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.

Equity Research: Valuation of Farfetch - The rise of Farfetch in luxury e-commerce

David Alexandre Tomás Gonçalves 40895

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

Nuno Vasconcelos e Sá

04/01/2021

Abstract

This final work project forecasts Farfetch's results, analyzing its business and position in the luxury market. The COVID-19 pandemic brought good things for the company, experiencing a high in new active consumers. This allied with the new focus on brand development brings great prospects for the revenues' growth. Following our assumptions and calculations, we forecast a price target of US$70,33 for FY21, resulting in a return of 10% for the shareholders, giving a HOLD recommendation.

Keywords

Valuation, Equity Research, Farfetch, Online Luxury

This work used infrastructure and resources funded by Fundação para a Ciência e a Tecnologia (UID/ECO/00124/2013, UID/ECO/00124/2019 and Social Sciences DataLab, Project 22209), POR Lisboa (LISBOA-01-0145-FEDER-007722 and Social Sciences DataLab, Project 22209) and POR Norte (Social Sciences DataLab, Project 22209).

This report is part of the “Equity Research: Valuation of Farfetch” report (annexed) and should be read has an integral part of it.

Table of Contents

Company overview

Farfetch

Farfetch was founded in 2007 by José Neves in a small office in London. Born from the dream of creating an e-commerce marketplace for luxury retailers and fashion enthusiasts around the world, the company focused on small retailers that wanted to expand their exposure and client base.

Neves became the first portuguese CEO of a unicorn.

In 2015 Farfetch become a unicorn (start-ups that are valued at US$1 billion) – raising US$86 million at a valuation of US$1 billion joining the likes of Facebook, Airbnb, Zomato and Uber. After several seed investments, in September 2018 Farfetch launched its IPO, at a value of over US$5,8 million selling its shares at US$20 each. A few minutes later the stock was already at around US$28.

However, the company has never had positive results but has seen jumps in revenues every year and keeps focused on technological investments to stand out from its competitors expecting to see big returns from these investments.

In 2017 Farfetch launched the Farfetch Store of the Future concept, which aimed to reinvent the consumer experience in luxury retail, teaming the physical experience with the digital advantages of online shopping, capturing consumer data and preferences which will improve the experience with the sales associates. Farfetch's Store of the Future pilot is being used at a CHANEL boutique in Paris, which shows the confidence that brands have in Farfetch's innovative culture.

Today, Farfetch serves as platform for over 500 luxury brands, 700 luxury retailers, 2,5 million customers and acquired and partnered with several businesses, such as JD.com, Browns, Stadium Goods and the New Guards Group, among others.

Business Model and Segments

Online luxury marketplace with revenues based on sales and commissions

Farfetch is an online luxury retailer that works with several luxury brands, retailers, wholesalers and boutiques. Its main busines unit is the **Digital Platfrom** – this is how Farfetch was first imagined and conceptualized. This business unit represents the online marketplace, the company's core business and comprises StadiumGoods.com, Farfetch Store of the Future, Farfetch Platform Solutions (white-label technology developer for luxury sellers), BrownsFashion.com and Farfetch's website, currently being the biggest driver of the company's revenues.

The business model within this unit revolves around two different types of sale: first-party and third-party. The former consists of sales on Farfetch's platform of inventory that was purchased by the company. In this type of sales, Farfetch recognizes as revenues the whole price that the client pays – this means that the revenues will be equal to the Gross Merchandise Value (GMV). On the other hand, third-party sales derive from sales made on inventories held by partner boutiques or retailers. Here the company takes a predetermined Take-Rate, a commission on these types of sales. In this case the revenues will be a certain percentage of the full GMV. This business segment has been the biggest source of revenue for Farfetch and the company's valuation depends highly on it, ultimately leading the share price upwards or downwards, depending on its success.

The company also provides fulfilment solutions, from shipping to customs clearing, enabling its partners to ship to 190 countries and giving them access to a "fully integrated logistics network", to grow the Digital Platform. Farfetch does not record profit from these services, breaking even on their costs.

Major investment in new business unit that will likely be a big driver in the company

Farfetch invested in 2019 in a new business unit that is expected to become one of the major drivers for its growth. It acquired the New Guards Group, and the business unit of **Brand Platform** was born. This segment focuses on B2B activities including "design, production, brand development and sales" of brands owned by New Guards to wholesalers, as per Farfetch's annual report. It works as an "incubator" of brands - New Guards owns brands like Off-White and Palm Angels which have proven very popular and successful, if this is maintained and improved by Farfetch it could lead to very positive results.

The acquisition took place in August 2019 and in December 2019 Brand Platform revenues represented 16% of Farfetch's total revenues for that year. This highlights the impact that this new segment might have in the future of the company's future revenues, being an important variable when valuating Farfetch.

These revenues include New Guards' revenues excluding the ones from directly operated stores (included in the in-store business unit) and from New Guards' owned e-commerce websites or from Farfetch's marketplace (which are included in the Digital Platform segment).

The third business unit is the **In-Store**, which includes all revenues made from retail stores operated by Browns, Stadium Goods and New Guards (all acquired by Farfetch) not including the franchised stores. This is the business unit with smaller contribution to Farfetch's revenues, something that became even more emphasized with the COVID-19 pandemic and the lockdowns necessary to contain it. We do not anticipate this segment to have a major impact on the company's valuation since its revenues have not been and are not expected to become significant in the future, not greatly affecting the valuation. The revenues on the two latter segments are not commission based, as they are both first party based.

It is fair to say that the pandemic had a positive impact in the two business units firstly mentioned which depend more on the online environment and on the development of brands while strongly damaging the in-store segment, which needs to have people through the doors to capture revenues.

Trends

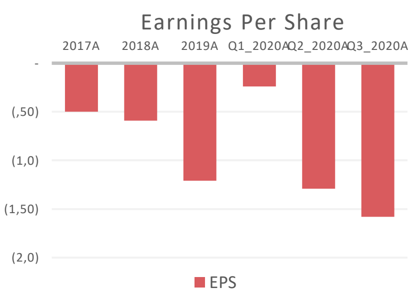

Figure 1: Earnings per Share evolution (in US$).
Source: Company data

Farfetch has only seen negative results in the past, in 2017 it had losses after taxes of US$112.275 and in 2019 these losses increased to US$373.688. Despite these results there is some light at the end of the tunnel: revenues have seen massive growth, growing by more than 50% on both years and the largest and growing expenses are mainly general and administrative ones, linked to the acquisition of New Guards. Because of this we expected that these expenses will be offset by the revenues in the future and that with time, the group becomes more cost efficient, arriving at better results at the end of the year.

The main driver for Farfetch's growth has been the Digital Platform segment, representing over 80% of the company's total revenue in 2017, 2018 and 2019 and growing 65% and 43% in the last two years. This growth is mainly due to the increase in active consumers (clients who have purchased in the last 12 months), that have grown by almost 50% in both 2018 and 2019, increasing by 686 thousand active consumers only in 2019. Another factor for this jump in revenues in this segment was the increase of 75% of First-Party GMV, which translates 100% to the Digital Platform sales, instead of accounting for commissions like Third-Party GMV. These increases were partially counteracted by small decreases in the Average Order Value on Farfetch's Marketplace.

The Digital Platform is the biggest driver in Farfetch's value.

We expect these trends to continue going forward: The Digital Platform segment will continue being the major source of revenues, but its percentage of revenues will decrease due to the strong appearance of the Brand Platform segment; active consumers will ride the e-commerce explosion wave and continue increasing throughout all regions and First-Party sales will increase as Farfetch begins selling more of their own brands instead of third-party products.

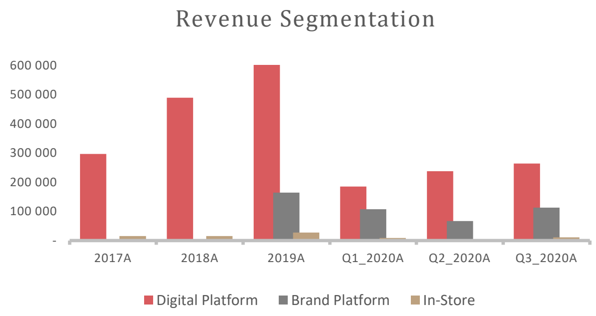

Figure 2: Revenue segmentation (in thousands of US$).
Source: Company data

With the COVID-19 pandemic, small boutiques and retailers faced tough challenges and many grasped for survival. The ones partnered with Farfetch saw these challenges being eased due to the presence of this online player and many new partnerships with small physical stores were made. This pandemic was an unexpected blessing to Farfetch, as boutiques built trust in the platform and realized the importance of the marketplace they were inserted into. This meant that Farfetch gained importance and negotiating power to possibly increase the Third-Party Take-Rate in the future and find new interested stores, which can be very important for this segment going forward.

The In-Store segment, which was represented by 5 stores in 2019 in the USA and in Europe, has never had, and we do not expect it to have, significant materiality in Farfetch's result: in all three past years this business unit did not account for more than 5% of the company's revenues. Despite this, it is still relevant to note that Browns, Stadium Goods and New Guards' directly operated stores showed good results in 2019, increasing Farfetch's in-store revenues by over 70%.

The Brand Platform segment is ready to represent a bigger percentage of revenues.

The Brand Platform segment, as previously stated, was only introduced in August 2019 which does not give us a possibility to analyse past information but allowing us to check for future potential. In 5 months, New Guards' brands accounted for 16% of Farfetch's revenues in 2019. This segment expands Farfetch's offer of brands and allows it to capture new up-coming trends that can prove very successful, absorbing 100% of the GMV which will lead to higher revenues and profits. In the first half of 2020 this segment already represents 28,5% of the company's total adjusted revenue (total revenue less fulfilment revenue, which has no economic benefit for Farfetch), in the future we expect this percentage to increase.

The regions of Europe, Middle East and Africa were the biggest sources of Farfetch's revenues, representing 40% of revenues in 2017. However, emerging economies such as China and other countries in the Asia Pacific region are ready to turn this around, in 2019 the revenues coming from this area increased by 95% and its significance became almost the same as the Europe, Middle East and Africa regions, representing 36% contrasting with the 37% of the latter. In the future, this trend is expected to continue, Asia will be an even bigger player in the luxury market.

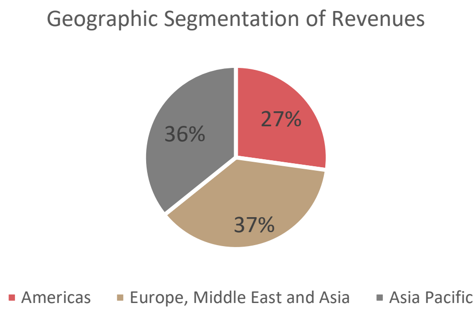

Figure 3: Geographic Segmentation of Revenues in 2019.
Source: Company data

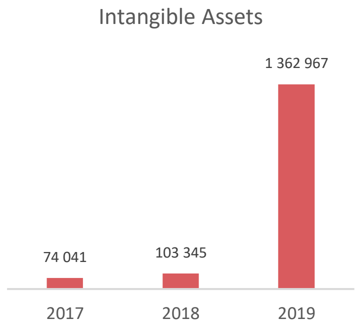

Figure 4: Intangible Assets growth (in thousands of US$)
Source: Company data

In 2019 the large investment in New Guards Group translated into a massive increase in the value of intangible assets in the company (from US$103 345 in 2018 to US$1 362 967 in 2019) and technology investments, demand generation expenses among others lead to the negative results in the past years while creating a strong foundation for the future, in hopes to create a solid luxury company, with space and capability to grow further. We expect these investments to be profitable in the long run, but despite Neves's optimistic forecast of Farfetch seeing positive results already in 2021, we believe that profitability will take longer to achieve, only in 2022.

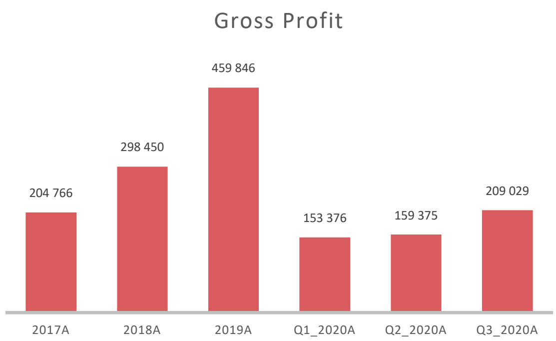

Figure 5: Gross Profit (in thousands of US$).
Source: Company data

Stock Performance

Since Farfetch's IPO in 2018 its stock has experienced high fluctuation. The announcement of the IPO generated a considerable interest among investor and, starting from a price of US$20 per share, at the end of the first day it was already trading at US$28, confirming interest and expectations of investors regarding Farfetch. The first and most relevant negative fluctuation came in August 2019 when the company announced the acquisition of the New Guards group. Farfetch stock's price suffered a massive drop from US$18.25 to US$10,13 (-44,4%). This was attributed to the doubts of investors about the change of the company's business plan, as they expected Farfetch to focus on its marketplace and an asset-light strategy taking advantage of the relations established with external boutiques. With this investment, however, that perspective has changed, with the company owning several designers, growing vertically, and moving away from a pure retailer business model.

The stock price gradually increased throughout time facing the second big change in the begining of November 2020 when it jumped from US$28,13 to US$43,84 in just 9 days, an increase of 55,8%. This increase was caused by the announcement of a deal made between Farfetch, the Chinese giant Alibaba and Richemont, which brought great prospects for the future of the Farfetch marketplace.

Forecasts

Revenues driven by active consumers growth

As seen previously, one of the more important drivers in the Digital Platform business unit are the platform's active consumers. These are the people that not only visit Farfetch's webpage but also shop regularly through it. The increase seen in the past years has been of major importance to the company's evolution and is expected to keep reaching new highs in the future. With COVID-19 online shopping became more prevalent, people who did not use to shop through the Internet were "forced" to embrace this new reality, and those who already did, reinforced this habit. Despite sacrificing some of the shopping experience, there was a general movement to the online in search of safety in these current times.

For this reason, we expect Farfetch to experience a big rise in active consumers during the pandemic, as these gain trust and become loyal to the company, representing, in 2021, a growth of 30% and 35% in the Americas and Europe, Middle East and Africa respectively, as the latter as shown far greater historical growths. In the future we expect the active consumers growth to gradually converge to 10% in the former region and to 5% in the latter.

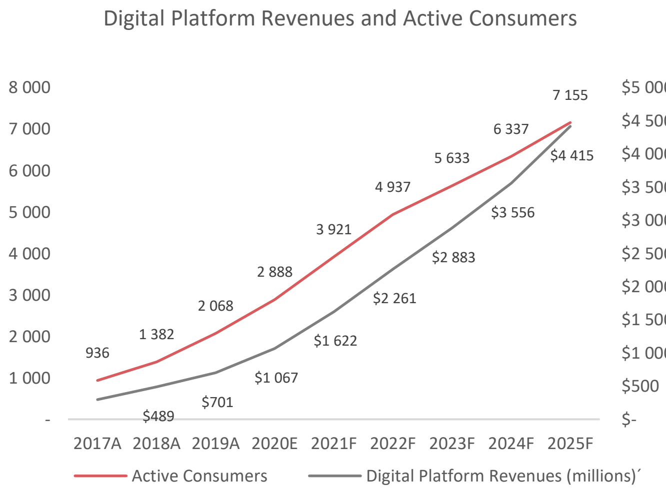

Figure 6: Digital platform revenues (in US$ millions) and active consumers forecast.
Source: Company data and analysts' forecast

Active consumer numbers' in the Asia Pacific region will experience a steep increase

The region of Asia Pacific is another dimension and is expected to support most of the market's growth. Furthermore, China (the biggest contributor to the region's market) faced the crisis brought by the pandemic before any other country, recovering at a fast pace, and with its luxury sales expected to grow in relation to 2019. Because of this and fuelled by the partnership made between Alibaba and Farfetch, we expect the number of active consumers to grow at a higher pace in this region, by 40% in 2021 and then gradually declining to a growth of 20% in 2025. In 2025 Farfetch's Digital platform is expected to record about 7,13 million active consumers in all regions, representing a CAGR of 22,90% between 2019 and 2025.

For this business unit, it was used a bottom-up forecast, as seen above. First-Party share of revenues is expected to continue increasing in relation to Third-Party, maximizing the revenue collected by Farfetch since this does not depend on a retained commission. This is positive since the take-over rate has been decreasing every year, representing smaller revenues in third-party sales. The cause of such a decrease can be mainly attributable to the maintenance of competitive advantage and attractiveness when brands begin to consider developing their own online marketplaces. Keeping the take-rate at around 25%, allied with all Farfetch's experience and technical expertise, encourages boutiques to maintain their partnerships over developing their own selling platforms.

Such increases will be shortly offset by decreases in average order values. In turn, there will be an increase in the average number of orders by active consumers, as people become more used to shop online and do it more often. All these factors combined lead to a steep increase in the revenue growth rate for 2020 due to the prevalence of online shopping. These will slow down from then on, stabilizing at 24% in the final years of forecast. We expect this business unit's revenues to grow at a CAGR of 35,89% between 2019 and 2025 arriving at a value of US$5,2 billion in the last year of the forecast.

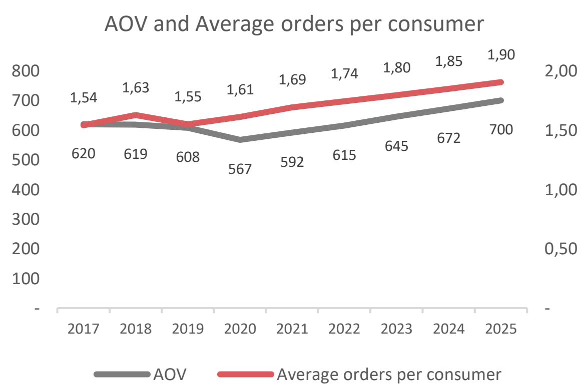

Figure 7: Average order value (US$) and Average order per consumer forecast
Source: Company data and analysts' forecast

Brand Platform for the future

Farfetch's biggest investment was made to create the Brand Platform business unit with the acquisition of New Guards. This brought a whole new way of getting revenues, a whole new business model which investors were wary off due to the higher risk that the company was incurring in. But by facing higher risks, Farfetch opened itself to the possibility of higher rewards, hoping that brands like Off-White and Palm Springs along with the group's' ability to create brands from scratch would prove the profitability of the deal.

According to Neves, New Guard's revenue growth of close to 60% every year along with its high profitability attracted Farfetch's investment. New Guards differentiates itself from other companies by their ability to scout talent, create community driven brands and initiate buzz and hype around its brands through social media platforms. Before the acquisition, New Guards was digital oriented but did not have the capability to digitally sell their products, focusing on wholesale, which was the synergy that Farfetch looked to tackle with the purchase of New Guards.

The group stands out given its ability to scout talent and create community-driven brands

Brands brought up by New Guards like Off-White, Palm Angels and Heron Preston are what gives the group a good track record at identifying the best brands to be launched according to new demanded luxury, leading Farfetch's hopes on the investment.

The new luxury consumers demand for individuality, especially Gen Z, which is rising as the most important costumer group in this market is shifting demand and preferences. Today, streetwear is the new luxury demanded by the masses: sneakers, sweaters, hoodies, and others are the first to be sold out as soon as each product launches. Brands need to be different, have a defining culture and mark their position. Because New Guards focuses on these points and historically has proven that they understand the luxury landscape there are high expectations for the success of this venture.

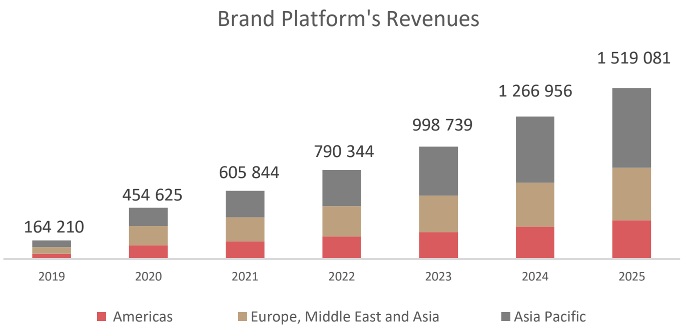

Figure 8: Brand Platform revenues by region forecast (in thousands of $)
Source: Company data and analysts' forecast

Farfetch began focusing on the development of brand, opening doors to new business possibilities

Due to the lack of past information, the forecasts for this segment were based on a Deloitte's study that projects the growth for the top luxury brands in the world for the upcoming years. It was forecasted that sales in the Americas, also due to Amazon's new entry in the luxury market, grow at lower rates than the other regions – 27% in 2021 and 2022 and 19,9% in the following years. Europe, Middle East and Africa will be forecasted to grow at 27% in 2021 and 2022 and from then on at the same pace as the Americas region (19,9%). Asia Pacific, the region in which China is included and that according to Bain & Company is expected to account for 50% of the market in 2025 is expected to grow even faster, at 44,5% in 2021, 35,90% in 2022 through 2024 and then converging to the pace of the other two regions. We expect Brand Platform's revenues to reach US$1,5 billion in 2025, growing at a CAGR of 44,9% between 2019 and 2025.

Nonetheless it is important to note the risks in this business segment, and not only look at how the company will do if the venture is successful. New Guards might not be able to identify and promote successful brands in the future, while bad marketing strategies and product positioning can lead to a loss of relevance of its brands. Furthermore, New Guard's biggest revenue source is Off-White, to which the Group does not own the trademark, only having an exclusive deal with the designer.

A big risk that Farfetch faces is that the exclusive contract runs out in 2035 with a clause that allows Off-White to opt-out of the deal in 2026. This is significant because Off-White designer is now Louis Vuitton's Creative Director and is likely to leave New Guards to join the giant's umbrella, highlighting the importance to keep focusing on the development of new brands, build a community, tackle social causes, and create buzz around them.

In-Store forecasts

This segment has always been of small importance in Farfetch's business and we expect this trend to continue. COVID-19 and the lockdowns related to the pandemic will strengthen this factor - in the first half of 2020 there was a massive drop of in-store sales. This allied with the new trust in online shopping will lead to even smaller results coming from this segment.

We expect the In-Store segment to continue losing strength as a source of revenue.

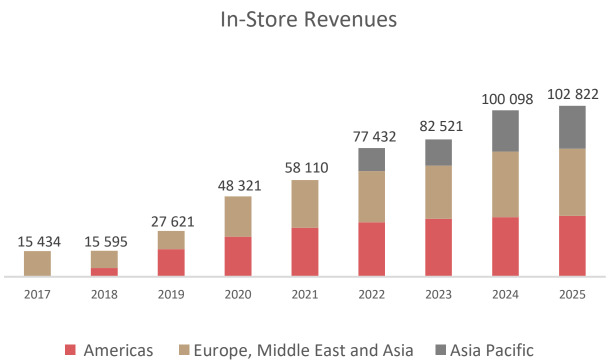

Figure 9: In-Store revenues per region forecast (in thousands of $).
Source: Company data and analysts' forecast

Nevertheless, it is always important to have a physical presence in luxury to enhance the consumer experience and relation with the brand. Because of this, Farfetch is in the process of opening 5 stores in 2020 in Europe and in the USA, while we expect new openings in the future, especially in the Asia Pacific region, capturing the most value from this growing market.

The forecast for this business unit was done on a top-down basis, considering the market and its scenarios and due to the lack of information it was assumed equal revenue per store. The revenues per region were then adjusted for small differences in growth rates. In the Americas region, it was assumed that they will grow slightly above the market, just like in the region of Europe, Middle East and Africa, given the more mature stages that the luxury market is in these regions. In the Asia Pacific region, the stores' revenues are expected to grow at a higher rate than the market for the first years of operations as an emerging and full of new luxury costumers region.

It is possible that, by the end of 2021, retail operations go back to how they used to be.

These forecasts can have implications due to the COVID-19 crisis. If it lasts much longer and more lockdowns are necessary, the growth will further shrink. At the moment, the expectation is that a vaccine will be available soon. However, this does not mean that normal retail activity will fully recover but evidences good prospects for the future. If there are no further complications with the disease, it is possible that at the end of 2021 retail operations are back to how they used to be. Finally, this segment would gradually continue to lose materiality in the company's operations, arriving at a relative weight of 1% of Farfetch's revenues in 2025, with revenues of US$102,8 million growing at a CAGR of 24,5% between 2019 and 2025.

Cost of Revenue & Demand Generation Expenses

Cost of revenue in Farfetch's business represents the cost of goods sold (inventory from first-party sales and from in-store sales), delivery costs associated with the fulfilment of orders and cost of revenue associated with New Guards Group operations. These costs have been increasing and driving gross margins down, but as a luxury player, we expect Farfetch to become more cost efficient and reach the high gross margins normally obtained by its competitors in luxury (for example LMVH with a gross margin of 66% and Kering, 55%), allied with the good prospects of the Brand platform segment which we expect to incubate several high success brands, delivering high gross margins. In 2025 this caption is expected to reach 53%, between all business units.

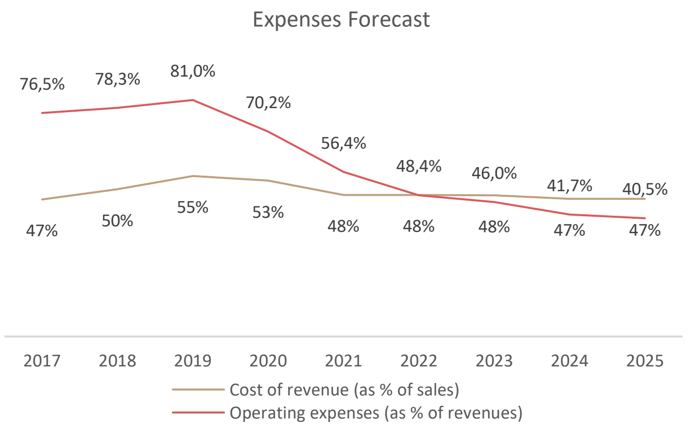

Figure 10: Cost of revenues and operating expenses forecast as percentage of sales.
Source: Company data and analysts' forecast

The Digital Platform is responsible for a determinant cost in the business: demand generation expenses. These are marketing costs, with the purpose of acquiring and retaining costumers, mostly paid to media and affiliate partners. In the past these costs have not changed much in relation to the platform's sales, but Neves expects these to decrease in relation to sales.

Still, it is important to not disregard the necessity of these expenses since it is one of the biggest forms of consumer acquisition, driving the company's revenues. As time progresses and clients become more loyal and word-of-mouth starts to carry Farfetch around communities, it is natural that expenses of this type are less necessary, thus the expected decrease in relation to sales forecasted by the CEO.

Resale luxury as an opportunity

Since the most primitive type of trade began it was normal to keep exchanging things that people did not need anymore. If someone has a baby on the way, they will need to buy baby clothes and toys and a crib. Once the baby grows those things become unnecessary for the parents and a generally accepted thing to do is to resell those products at a lower cost, as second-handed products. People do this with all kinds of stuff, from clothes to cars or to smartphones without any problem or dispute from brands.

Luxury items have the singularity of being expensive, scarce, and exclusive and sometimes only a few copies of a product are sold for a limited time which increases the previous attributes. People saw the opportunity to resell these types of products, which due to its increased rarity, if kept in their original condition would increase their market price due to simple supply and demand rules. This brought business opportunities to companies: people needed a platform to do these trades and most important of all, a caveat in this market, there was a need to check for the authenticity of the products.

Despite the fight of some luxury brands against resale companies, there are some very successful start-ups in this market.

Rising to this challenge appeared several start-ups that specialized in checking for fake products and reselling to other consumers, like TheRealReal, Vestiaire Colective, ThredUp and even eBay launched eBay Valet (which later was discontinued) that aimed to serve as a platform to resell luxury items. The start-ups saw great success, leveraging a fast-growing market that is expected to reach US$51 billion in 2024. There are several advantages to this business model, according to Vestiaire Colective's CEO it will allow people that cannot pay for luxury's full price to still shop and participate in the luxury community at a lower starting price. Furthermore, the money that people receive from reselling their products will most likely be kept in the luxury market, as they save to get their next handbag or jacket. Finally, when people know that they can resell their products they will pay a premium for this safety, which means that more people will be attracted to buy luxury.

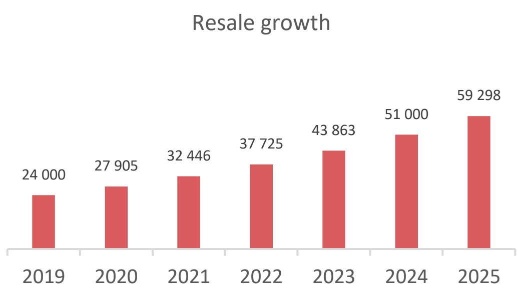

Figure 11: Luxury Resale Market forecasted growth (in thousands of $)
Source: ThredUp and analysts' computations

Despite all these advantages that the resale market can bring, and the fact that companies operating in this sector can get useful data from luxury consumers (which brands and collections are doing good, being more demanded), they still have a complicated relationship with some luxury brands. Possible reasons for this are that luxury brands believe that their items should be held forever, not wanting their products to be sold through other channels rather than their own, or even that it is not fair that sometimes the resale price is higher than the first price.

The resale market presents itself as an important opportunity that if taken can boost the company's results

Chanel has been in the center of the fights between luxury resellers and brands, even realigning its pricing format in 2015 to fight the reselling market in China, where people would buy products in Europe where they were cheaper and sell them in China where they were very expensive. Their worries were that people would buy their products in this "grey-market" instead of in their stores, while also risking buying counterfeits further damaging the brand's image. Chanel went further as to even filling lawsuits against the reselling start-ups, claiming that these were making use of the brand's reputation for their own financial gain.

Unlike Chanel, many other brands are looking to these start-ups as opportunities rather than threats – consumers who start buying a brand on these platforms for a lower price can fall in love with it and start being loyal clients of its products. Thus, many top luxury brands now partner with resellers in some shape or form, from sharing data to having active partnerships.

Neves defends reselling, saying that the fact it exists proves that brands did a good job with marketing and designing, debunking one of luxury's brands points easily: resale products are sometimes sold at a mark-up (mostly products that had limited production and will never be launched again) because after the first sale there will be even less available for sale, which will increase their value because people will still want to own that exclusive item and will be willing to pay extra for it. Without platforms for reselling, the pricing of these products would not be transparent, nobody would know how much other people would be willing to sell for and a seller could ask for whatever price they wanted. Thus, these platforms serve as intermediaries and allow for transparency in the transactions.

To back this position, in 2019 Farfetch launched the "Second Life" initiative, a reselling platform that allows for the sale of secondhand handbags. This is part of Farfetch's sustainable strategy and will allow it to capture value from the growing luxury resale market.

Farfetch launched the "Second Life" initiative to test for the success of this business model.

On this platform, people can sell their owned designer bags in exchange for Farfetch credit, a way to ensure that all proceedings are put back into the luxury market. This initiative tests for the demand of the company's consumers for this type of service and a way to raise awareness for sustainability, while also increasing the company's revenues. In the future, if Farfetch continues investing in this strategy and embracing the resale model, including all types of products, it will increase the company value massively, as the secondhand market grows.

In 2019 the resale luxury market already represented US$24 billion, being forecasted by ThredUp to reach US$51 billion in 2024, with a CAGR of 16,27%, fueled mostly by Gen Z's acceptation of resale and the awareness of the need for sustainability, which brings people to shop second-hand. Assuming that Farfetch sees this opportunity and further develops its resale platform, accepting a broader selection of luxury items, and captures only 2% of this market, this would mean an increase of revenues of almost US$1,2 billion in 2025. This would be offset by an initial investment to further develop the platform and an increase of costs of fulfilment involved with getting the products from the owner and to the second-hand buyer, but the upside largely surpasses the downside, thus this would be a good investment that promotes sustainability and further develops the luxury market, bringing in new costumers and making people who sell their products on the platform to use the proceeds to buy on Farfetch.

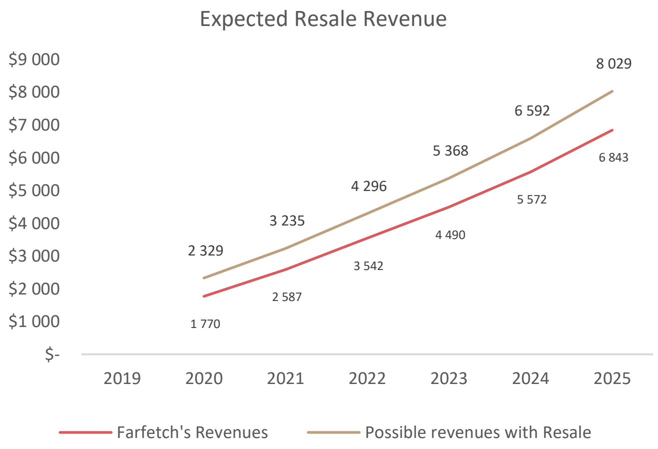

Figure 12: Possible revenues with Resale (in thousands of $).
Source: Analysts' forecast

Multiples Valuation

According to José Neves, Farfetch's does not have any direct competitors on the Farfetch Marketplace, but the truth is that companies like Net-a-Porter and MyTheresa operate in the same format as the marketplace and can act as its competition since consumers can shop on all these websites and can choose between them. Furthermore, Farfetch has competition in other areas, such as companies that provide platforms for online shopping and luxury sellers, such as brands, boutiques, luxury stores, etc. Also, with the addition of the Brand Platform business unit with the acquisition of New Guards Group, Farfetch saw new competitors in streetwear brands.

To perform the multiples valuation the companies considered were Amazon, Ebay and Alibaba that can be comparable with Farfetch because of their online presence. We added Netflix, Appfolio and Etsy as comparable companies as they are fast growing tech companies, and the two latter have similar book values and sales as Farfetch. The multiples used were Price/Sales (P/S), Enterprise Value/Sales (EV/S) and Price/Book Value (P/B). Multiples depending on EBITDA or Net Income were not applied since Farfetch has never had positive values of EBITDA nor Net Income in the past and using these multiples would result in an incorrect valuation of the company's share price.

Using these multiples within this peer group and the values forecasted by the analysts for Farfetch in 2021, we arrive at a share price of US$75,64, US$74,97, and US$25,32 for P/S, EV/S and P/B respectively. This gives us a median share price of US$74,97 for Farfetch. This value is a little higher than the true share price for Farfetch but it is a possible value for the future price of the stock, as the company grows and matures and looks more like the peer group chosen.

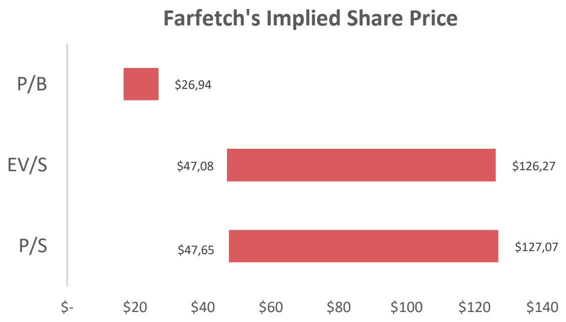

Figure 13: Implied share price of Farfetch through multiple valuation.
Source: Bloomberg, Analysts calculations

Comparables	P/S	EV/S	P/B
Amazon	4,77x	4,85x	19,89x
Alibaba	7,58x	6,96x	4,82x
Ebay	3,28x	3,66x	11,97x
Appfolio	20,77x	20,30x	22,55x
Etsy	16,19x	15,89x	33,46x
Netflix	9,79x	10,20x	22,59x
25% quartile	**5,47x**	**5,38x**	**13,95x**
Median	**8,69x**	**8,58x**	**21,22x**
75% quartile	**14,59x**	**14,47x**	**22,58x**

Figure 14: Multiples and comparables used for multiple valuations
Source: Bloomberg, Analysts

Scenario Analysis

To perform the valuation three different scenarios were forecasted and given different probabilities according to what we expect is the likelihood of them happening. The base scenario, which was calculated based on the most probable assumptions, previously described, given the current economic and market landscape arrived at a value of US$64,48, through DCF's and was given a weight of 80%. The optimistic and pessimistic scenarios differ in the negotiating power of Farfetch, affecting its Working Capital, the market growth, how well Farfetch penetrates the Asia Pacific region and how Farfetch will fare against more direct competitors.

The pessimistic scenario sees worse bargaining power for the company, which worsens the Working Capital for Farfetch, where wholesale clients take longer to pay and Farfetch pays faster to its suppliers, bringing the cash conversion cycle down. Furthermore, in this scenario, the appearance of Amazon's luxury platform brings active costumers down, while the partnership with Alibaba and Richemont that looks to increase Farfetch's presence in the Asia Pacific region does not go according to plan and the increase in active costumers and average order value does not grow as expected. In addition, the Brand Platform sees lower revenues, as they prove not as effective in discovering and developing good brands that can compete with the ones already established, not taking advantage of the luxury trends, and not creating good enough value for Farfetch. In the pessimistic scenario, Farfetch's valuation translates a share price of US$32,72.

The optimistic scenario implies better market conditions, which improve in-store sales, better Working Capital conditions due to Farfetch having better negotiating power and Brand Platform proving their ability to develop good brands that go in line with the market trends. In this scenario, Farfetch penetrates the market more easily, getting more active consumers than expected and the partnership between Farfetch and Alibaba proves successful, while Amazon's platform is considered unnecessary, as Neves claims it will be, since there are plenty of players that already provide the same service as this new platform will try to offer. The share price that comes with this scenario is of US$114,04.

Scenario	Share Price	Probability
Pessimistic	$32,72	5%
Base	$64,48	80%
Optimistic	$114,04	15%
Target Price	**$70,33**	

Figure 15: Different scenarios' share price and probability
Source: Analysts' assumptions

To the bear scenario we gave a probability of only 5%, since we believe this scenario is highly unlikely, as the biggest part of luxury's growth comes from Asia and partnering with one of the biggest players in this region will most likely bring good results. Furthermore, we expect that with the COVID-19 pandemic both suppliers and wholesale clients realised that Farfetch is an important and reliable player, which can give it higher bargaining power and we see as more likely that the New Guards Group brings new trendy brands, as they have done in the past, bringing good results to the parent company. Because of this, we gave the bull scenario a probability of 15% which finally gives the scenario analysis a value of **US$70,33**.

References

Beauloye, Florine Eppe. “Luxury Resale: A Secondhand Strategy for Brands.” Luxe Digital, 2019. https://luxe.digital/business/digital-luxury-reports/luxury-resale-transformation/.

Bloomberg, Negócios com. “IPO Da Farfetch Leva Fortuna De José Neves a Superar Mil Milhões.” Jornal de Negócios. Jornal de Negócios, September 26, 2018. https://www.jornaldenegocios.pt/mercados/bolsa/detalhe/ipo-da-farfetch-leva-fortuna-de-jose-neves-a-superar-mil-milhoes-de-dolares.

Campbell, Maeve. “Luxury Online Retailer Farfetch Is Re-Selling Designer Handbags.” Euronews, May 22, 2019. https://www.euronews.com/living/2019/05/21/luxury-online-retail-farfetch-resale-designer-handbags.

Capital, Felix. “The Farfetch Journey, 10 Years from Start-up to IPO.” Medium. Felix Capital, October 9, 2018. https://medium.com/felix-capital/the-farfetch-journey-10-years-from-start-up-to-ipo-aa734575b03b.

Farfetch. Rep. *Annual Report 2019*. Farfetch, 2020. https://s22.q4cdn.com/426100162/files/doc_financials/2019/ar/2019-Annual-Report.pdf.

Fortune. “100 Fastest-Growing Companies.” Fortune. Fortune, October 29, 2020. https://fortune.com/100-fastest-growing-companies/.

“Global Personal Luxury Goods Market Set to Contract between 20 - 35 Percent in 2020.” Bain. Accessed December 29, 2020. https://www.bain.com/about/media-center/press-releases/2020/spring-luxury-report/.

Key contact Patrizia Arienti EMEA Fashion & Luxury Leader parienti@deloitte.it Pa. 2020. “Global Powers of Luxury Goods: Deloitte: Global Economy, Luxury Consumer.” Deloitte. November 30. https://www2.deloitte.com/global/en/pages/consumer-business/articles/gx-cb-global-powers-of-luxury-goods.html.

Milnes, Hilary. “The Complicated Relationship between Luxury Brands and Resale Sites.” Digiday, May 20, 2016. https://digiday.com/marketing/complicated-relationship-luxury-brands-resale-sites/.

Morency, Christopher. “Farfetch Founder Explains His New Guards Group Purchase: Listen.” Highsnobiety, October 15, 2019. https://www.highsnobiety.com/p/jose-neves-farfetch-on-the-record-podcast/.

T. Koller, M. Goedhart, and D. Wessels, Valuation: Measuring and Managing the Value of Companies, McKinsey & Company, John Wiley & Sons, 5th ed.

“The Rocky Relationship Between Luxury Resale and (Some) Luxury Brands.” The Fashion Law, February 27, 2020. https://www.thefashionlaw.com/relationship-between-luxury-re-sale-luxury-brands-is-rocky/.

Thredup. “2020 Fashion Resale Market and Trend Report.” thredUP. Accessed December 29, 2020. https://www.thredup.com/resale/.

White, Sarah, and Melissa Fares. “Farfetch Tops Price Range in IPO in Boon to Luxury Market.” Reuters. Thomson Reuters, September 21, 2018. https://www.reuters.com/article/us-farfetch-ipo-luxury-idUSKCN1M11BQ.

Willersdorf, Sarah, Joël Hazan, Guia Ricci, Alexandre Prénaud, Filippo Bianchi, Javier Seara, and Veronique Yang. “A New Era and a New Look for Luxury.” BCG Global. BCG Global, November 17, 2020. https://www.bcg.com/publications/2020/new-era-and-new-look-for-luxury.

Wu, Jasmine. “Why Luxury Online Retailer Farfetch's Stock Cratered despite Acquisition of Megabrand.” CNBC. CNBC, August 12, 2019. https://www.cnbc.com/2019/08/09/why-farfetchs-stock-cratered-despite-acquisition-of-a-megabrand.html.