CUBEWEALTH

FARFETCH
EQUITY REPORT

DECEMBER 7TH, 2020

FARFETCH

BY THE NUMBERS

TICKER: FTCH
PRICE: $57.16

Farfetch Limited, through its subsidiary, Farfetch.com Limited, provides an online marketplace for luxury goods in the Americas, Europe, the Middle East, Africa, and the Asia Pacific. It operates in three segments: Digital Platform, Brand Platform, and In-Store.

Farfetch Limited was founded in 2007 and is headquartered in London, the United Kingdom.

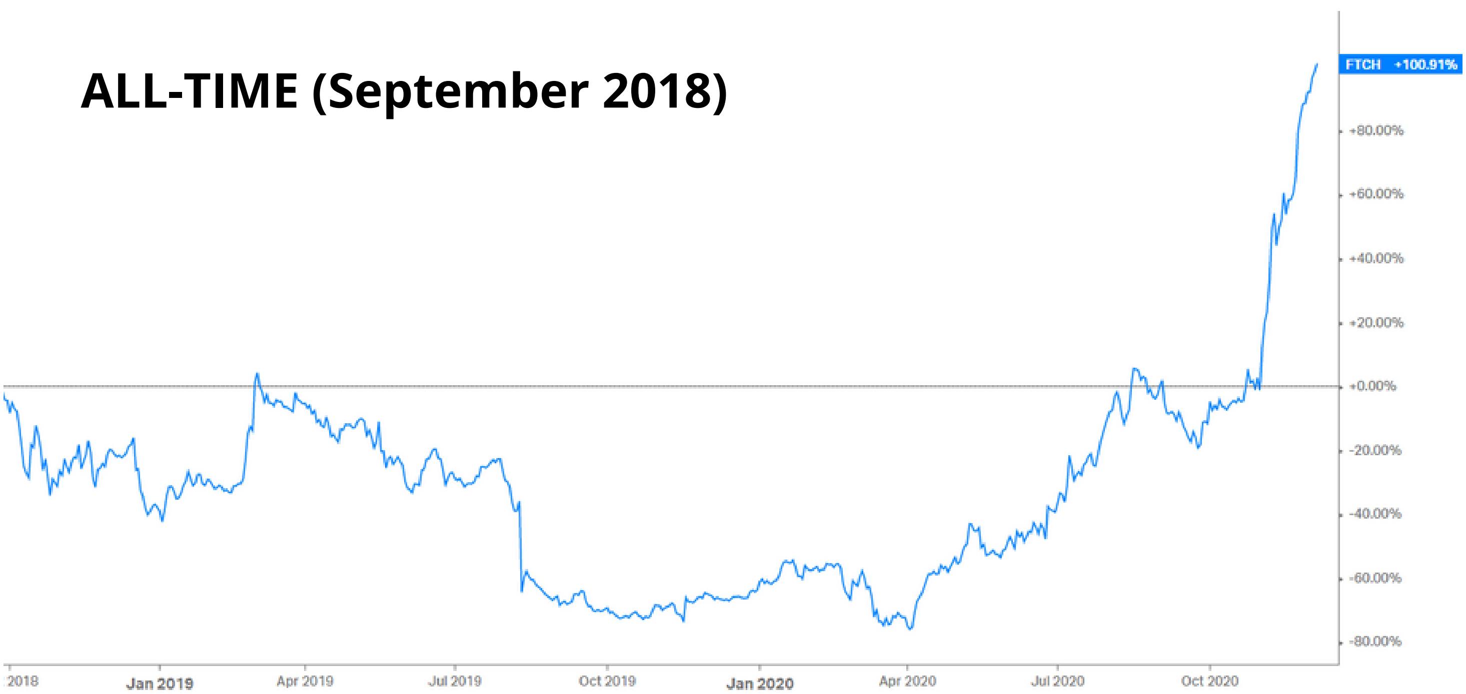
N/A	+452%	$19.4B
DIVIDEND YIELD	YTD RETURN	MARKET CAP

FTCH

SHARE PRICE PERFORMANCE

1-YEAR

ALL-TIME (September 2018)



ANALYSIS

The company operates Farfetch.com, an online marketplace, as well as Farfetch app for retailers and brands. It also offers web design, build, development, and retail distribution solutions for retailers and brands. In addition, the company operates two Browns retail stores in London; one Stadium Goods retail store in New York; and two New Guards Off-White stores in Las Vegas and New York. Further, it operates approximately 50 New Guards franchised retail stores.

Today, the Farfetch Marketplace connects customers in over 190 countries with items from more than 50 countries and over 1,300 of the world’s best brands, boutiques and department stores.

The COVID19 pandemic has been an absolute blessing for FTCH's business as the lockdowns have played right into their ecommerce platform while also focusing on a growing high-net worth class that is less effected by economic headwinds.

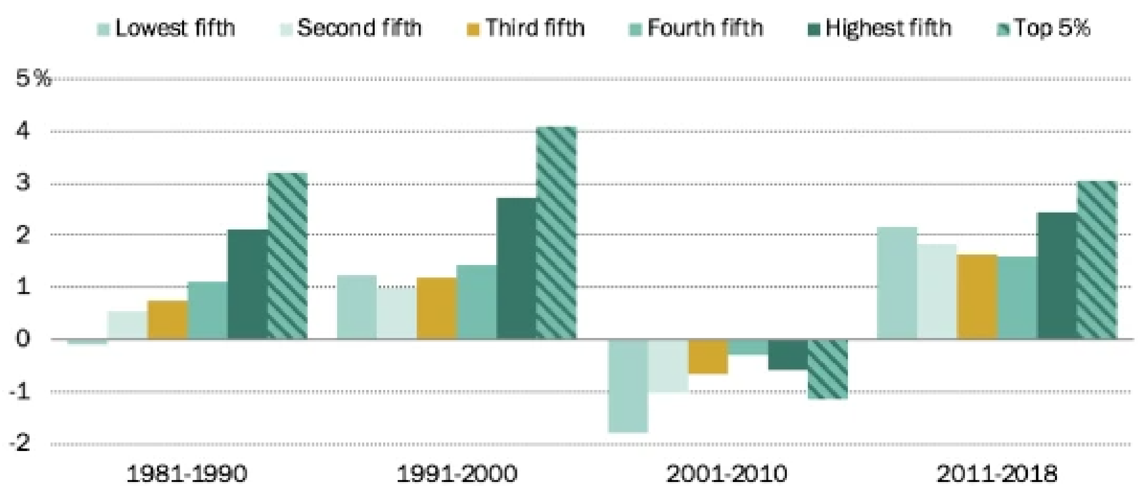
As we'll see in the pages to follow, the question isn't whether Farfetch is operating the business well, it's whether or not there is still upside in the stock price because when CUBE issued the vote for this stock the price of FTCH was $32 and is now $57, a 78% jump.

Before getting into the company, we need to discuss the overall economic backdrop for Farfetch's business. This is not an ordinary e-commerce company. They operate in a niche market of selling very expensive luxury goods so it's wise that we first look into their customer base who can sustainably afford these products to better understand the long-term viability of their service.

From 1981 to 1990, the change in mean family income ranged from a loss of 0.1% annually for families in the lowest quintile (the bottom 20% of earners) to a gain of 2.1% annually for families in the highest quintile (the top 20%). The top 5% of families, who are part of the highest quintile, fared even better – their income increased at the rate of 3.2% annually from 1981 to 1990. Thus, the 1980s marked the beginning of a long and steady rise in income inequality.

Since 1981, the incomes of the top 5% of earners have increased faster than the incomes of other families

Average annual change in mean family income, by income quintile and for the top 5%

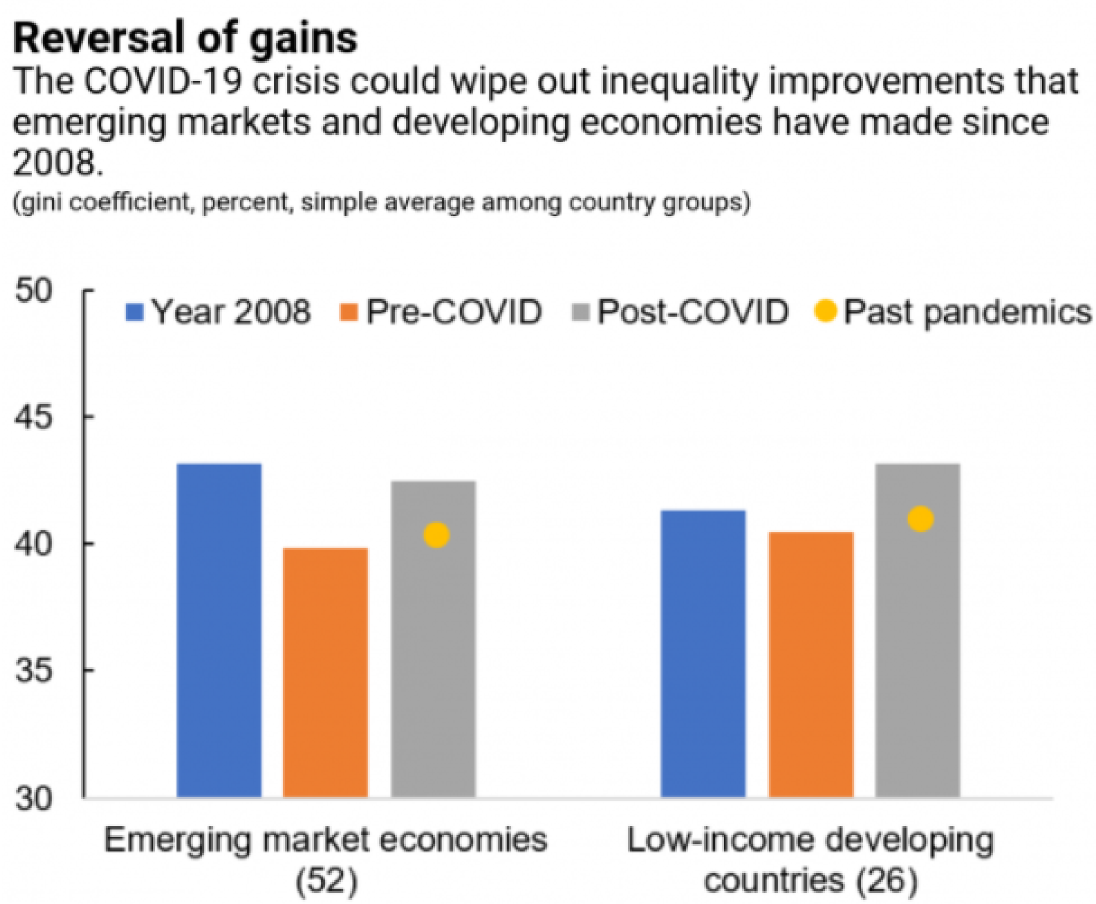


Note: Estimates of change from 2011-2018 are affected by revisions to the Current Population Survey in 2014. See Methodology for details.
Source: U.S. Census Bureau, Historical Income Tables, Table F-3.
"Most Americans Say There Is Too Much Economic Inequality in the U.S., but Fewer Than Half Call It a Top Priority"

PEW RESEARCH CENTER

The wealth gap between upper-income and lower- and middle-income families has grown wider this century. Upper-income families were the only income tier able to build on their wealth from 2001 to 2016, adding 33% at the median. On the other hand, middle-income families saw their median net worth shrink by 20% and lower-income families experienced a loss of 45%. As of 2016, upper-income families had 7.4 times as much wealth as middle-income families and 75 times as much wealth as lower-income families. These ratios are up from 3.4 and 28 in 1983, respectively.

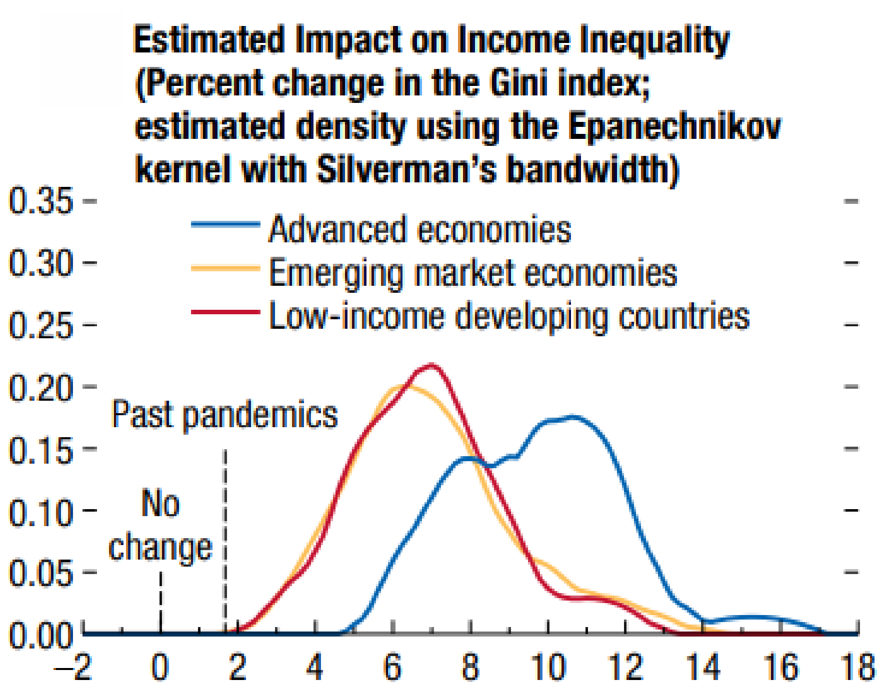
This is now believed to have gotten worse during the COVID19 pandemic.



In economics, the Gini coefficient, sometimes called the Gini index or Gini ratio, is a measure of statistical dispersion intended to represent the income inequality or wealth inequality within a nation or any other group of people. It was developed by the Italian statistician and sociologist Corrado Gini and published in his 1912 paper Variability and Mutability.

As we look at the Gini coeffiicent above, the income inequality gap is growing wider. A recent IMF study shows that the ability to work from home is lower among low-income workers than for high-income earners. Based on data from the United States, we know that sectors with activities more likely to be performed from home saw a smaller reduction in employment. These two facts combined tell us that lower-income workers were less likely to be able to work from home and more likely to lose their jobs as a result of the pandemic, which would worsen the income distribution.

The higher the Gini coefficient, the greater the inequality, with high-income individuals receiving much larger percentages of the total income of the population.



Why does CUBE bring this up? Because it is essential for laying out the underlying thesis that the rich will grow richer and inevitably lead to more business for companies like Farfetch. The global luxury goods market is expected to increase from $285.1B in 2020 to $388B in 2025, at a CAGR of 6.4%.

One of the biggest growth areas will be China and Farfetch is there through a recent partnership and investment with Alibaba.

Alibaba and Richemont will invest $300M apiece in Farfetch. The investment will be through the purchase of 0% convertible senior notes due 2030 issued by Farfetch. Alibaba and Richemont will also each invest $250M in a new joint venture, Farfetch China, taking a combined 25% stake. The two companies will also have the option to take another combined 24% stake in the venture after the third year.

This is so important and is much of the reason FTCH has been running as of late because we all know when it comes to ecommerce, Amazon is always a threat. It's also important because the consulting firm McKinsey & Company predicts China will account for $178B in luxury spending by 2025.

Spending by millennials from Mainland China, both at home and overseas, is one of the main drivers of the global luxury market. Mainland China currently has around 400 million millennials, five times more than the U.S., and they are expected to make up around 65% of the region's consumption growth by the end of 2020 and are much more digitally native than arguably any other country.

Further research CUBE found shows that in September, Prada said the company's sales jumped in China by 66% while its sales in the rest of the world were down or grew by a small amount. In July, LVMH said the company's sales in China have doubled since March.

Even Wells Fargo notes that the online luxury market could reach $112B in sales by 2025, up from $28B currently.

Why such amazing growth? CUBE believes many luxury brands are finally realizing that their expensive storefronts are not worth the cost of trying to acquire new customers.

For example, Ralph Lauren is subleasing its Fifth Avenue location for just a fraction of the price to Mango, a Spanish fast-fashion retail chain. Under the deal, Mango will pay $5M annually, less than 20% of the more than $27M per year that Ralph Lauren pays to occupy the prime piece of real estate.

This speaks major volumes and shows why a company like Farfetch is in the perfect place at the perfect time. The COVID19 pandemic was a huge wake up call for these luxury brands because they have to factor in that these massive rents they pay is also baked into the cost of acquiring customers. If they can realize lower customer acquisition rates without all of the overhead, it makes for a win/win situations for all parties involved.

This is exactly why we want to now bring up FTCH's take rate. This is the rate that Farfetch charges for products sold on their site.

In their most recent quarter, their take rate was 30.4%. This means that if Balenciaga sold a bag on their site for $1,000, $304 went to FTCH. This is where FTCH has a leg up on other ecommerce companies because luxury brands are willing to pay for this when you consider the cost of a physical location, as mentioned previously, vs. digital real estate.

We will dive into this more in later pages.

CUBE'S TOP PROS FOR FTCH

LEADING PLAYER IN SPACE

STRONG TAKE RATES

PARTNERSHIPS TO CAPTURE CHINA MARKET

CUBE'S TOP CONS FOR FTCH

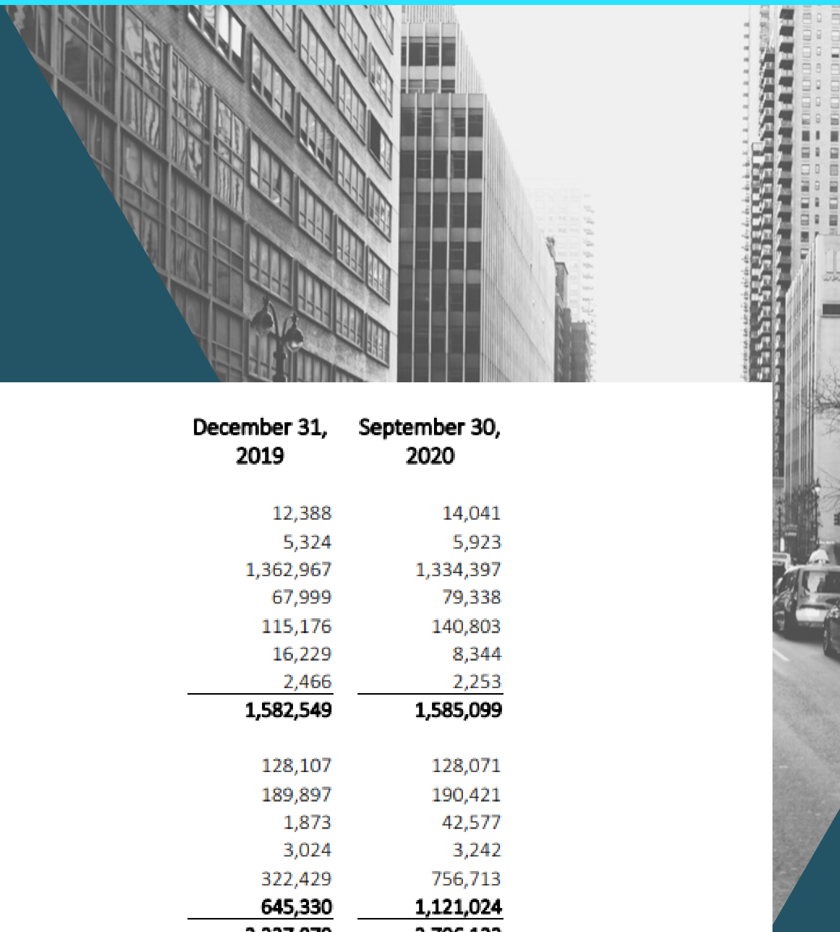
EXPENSIVE VALUATION

FUTURE COMPETITION

LARGE LOSSES AND CASH FLOW BURN

FINANCIAL STATEMENTS

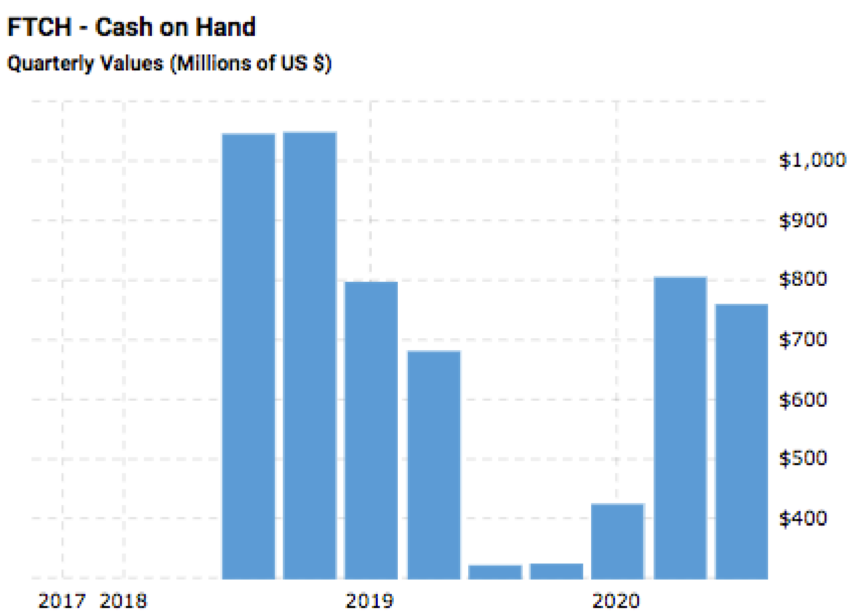
BALANCE SHEET

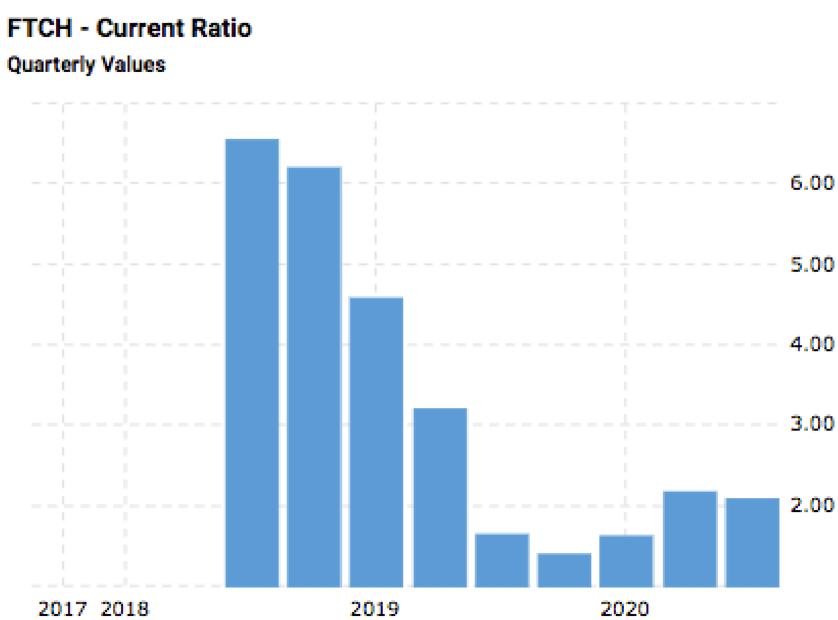


	December 31, 2019	September 30, 2020
Non-current assets		
Other receivables	12,388	14,041
Deferred tax assets	5,324	5,923
Intangible assets, net	1,362,967	1,334,397
Property, plant and equipment, net	67,999	79,338
Right-of-use assets	115,176	140,803
Investments	16,229	8,344
Investments in associates	2,466	2,253
Total non-current assets	**1,582,549**	**1,585,099**
Current assets		
Inventories	128,107	128,071
Trade and other receivables	189,897	190,421
Current tax assets	1,873	42,577
Derivative financial assets	3,024	3,242
Cash and cash equivalents	322,429	756,713
Total current assets	**645,330**	**1,121,024**
Total assets	**2,227,879**	**2,706,123**
Liabilities and equity		
Non-current liabilities		
Provisions	23,704	55,252
Deferred tax liabilities	219,789	200,156
Lease liabilities	100,833	129,833
Employee benefit obligations	16,455	19,204
Derivative financial liabilities	-	659,576
Borrowings	-	469,430
Put and call option liabilities	61,268	182,249
Total non-current liabilities	**422,049**	**1,715,700**
Current liabilities		
Trade and other payables	413,696	459,036
Provisions	-	12,597
Current tax liability	28,289	35,735
Lease liabilities	18,485	21,783
Derivative financial liabilities	5,601	10,825
Put and call option liabilities	1,118	1,125
Other financial liabilities	809	1,374
Total current liabilities	**467,998**	**542,475**
Total liabilities	**890,047**	**2,258,175**
Equity		
Share capital	13,584	13,842
Share premium	878,007	890,116
Merger reserve	783,529	783,529
Foreign exchange reserve	(30,842)	(8,578)
Other reserves	349,463	415,850
Accumulated losses	(826,135)	(1,810,512)
Equity attributable to the parent	**1,167,606**	**284,247**
Non-controlling interests	170,226	163,701
Total equity	**1,337,832**	**447,948**
Total equity and liabilities	**2,227,879**	**2,706,123**

FTCH has a pretty healthy balance sheet with approximately $756M in cash and cash equivalents on hand. Inventories and account receivables are healthy and steady.

On the liabilities side, FTCH has about $660M in debt as they recently did a big raise this year in convertible notes. Liquidity is not an issue with a current ratio around 2.0x. As we'll see with cash flows, FTCH will rely on debt and secondary equity issuances to sustain the business for at least the next 2-4 years.





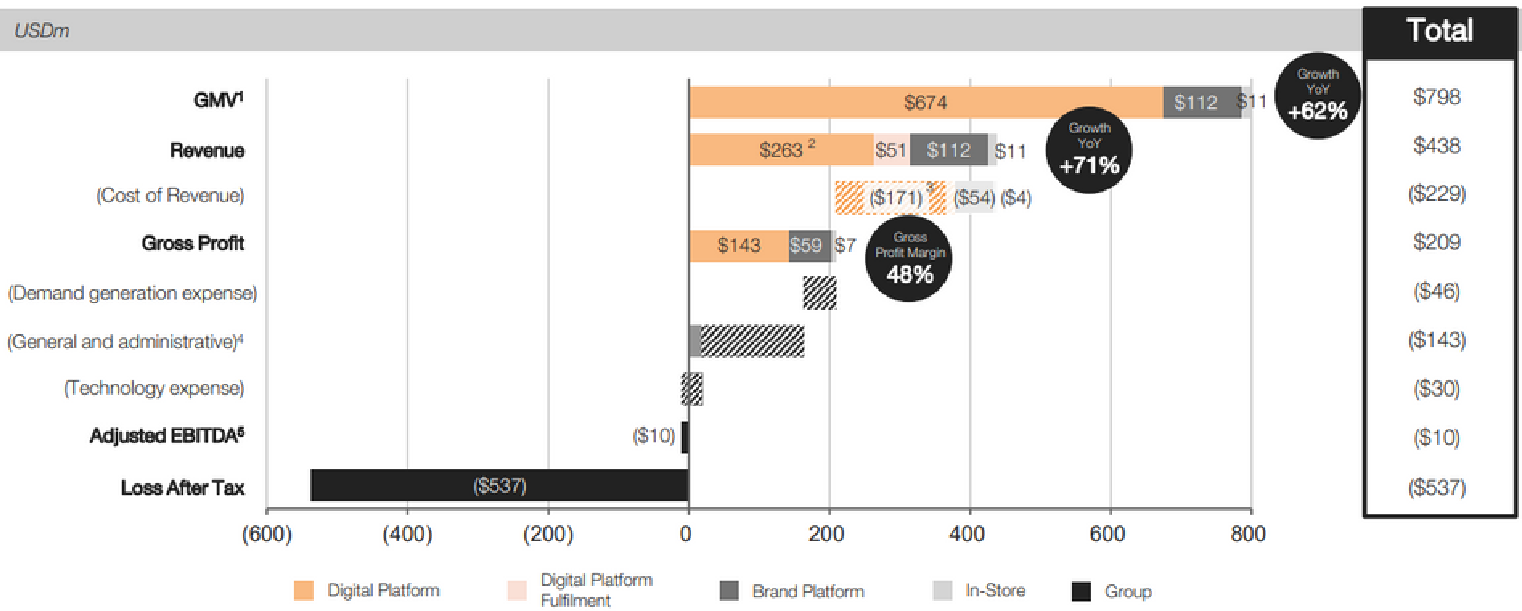
FINANCIAL STATEMENTS

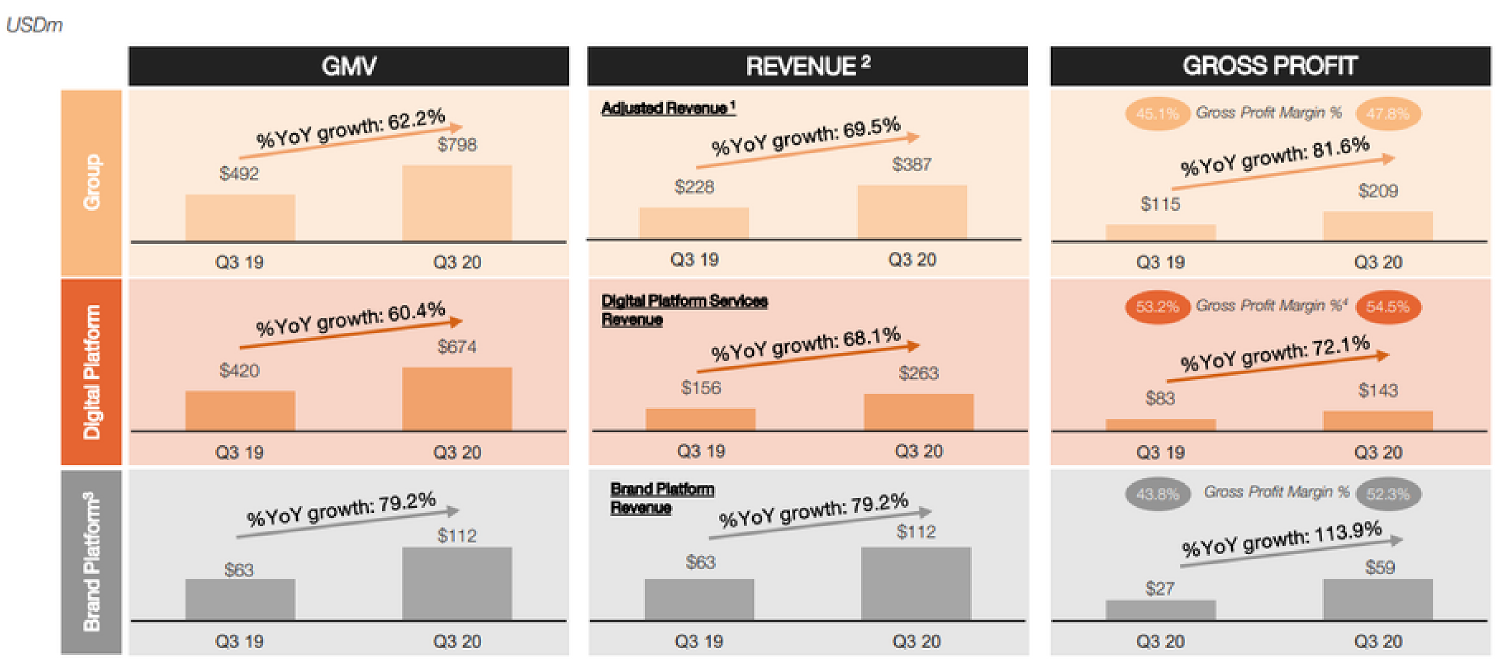
INCOME STATEMENT

	2019	2020
Revenue	**255,481**	**437,700**
Cost of revenue	(140,342)	(228,671)
Gross profit	**115,139**	**209,029**
Selling, general and administrative expenses	(227,695)	(356,050)
Operating loss	**(112,556)**	**(147,021)**
Gains/(losses) on items held at fair value and remeasurements	32,286	(373,079)
Share of results of associates	371	385
Finance income	1,672	1,033
Finance costs	(12,361)	(15,396)
Loss before tax	**(90,588)**	**(534,078)**
Income tax benefit/(expense)	104	(2,882)
Loss after tax	**(90,484)**	**(536,960)**
(Loss)/profit after tax attributable to:		
Equity holders of the parent	(95,277)	(544,320)
Non-controlling interests	4,793	7,360
	(90,484)	**(536,960)**
Loss per share attributable to equity holders of the parent		
Basic and diluted	(0.30)	(1.58)
Weighted-average ordinary shares outstanding		
Basic and diluted	322,226,776	344,185,603

Farfetch reported Q3 non-GAAP EPS of -$0.17 beating estimates by $0.08 on revenue of $437.7M (+71.3% Y/Y) beating by $67.31M.

- Q3 2020 Gross Merchandise Value and Digital Platform GMV growth rates accelerated – up 62% and 60% Y/Y, respectively, to record highs of $798M and $674M, respectively
- Q3 2020 Loss After Tax of $537M
- Adjusted EBITDA improved to -$10M from -$36M in Q3 2019

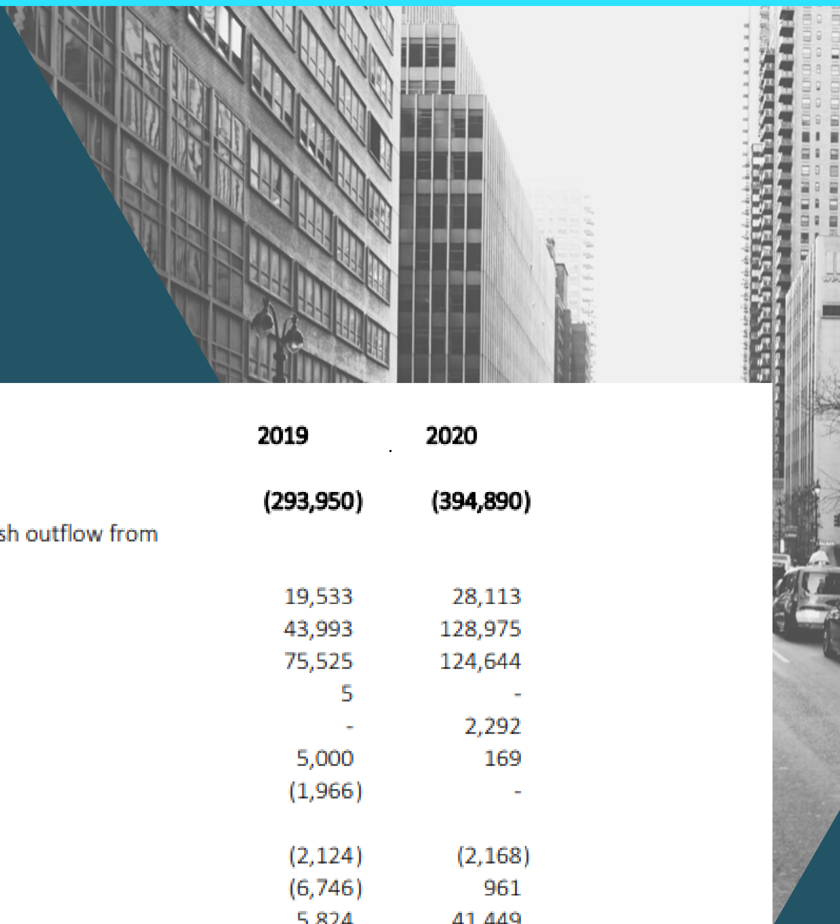




Continuing to target Adjusted EBITDA profitability for FY 2021

FINANCIAL STATEMENTS

CASH FLOW

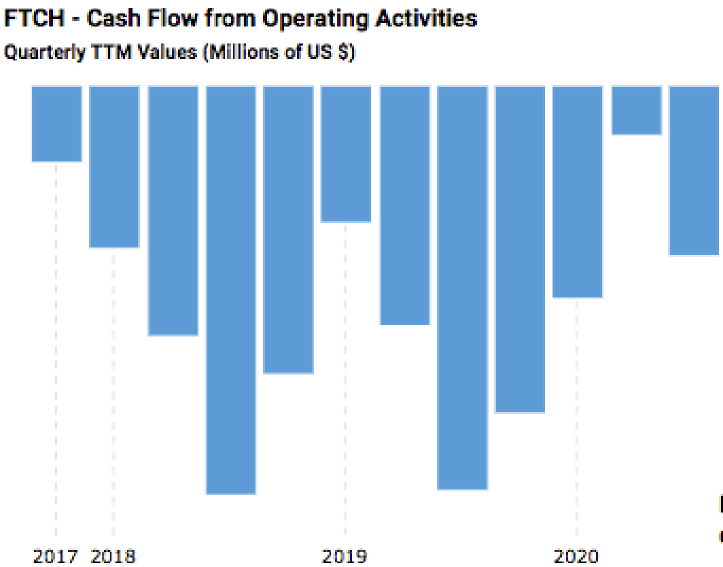


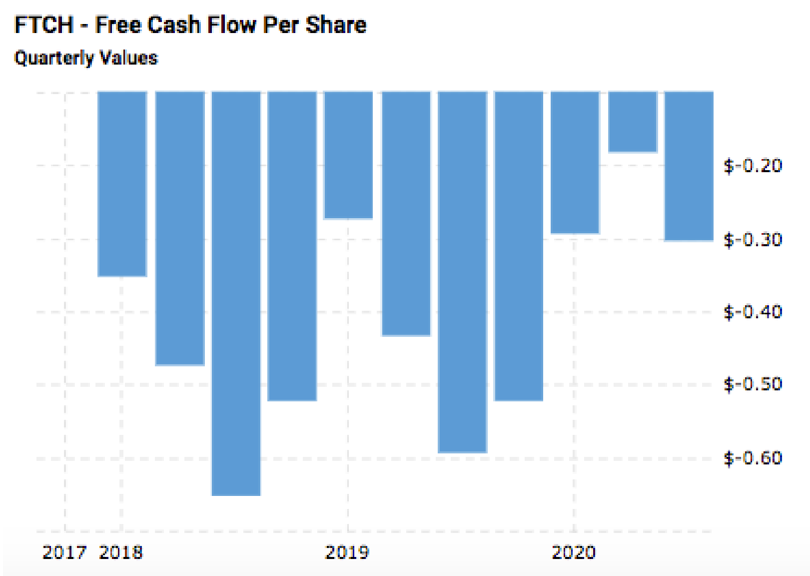
	2019	2020
Cash flows from operating activities		
Operating loss	**(293,950)**	**(394,890)**
Adjustments to reconcile operating loss to net cash outflow from operating activities:		
Depreciation	19,533	28,113
Amortization	43,993	128,975
Non-cash employee benefits expense	75,525	124,644
Net loss on sale of non-current assets	5	-
Impairment losses on tangible assets	-	2,292
Impairment of investments	5,000	169
Net exchange differences	(1,966)	-
Change in working capital		
Increase in receivables	(2,124)	(2,168)
(Increase)/decrease in inventories	(6,746)	961
Increase in payables	5,824	41,449
Change in other assets and liabilities		
Increase in non-current receivables	(2,558)	(1,203)
Increase in other liabilities	16,936	15,749
Increase in provisions	-	42,616
Decrease in derivative financial instruments	(5,011)	(13,549)
Income taxes paid	(1,947)	(57,790)
Net cash outflow from operating activities	**(147,486)**	**(84,632)**
Cash flows from investing activities		
Acquisition of subsidiary, net of cash acquired	(461,690)	(12,016)
Payments for property, plant and equipment	(38,013)	(16,732)
Payments for intangible assets	(58,497)	(65,525)
Payments for investments	(18,733)	(2,872)
Interest received	10,701	3,345
Dividends received from associate	-	58
Net cash outflow from investing activities	**(566,232)**	**(93,742)**
Cash flows from financing activities		
Repayment of the principal elements of lease payments	(13,597)	(12,695)
Interest paid and fees paid on loans	(2,807)	(20,662)
Dividends paid to holders of non-controlling interests	-	(20,515)
Proceeds from issue of shares, net of issue costs	8,249	27,687
Proceeds from borrowings, net of issue costs	-	641,861
Net cash (outflow)/inflow from financing activities	**(8,155)**	**615,676**
Net (decrease)/increase in cash and cash equivalents	**(721,873)**	**437,302**
Cash and cash equivalents at the beginning of the period	1,044,786	322,429
Effects of exchange rate changes on cash and cash equivalents	(4,538)	(3,018)
Cash and cash equivalents at end of period	**318,375**	**756,713**

FTCH is not driving in any free cash flow as the business is still operating at heavy losses. For 2020, the company has thus far burned $84M in operating free cash flow and about $100M in free cash flow after accounting for $16M spent on PP&E.

During the year, FTCH raised $641M via convertible debt which is why their cash on hand is higher than last year.

According to CUBE's models, we do not expect FTCH to reach positive free cash flow until 2023 under an optimistic view but more likely not until 2024.

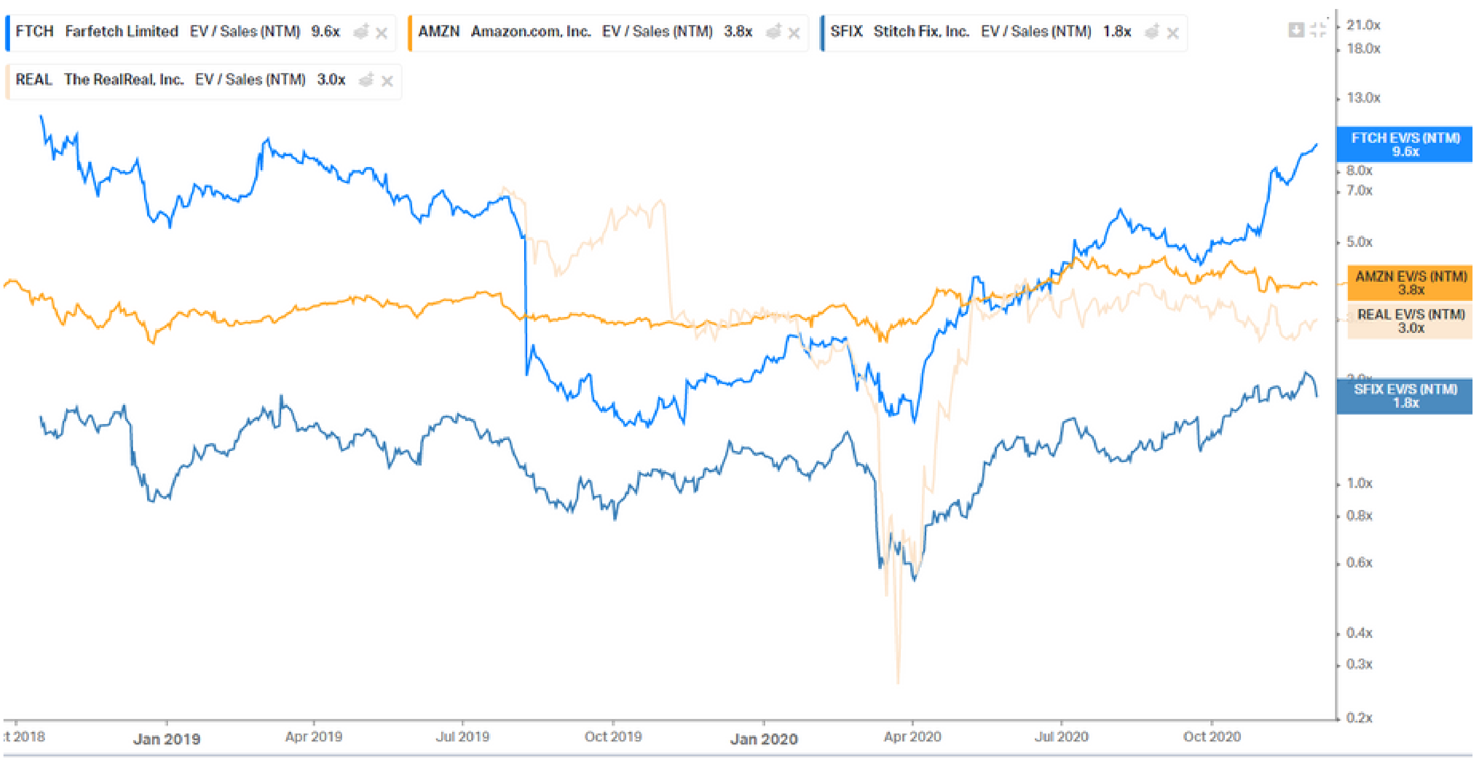




FTCH FUNDAMENTALS

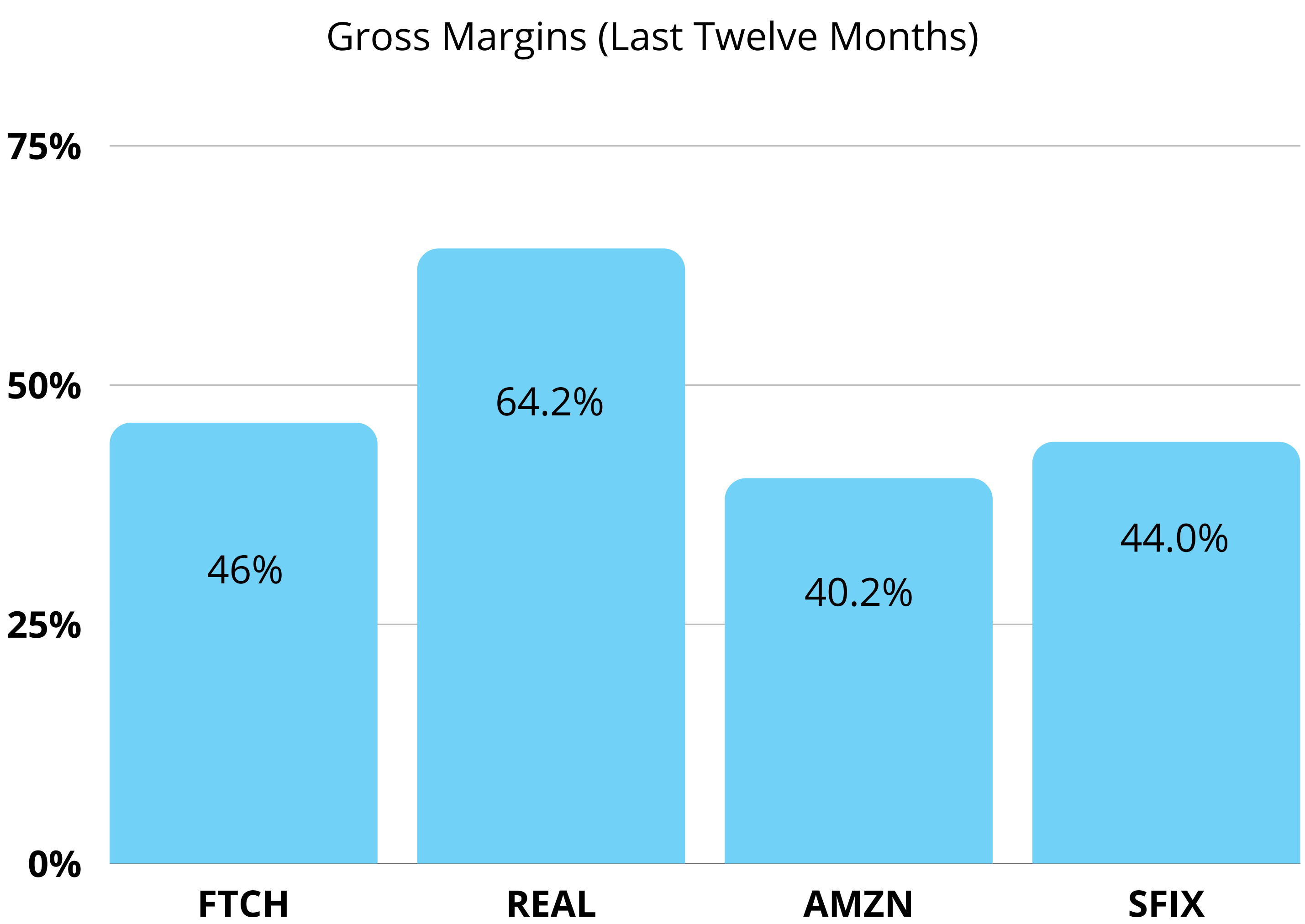
We are going to compare Farfetch to Amazon (AMZN), TheRealReal (REAL), and StitchFix (SFIX).

On a Price to Sales basis, FTCH is far higher at 9.6x vs other ecommerce plays that trade at 3.8x, 3.0x, and 1.8x, respectively. CUBE places more emphasis on REAL and SFIX as AWS helps boost AMZN's revenue and they are less of an ecomm play today.



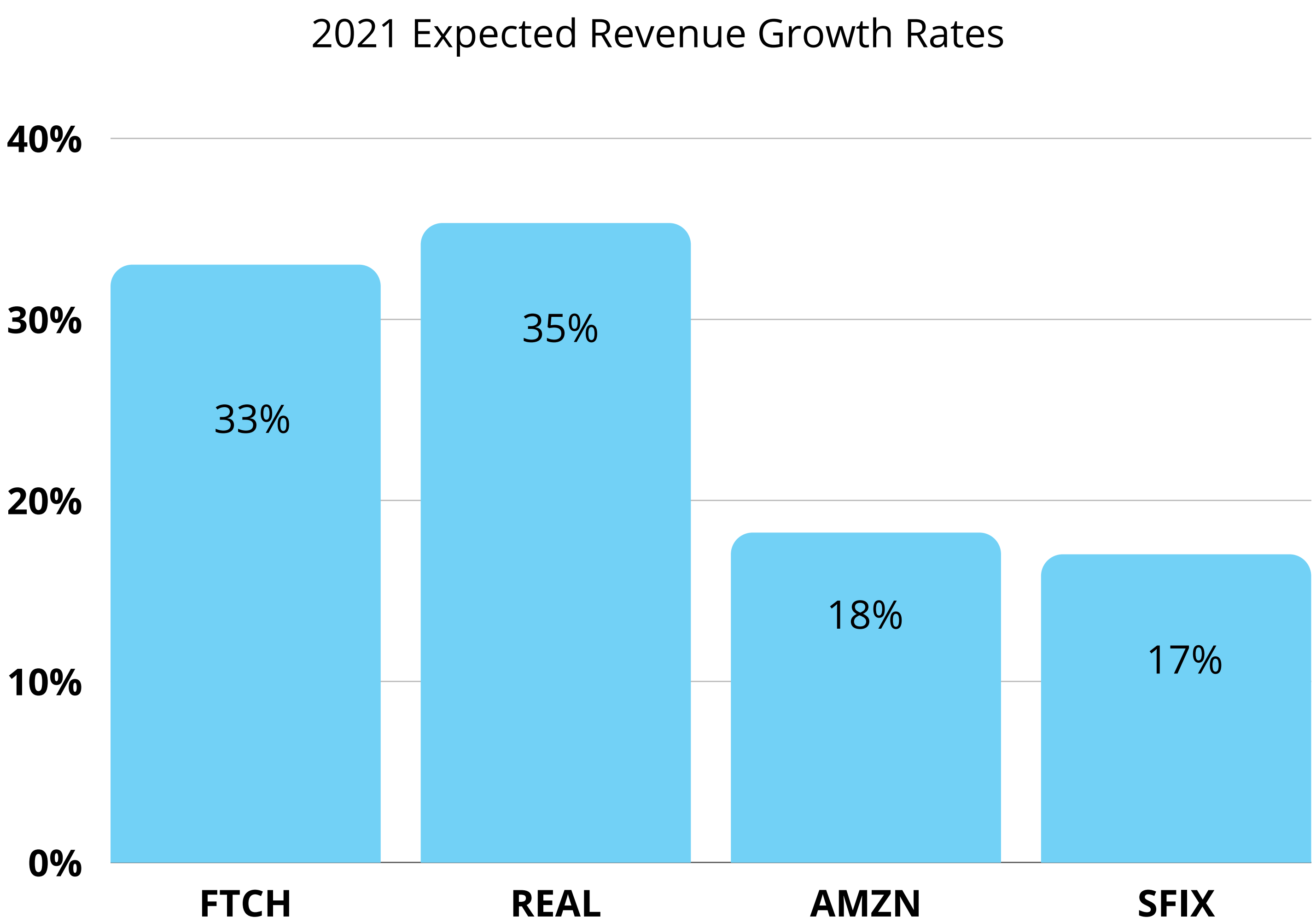
FTCH FUNDAMENTALS

When it comes to gross margins over the last twelve months, REAL takes the lead at 64.2% while FTCH is in line with AMZN and SFIX in the mid 40% range.



FTCH FUNDAMENTALS

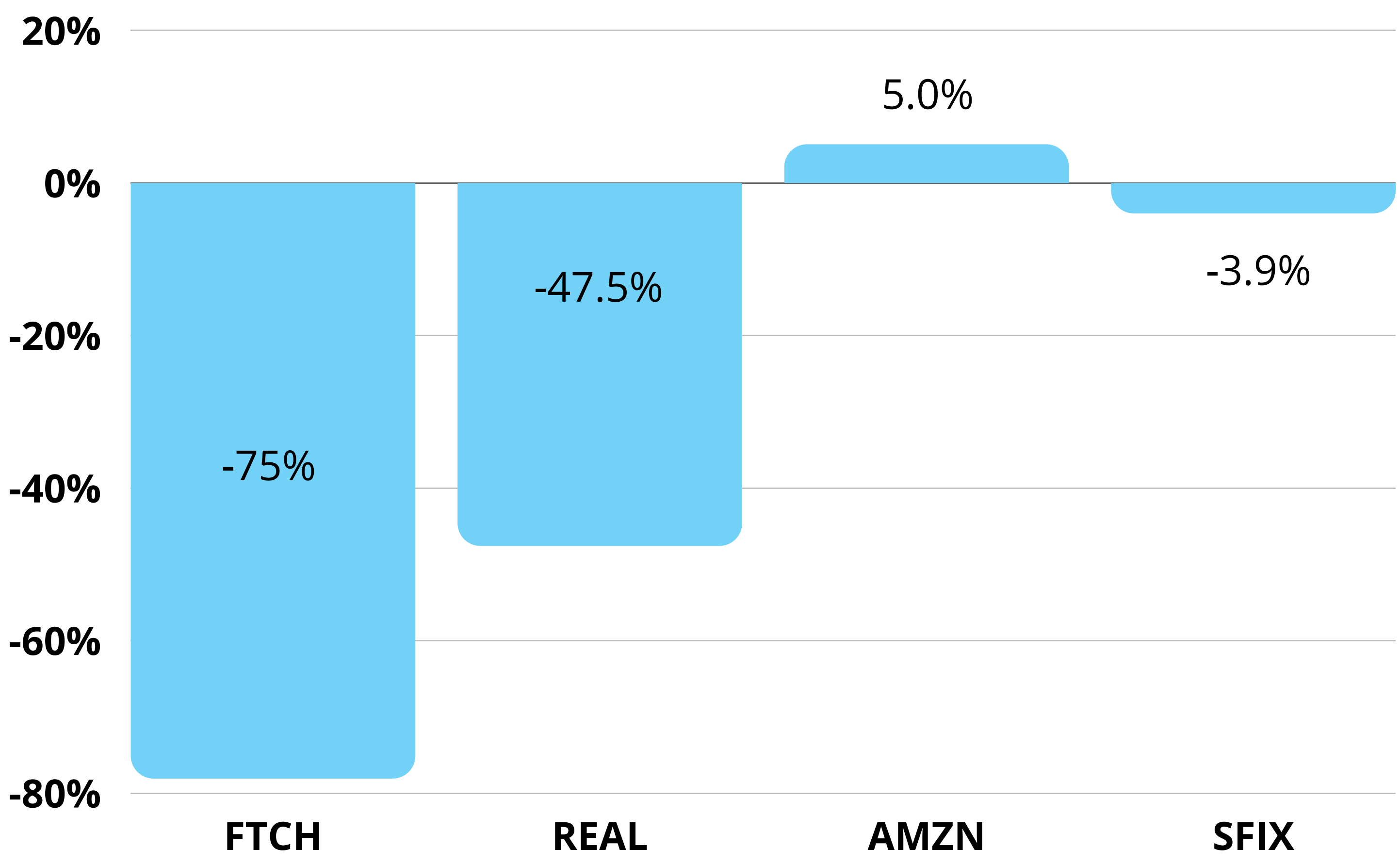
With regard to revenue growth rates for 2021, analysts expect the following below. CUBE actually anticipates FTCH will grow revenues closer to 45%.



FTCH FUNDAMENTALS

On a net income margin basis, this is where FTCH needs to start turning things around. We expect the company to finally reach positive net income in 2023/2024 as they continue to invest heavily in growth for the next couple years.

Net Income Margins (Last Twelve Months)



FTCH DCF MODEL

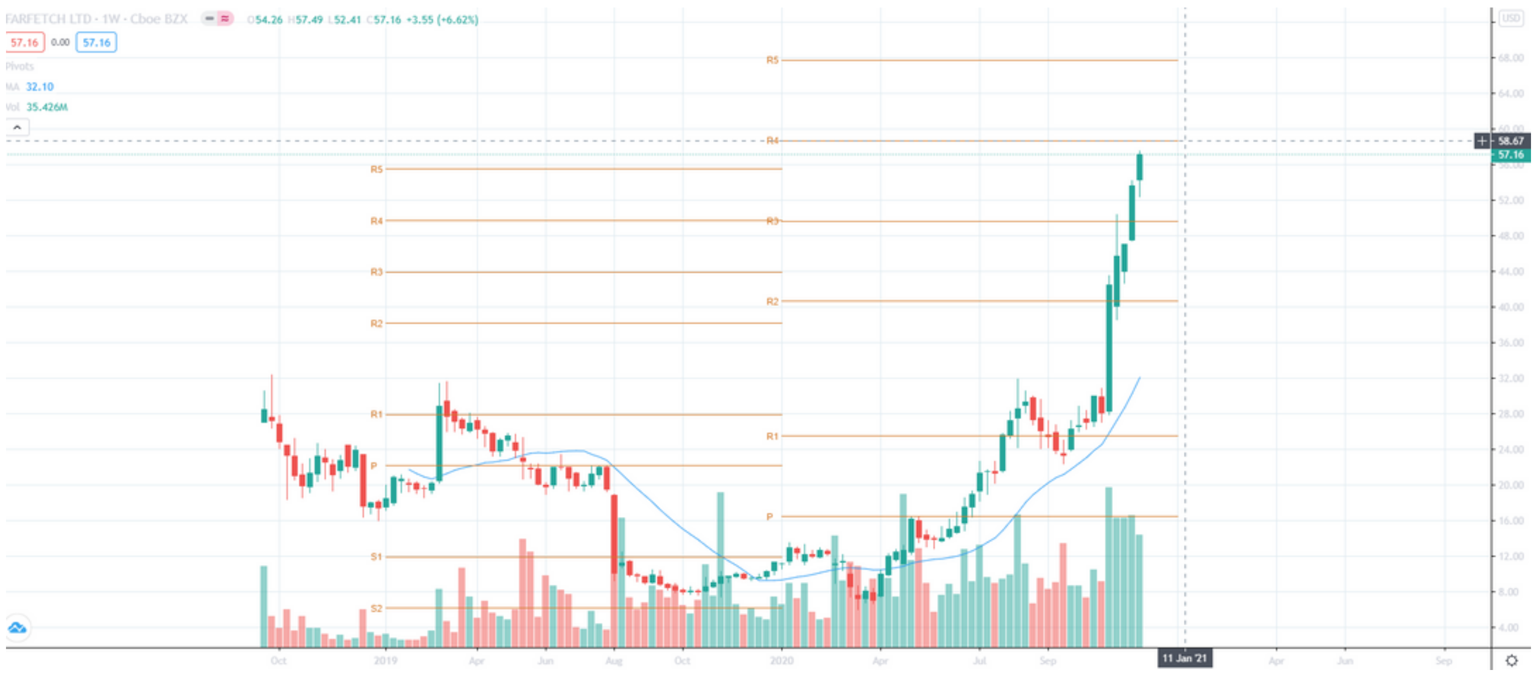
Attached in the email, as well as in the Vault, you will see the discounted cash flow model. Here are the following variables used:

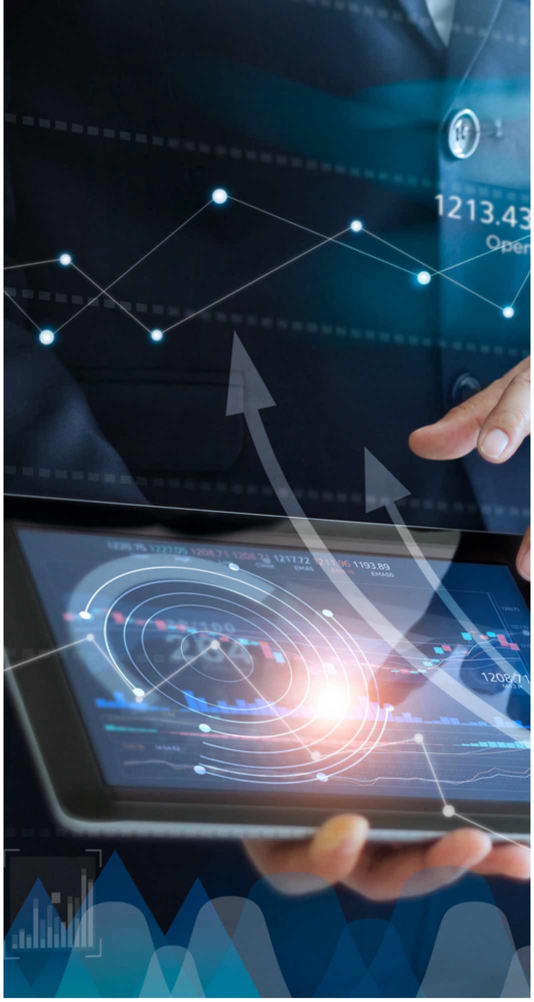
- Discount Rate: 9.37% +/- 0.50%
    - Beta: 1.36
    - 30 YR Treasury (Risk Free Rate): 1.42%
    - Market Risk Premium: 6.00%
    - Debt to Equity: 2.9% weight at 3.75% average interest rate
- Perpetual Growth Rate: 3.00% +/- 0.50% (helped by China luxury market growth)
- Shares outstanding: 344M
- Free Cash Flow: No free cash flow until 2023 and doesn't surpass 10% given low margin based business
- CUBE purposefully created an optimistic free cash flow model where revenues grow 45% in 2021, 40% in 2022, and hit $9.6B in 2029 from $1.0B in 2019.
- Current Price: $57.19

Model predicts:

- **Base case: $25.14 (-56%)**
- **Bull Case: $29.92 (-48%)**
- **Weak Case: $21.64 (-62%)**

FTCH
TECH ANALYSIS





TECH ANALYSIS SUMMARY

Looking at the charts, FTCH is an investor's dream. The stock has been on an absolute tear and we expect shares to rise to the weekly R4 of $58.67.

This is the key resistance level to keep an eye out for. If the stock is able to break this level we believe shares will rise to the daily R1 fibbonaci level of $63.81.

In the case that momentum fades, FTCH has support at $56.00 on the hourly levels, $49.52 on the weekly R3, and $48.75 on the 20 day moving average.

BULLISH OR BEARISH?

MORE BULLISH (POSITIVE)

MORE BEARISH (NEGATIVE)

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FTCH CONCLUSION

Overall, CUBE is short-term bullish based on technicals but long-term bearish based on fundamentals.

This is an odd situation where when we first began looking into Farfetch, the valuation seemed appropriate and pointed to some upside.

Now, at the time of delivery, we believe FTCH shares are quite a bit overvalued after running 78% since conducting research. As per our overly optimistic discounted cash free flow model, we cannot justify a $57 per share valuation.

Yes, FTCH is the king of the niche luxury e-commerce space and they are paving the way into capturing China's growth but we feel shares are now fully pricing that in and some. At a near $20B valuation, 9.6x next year's sales, and no free cash flow until at least 2023/2024 (by our models) we simply cannot get behind the stock here.

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