THE PRANCING HORSE PREMIUM: FERRARI'S IPO

The "other" ride sharing company!

Ferrari: The Back Story

- The Ferrari story started with Enzo Ferrari, a racing car enthusiast, starting Scuderia Ferrari in 1929, to assist and sponsor race car drivers driving Alfa Romeos.
- Ferrari as a car making company was founded in 1947, with its manufacturing facilities in Maranello in Italy.
- In the mid-1960s, in financial trouble, Enzo Ferrari sold a 50% stake in the company to Fiat. That holding was subsequently increased to 90% in 1988 (with the Ferrari family retaining the remaining 10%).

The Ferrari Legend

- **From the race tracks**: The company acquired its racing legend status from winning on more Formula 1 races than any other company in history.
- **From celebrity connections**: some of Ferrari's standing comes from its connection to celebrities. From Thor Batista to Justin Bieber to Kylie Jenner, the Ferrari has been an instrument of misbehavior for (usually young and rich) celebrities.

The auto business is a bad one

- With low revenue growth: Revenues grew only 5.63% a year from 2005 to 2014, in spite of the boost from emerging market sales.
- Poor profit margins: The median pre-tax operating margin across all global auto companies is only 4.46% and a significant proportion have operating losses.
- And big reinvestment needs: Traditional investments in plant and equipment (and assembly lines), supplemented with R&D (as the tech component grows) has pushes this expense up to almost 5% of revenues.

The saving grace for Ferrari

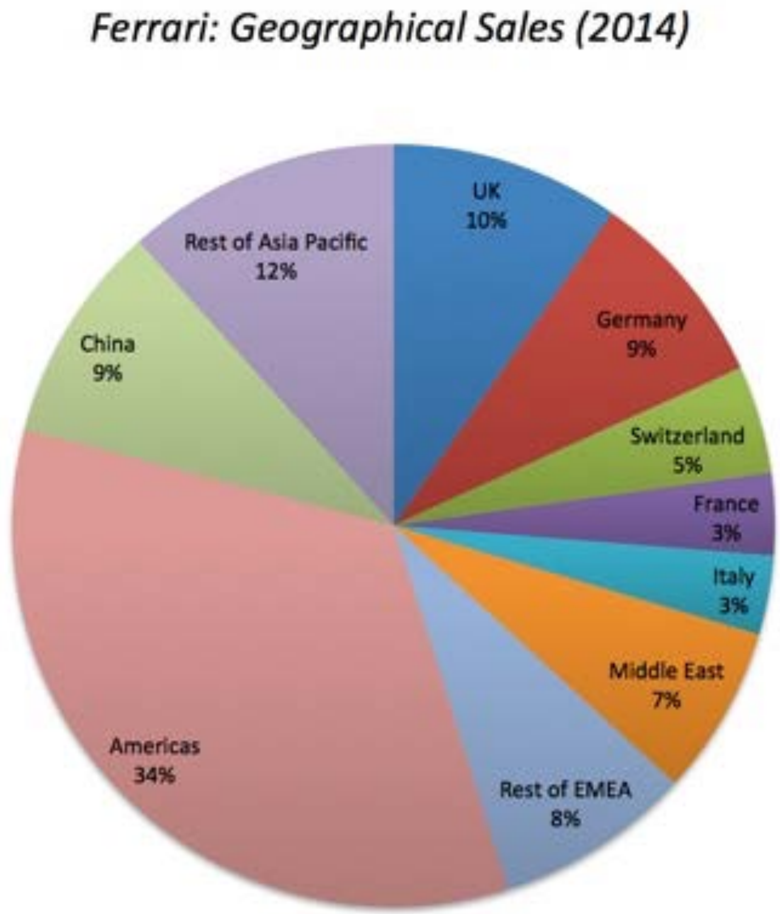
- Ultra luxury automobiles are seeing revenues grow faster than the rest of the auto business, primarily as a result of the rise of the rich in Asia. (Ferrari's sales have been flat for the last five years)
- These companies have among the highest operating margins among the auto companies (With an 18.2% operating margin, Ferrari ranks in the 95th percentile.
- By sticking to a low growth strategy, Ferrari has been able to keep its reinvestment needs modest.

The Ferrari Value Proposition

- Styling: A Ferrari is a work of art, and the company spends substantial amounts on styling and the little details that go into every Ferrari.
- Speed: What more is there to say? If you have dreamed of being a Formula 1 driver, this is about as close as you can get..
- Story: The car comes with a story that draws as much from its celebrity connections as it does from its speed exploits.
- Scarcity: Notwithstanding the first three points, it would be just another luxury car if everyone had one. So, it has to be kept scarce to command the prices that it does, both as a new car and in its used versions.

Ferrari: An Exclusive Global Club

Ferrari sold only 7255 cars in 2014, barely changed from how many it sold in 2008.



The Status Quo Narrative

The Status Quo

Revenues	**Keep it scarce**	Revenue growth of 4% (in Euro terms) a year for next 5 years, scaling down to 0.7% in year 10. Translates into an increase in production of about 25% in next 10 years
Operating Margin & Taxes	**And pricey**	Ferrari's pre-tax operating margin stays at 18.2%, in the 95th percentile of auto business.
Operating Income		
Reinvestment	**Little need for capacity expansion**	Sales/Invested Capital stays at 1.42.
Cash Flow		
Discount Rate (Risk)	**Super-rich clients are stable market**	Cost of capital of 6.96% in Euros and no chance of default
Value		

The Rev it up narrative

Rev it up

Revenues	**Push up sales**	Revenue growth of 12% (in Euro terms) a year for next 5 years, scaling down to 0.7% in year 10. Translates into an increase in production of about 100% in next 10 years
Operating Margin & Taxes → Operating Income	**With lower prices/more sellng costs**	Ferrari's pre-tax operating margin drops to 14.32%, in the 90th percentile of auto business.
Reinvestment → Cash Flow	**More capacity needed.**	Sales/Invested Capital stays at 1.42, but higher sales create more reinvestment
Discount Rate (Risk) → Value	**Very rich clients are more sensitive to economic conditions.**	Cost of capital of 8% in Euros and no chance of default

Where is the brand name premium?

	Ferrari (my estimated value)	*Auto Sector*	*Reason for difference*
EV/Sales	2.10	0.94	Ferrari's operating margin is 18.2% versus Industry average of 6.58%.
EV/Invested Capital	1.97	1.02	Ferrari earns a much higher return on capital (14.56%) than the sector (6.68%)
EV/EBITDA	12.57	9.05	Ferrari EBITDA/Invested capital is 15.68% versus Industry average of 14.45%.
PE	22.87	10.00	Ferrari has a debt ratio of 9.43% versus Industry average of 39.06%.
PBV	2.56	1.29	Ferrari has a slightly higher ROE and lower equity risk (because of less debt)

The IPO Twists

- Use of proceeds: In this IPO, the billion dollars expected to be raised from the offering will go to Fiat for cashing out some of its ownership stake, and thus not benefit Ferrari stockholders. There is therefore no need to add these proceeds back to the cash balance (as I would have, if the IPO proceeds had been retained by the firm).
- Number of shares/IPO price per share: Tthe number of shares is still in flux (notice all the empty spaces in the prospectus). The second is that the per share value will be a function of the number of shares created in the company.
- Control: The existing owners will get twice the voting rights on their shares, relative to the those who buy shares in the IPO, for their loyalty. The two big owners, Exor (the investment fund for the Agnelli family) and the Ferrari family will control 49 of the voting rights with about 33% of the shares. The shares that you and I will have a chance to buy at the IPO will be the low-voting right shares. I don't see much of a discount on these shares since even without the additional voting rights, it is unlikely that anyone can force the company to change its operations, if that change is against the wishes of the Agnelli/Ferrari clan.

To buy or not to buy?

- Ferrari is an iconic brand name and it will undoubtedly be marketed as such. Investors may very well price in a premium to reflect that brand name.
- The brand name value comes with a catch, which is that it derives some or a big portion of that value from exclusivity.
- To arrive at a value of $11 or $12 billion, you need a narrative where Ferrari can double cars sold while preserving a price premium for the cars.