their category, that have higher quality and unusual designs.

Fashion is highly impulsive and volatile due to the rapidly changing nature of its trends. Therefore, brands and retailers must constantly be one step forward in relation to its consumers - adapting the supply to the demand.

The global personal luxury goods market grew 6% at constant exchange rates, outperforming the overall market with $260 billion of value in 2018 (graph 7). It is expected to grow 3-5% per year from 2019 until 2025.[1]

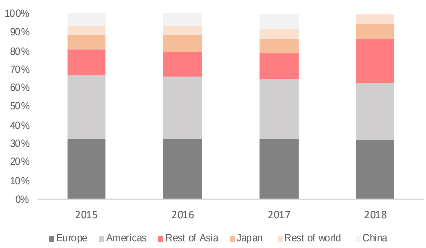


Graph 8 - Luxury Fashion Market Revenue per Geography (in $ million)

To forecast the company’s revenue, we have considered the luxury fashion market revenue per the main geographies in which the company operates - America, EMEA and Asia Pacific. As it can be seen in graph 8, EMEA detains the highest revenue stake when compared to America, and Asia Pacific. However, it is expected that in 2022, Asia Pacific luxury fashion revenue growth will overtake America’s. The overall CAGR of these geographies is predicted to be 2.4% until 2025.[4]

What is driving the market growth?

Emerging Markets

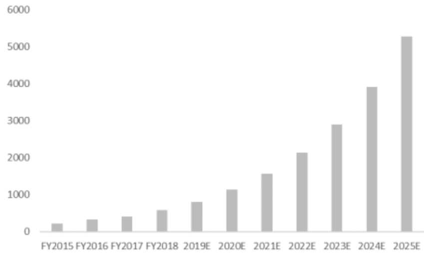


Graph 9 - Share of The Personal Luxury Goods Market Worldwide from 2015 to 2018

Europe, the current market share leader, holds approximately 32% of the market. However, emerging markets like Asia and Japan have been increasing its share over the years, with a CAGR of 10% from 2010 to 2018 in comparison to Europe or Americas, 4% and 5% respectively (graph 9). Also, it is expected that in 2025 China represents 46% of the personal luxury goods sales and that it will continue to be a market growth driver (its share is predicted to grow from 8% to 22% only

[4] This CAGR was calculated based on Statista’s forecasts for each geography.

until 2022).[1]

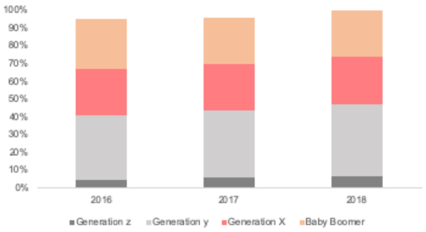


Graph 10 - Global Online Personal Luxury Goods Market (in billion)

Online Luxury Market

Although there is some consumer reluctancy on buying luxury goods online - most of the luxury consumers prefer to live the experience and personalized service in-store - due to technological improvements and the emerging of online platforms (Farfetch, YNAP, Amazon, etc), luxury brands are becoming more comfortable with the shifting to online (graph 10). By 2025, the online channel is expected to represent 25% of the market's value.

The New Era of Millennials



Graph 11 - Share of Global Personal Goods Luxury Consumers by Generation

Millennials, also known as Generation Y, one of the largest generations in history (92 million compared to 77 million baby boomers (U.S.)) were born in a time of technological change, globalization and economic disruption. Together with Generation Z, they represented 47% of the luxury consumers and 33% of the overall luxury purchases in 2018 (graph 11).[1]

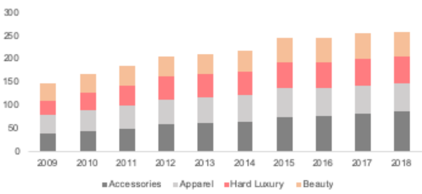
These generations have been changing luxury fashion due to their differentiated preferences comparing with previous generations – they are logo-driven (brand loyalty) and prefer streetwear and activewear instead of traditional styles. Also, millennials are more willing to go through the online platforms even though the in-store experience is still preferred.

In 2025, both Generations Z and Y are expected to represent 55% of the luxury market which makes undeniable the importance of younger consumers in the luxury fashion market – strongly connected to technology, highly educated and with purchasing power.

Farfetch customer average age is 36 and almost 70% of its clients are younger than 40. This may be one of the reasons why Farfetch is investing in companies like Stadium Goods and New Guards – to catch those market moves. Also, the company believes that over 50% of its consumers are Millennials.

Market Trends

Trends are what ultimately drive the Luxury Fashion Market. Therefore, it is expected that companies will make significant investments in stimulating the interest of younger population segments.[5]



Graph 12 - Personal Luxury Goods Market Value Worldwide from 2009 to 2018, per Segment (in billion)

Accessories remained the largest personal luxury goods category, with a CAGR of 9% from 2010 to 2018 (graph 12). As mentioned before, shoes and jewellery were the fastest-growing products in the accessories segment and both represent 7%

[5] Patrizia Arienti, *Global Powers of Luxury Goods* (Deloitte,2019).

of the total personal luxury goods.

Competitive Landscape

Competitors

The luxury fashion retail industry is highly competitive, being characterized by its concentration, differentiation, product mix, and cost structure.

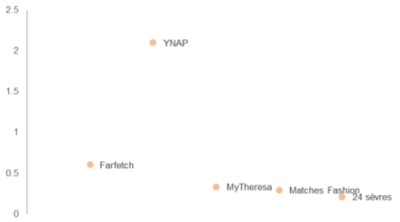
Farfetch is a high-tech luxury fashion marketplace that acts more like a technology company than as a typical retailer - one of the reasons why it differentiates itself from the others.

On one hand, Farfetch is competing with offline channels such as LVMH - the leading luxury fashion company, which detains the highest stake in the luxury market sales. On the other hand, it is competing with more direct competitors - online luxury retailers, such as Yoox Net a Porter, MyTheresa, Matches Fashion and 24 sèvres. We analysed all the companies mentioned above, once there are some operational and business similarities between those companies and Farfetch in terms of the target audience, cost structure and upcoming strategies (table 5).

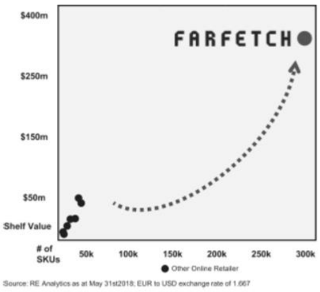
Table 5 - Competitors Analysis

(2018)	Farfetch	YNAP	MyTheresa	Matches Fashion	24sèvres
Founded Date	2007	2015	2006	2007	2017
Sales (in billion)	$0.603	$2.1	$0.336	$0.293	$0.21
AOV	$619	$328	$600	$727	-
Business Model	Marketplace	Multibrand online Retailer	Multibrand online Retailer	Multibrand online Retailer	Online retailer
Physical Stores	Yes	No	No	Yes	No
Official Brand	No	No	No	Yes (Raey)	No
Brands/Designers	>1000	>1000	>250	>400	>150
Mobile App	Yes	Yes	Yes	Yes	Yes
Value Chain	Retailers handle fulfilment. Farfetch only creates the bridge between consumers and brands/designers	Controls the entire value chain – from product inventory, to fulfilment	-	Controls the entire value chain – it has inventory management software and local warehouse teams. Third party logistics firms transport the products to the end costumers	-
Geographic Reach	Worldwide	Europe and US	Worldwide	Worldwide	Worldwide except China

LVMH is a French multinational luxury goods conglomerate, headquartered in Paris. Its business plan aims to tightly control the brands it manages to maintain the luxury perception related to its products – as an example, Louis Vuitton is only sold through its boutiques or online platform. In 2010 LVMH launched the online store 24 sèvres that sells more than 150 brands, 20 of which are group owned. It



Graph 13 - Farfetch and its Competitors Sales in 2018 (in billion)



Graph 14 - Farfetch's SKU

is the only multi-brand online retailer selling Dior, Celine and Louis Vuitton.

Farfetch and Yoox Net a Porter, a pure e-commerce retailer that controls the entire value chain, which concept is to sell overstocked or unsold items at discounted outlet prices, are currently the most established companies (graph 13) in the luxury fashion online market. In that sense, YNAP is Farfetch's biggest competitor.

By comparing Farfetch with the competitors previously identified, we concluded that two of the main competitive advantages are:

1. Farfetch has no inventory which means that it can focus all its efforts on the platform, product, service, and technology;

2. Farfetch has 10 times more Stock Keeping Units (SKU's) than its biggest competitor, YNAP (graph 14). This achievement was a consequence of the aggregation supply from many global sources, offering consumers both breadth and depth of luxury merchandise.

Analysing the competitive landscape in terms of differentiation, it is possible to highlight the following:

- YNAP launched a print magazine called Porter;
- 24 sèvres is the only online retailer selling Louis Vuitton and its app includes a video chat feature which allows users to talk with a stylist based in Paris;
- Matches Fashion has its own brand, one of Farfetch's goals – to build the Farfetch brand;
- The founder of Net-a-Porter joined Farfetch team and will help the company to enhance its consumers' engagement.

Comparables

We chose the companies Grubhub, Just Eat, Square and Shopify as Farfetch's comparables. The first two companies are online marketplaces that have a similar growth profile to Farfetch. The last two companies are technology enablement companies that Farfetch defined as comparables.[6] The comparison between companies can be found in table 6.

[6] Both Square and Shopify are mentioned in the company's form F-1 – Registration Statement as competitors. We chose them as comparables because we consider both companies to be indirect competition (not a luxury fashion marketplace).

Table 6 - Farfetch's Comparables

	Farfetch - FTCH (NYSE)	Grubhub - GRUB (NYSE)	Just Eat - JE. (LSE)	Square - SQ (NYSE)	Shopify - SHOP (NYSE)
Founded	2007	1999	2001	2009	2004
Headquarters	London, the United Kingdom	Chicago, Illinois	London, the United Kingdom	San Francisco, California	Ottawa, Canada
Industry	Internet and Direct Marketing Retail	Internet and Direct Marketing Retail	Internet and Direct Marketing Retail	Data Processing and Outsourced Services	Internet Services and Infrastructure
Business Model	Online Marketplace for Luxury Goods	Online and Mobile Platform for Restaurant Pick-up and Delivery Orders	Hybrid Marketplace for Online Food Delivery	Payment and Point-of-sale Solutions Provider	Cloud-based Multi-channel Commerce Platform
Number of employees	3232	2722	4772	3349	4000
Geographic reach	Worldwide	USA and UK	Worldwide	US and internationally	Worlwide
2018 Sales (in $ million)	602.4	1,007.3	993.5	3,298.2	1,073.2
Sales CAGR 2019E - 2021E (%)	52.1%	17.6%	26.2%	3.6%	37.9%
Market Cap (in $ million) (1)	3,094.5	4,486.5	7,171.2	27,413.7	47,284.0
Total EV (in $ million) (1)	2,938.9	4,672.7	7,265.8	27,308.7	44,727.9
D/E ratio (%) (2)	7.1%	40.8%	29.5%	85.2%	3.9%
Take-Rate (%)	32.00%	14.00%	18.00%	2.75%	NA

(1) As of 27/12/2019
(2) As of 30/09/2019, except for Just Eat, where the last available data is dated 30/06/2019

Followed by the company's position in the market, we will now understand where the company is expected to be in the forecasted years.

Financial Outlook

Revenue Drivers

As it was explained before, Farfetch generates revenue through four sources: the Marketplace (which includes Fulfilment Revenue, First-Party (1P) Platform Revenue, and Third-Party (3P) Platform revenue); Black & White Solutions and other services; physical stores and now, with the New Guards' acquisition, Brand Platform (figure 3).

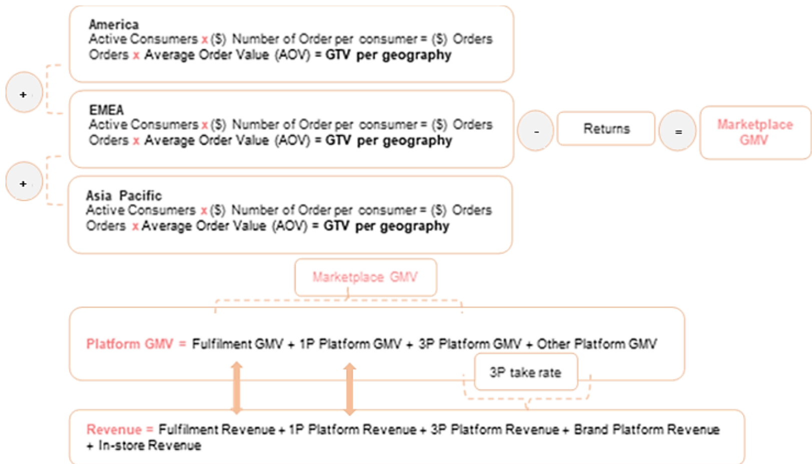


Figure 3 - Farfetch's Revenue Drivers

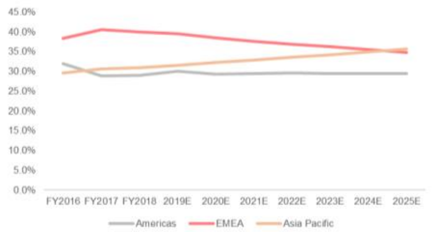
Marketplace GMV [Fulfilment GMV + 1P Platform GMV + 3P Platform GMV]

The company generates the Marketplace Gross Transaction Value (GTV) through transactions between sellers and consumers (equation 1). The GTV net of returns results on the Gross Merchandise Value (GMV), the total dollar value of orders processed that the company collects and remits to sellers after deducting its income (equation 2). We estimated the Marketplace GMV by forecasting the number of Active Consumers (AC), the Number of Orders, the Average Order Value (AOV) and the Returns – which are the Marketplace Drivers.

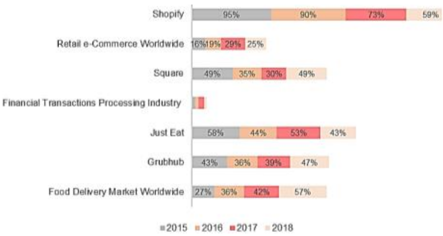
$$GTV = AC \ x \ \# \ of \ Orders \ Per \ Consumer \ x \ AOV \tag{1}$$

$$Marketplace \ GMV = GTV - Returns \tag{2}$$

Before going through the forecast, there are two main assumptions to consider:



Graph 15 - Percentage of Each Geography on The Total Revenue



Graph 16 - Comparables Growth as a % of the Market Growth

1. When estimating the GTV, we forecasted the weight of each geography on the total revenue until 2025, considering the past weight and the increasing importance of China in the luxury personal goods market (6% CAGR in terms of Chinese consumers market share)[7] (graph 15). Consecutively, we assumed that the number of active consumers and number of orders per geography would be calculated based on that weight.

2. As a high-growing company, Farfetch is expected to grow faster than the market. Therefore, to analyse both the impact of the market and of the company's internal strategies on Farfetch's ability to generate results, we have analysed Farfetch's comparable firms – Shopify, Square, GrubHub and Just Eat (graph 16). We were then able to conclude that in those high-growth companies, 33.77% of its growth was explained by the market and the other 66.23% by the company itself.

3. Fulfilment GMV = Fulfilment Revenue and 1P Platform GMV = 1P Platform Revenue because Farfetch acts as the principal in these transactions. The same doesn't apply to 3P Platform Revenue, which is commission based on a third-party take rate.

<u>Active Consumers</u>

Consumers are deemed to be active if they purchased on Farfetch Marketplace within the last 12-month period. We considered that the number of active consumers (AC) depends on the number of Existing Consumers (EC) (the ones the company retains) and the New Consumers (NC) (the ones the company attracts) (equation 3):

$$\# \ of \ AC = \# \ of \ EC + \# \ of \ NC \tag{3}$$

Farfetch disclosed the weight of existing consumers on the total GMV from 2015 to 2017. With this, we assumed that the number of existing consumers in those years was equal to equation 4, that then allowed us to evaluate the company's retention rate (equation 5):

$$\# \ of \ EC(t) = \% \ of \ EC \ on \ the \ total \ GMV(t) \ \times total \ \# \ of \ AC \ (t) \tag{4}$$

$$Retention \ Rate = \frac{\# \ of \ EC \ (t)}{\# \ of \ AC \ (t-1)} \tag{5}$$

In the previous years, the retention rate varied approximately between 76% and

[7] Lan Luan, Aimee Kim, Daniel Zipser, Minyi Su, Adrian Lo, Cherry Chen, and Cherie Zhang, *China Luxury Report 2019* (McKinsey & Company,2019).

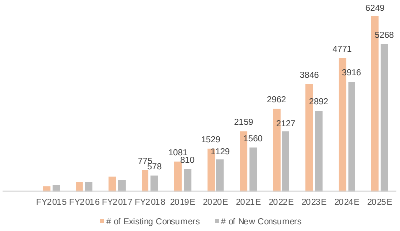
83%. For the forecast years, it is expected to desaccelerate reaching 72% in 2025 due to the increase in the number of AC. Therefore, the number of EC will grow from 1,801 thousand in 2019 to 6,249 thousand in 2025 (a CAGR of 34.7%).

Regarding the NC, its generation is influenced by both the luxury and e-commerce market growths (33.7% external impact) and by the company's Demand Generation Expenses (DGE) (66.3% internal impact) (equations 6 and 7):

$$\%\,of\ NC\ in\ DGE = \frac{\#\,of\ NC\ (t) - \#\,of\ NC\ (t-1)}{DGE\ (t)} \tag{6}$$

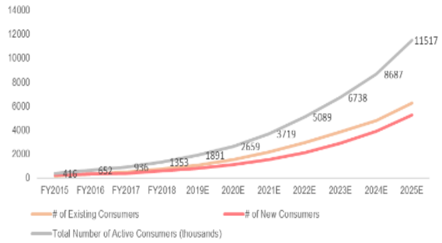
$$\#\,of\ NC\ obtained\ from\ DGE = \%\,of\ NC\ in\ DGE\ (t)\ \times DGE\ (t) \tag{7}$$

For the forecast years, the number of NC is expected to grow at a CAGR of approximately 37.1%, reaching 5,268 thousand in 2025. Both the forecasted EC and NC can be seen in graph 17.



Graph 17 - Forecasted Number of EC and NC

Combining both rationales, we concluded that the total number of AC in 2025 is expected to be 11,517 thousand (graph 18) which reflects the company's consolidation in the market, consumer loyalty and the value added by its acquisitions (Stadium Goods and New Guards Group).



Graph 18 - Forecasted Number of Active Consumers

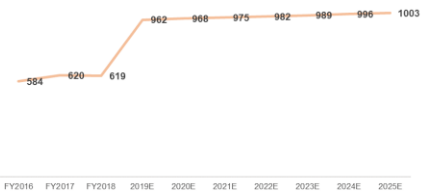
Lastly, the number of AC by geography goes in accordance with what was previously said – although Europe is expected to continue being the market leader in terms of sales, China is expected to overweight America.

<u>Number of Orders per Consumer</u>

The number of orders per consumer has been growing between 4.0% and 7.1%. For the forecast years, we are estimating it to grow at a slower rate reaching 3.2 orders per consumer in 2025 compared with 2.2 in 2018.

<u>Average Order Value</u>

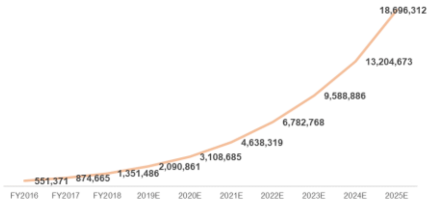
Luxury brands are exercising their pricing power linked to fierce customer loyalty (CPI,2018). While for the most traditional goods like Louis Vuitton prices went up less than inflation, for the trendiest ones the opposite happens, due to the market's demand. That is why it is so hard to predict the AOV as it depends on each brand/designers' product mix and pricing strategies and on Farfetch's ability to influence its consumers to add more items per basket.



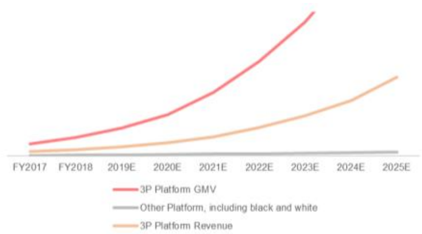
Graph 19 - Forecasted Average Order Value

Therefore, we assumed that the best approach to forecast the AOV was considering 2.1% Consumer Price Index CAGR until 2025 for luxury fashion and the increasing number of orders per consumer (graph 19).[8]

[8] Statista based on International Monetary Fund



Graph 20 - Marketplace Forecasted GMV



Graph 21 - 3P Platform Revenue

<u>Return Rate</u>

Farfetch has a free return policy that attracts consumers. According to Narvar's report, luxury shoppers (51.0% of them) are buying multiple versions of an item, trying at home and returning the products that don't fit well – *bracketing effect*. This fact along with the increased number of active consumers led us to conclude that the rate of returns will increase in the forecast years.

To conclude, the Marketplace GMV is predicted to grow at an annual compounded rate of 45.5% until 2025, which was expected considering the market trends and what the company is doing to cover those trends (graph 20).

<u>1P Platform Revenue</u>

From 2017 to 2018, 1P Platform revenue grew 181.2% and it is expected grow 80.5% from 2018 to 2019. Since this revenue segment derives from the Marketplace GMV, in the forecast years it is expected to grow as a percentage of it. Also, because this is not the company's core activity (it would rescind the entire point of the marketplace model), this growth rate is expected to deaccelerate. In 2025, 1P Platform Revenue is predicted to be $322,613 thousand compared to $111,368 thousand in 2018.

<u>3P Platform GMV</u>

3P Platform GMV represents the highest stake in the company's revenue. For the forecast years, we expect it to continue increasing. As it is possible to see in graph 21, it is what drives 3P Platform Revenue, as it depends on both 3P Platform GMV and Other Platform GMV.

<u>Other Platform Including Black & White Solutions GMV</u>

The Other Platform GMV grew 106% from 2017 to 2018. In the forecasted years it is expected to remain a small part of Farfetch's overall business, growing at a CAGR of 28.2% - Black & White Solutions GMV equal to $230,960 thousand in 2025.

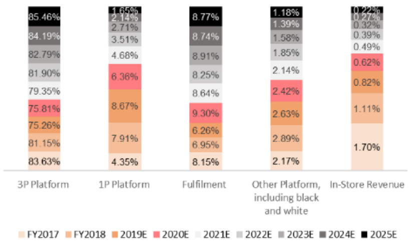
<u>Third-Party Take Rate</u>

In the past years, the company's take rate varied between 30% and 32% respectively, but due to high competition, we are expecting this rate to decrease to 29.3% until 2025. Brands and especially small boutiques can start rejecting Farfetch high take rates if it affects their ability to make profitable sales.

In-Store Revenue

In-Store Revenue results from in-store sales at the two Browns boutiques in London, Stadium Goods and New Guards Group in-store sales.

In 2017 and 2018, it represented approximately 1% (graph 22) of the total Group's GMV. For the forecasted years, we are expecting its stake to remain a small part of the overall business, increasing at a CAGR of 15.5% until 2025. In 2019, In-Store Revenue is expected to be $18,989 thousand, representing a 21.76% growth compared to the previous year.



Graph 22 - % of Each Service on the Group's GMV

Brand Platform Revenue

New Guards Group (NGG) is a brand platform that detains several luxury brands. With this acquisition, Farfetch added a new layer to its business model, Brand Platform Revenue that provides design, production and brand development capabilities.

On the company's 2019 third-quarter results, the two months revenue associated with the Brand Platform was approximately $62,000 thousand. Farfetch is expecting a revenue between $80,000 and $90,000 thousand in the fourth quarter. With this, we are predicting a final year's revenue equal to $147,671 thousand. As there is no additional information regarding the future of this caption, for the forecast years we considered that it will grow as a percentage of the 3P Platform Revenue since Brand Platform Revenue is related with sales to boutiques which sells in-store or online (figure 4). In 2025, Brand Platform Revenue is expected to be $529,993 thousand (23.7% CAGR).

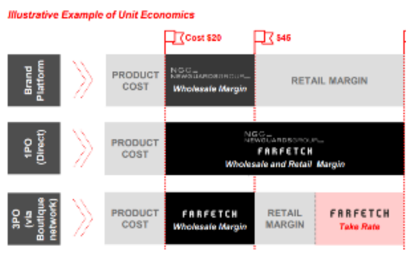
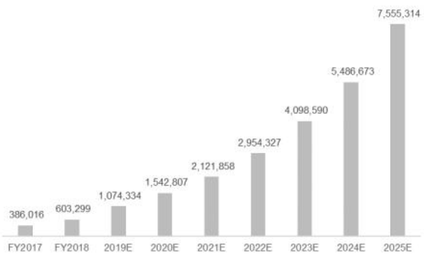


Figure 4 - Brand Platform Revenue

After showing the rationale used to calculate the company's revenue, it is now possible to conclude that in 2019, it is expected to be $1,074,334 thousand and that the annual compounded growth rate will be approximately 44% from 2019 to 2025 (graph 23).



Graph 23 - Company's Total Revenue

Valuation

DCF Model

After traveling through the journey that is Farfetch, we've reached the destination: its valuation.

It made sense for us to divide Farfetch's valuation into three time horizons, due to the different phases we expect the company to go through in terms of growth profile: 2019E – 2025E; 2026E – 2041E and 2042E – Perpetuity. The time horizon segmentation was based on the company's comparables plus Amazon, a high-tech company that allowed to look a little bit further into the future. The first time horizon is the current one – high annual growth rates, ranging from 55% to 80%.

Table 7 - Comparables' Revenue Growth Analysis

Revenue Growth	Company's Age					
	15	16	17	18	19	20
Grubhub	85.12%	42.52%	36.35%	38.46%	47.46%	28.69%
Just Eat	27.04%	59.18%	34.55%	13.28%		
Amazon	27.88%	39.56%	40.56%	27.07%	21.87%	19.52%

Source: Capital IQ

Table 8 - Age at which the comparables' revenue growth started to slow down

Company	Age (1)
Grubhub	19
Just Eat	16
Amazon	17
Average	*17.33*
Farfetch	18

(1) Age at which its growth rate started to slow down

We defined it to end on 2025 because, by then, the company will have 18 years, average age at which the comparables' growth rate starts to decrease (tables 7 and 8). The second time horizon is characterized by annual growth rates of about 30%. We set it to last from 2026 to 2041 based on our judgement – the oldest comparable, Amazon, has only "lived" for 25 years bu is still growing at 30% rates that aren't predicted to decrease yet. The last time horizon is the one until perpetuity, with an annual growth rate of around 4% (the same as inflation). The growth rates' rationale will be explained below.

Cost of Capital

We derived the company's Weighted Average Cost of Capital (WACC) (equation 8) to serve as the model's cost of capital/discount rate. To estimate it, we computed the company's cost of equity and cost of debt and defined the target D/Es.

$$WACC = \frac{E}{V} * r_e + \frac{D}{V} * r_d * (1 - T_C) \tag{8}$$

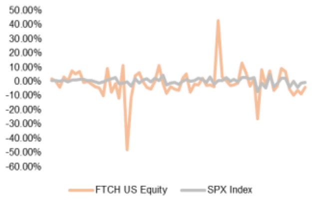
E=Equity re=Cost of Equity V=Enterprise Value
D=Debt rd=Cost of Debt Tc=Corporate Tax Rate

Cost of equity

We started by getting the company's cost of equity through the CAPM formula (equation 9). As Market-Risk Premium (MRP), we used 5.75% suggested by the literature.[9] As risk-free rate (r_f) we used the US 10-year Government Bond rate – 1.692%[10] - once it is denominated in the same currency as our cash flows and it is perceived as a risk-free asset.

$$E(r) = r_f + \beta * MRP \tag{9}$$

E(r)=Expected return of the company's stock
rf=Risk-free rate
β=beta of the company's equity
MRP=Market Risk Premium



Graph 24 - Company Returns VS Market Returns

Beta

The beta estimation comprised two steps: first, we estimated the beta performing a regression of Farfetch's available weekly returns and the S&P 500 Index (used as a proxy for the market returns). Secondly, we estimated our comparables' betas. In our estimation, we got a levered beta of 1.91, which may be inflated by abnormalities shown by a beta interval confidence of]0.78;3.03[, and visible in graph 24. On the comparables' estimation, the beta equalled 1.24, which seems too low for a luxury/high tech company's stock. Therefore, the best approach was to compute the median between the two, resulting in a beta estimation of 1.58. The levered cost of equity equalled 10.8% using the CAPM formula (table 9).

Table 9 - Cost of Equity

Risk-free rate (rf)	1.69%
Levered Beta (βe)	1.58
Unlevered Beta (βu)	1.49
Market Risk Premium	5.75%
Levered Cost of Equity (re)	10.75%
Unlevered Cost of Equity (ru)	10.26%

[9] KPMG. (2019). *Equity Market Risk Premium - Research Summary (30 September 2019).* KPMG.
[10] Extracted from Bloomberg on 30/10/2019

Table 10 - Cost of Capital Leases and Cost of Regular Debt

Credit Rating	BB-
Yield to Maturity (YTM)	4.73%
Probabillity of Default (PD)	0.36%
Loss Given Default	56.50%
Cost of Capital Leases	4.52%
Credit Rating	BB-
Yield to Maturity (YTM)	5.45%
Probabillity of Default (PD)	0.36%
Loss Given Default	56.50%
Cost of Regular Debt	5.25%

Table 11 - Costs of Debt

	2019	2026E-2041E	20342E-Perpetuity
	Weights		
Capital Leases	100.00%	57.64%	15.38%
Regular Debt	0.00%	42.36%	84.62%
Cost of Debt	4.52%	4.83%	5.14%

Table 12 - WACC for the three-time horizons

	2019E - 2025E	2026E - 2041E	2042E - Perpetuity
D/E	6.49%	20.82%	35.15%
re	10.75%	10.75%	10.75%
E/V	93.90%	82.77%	73.99%
rd	4.52%	4.83%	5.14%
D/V	6.10%	17.23%	26.01%
Tc	19.00%	16.00%	16.00%
WACC	10.32%	9.60%	9.08%

Cost of debt

The cost of debt was estimated for each time horizon as a weighted average of the costs of the forms of debt we believe the company is going to sustain in the future. The capital leases and regular debt's costs of debt were calculated based on equation 10.

$$r_d = YTM - PD * LGD \tag{10}$$

rd=Cost of Debt YTM=Yield-to-Maturity
PD=Probability of Default LGD=Loss Given Default

Applicable to the whole company, the current Probability of Default[11] (PD) of the company equals 0.36% and the Loss Given Default[12] (LGD) 56.50%. The current company's credit rating is BB-[11].

For the Capital Leases, the YTM was calculated as a weighted average of the comparables' capital leases costs (4.73%) which resulted in a Cost of Capital Leases of 4.52% (table 10). For the regular debt, the YTM was based on an external source[13], considering the company's credit rating (5.45%) – led to a Cost of Regular Debt of 5.25% (table 10). The Costs of Debt for each period are presented in table 11.

D/E Ratio

As a result of our calculations, the 2019E D/E ratio was equal to 6.49%, value we assumed for 2019E – 2025E. The 2042E – Perpetuity D/E ratio was based on the average of the most ancient comparables' current D/E ratios (Just Eat (29.5%) and Grubhub (40.8%)) – 35.15%.The 2026E – 2041E D/E ratio is the average between both D/E ratios – 20.82% - because we believe the company's transition to debt will be done progressively.

The Corporate Tax Rate used to calculate the WACC meets the assumption made in the model.

A summary of the WACCs is presented in the left (table 12).

Growth Rate

The 2026E – 2041E Growth Rate was computed through equation 11.

$$g = ROIC * RR \tag{11}$$

g=growth rate
ROIC=Return on Invested Capital
RR=Reinvestment Rate

ROIC was computed as 2025E ROIC plus an average of the absolute variation between ROICs from 2021E to 2025E because we believe most of the company's

[11] Thomson Reuters
[12] Exhibit 20 - Ou, S., Irfan, S., Liu, Y., Jiang, J., & Kanthan, K. (2018). *Annual Default Study: Corporate Default and Recovery Rates, 1920 - 2017.* Moody's Investors Service.
[13] Exhibit 11.13 - Koller, T., Goedhart, M., & Wessels, D. (. (2010). *Valuation (University Edition) - Measuring and Managing the Value of Companies.* New Jersey: John Wiley & Sons, Inc.

returns on investments will be realized on this period but, after a certain number of years, it will stabilize again around the same numbers it has shown before. The Reinvestment Rate (RR) was assumed the same as 2025E's (96%), since we expect that, whenever the company turns profitable, it will reinvest its earnings on itself. We are confident in this assumption since a company only starts to pay dividends to its shareholders when it is stable enough to do so, and tech companies' stability is difficult to predict. Also, we looked at the comparables' dividend policy and no comparable has paid dividends since it was born, and when it did, it stopped a few years after (Grubhub). Lastly, for the 2026E – 2041E period the Growth Rate equalled 27%.

For the last time horizon, we assumed the 2042E – Perpetuity Growth Rate to be equal to the average inflation rate[14] – 3.34% - since we are expecting the industry to mature and only grow with inflation.

Outcome

Our Discounted Cash-Flow model assigns an intrinsic value to Farfetch's stock of $16.98. For more detail, see below Table 13.

Table 13 - DCF Model

Discounted Cash Flows (DCF) Model

	2020E	2021E	2022E	2023E	2024E	2025E	2026E - 2041E	2042E - Perpetuity
Unlevered FCF	(480,468)	(585,114)	(587,797)	(577,977)	(352,292)	53,293		
@ WACC	10.32%	10.32%	10.32%	10.32%	10.32%	10.32%	9.60%	9.08%
Growth Rate							*27.39%*	*3.34%*
Discounted Unlevered FCF	**(480,468)**	**(530,384)**	**(482,978)**	**(430,487)**	**(237,850)**	**32,615**	**373,818**	**6,610,925**

Value of Operations	**4,855,192**
Net Debt	(235,682)
Equity Value	**5,090,874**
Outstanding Shares	299,857
Share Price	**16.98**

Sensitivity Analysis

After completing the model, we performed two sensitivity analysis. Regarding the first analysis, we tried to understand the impact of the WACC and the growth rate used to calculate the Terminal Value on the company's share price. As it is possible to see in table 14, Farfetch's share price is extremely sensitive to slight incremental

Table 14 - Sensitivity Analysis 1

		WACC										
	16.98	**6.58%**	**7.08%**	**7.58%**	**8.08%**	**8.58%**	**9.08%**	**9.13%**	**9.18%**	**9.23%**	**9.28%**	**9.33%**
Growth Rate	**0.34%**	28.70	23.14	18.63	14.95	11.92	9.41	9.18	8.96	8.74	8.52	8.31
	1.34%	35.16	28.06	22.43	17.92	14.27	11.28	11.01	10.75	10.49	10.24	9.99
	2.34%	44.65	35.05	27.68	21.93	17.37	13.70	13.38	13.06	12.75	12.44	12.14
	3.34%	60.02	45.79	35.42	27.63	21.65	**16.98**	16.57	16.17	15.78	15.39	15.02
	4.34%	89.15	64.39	47.93	36.39	27.96	21.63	21.09	20.56	20.04	19.54	19.05
	5.34%	165.43	104.42	71.65	51.54	38.17	28.78	28.00	27.24	26.51	25.79	25.10
	6.34%	890.61	253.37	133.76	84.17	57.52	41.16	39.87	38.64	37.45	36.31	35.21

oscillations of both variables – fact that we observed when building the model. This

[14] Fund, I. M. (2019, October). *Inflation rate, average consumer prices*. Retrieved from https://www.imf.org/external/datamapper/PCPIPCH@WEO/WEOWORLD

sensitivity comes from the fact that most of the value of the company relies on the terminal value, which is calculated using both the WACC and growth rate. A small change in one of these variables escalates to a great variation of the Terminal Value. In the second analysis, we wanted to evaluate if the share price would be affected by the D/E ratios previously defined for the Annuity and the Perpetuity periods (table 15). It was possible to conclude that contrarily to the WACC and Growth Rate, when the D/E ratios vary, the share price doesn't oscillate that much.

Table 15 - Sensitivity Analysis 2

		2026E - 2041E D/E										
	16.98	**0.00%**	**0.82%**	**5.82%**	**10.82%**	**15.82%**	**20.82%**	**25.82%**	**30.82%**	**35.82%**	**40.82%**	**45.82%**
	0.00%	6.79	6.80	6.89	6.97	7.05	7.14	7.22	7.30	7.38	7.46	7.53
	0.15%	6.83	6.84	6.92	7.01	7.09	7.18	7.26	7.34	7.42	7.50	7.57
	5.15%	8.15	8.17	8.25	8.34	8.42	8.50	8.59	8.67	8.75	8.82	8.90
	15.15%	10.90	10.91	11.00	11.08	11.16	11.25	11.33	11.41	11.49	11.57	11.64
2042E - Perpetuity D/E	**25.15%**	13.73	13.74	13.83	13.91	14.00	14.08	14.16	14.24	14.32	14.40	14.48
	35.15%	16.63	16.64	16.73	16.81	16.89	**16.98**	17.06	17.14	17.22	17.30	17.37
	45.15%	19.57	19.58	19.67	19.75	19.84	19.92	20.00	20.08	20.16	20.24	20.31
	55.15%	22.54	22.55	22.63	22.72	22.80	22.89	22.97	23.05	23.13	23.20	23.28
	65.15%	25.52	25.53	25.62	25.70	25.78	25.87	25.95	26.03	26.11	26.19	26.26
	75.15%	28.50	28.51	28.60	28.68	28.77	28.85	28.93	29.01	29.09	29.17	29.25
	85.15%	31.48	31.49	31.58	31.66	31.74	31.83	31.91	31.99	32.07	32.15	32.22

Scenario Analysis

There were four important factors that we felt that needed further discussion after building the model due to its high importance to the company – Take Rate, Brexit, *Farfetch Store of the Future* and M&A. Therefore, we performed a scenario analysis for each one of them to quantify what would the impact of each one of these factors be on our valuation, *ceteris paribus*. Two of the factors – Take Rate and Brexit will be subject to a deeper discussion in our individual reports, annexed to this report.

Take Rate

As already mentioned, Farfetch's current third-party take rate rounds 30%, one of the highest take rates charged by marketplaces.[15] But this value can be threatened in a close future. To perform the scenario analysis, the factor influenced was the take rate. In the Downward (Upward) scenario, the take rate would progressively decrease (increase). We got to an Expected Value per Share of $13.80, as it can be seen in table 16 – if the company doesn't make the effort of maintaining its take rate at the current values, the result can be disastrous. Further discussion about this topic can be read in the complementary analysis *How do Take Rates Impact on the Online Marketplaces – A Case of Farfetch*.

[15] For a more detail, see Chen, L. (2018, September 23). *A Comparison of Take Rates: Drivers of Value.* Retrieved from Medium: https://medium.com/@lilianxchen/a-comparison-of-take-rates-drivers-of-value-df77d81aee74

Table 16 - Take Rate Scenario Analysis

Take Rate	Downward	Base	Upward
Average Take Rate 2019E - 2025E (%)	23%	30%	38%
Enterprise Value ($ thousand)	-3,378,829	4,855,192	18,728,524
Net Debt ($ thousand)	-235,682	-235,682	-235,682
Equity Value ($ thousand)	-3,143,147	5,090,874	18,964,206
# of Outstanding Shares	299,857	299,857	299,857
Price per Share ($)	-10.48	16.98	63.24
Probability (%)	20%	75%	5%
Expected Value per Share ($)		**13.80**	

Brexit

There is an important issue to be considered – talent acquisition. As a high-tech company, Farfetch strongly depends on its human capital that contributes to the marketplace development. What if Farfetch loses its talent? A more detailed discussion of this topic will be performed in the complementary analysis *Should Farfetch make an (Br)Exit?*. From the analysis, we can conclude that Farfetch's expect share price doesn't differ that much from the one derived from the model – Brexit is not expected to hit Farfetch hard.

Table 17 - Brexit Scenario Analysis

Brexit	Downward	Base
Average Technology Expenses as a % of Revenues (%)	-9%	-6%
Enterprise Value ($ thousand)	1,226,682	4,855,192
Net Debt ($ thousand)	-235,682	-235,682
Equity Value ($ thousand)	1,462,364	5,090,874
# of Outstanding Shares	299,857	299,857
Price per Share ($)	4.88	16.98
Probability (%)	15%	85%
Expected Value per Share ($)		**15.16**

Farfetch Store of the Future

As already discussed, Farfetch's goal was, is and will be to disrupt the market, and *Farfetch Store of the Future* is just one example. However, this is a difficult topic to quantify – the company hasn't disclosed anything about this special project. This analysis is just an attempt to try to qualify this. However, there is no real information behind it, only our perception of what is a possible outcome of this project.

The influenced factor in this analysis is the 2026E – 2041E Average ROIC. In both upward and downward scenarios, we don't expect the overall ROIC of the company's operations to oscillate much – that's why we only increased/decreased this factor on about 10%. This is a high value because we expect this to represent a big stake in the operations of the company in the future.

The base probability is the highest one because we believe it is the most likely one. The downward probability is also quite high because it is likely that this project doesn't turn out what the company (and we) are expecting.

Based on this, the expected value per share is $14.91, not that far from our valuation.

Table 18 - Farfetch Store of the Future Scenario Analysis

Farfetch Store of the Future	Downward	Base	Upward
Average ROIC 2026E - 2041E (%)	20%	28%	40%
Enterprise Value ($ thousand)	370,514	4,855,192	23,874,895
Net Debt ($ thousand)	-235,682	-235,682	-235,682
Equity Value ($ thousand)	606,196	5,090,874	24,110,577
# of Outstanding Shares	299,857	299,857	299,857
Price per Share ($)	2.02	16.98	80.41
Probability (%)	35%	60%	5%
Expected Value per Share ($)		**14.91**	

M&A

We performed an analysis on one of the company's main strategy – inorganic growth. We influenced the forecasted revenues that come from the recently acquired companies – Brand Platform Revenue, descendant of the New Guards Group, and In-Store Revenue descendant of New Guards Group and Stadium Goods. We based this whole analysis on the McKinsey article "Where mergers go wrong". Acquisitions can go wrong because companies overestimate the synergies created by the merger. In this case, we considered that the synergies would be a revenue variation. The percentages were defined as the lower and upper bounds of the realized synergies. The probability was the number of companies in the study that experienced the upper/lower bound as a percentage of the total studied companies.

Table 19 - M&A Scenario Analysis

M&A	Downward	Base	Upward
Percentage of forecasted Brand Platform Revenue (New Guards) (%)	30%	100%	130%
Percentage of forecasted In-Store Revenue (New Guards and Stadium Goods) (%)	30%	100%	130%
Enterprise Value ($ thousand)	-66,151,466	4,855,192	15,691,584
Net Debt ($ thousand)	-235,682	-235,682	-235,682
Equity Value ($ thousand)	-65,915,784	5,090,874	15,927,266
# of Outstanding Shares	299,857	299,857	299,857
Price per Share ($)	-219.82	16.98	53.12
Probability (%)	30%	48%	22%
Expected Value per Share ($)		**-45.78**	

As it is possible to see in Table 19, we got to an Expected Value per Share of $-45.78. From this, we can conclude that this is a strategy the company shouldn't probably be following – the downward outcome is catastrophic and possible. However, this is under the assumption that the only synergies created are a variation of revenues. This makes this analysis very limitative.

Multiple Valuation

In order to have another reference to what value Farfetch's share price should take, we additionally performed a Multiple Valuation.

We considered a multiple that comes from the company – EV/GMV. We also considered another multiple – EV / Revenue – that are based on the values of the comparables selected by us, already analysed by us – Just Eat, Grubhub, Square and Shopify. These are the ones that better represent the operating performance of the company.

The "past", "current" and "forward" multiples are based on FY2018, 2019E and 2020E, respectively. EV / GMV is based solely on the company's disclosed values and on our forecast. EV / Revenue is calculated based on the comparables' value extracted from Capital IQ.

The summary of the valuation is presented in tables 20 and 21.

Table 20 - Enterprise Value based on multiples ($ billion)

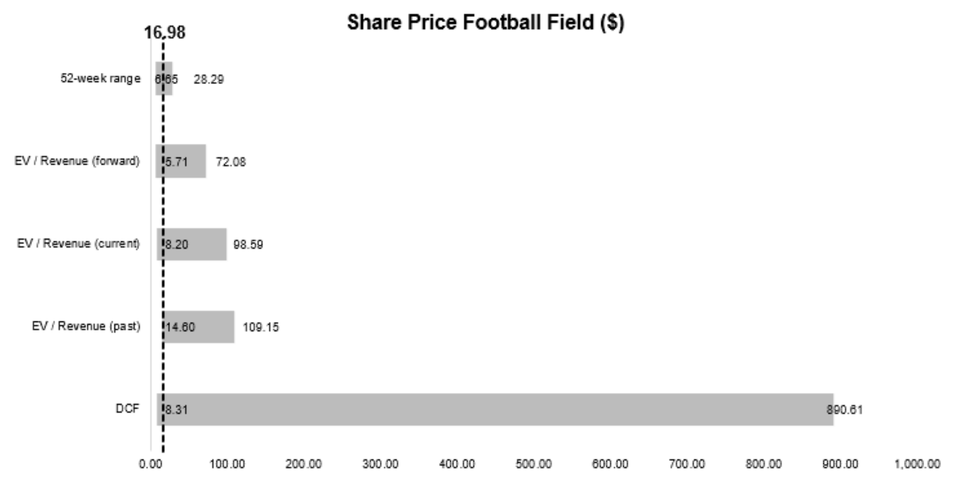
Valuation - *Enterprise Value* ($ billion)			
EV/GMV (past)	3.54		
EV/GMV (current)	2.46		
EV/GMV (forward)	1.55		
	Low	**Base**	**High**
EV/Revenue (past)	4.38	7.49	32.73
EV/Revenue (current)	2.46	5.59	29.56
EV/Revenue (forward)	1.71	4.51	21.61

Table 21 - Price per Share based on multiples ($)

Valuation - *Price per Share* ($)			
EV/GMV (past)	11.82		
EV/GMV (current)	8.20		
EV/GMV (forward)	5.18		
	Low	**Base**	**High**
EV/Revenue (past)	14.60	24.97	109.15
EV/Revenue (current)	8.20	18.64	98.59
EV/Revenue (forward)	5.71	15.04	72.08

Football Field

As it can be observed in graph 25, we get a range of share prices from $5.18 to $890.61 that comes from both the DCF and the Multiples.



Graph 25 - Football Field

We consider that the results that come from the DCF model are the most accurate ones since the valuation process is the most complete. Our recommendation is a **BUY** with a share price of **$16.98**.

Appendix

Financial Statements

Income Statement

Reformulated Income Statement				Forecasted Income Statement						
(in $ thousands, except share and per share data)	FY2016	FY2017	FY2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Core Income										
Operating Revenue	**242,116**	**385,966**	**602,384**	**1,010,104**	**1,542,807**	**2,121,858**	**2,954,327**	**4,098,590**	**5,486,673**	**7,555,314**
Cost of Revenue	(125,238)	(181,200)	(303,934)	(566,872)	(834,970)	(1,105,917)	(1,480,714)	(1,972,249)	(2,530,464)	(3,333,418)
% of Revenues	-52%	-47%	-50%	-56%	-54%	-52%	-50%	-48%	-46%	-44%
Selling, General and Administrative Expenses (SG&A)	(205,558)	(299,260)	(471,766)	(708,944)	(1,323,437)	(1,635,000)	(2,020,764)	(2,554,857)	(3,077,771)	(3,813,073)
Depreciation	(2,451)	(3,648)	(7,338)	(9,491)	(15,136)	(14,513)	(21,537)	(32,384)	(45,986)	(55,462)
% of PPE (n-1)		-23%	-27%	-25%	-24%	-23%	-22%	-21%	-20%	-19%
Amortization	(4,446)	(7,332)	(16,199)	(14,052)	(291,695)	(277,021)	(223,988)	(182,610)	(159,680)	(152,944)
% of IA (n-1)		-17%	-22%	-21%	-20%	-19%	-18%	-17%	-16%	-15%
Demand Generation Expense	(48,381)	(69,202)	(97,295)	(134,509)	(238,106)	(285,035)	(367,319)	(427,617)	(517,573)	(561,607)
% of Adjusted Revenue	-25%	-22%	-19%	-16%	-15%	-13%	-12%	-10%	-9%	-7%
Technology	(12,269)	(31,611)	(68,224)	(82,850)	(102,269)	(140,653)	(166,292)	(271,685)	(308,831)	(425,270)
% of Revenues	-5%	-8%	-11%	-8%	-7%	-7%	-6%	-7%	-6%	-6%
Share Based Payments	(19,848)	(21,486)	(53,819)	(151,516)	(151,715)	(238,837)	(355,403)	(493,057)	(619,302)	(804,702)
% of Revenues	-8%	-6%	-9%	-15%	-10%	-11%	-12%	-12%	-11%	-11%
General and Administrative	(118,163)	(165,981)	(228,891)	(316,527)	(524,516)	(678,942)	(886,225)	(1,147,504)	(1,426,399)	(1,813,088)
% of Revenues	-49%	-43%	-38%	-36%	-34%	-32%	-30%	-28%	-26%	-24%
Depreciation	2,451	3,648	7,338	9,491	15,136	14,513	21,537	32,384	45,986	55,462
EBITA	**(86,229)**	**(90,846)**	**(165,978)**	**(256,221)**	**(600,464)**	**(604,546)**	**(525,614)**	**(396,132)**	**(75,576)**	**464,284**
Share of Profits of Associates	18	31	33	774	1,667	2,333	3,586	5,274	7,741	11,310
% of Investment in Associates	78%	53%	38%	46%	46%	43%	45%	45%	44%	45%
Depreciation	(2,451)	(3,648)	(7,338)	(9,491)	(15,136)	(14,513)	(21,537)	(32,384)	(45,986)	(55,462)
Operating (loss)/gain (LBT/EBT)	**(88,662)**	**(94,463)**	**(173,283)**	**(264,938)**	**(613,932)**	**(616,726)**	**(543,566)**	**(423,242)**	**(113,821)**	**420,132**
Operating cash taxes	17,732	18,184	32,924	50,338	104,368	104,843	92,406	67,719	18,211	(67,221)
Tax adjustments	(17,708)	(18,084)	(33,007)	(54,952)	(110,490)	(120,155)	(99,218)	(90,668)	(32,080)	48,341
(NOLLAT) / NOPLAT	**(88,637)**	**(94,363)**	**(173,366)**	**(269,552)**	**(620,054)**	**(632,038)**	**(550,377)**	**(446,191)**	**(127,690)**	**401,252**
Non-Core Income										
Other interest income	278	323	4,401	8,802	15,844	25,350	35,490	46,137	57,671	69,205
Growth Rate		16%	1263%	100%	80%	60%	40%	30%	25%	20%
Other interest expense	(29)	(1)	(537)	-	-	-	-	-	-	-
Result before taxes	**249**	**322**	**3,864**	**8,802**	**15,844**	**25,350**	**35,490**	**46,137**	**57,671**	**69,205**
Non-Operating cash taxes	(50)	(62)	(734)	(1,672)	(2,693)	(4,309)	(6,033)	(7,382)	(9,227)	(11,073)
Tax adjustments	(272)	(27)	(37)	(32)	(35)	(33)	(34)	(34)	(34)	(34)
Non-core result	**(73)**	**233**	**3,093**	**7,130**	**13,150**	**21,040**	**29,456**	**38,755**	**48,443**	**58,132**
Financing										
Deposit account interest	1,359	2,510	6,859	18,662	6,493	10,352	11,528	10,136	6,467	2,105
% of Cash and Cash Equivalents (n-1)		2%	2%	2%	2%	2%	2%	2%	2%	2%
Interest on borrowings	(1,473)	(1,572)	-	-	-	-	-	-	-	-
Warrants issued	(376)	-	-	-	-	-	-	-	-	-
Result before taxes	**(490)**	**938**	**6,859**	**18,662**	**6,493**	**10,352**	**11,528**	**10,136**	**6,467**	**2,105**
Adjusted taxes	98	(181)	(1,303)	3,546	1,104	1,760	1,960	1,622	1,035	337
Financing result	**(392)**	**757**	**5,556**	**22,208**	**7,597**	**12,112**	**13,488**	**11,758**	**7,502**	**2,442**
Comprehensive result	**(89,102)**	**(93,373)**	**(164,718)**	**(240,215)**	**(599,307)**	**(598,885)**	**(507,433)**	**(395,678)**	**(71,745)**	**461,826**
Exchange differences on translation of foreign operations	(27,322)	33,504	(24,142)	(5,987)	1,125	(9,668)	(4,843)	(4,462)	(6,324)	(5,210)
Gains on cash hedges	-	-	436	436	436	436	436	436	436	436
Unrealised exchange gains	7,643	-	9,143	5,595	4,913	6,550	5,686	5,716	5,984	5,796
Unrealised exchange losses	-	(18,902)	-	(18,902)	(18,902)	(18,902)	(18,902)	(18,902)	(18,902)	(18,902)
Other comprehensive (loss)/income	**(19,679)**	**14,602**	**(14,563)**	**(18,857)**	**(12,428)**	**(21,583)**	**(17,623)**	**(17,212)**	**(18,806)**	**(17,880)**
Total comprehensive loss for the year	**(108,781)**	**(78,771)**	**(179,281)**	**(259,072)**	**(611,736)**	**(620,469)**	**(525,056)**	**(412,890)**	**(90,551)**	**443,946**

Balance Sheet

Reformulated Balance Sheet for the year ended December 31, (in $ thousands)	FY2016	FY2017	FY2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
				Forecasted Balance Sheet for the year ended December 31,						
Total funds invested: Uses										
Operating Cash	4,842	7,719	12,048	20,202	30,856	42,437	59,087	81,972	109,733	151,106
% of Revenues	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Trade and Other Receivables	17,281	18,180	93,670	197,933	190,209	244,159	323,762	437,932	571,215	765,881
Collection Period	-	17	34	17	45	42	40	39	38	37
Inventories	13,591	50,610	60,954	105,130	137,255	181,795	243,405	324,205	415,967	547,959
Average Inventory Holding Period	-	65	67	60	60	60	60	60	60	60
Operating Current Assets	35,714	76,509	166,672	323,265	358,321	468,391	626,253	844,109	1,096,915	1,464,947
Other liabilities	(2,364)	(19,146)	-	(19,456)	(19,456)	(19,456)	(19,456)	(19,456)	(19,456)	(19,456)
Trade and Other Payables	(84,388)	(136,744)	(194,158)	(351,570)	(411,766)	(515,084)	(669,364)	(864,548)	(1,074,581)	(1,369,898)
Payable Period	-	223	199		180	170	165	160	155	150
Operating Current Liabilities	(86,752)	(155,890)	(194,158)	(371,026)	(431,222)	(534,540)	(688,820)	(884,004)	(1,094,037)	(1,389,354)
Operating Working Capital	(51,038)	(79,381)	(27,486)	(47,761)	(72,901)	(66,150)	(62,566)	(39,895)	2,879	75,593
Net PP&E	15,795	26,696	37,528	62,309	96,614	152,097	226,626	287,495	338,266	397,596
Intangible Assets (w/o Goodwill)	17,440	35,592	67,302	1,467,396	1,252,841	1,081,913	1,005,641	1,027,961	1,142,615	1,367,436
Goodwill	25,503	38,449	36,043	219,543	307,360	399,568	479,482	565,789	656,315	748,199
Growth		*51%*	*-6%*		*40%*	*30%*	*20%*	*18%*	*16%*	*14%*
Other long term assets	(13,984)	(1,072)	(18,346)	(30,637)	(46,794)	(64,356)	(89,605)	(124,311)	(166,412)	(229,154)
% of revenues	-6%	0%	-3%	-3%	-3%	-3%	-3%	-3%	-3%	-3%
Core Invested Capital	**(6,284)**	**20,284**	**95,041**	**1,670,850**	**1,537,121**	**1,503,072**	**1,559,578**	**1,717,039**	**1,973,662**	**2,359,669**
Investment in Associates	23	58	86	2,454	3,632	5,375	7,955	11,774	17,425	25,267
Growth		152%	48%	2753%	48%	48%	48%	48%	48%	45%
Investments	-	278	566	15,289	21,405	27,826	35,617	44,878	55,648	67,891
Growth			104%	2601%	40%	30%	28%	26%	24%	22%
Non-core Invested Capital	**23**	**336**	**652**	**17,743**	**25,037**	**33,201**	**43,573**	**56,652**	**73,074**	**93,158**
Invested Capital	**(6,261)**	**20,620**	**95,693**	**1,688,593**	**1,562,157**	**1,536,274**	**1,603,150**	**1,773,691**	**2,046,736**	**2,452,827**
Total funds invested: Sources										
Interest bearing loan and borrowings	20,013	-	-	-	-	-	-	-	-	-
Lease Liabilites	-	66,133	103,034	107,616	112,997	119,777	126,964	134,581	144,002	154,082
Growth Rate			56%	4%	5%	6%	6%	6%	7%	7%
Debt and debt equivalents	**20,013**	**-**	**-**	**107,616**	**112,997**	**119,777**	**126,964**	**134,581**	**144,002**	**154,082**
Equity and equity equivalents	**118,916**	**396,903**	**1,128,431**	**1,924,276**	**1,997,877**	**2,019,461**	**1,984,578**	**1,919,212**	**1,910,853**	**2,106,311**
Excess of Cash	(145,190)	(376,283)	(1,032,738)	(343,299)	(548,717)	(602,964)	(508,392)	(280,103)	(8,119)	192,434
Invested Capital	**(6,261)**	**20,620**	**95,693**	**1,688,593**	**1,562,157**	**1,536,274**	**1,603,150**	**1,773,691**	**2,046,736**	**2,452,827**
Transactions with Shareholders		371,360	896,246	1,036,059	672,909	620,469	472,550	330,312	63,385	(266,368)
Payout Ratio		-471%	-500%	-400%	-110%	-100%	-90%	-80%	-70%	-60%

Cash Flow Statement

Reformulated cash flow statement (in $ thousands)	FY2016	FY2017	FY2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
				Forecasted Cash Flow Statement						
Core Business										
(NOLLAT) / NOPLAT	**(88,637)**	**(94,363)**	**(173,366)**	**(269,552)**	**(620,054)**	**(632,038)**	**(550,377)**	**(446,191)**	**(127,690)**	**401,252**
Depreciation and Amortization	6,897	10,980	23,537	23,543	306,831	291,534	245,525	214,994	205,666	208,407
Gross Cash Flow	**(81,740)**	**(83,383)**	**(149,829)**	**(246,009)**	**(313,223)**	**(340,504)**	**(304,852)**	**(231,197)**	**77,976**	**609,659**
Net working capital (NWC)	*(51,038)*	*(79,381)*	*(27,486)*	*(47,761)*	*(72,901)*	*(66,150)*	*(62,566)*	*(39,895)*	*2,879*	*75,593*
Change in NWC		28,343	(51,894)	20,275	25,140	(6,752)	(3,583)	(22,672)	(42,774)	(72,714)
Others	*11,519*	*37,377*	*17,697*	*188,906*	*260,567*	*335,212*	*389,877*	*441,478*	*489,903*	*519,045*
Change in Others		(25,858)	19,680	(171,209)	(71,660)	(74,645)	(54,665)	(51,601)	(48,425)	(29,142)
Capital Expenditures in Net PP&E		(14,549)	(18,170)	(34,272)	(49,441)	(69,995)	(96,066)	(93,253)	(96,756)	(114,793)
% of Revenues		*-4%*	*-3%*	*-3%*	*-3%*	*-3%*	*-3%*	*-2%*	*-2%*	*-2%*
Capital Expenditures in Intangible Assets (w/o Goodwill)		(25,484)	(47,909)	(1,414,146)	(77,140)	(106,093)	(147,716)	(204,930)	(274,334)	(377,766)
% of Revenues		*-7%*	*-8%*	*-140%*	*-5%*	*-5%*	*-5%*	*-5%*	*-5%*	*-5%*
Capital Expenditures (CAPEX)		(40,033)	(66,079)	(1,448,418)	(126,582)	(176,088)	(243,782)	(298,183)	(371,090)	(492,558)
Gross Investment		**(37,548)**	**(98,293)**	**(1,599,353)**	**(173,101)**	**(257,485)**	**(302,030)**	**(372,455)**	**(462,289)**	**(594,414)**
Free Cash Flow		**(120,931)**	**(248,123)**	**(1,845,361)**	**(486,325)**	**(597,989)**	**(606,882)**	**(603,652)**	**(384,313)**	**15,245**
Non-Core Business										
Non Core Result	(73)	233	3,093	7,130	13,150	21,040	29,456	38,755	48,443	58,132
Invested Capital in Non-core Business	*23*	*336*	*652*	*17,743*	*25,037*	*33,201*	*43,573*	*56,652*	*73,074*	*93,158*
Investment Cash Flow		(313)	(316)	(17,091)	(7,294)	(8,165)	(10,371)	(13,079)	(16,422)	(20,084)
Non-Operating Cash Flow		**(80)**	**2,777**	**(9,961)**	**5,857**	**12,876**	**19,085**	**25,676**	**32,021**	**38,048**
Cash Flow available to Investors		**(121,011)**	**(245,346)**	**(1,855,323)**	**(480,468)**	**(585,114)**	**(587,797)**	**(577,977)**	**(352,292)**	**53,293**
Other Comprehensive Income	**(19,679)**	**14,602**	**(14,563)**	**(18,857)**	**(12,428)**	**(21,583)**	**(17,623)**	**(17,212)**	**(18,806)**	**(17,880)**
Financing										
Financial Result	(392)	757	5,556	22,208	7,597	12,112	13,488	11,758	7,502	2,442
Net Financial Assets	*(125,177)*	*(376,283)*	*(1,032,738)*	*(235,682)*	*(435,720)*	*(483,187)*	*(381,428)*	*(145,521)*	*135,883*	*346,516*
Investment in Net Financial Assets		(251,106)	(656,456)	797,056	(200,038)	(47,467)	101,759	235,907	281,404	210,633
Equity	*118,916*	*396,903*	*1,128,431*	*1,924,276*	*1,997,877*	*2,019,461*	*1,984,578*	*1,919,212*	*1,910,853*	*2,106,311*
Total Comprehensive Result	*(108,781)*	*(78,771)*	*(179,281)*	*(259,072)*	*(611,736)*	*(620,469)*	*(525,056)*	*(412,890)*	*(90,551)*	*443,946*
Net Cash Transaction with Shareholders		356,758	910,809	1,054,917	685,337	642,052	490,173	347,523	82,191	(248,487)
Financing Free Cash-Flow		**(106,409)**	**(259,909)**	**(1,874,180)**	**(492,896)**	**(606,697)**	**(605,420)**	**(595,188)**	**(371,098)**	**35,413**

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Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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How do Take-Rates Impact on The Online Marketplaces – A Case of Farfetch

Maria Inês Barreiro Enes, 33814

A Project carried out on the Master in Finance Program, under the supervision of:

Professor Filipa Frade de Castro

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Abstract
The present individual report serves the purpose of analyzing the importance of the take-rate on the online marketplaces as well as evaluating its impact on the company's financials.

This analysis was then focused on Farfetch, the leading technology platform for the global luxury fashion, through a comparison between the company and its competitors and other online marketplaces.

After evaluating the differences and similarities, we performed a sensitivity analysis to measure the take-rate oscillations impact on the company's revenue and share-price. It was then possible to conclude that Farfetch is highly sensitive to changes in the take-rate and that the company should manage its partnerships mix to include more new designers and small boutiques so it can maintain its high rake.

Keywords
Take-Rate, Exclusivity, Managed-Marketplace, Impact

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Literature Review

Luxury fashion market is shifting to online and so it became crucial for traditional luxury brands to update its business model (D'Arpizio, 2018), whether through investing resources into their own online platforms or selling through online luxury marketplaces, such as Farfetch. Nowadays, luxury retail represents the delivery of value for both customers and sellers and specially it represents the understanding of who the target is – Millennials.

In recent years, online retailers allowed sellers (brands, manufacturers or designers) to use their platforms as a channel to reach customers in exchange for a commission (take-rate), disrupting the traditional reselling format (Abhishek, 2016). However, sellers are still the ones who decide about the products' prices, contrarily to the buy and sell format.

Kotler (2010) believes that companies use third-party providers to increase the penetration probability of the products in the market at a lower cost and because companies are then able to focus on the core activities instead of worrying about the logistics. In the luxury market, for new designers or small boutiques, third-party partners can be helpful to reach the global market and for marketing purposes.

As it was previously said, retailers' revenue derives from the type of service they provide – whether they can have their own inventory and sell directly to the final consumer acting as principal, or they can act like an intermediary and connect the seller with the client winning a commission. There is when the take-rate concept emerges.

The take-rate (or rake) refers to the percentage of the transactions that each marketplace facilitates between sellers and customers that they keep as revenue. It is considered as a marketplace key performance indicator as it can show how a company differs from its competitors.

How do Retailers define their prices?

The take-rate indicates how the company is positioned in the market and consecutively the company's negotiation power.

In the retail industry, it is possible to find a wide range of commission rates, from 0% to 85% (Chen, 2018), so the question is why are some markeplaces able to charge more than others? In order to define the take-rates, companies have to demonstrate its proposition value and if possible some exclusivity (and consequently reach higher rakes) that is crucial to be the best alternative in the market meaning, retailers have to consider that what sellers are willing to pay depends on how good or bad the alternative is.

With this, there are two key matters for pricing definition:

- Fragmented Category
- Managed Marketplaces

Fragmented Category

Fragmented Category helps evaluating how easy it is to find an alternative, depending on the business. When we refer to a marketplace which collects products from various sellers, consumers' alternative would be sorting a hundred of options from different sources. As an example, online travel agencies imposed a take-rate for flight booking of approximately 3% when compared to hotels that is almost 15%. The reason behind this fact is that as a customer, it is easier to search for 3 or 5 airline websites and book a flight. However, considering that the hotels landscape is so fragmented, it would be simpler to work with an agency that would aggregate all the possibilities than going through each individually (Chen, 2018).

The same happens with the luxury fashion marketplaces which are highly fragmented due to a large number of brands, and to the various categories such as clothes, shoes, accessories, and others. For a customer, it is easier to use a "one-stop-shop" than going through each brand website.

Managed Marketplace

The Managed Marketplace factor is related to the value added to the marketplace – beyond connecting buyers and sellers. For example, in luxury fashion, online platforms apart from acting as an intermediary can add value by creating content - styling, photographing, photo-editing and content management.

What is happening with Farfetch?

Farfetch is currently exercising its pricing power. The company's take-rate varied between 30% in 2015 to 32% in 2018, charging lower rakes to brands than to boutiques - boutiques generally are less exposed to the market and need Farfetch to empower their online presence.

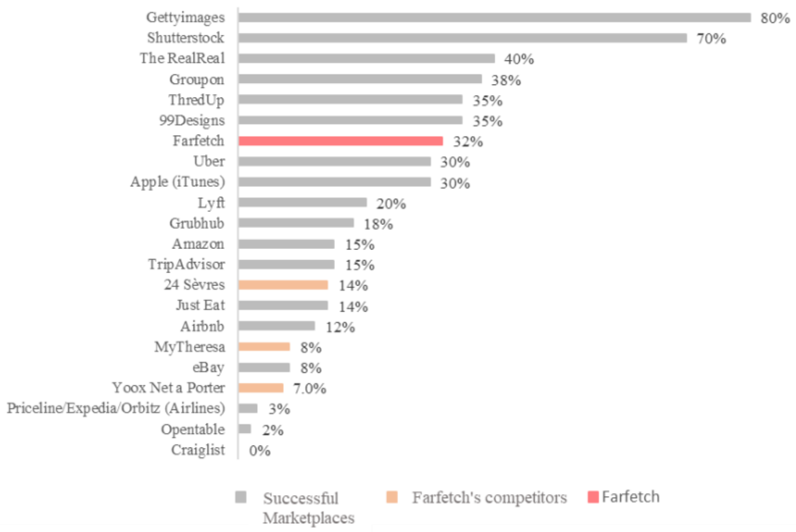
Along with the primary application (the marketplace), Farfetch offers three other applications and various types of services such as content creation, inventory management, fulfilment, customer service– which led to conclude that is a managed marketplace. The company also entered into a partnership with Prada to become its permanent retail partner for Linea Rossa collection, and it offers more than 500 designer exclusives on its marketplace. When compared to its closest competitors (luxury online retailers), Farfetch has the highest take-rate (table 1). The reason behind this fact is that more than a typical retailer, Farfetch is a technological company which aims to provide its sellers the best service, from the basic services such as fulfilment to the most complex ones such as data insights, luxury market trends, and others.

Table 1 - Farfetch vs Competitors

Company	Take-Rate	Exclusives Designs
YNAP	7.0%	1,131
MyTheresa	8.0%	686
Matches Fashion	-	1,350
24 sèvres	14.0%	124
Farfetch	32.0%	500+

Source: Each company website and External sources

After comparing Farfetch's rake with some of the most successful marketplaces it was possible to conclude that the company's commission rate is one of the highest in the online retail market and that most of the high take-rates are associated with managed platforms as it can be seen in graph 1.



Source: (Chen 2018)

Graph 1 - Successful marketplaces and Farfetch's competitors take rate

Therefore, it is necessary to understand if Farfetch is going to be able to maintain its take-rate and which are the take-rate oscillations impact on the company's revenue and share price.

Is it good to have high take-rates?

Gurley (2013) stated that even though it may be logical to assume that high take-rates are always better, in some cases the opposite may be often true. What can happen when online marketplaces charge high rakes is that the products' price will probably jump becoming part of the consumers' stake. It can also influence sellers to look for cheaper alternatives. Therefore, if in the future Farfetch's take-rate continues increasing, it may turn unsustainable for the small boutiques/new designers, which aim to boost their online presence at a low cost, to continue working with Farfetch. However, decreasing the commission to its competitors' level may compromise the company's operation.

So, will Farfetch be able to maintain its rake?

Although Farfetch delivers high-value proposition to its consumers offering services beyond aggregating supply and demand, the online luxury industry is becoming increasingly competitive and competition can impact on how online marketplaces optimize take-rates (Caplinger, 2017). So on one hand, having high take-rates is good if in the future the company is able to maintain it whether through its exclusivity or services provided to sellers. On the other hand, it can give a negative effect if sellers start selling on other platforms with lower rakes – specially those new designers and small boutiques. Therefore, to evaluate the impact of both situations in the company's revenue and share price, we created two scenarios: the first one where the take-rate would converge to the average of the sixth most successful marketplaces (49.70% in 2025), and the second one where the take-rate would fall to the average of its competitors (9.70% in 2025). As it is possible to observe in Table 2, if in 2025 Farfetch's take-rate equals the average of its competitors (previously identified), its share price will be equal to -$11.14. However, if its rake converges to the second scenario (49.70%), the company's share price will jump to $93.78 compared with our expectation of $16.98. With this, it is possible to conclude that Farfetch is highly sensitive to changes in the take-rate. Therefore, the company must be able to maintain or increase it to be sustainable in the future.

Table 2 - Sensitivity Analysis

As of 2025E	Downward	Forecasted	Upward
Take-Rate	9.70%	29.30%	49.70%
Revenue (in thousand)	$4,243,920	$7,555,314	$11,001,866
Total Comprehensive Result (in thousand)	$187,003	$443,946	$701,909
Share Price	-$11.14	$16.98	$93.78

Knowing that the company charges higher rakes to boutiques and new designers than to well known consolidated brands, Farfetch should manage its partnerships mix in order to continue attracting boutiques and brand new designers to its marketplace.