

Is Ferrari's prestige enough to drive its high valuation?



Valuation Master Class



What's interesting
about Ferrari is that
when they **increase**
the **price, demand**
also rises



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Is Ferrari's prestige enough to drive its high valuation?



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Sector: Cons. Disc.



Leading manufacturer of luxury cars with an estimated brand value of over EUR€34bn

Our estimate:

EUR€121

(Downside 25%)

SELL



3 things to know about this company

- ★ Enhanced focus on Asia to accelerate top-line growth
- ★ Intended scarcity helps to defend competitive advantage
- ★ Costly shift to zero-emission cars could be a drag on margin

Key statistics

Analyst consensus (16)

EUR€206

(Upside 17%)

BUY

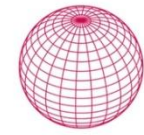
PE ratio

36x

Dividend yield

0.8%

Revenue breakdown 2021



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Sales

Story

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Value

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Risks



Cars & Spare parts 84%

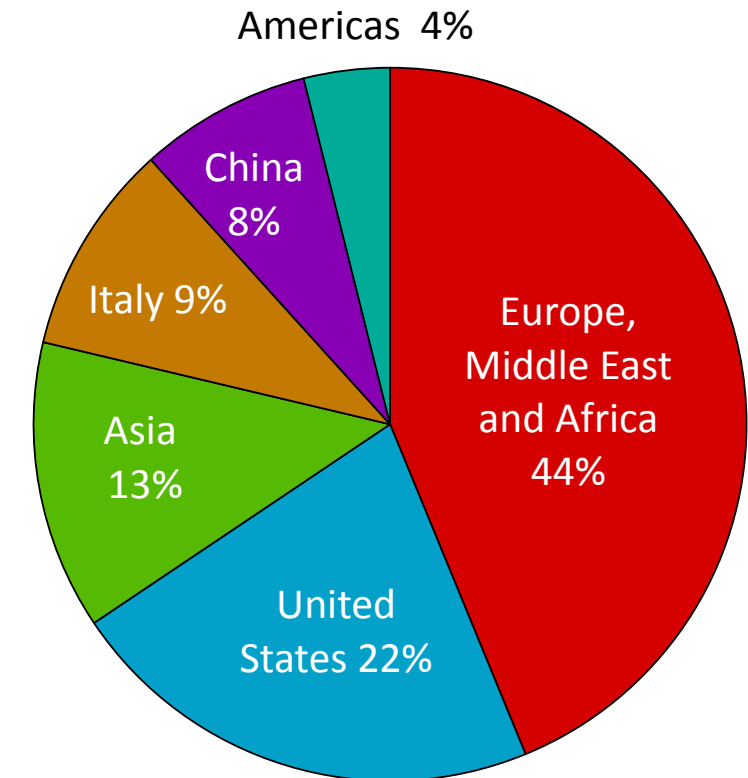


Sponsorship, commercial
and brand 10%



Engines and Other 6%

Breakdown by region



1 Enhanced focus on Asia to accelerate top-line growth



Sales

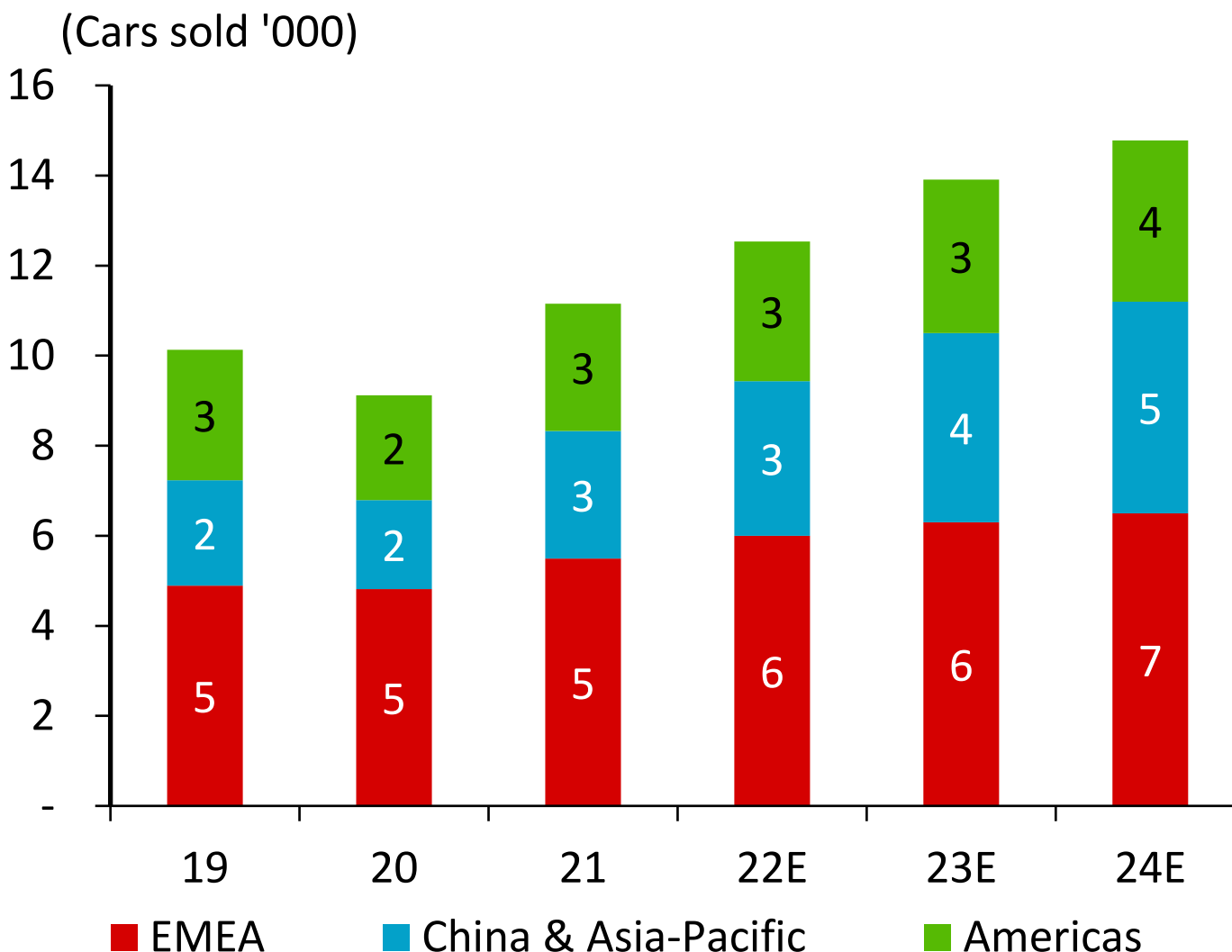
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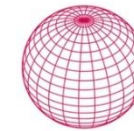
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Risks



- ★ For the first time, Ferrari sold more cars to Asia than to Americas in 2021
 - The company's appearance as a "Luxury Lifestyle Brand" is well perceived in Asia
- ★ Americas and major parts of Europe likely to see stagnation given the intense competition and weakened economic outlook

Growing wealth and urbanization unlocks growth in Asia



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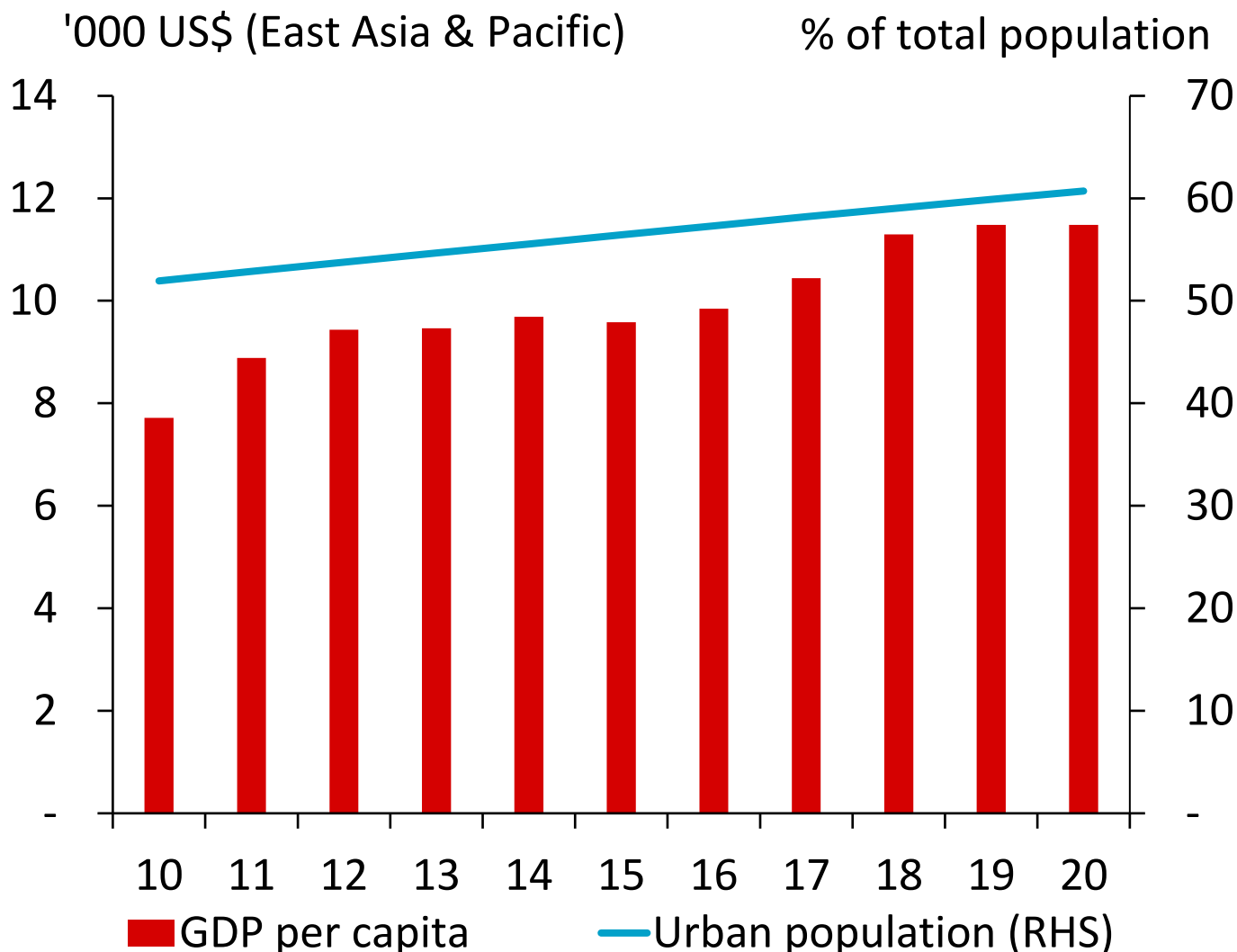
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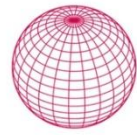
- ★ In East Asia & Pacific, GDP per capita has grown by a CAGR of 4% over the past 10 years
 - Also, rapid urbanization has led a growing part of the population to move from rural areas to bigger cities
- ★ Both, growing wealth and enhanced infrastructure raise the demand for luxury goods in Asia
 - There is a good opportunity for Ferrari to ride the Asian wealth wave

How I incorporated the story into my forecast

Car shipments ('000)	19	20	21	22E	23E	24E
EMEA	4.9	4.8	5.5	6.0	6.3	6.5
China & Asia-Pacific	2.3	2.0	2.8	3.4	4.2	4.7
Americas	2.9	2.3	2.8	3.1	3.4	3.6
Total car shipments	10.1	9.1	11.2	12.5	13.9	14.8

- The Asian market is the key driver of revenue growth in the upcoming years





Sales

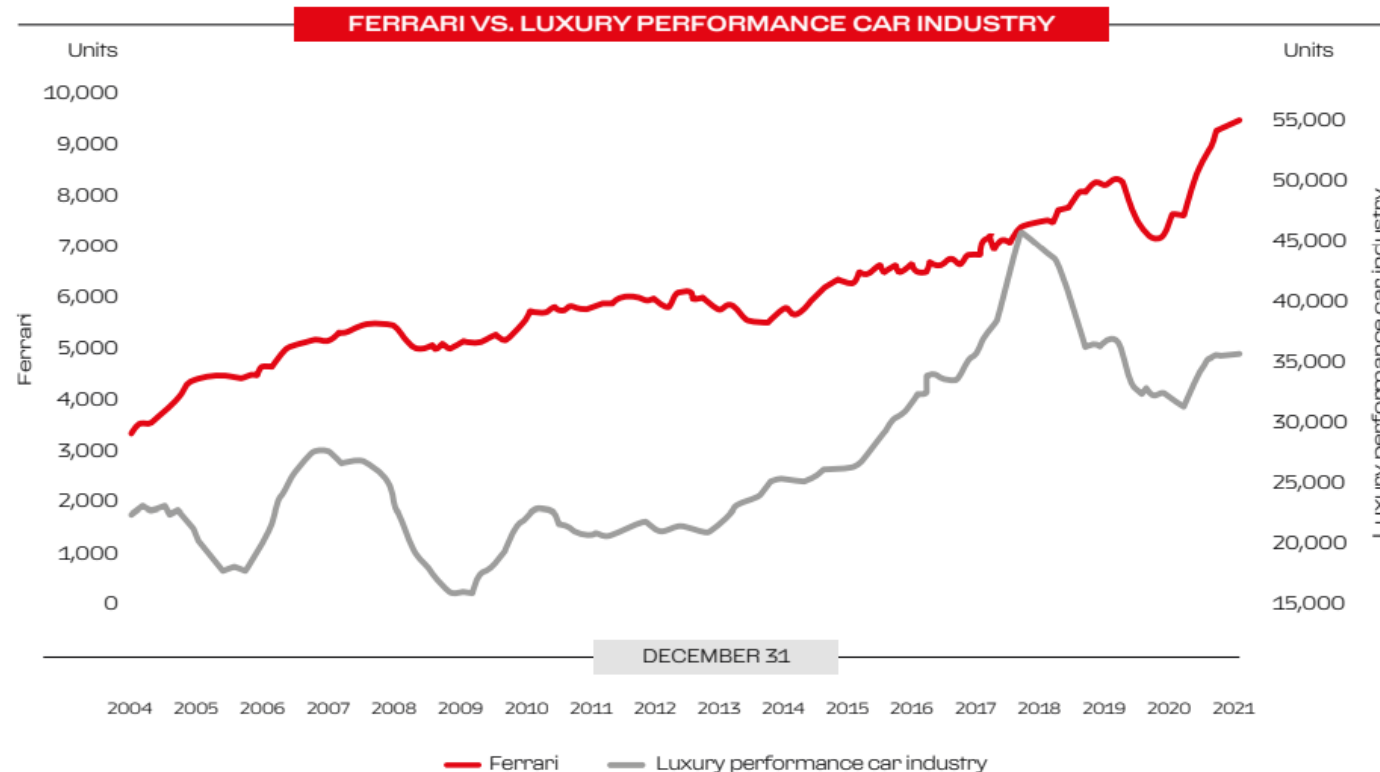
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★ Compared to its competitors, Ferrari's car deliveries have been consistent and less volatile

- In general, Ferrari faces excess demand for its products by keeping volume deliberately low

★ This is a great way of making products more desirable and keeping up the brand value

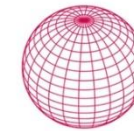
Increasing price to increase demand sounds very odd

- For the majority of goods, we observe that overall demand decreases when price increases
 - People tend to switch to cheaper variants or look for substitute products
- However, there are a few products where the law of demand does not hold
 - Economists call them “**Veblen goods**”
 - If luxury products become cheap, they lose the premium status as more people can afford it
 - Raising the price helps to keep exclusivity



Ask
Ajarn
Andrew

Ferrari's strategy is to increase the price and keep volume low



Sales

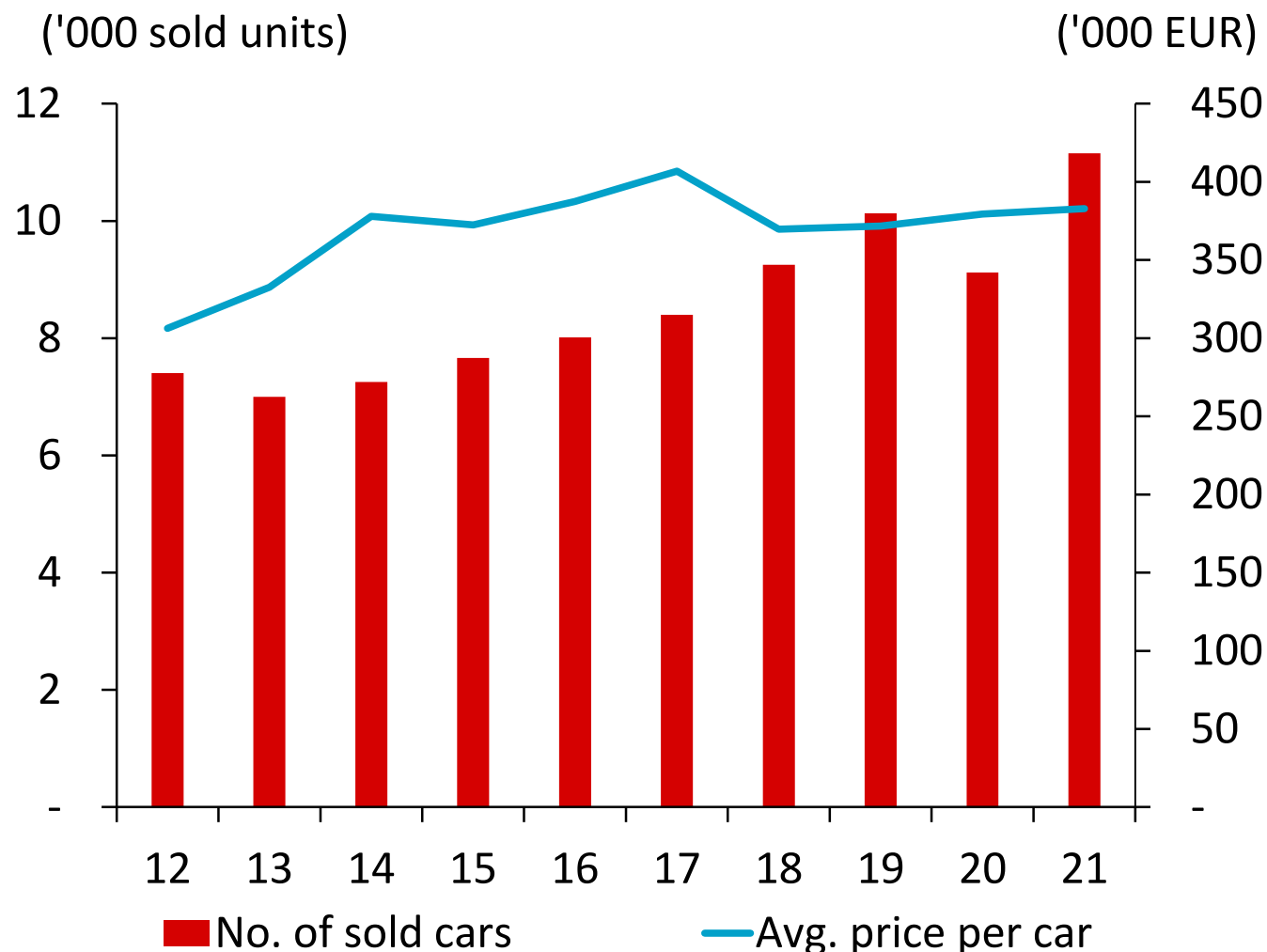
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★ From the 2021 annual report, on page 99:

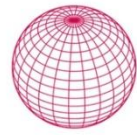
- “We seek to increase the average price point of our range and special series models over time by continually improving performance, technology and other features, as well as by leveraging the exclusivity of certain model offerings and the scarcity value resulting from our low volume strategy.”

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China & Asia-Pacific	2.3	2.0	2.8	3.4	4.2	4.7
Americas	2.9	2.3	2.8	3.1	3.4	3.6
Total car shipments	10.1	9.1	11.2	12.5	13.9	14.8
Avg. selling price ('000 €)	289	311	320	340	375	390
Revenue from cars and spare parts (€m)	2,926	2,835	3,573	4,261	5,216	5,764
Revenue for other segments	840	625	698	850	900	950
Total Revenue (€m)	3,766	3,460	4,271	5,111	6,116	6,714



- Raising price helps to increase the exclusivity of its cars
- Higher volume and higher price lead to stronger revenue growth



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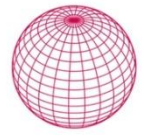
Risks

- ★ In 3Q20 earnings release, former CEO said
 - “I really don’t see Ferrari ever being at 100 percent EV and certainly not in my lifetime will reach even 50 percent.”
- ★ However, the pressure rises to move away from internal combustion engines (ICE) to hybrid and electric models



Former CEO Louis Camilleri

Are customer willing to give up the satisfaction of a great sound?



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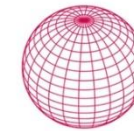
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Risks



Shift to hybrid is unavoidable and increases costs



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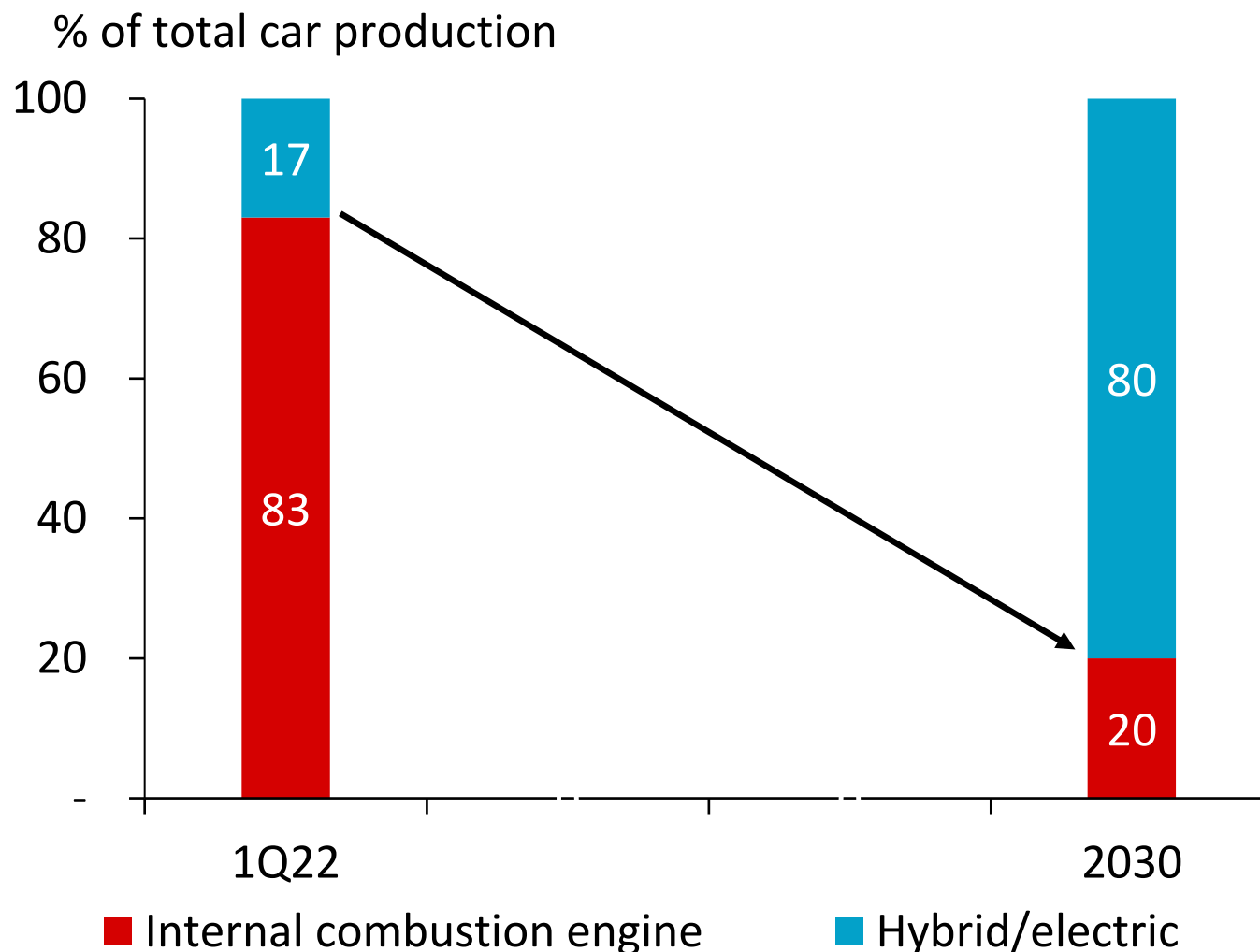
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Risks



- ★ As of 1Q22, around 17% of Ferrari's sold cars were hybrid
 - **The company's objective is to increase the percentage to 80% by the end of 2030**
- ★ A consequence of the shift is an increased spending in R&D
 - **Also, the margin on hybrid models is lower given higher production costs**
 - **As a result, we expect a slight margin contraction in the short run**

How I incorporated the story into my forecast

Car shipments ('000)	19	20	21	22E	23E	24E
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Revenue for other segments	840	625	698	850	900	950
Total Revenue (€m)	3,766	3,460	4,271	5,111	6,116	6,714
Profitability (%)	19	20	21	22E	23E	24E
Gross margin	52.1	51.3	51.3	50.0	50.0	50.5
ROE	89.0	56.3	60.8	67.4	72.8	70.0
ROIC	29.7	24.5	27.4	28.9	31.6	32.1



- We expect a slight decrease in gross margin due to higher production costs
- However, Ferrari is able to maintain its massive profitability as shown by ROE and ROIC

Consensus is divided



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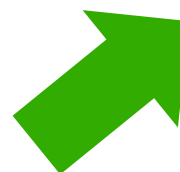
Risks

Analyst consensus valuation

Recommendation	Mar-22	Apr-22	May-22	Current
Strong buy	1	1	1	1
Buy	3	3	4	4
Hold	7	7	6	6
Sell	1	1	1	1
Strong sell	4	4	4	4
Average score	3.3	3.3	3.2	3.2

Price target	Mar-22	Apr-22	May-22	Current
Median	220	218	215	213
Mean	214	210	210	206

**16
analysts**

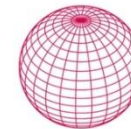


Upside: 17%

Analyst consensus 3-year forecast

	Consensus forecast					
(%)	19	20	21	22E	23E	24E
Revenue growth	2.5	(8.1)	23.4	12.0	12.1	7.9
Gross margin	52.1	51.2	51.3	51.9	51.4	49.4
EBIT margin	24.3	20.7	25.2	24.6	26.4	27.1
Net margin	18.5	17.6	19.5	18.5	20.2	20.6

- ★ Most analysts have a HOLD recommendation, while 4 analysts issued a strong SELL
- ★ Analysts predict gross margin to shrink in 24E
 - However, the effect is offset by lower SG&A, which results in an operating margin expansion



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Risks

(YE Dec, € m)	2020A	2021A	2022E	2023E
Revenue	3,460	4,271	5,040	5,644
Cost of goods & services	(1,686)	(2,081)	(2,520)	(2,822)
Gross profit	1,773	2,190	2,520	2,822
SG&A	(1,044)	(1,116)	(1,285)	(1,439)
Other operating (exp)/inc	(18)	(6)	(6)	(6)
EBIT	711	1,069	1,229	1,377
Interest expense (net)	(49)	(33)	(46)	(50)
Other non-operating inc/(exp)	-	(0)	(0)	(0)
Earnings before taxes (EBT)	662	1,035	1,183	1,327
Income tax	(58)	(209)	(237)	(265)
Earnings after taxes (EAT)	604	826	946	1,062
Equity income/Minority interest	4	5	4	5
Earnings from cont. operations	608	831	950	1,067
Forex/Exceptionals before tax	-	-	-	-
Net profit	608	831	950	1,067

- ★ Net profit is driven by higher sales volume in Asia and increase in average selling price



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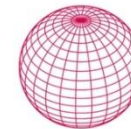
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Risks

(YE Dec, € m)	2020A	2021A	2022E	2023E
Cash & short-term investments	1,364	1,346	1,512	1,569
Accounts receivable	1,130	1,354	1,596	1,803
Inventories	461	541	630	729
Other current assets	122	123	202	226
Total current assets	3,076	3,364	3,939	4,327
Long-term investments	35	43	50	58
Net fixed assets	1,227	1,353	1,419	1,561
Intangible assets	979	1,138	1,219	1,288
Goodwill	785	785	785	785
Other long-term assets	160	180	198	218
Total assets	6,262	6,864	7,610	8,237

- ★ Ferrari holds around 20% of its assets in cash, which supports a solid balance sheet

Balance sheet - liabilities



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(YE Dec, € m)	2020A	2021A	2022E	2023E
Overdrafts & short-term loans	889	516	696	547
Accounts payable	808	932	1,050	1,176
Other current liabilities	563	634	766	858
Total current liabilities	2,260	2,083	2,512	2,581
Long-term debt	1,836	2,114	2,146	2,189
Other long-term liabilities	377	455	460	464
Total liabilities	4,473	4,652	5,118	5,235
Minority interest	4	6	8	12
Paid-up capital - Common shares	3	3	3	3
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	1,739	2,192	2,481	2,988
Revaluation/Forex/Others	43	11	-	-
Total equity	1,785	2,206	2,484	2,990
Total liab & shareholders' equity	6,262	6,864	7,610	8,237

- ★ The company has a moderate net debt-to-equity ratio of 1x
 - Given the strong cash flow generation ability, we do not consider its debt as a significant risk



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Risks

(YE Dec)	2020A	2021A	2022E	2023E
General growth (YoY, %)				
Revenue	(8.1)	23.4	18.0	12.0
Assets	15.0	9.6	10.9	8.2
Gross profit	(9.6)	23.5	15.0	12.0
Operating profit	(22.2)	50.2	15.0	12.1
Attributable profit	(12.6)	36.7	14.4	12.3
EPS	(13.3)	37.1	15.2	13.2
Recurring EPS	(11.6)	37.1	(14.1)	13.2
Du Pont analysis (%)				
Net profit margin	17.6	19.5	18.9	18.9
Revenue per €100 of assets	59.1	65.1	69.6	71.2
Assets/equity (x)	5.4	4.8	5.1	5.1
Return on equity	56.3	60.8	66.6	68.1
Others (%)				
Effective tax rate	8.8	20.2	20.0	20.0
Dividend payout ratio	26.5	30.2	30.1	30.0

- ★ Ferrari is characterized by a massive ROE, mainly driven by a strong net margin and leverage



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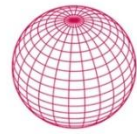
Risks

(YE Dec)	2020A	2021A	2022E	2023E
Internal liquidity (x)				
Current ratio	1.4	1.6	1.6	1.7
Quick, or acid test ratio	1.2	1.4	1.3	1.4
Working cap. mgmt (Days)				
Inventory conversion period	94	87	84	87
Receivables collection period	121	105	105	108
Days from raw mat to coll	215	191	189	195
Payables deferral period	174	151	142	142
Cash conversion cycle	41	41	47	53
Profitability ratios (%)				
Gross profit margin	51.3	51.3	50.0	50.0
EBIT margin	20.6	25.0	24.4	24.4
EBIT return on avg assets	12.2	16.3	17.0	17.4
Return on average assets	10.4	12.7	13.1	13.5
Financial risk (x)				
Liabilities-to-assets (%)	71.4	67.8	67.3	63.6
Debt-to-equity	2.0	1.9	1.9	1.7
Net debt-to-equity	1.0	0.9	0.9	0.7
Times-interest-earned	22.7	39.7	34.8	35.1
Effective interest rate (%)	2.1	1.4	1.9	2.1

★ Higher production costs for hybrid cars and pressure from rising commodity prices could drag the margin over the next few years

Stock Picking Checklist

Can this company be a ten bagger?



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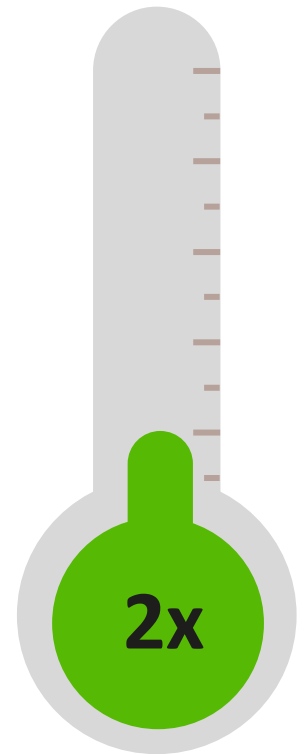
Ratios

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Risks

Checklist	Potential	Comment
1. Management is committed to growth	Good	Over the past 10 years, revenue grew at a CAGR of 7.7%
2. Growth can hit double-digits	Good	Asian market to provide growth
3. Gross Margin can remain high	Weak	Slight drop in gross margin expected
4. Earnings are predictable	Good	Ferrari has almost no exceptional items
5. Efficient at deploying assets	Weak	Asset turnover is 65%, which is below 100%
6. Cash Conversion cycle is low	Moderate	Cash conversion cycle is 41 days, comparable to the sector average
7. Cash Flow is consistently positive	Good	Ferrari delivered strong operating CF over time
8. Capital is readily available	Weak	The company has moderate high leverage
9. Valuation is reasonable	Weak	Trades higher on both PE and PB compared to its peers.

10x Bagger Potential



This is not investment advice and it's not a recommendation.



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(YE Dec, € m)	2020A	2021A	2022E	2023E
EBIT	711	1,069	1,229	1,377
Est tax rate (%)	9	20	20	20
NOPAT	649	853	983	1,102
Add: Depre & amort	427	456	618	637
Less: CAPEX	(356)	(348)	(440)	(492)
Chg in A/R	72	(224)	(242)	(207)
Chg in inventory	(41)	(80)	(89)	(99)
Chg in oth curr assets	(4)	(2)	(78)	(24)
Chg in A/P	(18)	125	118	126
Chg in oth curr liabs	(88)	71	132	92
Less: Chg in working cap	(78)	(110)	(161)	(113)
Less: Chg in invest cap				
Free cash flow to firm	641	851	1,000	1,135

- ★ Ferrari consistently delivered strong cash flows and we assume that it can grow further



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Forecast assumptions		
3-year average	Consensus	My assumptions
Revenue growth (CAGR)	10.6	12.9
Gross margin	50.9	50.2
EBIT margin	26.0	24.6
Net margin	19.8	19.1

My valuation method		
Market: Italy		
Market risk-free rate	3.5	
Market equity risk premium	8.0	
Market return	11.5	
Company beta (x)	0.7	
COE	9.1	
WACC	8.3	
Terminal growth rate	5.0	

Valuation Method:
FCFF

- ★ Expect higher revenue growth than consensus but slightly lower net margin
- ★ With a 5% terminal growth rate, I am already on the optimistic side
 - Also, I assume it to maintain its massive ROIC premium of 250% above WACC over time



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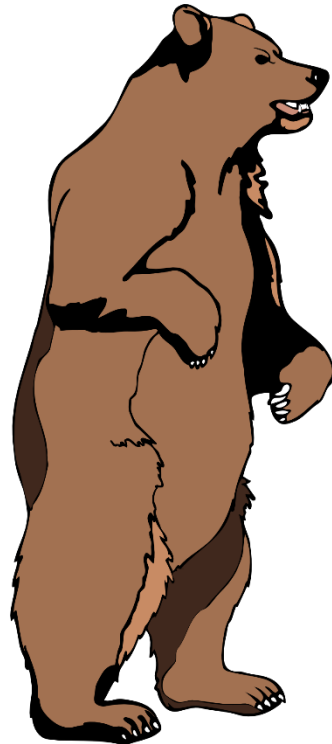
Value

Risks

Bear

US\$109

(Downside 33%)



Base

US\$121

(Downside 25%)



Bull

US\$137

(Downside 15%)





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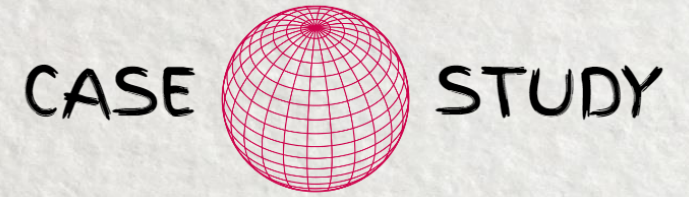
Risks

- ★ Failure to adopt to changing regulatory requirements (e.g., carbon neutral driving)
- ★ Change in collectors' appetite from overseas market, in particular Asia
- ★ Supply chain risks due to ongoing geopolitical conflicts

CONCLUSION

- Double-digit growth expected, supported by Asian market
- Competitive moat by maintaining exclusivity and low volume strategy
- Massive profitability but at a high price





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by
A. Stoltz INVESTMENT
RESEARCH

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