

Business analysis challenge – Part B

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Context

Ferrari S.p.A. was originally founded by Enzo Ferrari in 1939, and through various control transfers, formed the Ferrari holding company Ferrari N.V. - a spin-off from Fiat in 2015. It operates in the luxury automobile manufacturers market, where it “designs, engineers, produces, and sells luxury performance sports cars”¹. However, it also has other businesses that are a segment of its core business. Specifically, “the company licenses its Ferrari brand to various producers and retailers of luxury and lifestyle goods; Ferrari World, a theme park in Abu Dhabi, the United Arab Emirates; and Ferrari Land Portaventura, a theme park in Europe”². In addition, “it provides direct or indirect finance and leasing services to retail clients and dealers; manages race tracks, as well as owns and manages two museums in Maranello and Modena, Italy; and develops and sells a line of apparel and accessories through its monobrand stores.”³

The company’s main strategy is to promote an “exclusivity” to limit the number of models and cars it produces and maintaining car waiting lists “to reach the optimal combination of exclusivity and client service”⁴. This strategy allows Ferrari to control prices for the cars, although at the expense of limiting potential sales growth. However, it also allows the company to re-balance demand easily for each market, such as “decrease in shipments in the Americas and the growth in Mainland China, Hong Kong and Taiwan in 2019 compared to 2018”⁵. In addition, the company also has a brand diversification strategy in place, including profiting from non-car activities such as through licensing the brand through products and entertainment, as well as products and services to complement the cars. Moreover, the marketing strategy includes promoting the brand through Formula 1 Championship races, and the growth strategy includes expanding operations in regions with high growth potential and penetrating those new markets, as well as broadening the range of models to capture additional demand. On top of that, the company also plans to “expand hybrid and electric technology” for sports car customers as well as other target customers, and invests heavily in R&D, where it leverages R&D from its racing for its sportscars⁶.

Ferrari seeks to be a price leader and an industry leader in terms of the quality of the cars it manufactures as well as the services it provides to loyal customers. Its strategy focuses on exclusivity and limiting the supply artificially to control the sales demand, as well as continuously improving through R&D and innovation, allowing it to position itself as an industry leader. Ferrari’s sustainable competitive advantage comes from its significant pricing power over its customers and can control the supply of the cars to meet its sales targets for the most part. In addition, it has a very strong brand around the world, and it continues to invest in it through licensing it for non-manufacturing activities, as well as through Formula 1 Championships. Furthermore, it continues to maintain the quality of its race cars and evolve through developing new lines of cars that match consumer tastes through investments in technology. Lastly, it has strong relationships with its suppliers, especially those with highly advanced technological inputs, as well as strong relationships with its dealers, who also help promote the brand through dealership showrooms and after-sales maintenance across the world and allow the company to maintain its competitive advantage. Currently, various risks affect the industry and the company, including disruptions to the supply chain and customer purchases from COVID-19, as well as its falling demand in Europe and North America versus its growth in Asia-Pacific. In addition, due to climate change, electric vehicles are on the rise and the company has already started to make appropriate adjustments to adapt to these new challenges through various risk management processes.

¹ S&P Capital IQ. (2021). Ferrari N.V.: Public company profile. Retrieved June 7, 2021, from S&P Capital IQ database.

² Ibid.

³ Ibid.

⁴ Ferrari. (2021). 2020 20-F form. https://corporate.ferrari.com/sites/ferrari15ipo/files/ferrari_nv_20-f_2020.pdf

⁵ Ibid.

⁶ Ibid.

Role: Equity Research Analyst
Forecasting the financial statements

Forecasting approach:

The actual financial statements used in the projections for fiscal year (FY) 2017 to 2020 and 2021 Q1 were pulled from Capital IQ, as no major adjustments were made, and it is assumed that the company will continue with its existing accounting policy going forward. These actual financial statements are used to help project future year financial statements for 5 years from 2021 to 2025 through the use of rolling averages, % of revenue/ relevant financial statement accounts, as well as other information from external sources such as the annual report, earnings calls, and analyst research.

Key assumptions:

Income Statement (Appendix 2, Ex 1 in Excel)

Revenue: Revenue is arguably the most important financial statement line item (FSLI) on the income statement as it will drive the business's many expenses as well as its profits in the long term. Ferrari's revenues have been consistent over the years, except for 2020 where COVID-19 has decreased the trend of revenue growth. In addition, there was almost a 0% revenue growth between 2017 and 2018. Therefore, to project revenue, I have calculated the year over year (YoY) revenue change and determined that the 2020 year should not be used in the revenue growth projections due to an event that was extraordinary – COVID-19. The 3-year average breakdown showed a YoY increase of 6.76%. However, industry analysis has a 5-year projected cumulated average growth rate (CAGR) at a lower rate of 6.2% from 2021-2026⁷. According to an S&P Global article, revenue growth is expected for Ferrari due to strong Q4 2020 and Q1 2021 results⁸, therefore, a projected YoY revenue growth is reasonable. However, the article stated that the 2021 net revenue will be about €4.3 billion, which appears to be a significant increase of almost €1 billion compared to revenue in the previous 3 years. In addition, from the quarterly revenue growth analysis, the actual Q1 revenue growth rate is about 8.48%, and the YoY revenue growth rate from 2020 to 2021 is implied to be 16.67% based on the current Q1 results, which appear very high. Therefore, the a more conservative 6.2% rate was used to project revenues so that the growth is more reasonable and consistent compared to a sudden spike, and total revenue growth is capped to 6.2%.

As a result, there will need to be a pro-rata adjustment to the revenue projections to the cap at 6.2% CAGR for each revenue segment, including cars and spare parts, engines, sponsorship, commercial and brand and other revenues. For these revenue streams, I have assumed that the revenue will continue to change based on a 3-year rolling average and the total from all segments does not exceed the cap growth. The engines segment is the only exception in the projections, due to the fact that in the 2019 earnings call Ferrari's CEO has stated that "[eventually], we will no longer supply engines to Maserati, which actually from our perspective is actually a good thing, both from a margin perspective, but also the fact that we can transfer a lot of the labor that's been focused on the engines to the car side of the business"⁹. An article has also mentioned that it will likely be in 2021 or 2022 that Ferrari discontinues the engines segment of its business, and it can be seen from the actual income statements provided that the revenues from this segment has been consistently decreasing at a significant rate of almost 17% over the last 4

⁷ Luxury vehicles Market 2021 is estimated to clock a Modest CAGR of 6.2% during the forecast period 2021-2026 with top countries data. The Cowboy Channel. (n.d.). <https://www.thecowboychannel.com/story/43663413/luxury-vehicles-market-2021-is-estimated-to-clock-a-modest-cagr-of-62nbpsduring-the-forecast-period-2021-2026-with-top-countries-data>.

⁸ Riordan, D. (2021, February 2). Ferrari projects 2021 rebound as Q4'20 PROFIT, Sales beat expectations. Accelerating Progress. <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/ferrari-projects-2021-rebound-as-q4-20-profit-sales-beat-expectations-62432771>.

⁹ Transcribers, M. F. (2019, May 7). Ferrari N.V. (RACE) Q1 2019 earnings call transcript. The Motley Fool. <https://www.fool.com/earnings/call-transcripts/2019/05/07/ferrari-nv-race-q1-2019-earnings-call-transcript.aspx>.

years¹⁰. As it is uncertain when the engines will fully be eliminated, I have assumed conservatively that by the end of 2023 the segment will be generate zero revenue.

COGS, SG&A and other expenses: Other major expenses such as cost of goods sold (COGS), selling, general and administrative expenses (SG&A) are all calculated based on a percentage of the overall adjusted projected revenue due to the strong correlation of these variable costs with increases in revenue. In this case, depreciation of fixed assets is also included as a portion of COGS, but there was no financial information such as a depreciation schedule that was provided by Ferrari. In addition, various assets are purchased or sold throughout the year, which changes the PPE amounts and therefore depreciation expense calculations. Therefore, to keep calculations consistent this depreciation expense was not separated from COGS to ensure that the projections are accurate. As a result, I have calculated a 3-year rolling average for these expenses as a percentage of revenue and applied it to the projected revenue for the next 5 years to calculate the actual expenses during the same period.

Income tax expense: Ferrari has fluctuating tax rates over the years due to the application of deferred tax benefits/ expenses as well as taxes related to prior periods that are difficult to project. In 2020, Ferrari has received assistance from the Italian government that generated deferred taxes for future periods. In addition, from 2018 until 2022, the Revenue Agency has agreed to provide tax benefits for “companies that generate income through the use ... of copyrights, patents, trademarks, designs and know-how”¹¹. Therefore, while the corporate tax rate is 24.0%¹², government assistance and agreements, as well as the application of deferred tax benefits and other adjustments have changed the tax expense such that it is difficult to predict on a yearly basis. Therefore, income taxes are calculated through a 3-year rolling average as the 2020 tax expense may be subject to potential one-time events from COVID-19., and the effective average rate of 16.73% was used for each of the 5 projected years to determine the income tax expense as a percentage of earnings before taxes.

Minority interest in earnings: A non-controlling interest exists, related to Ferrari’s “Chinese distributor, Ferrari International Cars Trading (Shanghai) Co. Ltd” (FICTS).¹³ The financial statements have shown and stated that these “interests in FICTS are not considered to be significant to the Group for relevant periods”¹⁴. Therefore, a rolling average as a percentage of earnings from continued operations was used to project these amounts into the future.

Balance Sheet (Appendix 3, Ex 2 in Excel)

Cash and Equivalents: The standardized cash and equivalents is the sum of cash balances and other short-term investments and trading asset securities, as these assets can be sold very quickly in the market and therefore are considered to be very liquid assets similar to cash. The cash balance is tied to the ending cash balance generated from the statement of cash flows.

Accounts Receivable (A/R), Inventory, Accounts Payable (A/P): These accounts are calculated based on the days A/R outstanding, days inventory outstanding, and days A/P outstanding numbers, respectively. To project the days, I took the 3-year rolling average from 2017 to 2019 excluding 2020, due to effects of COVID-10 that has increased the days A/P outstanding as well as the days inventory outstanding. As the company has always had negative cash conversion cycles of roughly 30 days, the projected cash

¹⁰ Perkins, C. (2020, July 28). Ferrari will eventually stop building engines FOR MASERATI. Road & Track. <https://www.roadandtrack.com/new-cars/future-cars/a27422320/ferrari-will-eventually-stop-building-engines-for-maserati/>.

¹¹ Ferrari. (2021). 2020 20-F form. https://corporate.ferrari.com/sites/ferrari15ipo/files/ferrari_nv_20-f_2020.pdf

¹² Ibid.

¹³ Ibid.

¹⁴ Ibid.

conversion cycle will also be the same. The dollar amount for A/R is projected through multiplying revenue for the projected year by the days A/R outstanding and dividing by 365 days of the year. Similarly, for inventory, the amount equals to COGS multiplied by the days inventory outstanding divided by 365 and same for the accounts payable, as purchases and other adjustments were not outlined in the financial statements, so the COGS balance was the most appropriate to use. The projections are reasonable as they appear to be in line with the historical information and the company's policies do not appear likely to change drastically in the future in terms of how it pays its suppliers, how it receives payments from its customers and how inventory is managed.

Prepaid expense: This account is calculated as a proportion of revenue rather than a rolling average, because prepaid expenses are often related to operations and generally change with revenue rather than other asset balances.

Other current assets: Other receivables was calculated using a three-year rolling average, except the 2018 year was not used and the 2020 year was used instead due to the large fluctuation in the account in 2018. This is due to the large tax receivables for the year in 2018, which is abnormal. Aside from this, all other accounts for current assets are accounted for using a 3-year rolling average and not accounting for the 2020 year due to the need and incentive for management to increase current assets to guard against the pervasive effects of COVID-19 (e.g. having more than normal levels of current assets for additional liquidity or flexibility during an uncertain year).

Gross Property, Plant & Equipment (PPE), Accumulated Depreciation, Net PPE: $\text{Net PPE} = \text{Gross PPE} - \text{Accumulated Depreciation}$. While a schedule of acquisitions and dispositions of capital assets have been provided in the financial statement notes, there has been many changes and adjustments through each year and no depreciation schedule was provided for each asset aside from a table of depreciation policies. In addition, the accumulated depreciation appears to be consistent over the years as a percentage of gross PPE. Therefore, I have used a 3-year rolling average from 2018 to 2020 to project these assets and the accumulated depreciation going forward. Since these are non-current assets, it is unlikely that management will have the incentive to change the balances of these accounts to account for the effects of COVID-19, and these balances will also be more likely to stay consistent in future years compared to current assets, which can fluctuate.

Goodwill: There is no change to goodwill and there does not appear to be any indicators that it could be impaired, so the projections assume it have the same balance as it did before.

Deferred Tax Assets: As Ferrari has a volatile tax difference through various changes in provisions, deferred income, employee benefits, foreign exchange, inventory, depreciation, and other factors, the projections use a percentage of revenue to project these expenses from the 3-year rolling average of 2017 to 2019.

Other Non-Current Assets: Long-term investments and other long-term assets are calculated using a 3-year rolling average from 2018 to 2020, as they are long term assets, and the most recent years' values will be more indicative of future measures. Other intangible assets and deferred charges (long-term) are results from additions related "externally acquired and internally generated development costs for new and existing models"¹⁵ and amortizations.

Income Taxes Payable: Due to the varying tax rates and tax obligations that Ferrari has, the income taxes payable as a % of income tax has been varying throughout the past 4 years. Therefore, it was most appropriate to smooth out the difference and find an average rate for projections of this account balance

¹⁵ Ibid.

and I used the average of the last 4 years (23%) and applied it to the income tax expense incurred for the projected years.

Other Current Liabilities: Other liabilities such as accrued expenses, current portion of long-term debt and leases, current deferred tax liabilities and other current liabilities are all difficult to forecast due to the lack of information available in the financial statements. For instance, there was no detailed schedule of the long-term debt and the current portions, resulting in difficulties predicting that account balance. Therefore, a simple 3-year rolling average from 2017 to 2019 was used to calculate those account balances as the 2020 year has seen somewhat abnormal levels increasing in financing liabilities and a decrease in certain other current liabilities, likely due to the management's mitigation of the negative effects of COVID-19.

Long Term Debt: Long term debt components include bonds and notes, asset-backed financing (securitizations), borrowings from banks and other debt. As there are many adjustments throughout the year, including proceeds from and repayments of borrowings, as well as interest and translation adjustments, I chose to use 3-year rolling averages from 2018 to 2020 to calculate the debt balances, especially as the debt amounts have also been increasing, and significantly in Q1 2021, likely due to the need to finance capital expenditures due to adjustments for COVID-19.

Long Term Leases: As it appears that there has been a recent trend in the past 2 years of increased lease liabilities from zero in 2017 and 2018 to 40 and 46 million in 2019 and 2020 in the longer term due to either changes in operations or other factors, especially considering that Q1 of 2021 has also seen a lease liability of 62 million. Therefore, I have assumed that in the future the lease liabilities will be roughly the same as the existing amounts with minor increases.

Other Long-Term Liabilities: Other long-term liabilities include pension benefits, deferred tax liability (non-current), other non-current liabilities, and no current unearned revenue. These accounts appear to fluctuate somewhat but stay relatively constant within a range. Therefore, I have chosen to use a 3-4 year rolling average depending on the fluctuation of these account balances, or whether balances have been increasing, such as in the deferred tax liability account.

Common Stock and Additional Paid In Capital: The Q1 2021 financial statements from Capital IQ have shown a zero balance for the additional paid in capital compared to the previous 5.7 billion, but it is unclear why that is as the annual reports have not discussed the reasoning for this change. Thus, there were no changes made to these accounts because they did not see any changes in the last 4 years.

Retained Earnings: While retained earnings should be calculated through adding the current year's net income to the prior year's retained earnings ending balance, Ferrari's historical financial statements shows that that was not the case for its financials, and there was an undisclosed method used to adjust the retained earnings. Therefore, for the sake of simplicity, the retained earnings are forecasted as a 4-year rolling average, due to the fact that it has both increased and decreased but done so within a range.

Other Equity Accounts: Comprehensive income and the minority interest are calculated through a rolling average method due to the limited information that the financial statements have provided for forecasting. No changes were made to the treasury stock for the forecasting because there were no known adjustments made by the company.

Cash Flow Statement (Appendix 4, Ex 3 in Excel)

Net income, depreciation, amortization of goodwill and intangibles, and other amortization: Net income derives from the income statement (including minority interest's earnings/ loss). Depreciation is determined based on depreciation as a percentage of accumulated depreciation based on the past 3 years

of rolling average. Since depreciation is relatively consistent over the years, this method is appropriate. Amortization is calculated as a percentage of revenue, and the rolling average is then calculated and applied for the forecasted amounts.

Changes in A/R, Inventories, and A/P: These amounts are calculated from changes in the YoY account items for each respective account.

Other changes in cash flow from operating activities: Changes from other operating activities, gains and losses from sale of assets and investments are all calculated based on a 3-4 year rolling average, where the Q1 2021 amount is used for the balances that fluctuate significantly.

Changes in other net operating activities/ investing activities/ financing activities: These are the plugs that were used to balance the changes in cash for the year with the ending balance that is used for the cash balance of the balance sheet. Only changes have been made to the change in operating assets due to the fact that other investing activities or financing activities have not had significant historical balances. Therefore, these balances are not changed. Operating activities are responsible for the majority if not all of the major changes in the cash flows that are unaccounted for by other line items. As a result, this was the plug that was used to balance the cash account from the balance sheet and cash flow statement's ending balances.

Capital Expenditure: Capital expenditure is a major cost for a company like Ferrari, where much of its operations focus on production and use of capital assets and is often a factor related to revenue. Without the necessary capital expenditure investments, the operations of the business will not be able to grow and sustain itself. Therefore, a 3-year rolling average of capital expenditure to revenue from 2018 to 2020 is used, as the amount continues to increase over the years. The rolling average is continued for the projection of the account going forward.

Other changes in cash flow from investing activities: Sale/ purchase of intangible assets has been consistent over the last 3 years and is projected to be so through a 3-year rolling average. There have not been significant changes for all the other accounts related to investing activities, and this assumption is carried forward for the projections.

Long-term Debt Issued/ Repaid: Ferrari generally only issues long term debt or repays its long-term debt. As the balances are long-term averaging 5 years or so, it is difficult to estimate when the company will issue/ repay debt and the amount it will do so by. As a result, a 3-year rolling average from 2017 to 2019, excluding 2020, is used for projections. This is because COVID-19 could have impacted the financing needs and capacity that the company required, and the company likely foresaw its need for additional financing or simply a cushion to help with uncertainties, which is an abnormal event.

Repurchase of Common Stock and Common Dividends Paid: The company is currently repurchasing stock as management see fit and has a share buyback program in place. The program contains a “multi-year Euro 1.5 billion total share repurchase program expected to be executed between 2019 and 2022”¹⁶. However, there was a suspension in the repurchase program in 2020 due to COVID, and it is possible that the repurchase may be delayed or slowed down in future years when the economic environment is still volatile due to the negative effects of COVID-19, especially on the cash flows of the company. As a result, I have spread out the repurchase over the next 5 years, where the aggregate amounts will roughly be 1.5 billion.

¹⁶ Ibid.

Other changes in cash flow from financing activities: Proceeds from/ repayment of credit facility, short term debt issued, short term debt repaid, issuance of common stock, payments to former shareholders are all accounts that have not seen any changes in the past, and this assumption is carried forward into the future.

Foreign exchange rate adjustments: These are simply minor foreign exchange adjustments cashflows from operations across the globe and therefore the usage of multiple currencies. A 3-year rolling average is used for the projections going forward.

Beginning cash, changes in cash, ending cash: The beginning cash balances are the ending balances of the prior period. The net changes to cash from operating, investing, and financing activities are then added to the balance and generates the ending balance, which equals to the cash balance of the cash on the balance sheet. This is then the following year's beginning balance, and the cycle repeats.

Summarized/ condensed forecasted financial statements & key ratios/ KPIs:

Key ratios/ KPIs: Appendix 1

Standardized Income Statement: Appendix 2

Standardized Balance Sheet: Appendix 3

Standardized Cash Flow Statement: Appendix 4

Analysis and conclusion based on equity research perspective:

Overall, Ferrari is stated to be one of the “best-performing auto stocks in 2020”¹⁷ by analysts. However, the company still faces challenges going forward. Nonetheless, the forecasting of the financial statements show that the company is on track to improve its profitability, likely from its focus on its core automobile manufacturing business and improved margins due to re-allocation of its labor due to the discontinuation of engine sales to Maserati and other potential vendors. In addition, its R&D investments in the Formula One Championships continues to build its brand and helps the company achieve innovation with its cars as it pivots towards offering sportscars for audiences who are more interested in electric vehicles as well. The company has suffered like all others in the industry from economic disruptions due to COVID-19. However, with positive Q4 2020 and Q1 2021 results, the company should be able to rebound from a temporary setback. If it can manage to perform above the industry average, continue to sell cars, improve its supply chain and manufacturing process and be innovative, it can achieve greater profitability and market share than it did before. It is predicted that its profitability margin will increase to close to 30% compared to under 20% today. In addition, it should be able to maintain and increase its return on assets if it finds ways to productively use its existing capital and short-term assets. The company will also continue to be in good financial health due to paying its creditors on time and being able to pay back short-term interest and long-term debt as it sees fit. From its falling debt to equity ratio YoY, it can also be seen that the company will have greater financing capacity going forward without being heavily leveraged as it did more so in the past. From the current company analysis, Ferrari has a strong business model and good prospects for future growth, which makes it a good stock to consider for a potential buy.

Business valuation:

Key valuation assumptions:

From the company's financial statements, under the notes for goodwill impairment testing the company has assumed that the “medium/long-term growth rate for the sector equal to 2.0 percent in 2020”, while the “post-tax discount rate ... [was] determined by using a base WACC of 6.8 percent in 2020”¹⁸. As a result, these are two of the assumptions that will be used in the calculations for the discounted cash flows

¹⁷ <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/ferrari-projects-2021-rebound-as-q4-20-profit-sales-beat-expectations-62432771>

¹⁸ Ferrari. (2021). 2020 20-F form. https://corporate.ferrari.com/sites/ferrari15ipo/files/ferrari_nv_20-f_2020.pdf

(DCF) model. In addition, while the tax rate for Italian corporations is 24.0% for the years of 2018 to 2020¹⁹, the implied tax rate based on the income statement and income tax expense per year is actually at a lower rate of 16.7%, due to various tax saving programs that the government provides and tax-reduction planning that Ferrari partakes. Therefore, the implied tax rate will be used in the calculations rather than the theoretical tax rate.

Valuation Methods:

1 Discounted Cash Flows (DCF) (Ex 4 DCF):

The discounted cash flows model is calculated based on the cash flows of the company. The formula for earnings before interest and taxes (EBIT) is $EBIT = \text{net income} + \text{income tax expense} + \text{net financial expenses (interest and other minor expenses)}$. Then, depreciation and amortization from the cash flow statement for the year are added back to get to earnings before interest, taxes, depreciation, and amortization (EBITDA). The free cash flows each year starts with EBIT, and the tax rate is the implied 16.7% tax rate, resulting in the after-tax EBIT. Depreciation and amortization are added back to the EBIT after tax, and the recurring capital expenditures from the cash flow statements each year are deducted. Finally, increases in net working capital are deducted due to cash outflows and decreases are added back. The free cash flows are then discounted to present value through the after-tax WACC of 6.8%.

The Gordon growth method (Appendix 8) was used to determine the enterprise value of the company, where a terminal multiple is used, and the multiple factors in the perpetual growth of the company's cash flows at a rate of 2%, equal to the current management projections of the medium to long term growth rate of the sector, as well as the after-tax WACC of 6.8%. The enterprise value is then calculated to be the total of the present value of free cash flow from all projected years including the present value of the terminal multiple. Then, net debt is deducted, which is calculated through subtracting the total debt or short- and long-term debt obligations that the company has from its balance sheet, while adding back its cash balance. As of Q1 2021, Ferrari has roughly 185 million common shares outstanding, and the implied share price is then calculated through dividing the enterprise value by the shares outstanding, resulting in €176.06 compared to the last traded price of €179.50 on July 26th, 2021, with an implied downside of 1.9%.

2 Comparable Company Multiples (Ex 5 Comp Multiples):

For a list of comparable companies, Ferrari's annual report has already provided some close competitors as well as benchmark companies. Specifically, the management has stated the company's "principal competitors are Lamborghini, McLaren, Ford, Honda, Porsche, Mercedes, Aston Martin and Audi"²⁰ from its automobile business. In addition, through examining the annual report, the CEO's compensation was determined through examining a list of benchmark companies, many of which were vetted through a list of criteria and are companies that can also be used to compare Ferrari's performance with. Specifically, the criteria are as follows: "a) operating in the same business as Ferrari (Automotive); b) acting in similar sectors (car / motorcycle components); c) representing excellence and luxury in their respective sectors, d) presenting overall a similar Market Cap, Revenues and number of Employees with Ferrari"²¹. The list of companies that were determined are in Appendix 5. Therefore, along with the competitor list mentioned earlier, all these companies are used for determining comparable multiples.

From this list, some companies are owned by others, such as Lamborghini (owned by Volkswagen) and Mercedes (owned by Daimler). These companies are not included because they do not have publicly traded stock. Other companies like McLaren are not included because they are a private company, and no share price can be determined. I have also excluded Ford Motors, Porsche, and Pirelli, due to abnormally

¹⁹ Ibid.

²⁰ Ibid.

²¹ Ibid.

high multiples such as EV/ LTM EBIT, EV/ Sales and P/E as these may significantly skew the results. Overall, an average, median, max and min were calculated for the multiples based on EV/ LTM EBITDA as well as EV/ LTM EBIT, which were used to calculate an implied enterprise value range through Ferrari's EBIT or EBITDA. The net debt was adjusted for to result in an equity value and dividing by the shares outstanding provided a range of what the share price is expected to be. The average EV/ EBITDA was used to calculate the share price using the Exit Multiple Method (Appendix 9), where Ferrari's 2025 EBITDA was used to project the company's terminal value, and then the enterprise value. Adjusting for net debt and dividing by the shares outstanding provided an implied share price of €214.68, with an implied upside of 19.6%.

3 Precedent Transactions (Ex 6 Precedent Transactions) (Appendix 6):

I have used Capital IQ to help me screen for precedent transactions and relevant multiples. The selection criteria included luxury goods as well as automobile related industries. Overall, 5 company selections were made that were deemed similar to Ferrari and were used. The decision criteria included accounting for geographic location (Chinese transactions were excluded due to the location difference and market difference compared to Ferrari, which is predominantly based in Europe and sells more to Europe and North America), size of the transaction/ implied enterprise value (transactions less than \$1 Billion are not considered due to Ferrari's size), the type of deal (closed merger/ acquisition deal), and the recency of the transaction (the deal must have happened in the last 3-4 years, and in this case 2018 was the oldest historical year). Out of the five transactions selected, two of the transactions were not used due to the size of the transaction and due to an inappropriate Revenue/ EBITDA size compared to the other major transactions. This helped provide a range of share prices similar to the other methodologies used, with the average share price of €152.19 with a 15% downside.

Football Field (Ex 7 Football Field) (Appendix 7):

The range of valuations had the lowest theoretical price of €25.59 to the highest price of €317.97. However, both of these are unreasonable estimates and represent the extremities of the estimates – only the median and a reasonable range should be considered. In this case, I have allocated 30% of the weight for the football field to the discounted cash flows using the Gordon Growth rate method and another 30% to the Exit Multiple method. Then, 20% were allocated to precedent transactions and the comparable multiples, respectively. Overall, the result showed a price of €151.05 with an implied downside of 15.8%.

Analysis and conclusion based on equity research perspective:

Overall, the results from the valuation methods are mixed, as the football field and precedent transactions showed an implied downside of 15% to the stock while the DCF through the Gordon Growth method showed an almost immaterial 1.9% downside versus the Exit Multiple method, which showed an implied upside of 19.6%. The reason why the precedent transactions and the comparable multiples have shown a lower stock price is because some of the transactions simply did not perform as well as Ferrari did in the industry, and therefore carried a lower EV/ EBITDA multiple. In addition, the DCF and Exit Multiple Methods are generally speaking more accurate compared to looking at comparable companies or precedent transactions, provided that they provide insight into the cash flows of the company. As the Exit Multiple is more focused on the cash flows in 5 years, it is possible that this method is over-valuing the stock as Ferrari's performance in 5 years is expected to significantly increase compared to the current years, and if this amount is over-estimated, will naturally increase the company's share price. Therefore, based on the current assumptions and summary of results, I would consider holding the stock until more insights are gained from the next quarter's performance for a more accurate projection into Ferrari's future performance.

Risk management and sustainability:

Sensitivity analysis (Ex 8 Sensitivity Analysis) (Appendix 10):

There are numerous risks related to Ferrari's business (as described in the below sections), and the company outlines these risks early on in the annual report. However, as they are difficult to quantify in nature, a sensitivity analysis will be conducted on the discount rate only, without changing the cash flows for the projections. According to research from Finbox, a financial analysis tool, Ferrari's WACC ranges from 7.2% to 8.3%²² (Appendix 10). As the current WACC is at 6.8%, a range was used between 6.4% to 8% in increments of 0.4% to test the sensitivity of the WACC. In addition, the sensitivity analysis also tests the Gordon Growth rate's long term growth rate of 2%, ranging from 1.5% to 2.5% in increments of 0.25%, as well as the Exit Multiple method's multiple of 18.7x, ranging from 14.0x to 22.0x in increments of 2x. Currently, 6.8% is on the lower end of the range for a WACC discount rate, and higher rates along with decreased growth rates have shown to significantly decrease the company's value and therefore its share price. Similarly, lower multiples with higher WACC ranges will also decrease the company's value. However, since the multiples are already implying a higher share price, there is little downside in the company's value through this sensitivity analysis compared to the upside. However, there is a significantly larger range that the Exit Multiple offers compared to the Gordon Growth method, which questions its validity and likelihood. As the growth rate appears to be consistent given the state of the long-term economic growth, it is unlikely that the growth rate will be below 2%²³. However, management assumptions about WACC may need to be reviewed as the financial analysis tool showed a higher WACC of 7.8% as the mid-range compared to a 6.8%, which will cause a downside of around €30 in share price.

Internal/ operational risks:

Reputation and Brand: Ferrari's business strategy and model depends on its customers' and potential customers' views on its brand. Specifically, it focuses on exclusivity of its products and if it cannot deliver quality experience and products, then it will lose customers quickly as the premium pricing can no longer be justified. Therefore, from a reputational perspective, the company needs to continue to make its products known and seen all over the world, especially through participations in Formula One (F1) races and championships, as well as through its entertainment facilities and non-car products and experiences. One key risk that Ferrari faces is that it has not won a F1 championship since 2007-2008²⁴. This can be seen as a weakness with its competitors such as Mercedes Benz or McLaren strengthening their reputation and brands through their more recent victories while Ferrari continues to struggle. While F1 helps with the company's R&D department for creating more innovative designs, the company needs to win F1 championships to continue to establish that it is a leader in the field, instead of being pressured by its competitors, as its customers may think that Ferrari no longer makes the fastest cars or have not been able to demonstrate its superior racing capabilities like it did before. To maintain its brand, Ferrari needs to find ways to retain successful drivers and team managers for its F1 races, as this will help them win championships once again, and will therefore solidify their status and their reputation that will help with maintaining enthusiasm for its customers.

Processes and facilities: COVID-19 has had a significant negative impact in that many facilities were shutdown and production is halted for significant periods of time. In addition, fixed expenses must still be incurred even though sales had declined through the pandemic due to lack of visitors or customers going to show-rooms, dealerships and placing orders. In addition, entertainment sources such as the Ferrari Museum and Ferrari theme park were negatively impacted to the spreading of the virus. This not only reduces Ferrari's cash flow as it cannot sell tickets to cover its expenses for those areas, but also diminishes the company's brand as interested visitors and car enthusiasts will not be able to enjoy the

²² The complete toolbox for investors. (n.d.). <https://finbox.com/NYSE:RACE/models/wacc>.

²³ World bank global economic prospects. World Bank. (n.d.). <https://www.worldbank.org/en/news/press-release/2021/06/08/world-bank-global-economic-prospects-2021>.

²⁴ Ferrari. (2021). 2020 20-F form. https://corporate.ferrari.com/sites/ferrari15ipo/files/ferrari_nv_20-f_2020.pdf

brand that Ferrari has created. In addition, Ferrari depends on its significant suppliers to provide it with parts that are more technologically advanced, as well as with raw materials. Therefore, if there are disruptions such as via COVID-19 to Ferrari's suppliers, it will naturally also affect Ferrari's supply chains. These risks include increased costs of raw materials, as well as potential need to find new suppliers and therefore having delays in production during this transition period, as well as other factors. Therefore, in the short term, it is possible that Ferrari can suffer from reduced production, increased supply costs, as well as reduced revenues from certain channels, which can negatively affect its business. As there are no long-term solutions to COVID-19, the company should monitor its supply chain closely to ensure that it is paying reasonable prices for its materials and is producing enough vehicles and other products to meet consumer demand.

Market growth and penetration: Currently, Ferrari has unveiled up to 15 models²⁵ of new cars to be offered in the next few years. However, with the slowing consumer demand in regions such as China, along with geopolitical risks and other risk factors such as the uncertainty of the market size in Asia-Pacific, it is possible that this market can start to see declines or limitations. As a result, there may potentially be limitations in the market growth and can negatively impact Ferrari's sales in the region and therefore its profitability, as it may be possible that the company may have over-estimated the demand levels in the future.

Data security: Europe has recently introduced the General Data Protection Regulation (GDPR), which increases the protection of consumer data and privacy. This will impact Ferrari's business for a "connected car"²⁶, where the car systems are digitized, and software is integrated with traditional car services. As this allows Ferrari to store personal information related to its clients, it is increasingly important for the company to protect the data by its customers through spending on cybersecurity measures and other data protection measures such as secured databases. Any malicious or unauthorized attempt to compromise client's information can result in not only reputational risk to Ferrari but also litigation risk as well. Therefore, the company should examine the options it has to most effectively comply with the regulation but also ensure that its clients are still comfortable with the performance of Ferrari's products.

External risks:

Technological/ Environmental: The new Tesla Roadster is one of the most notable electric vehicle (EV) competitors from a technological perspective, as it is not only similar in terms of speed and horsepower performance compared to Ferrari models and other luxury sports cars, but also much cheaper in terms of cost – roughly \$200K compared to \$500K to \$1 million or more for Ferrari²⁷. With competitors offering cars that are equally or more technologically advanced at a cheaper cost to consumers, this is a significant risk that older, established brands such as Ferrari and others in the industry have not faced before. The rise of electric vehicles that are performance-driven and environmentally friendly will offer significant competition to Ferrari, and the company will need to ensure that it produces EVs that can match up to its competition's cars or give consumers a reason why they should pay the premium for a Ferrari compared to a Tesla. In addition, most other large automakers have already offered EV models, and it is up to Ferrari to stay innovative and continue to invest in R&D to help engineer vehicles that will cater to changing consumer tastes, where the latest generation of drivers not only want performance but are also more environmentally conscious.

Regulatory: Some of the biggest changes in regulations will tie to environmental concerns. Specifically, there will be an increased level of fuel economy requirements, reduced greenhouse gas (GHG) emissions, or other regulations. These environmental regulations (for the most part) will drive up the costs of production for Ferrari, as there will be more stringent manufacturing standards as well as other

²⁵ Ibid.

²⁶ Ibid.

²⁷ Evannex. (2019, June 26). EV supercar COMPARO: Tesla Roadster Vs ferrari sf90 Stradale PHEV. InsideEVs. <https://insideevs.com/news/356734/tesla-roadster-compared-ferrari-sf90-stradale-phev/>.

requirements on each individual car produced. The combined costs of upgrading facilities, vehicles to vehicle emission tests and other compliance costs will further erode Ferrari's margins. Therefore, the company will need to consider litigation risks from mal compliance, as well as methods to innovate and mitigate risks from these regulatory changes.

Economic: COVID-19 has had a significant disruption to businesses over the past 1-2 years. However, it is uncertain when this pandemic will be over and when businesses can be back to pre-pandemic levels of operations. Specifically, with the outbreaks of new variants and other uncertain factors, it is possible that the negative effects of COVID-19 will continue to persist. If so, the global economy will be in an uncertain state as governments around the world will have different approaches to re-opening, and it may also be possible that regional lockdowns will continue to persist once again. This will impact the business's operations through adverse impacts on supply chains, dealerships, manufacturing facilities and entertainment segments. Therefore, the company should be aware of government assistance, new regulations and develop an agile strategy to quickly adapt to changing environments.

Considerations of sustainability and climate change risk:

Every year since 2017, Ferrari has created a separate sustainability report that specifically discusses what it is doing from a sustainability perspective. Research by CSRHUB shows that the company ranks in the 61% range compared with more than 20,000 companies²⁸, which is considered to be the second-best tier out of six total tiers. In another article, the company is said to be ranking "significantly above both the European regional average and the sector's average"²⁹. Specifically, the company has done well in "Governance, Risk Management & Business Strategy" as well as accurately reporting its emissions for "Scope 1 and Scope 2", which are greenhouse gas emissions that is related to the company's core activities. Some activities that the company is doing includes emission reduction from production plants and vehicles, as well as aiming to be "carbon neutral" in the next years. In terms of its competitors, most companies have also started to publish their own sustainability reports, especially for companies in Europe. However, there are competitors who have not been meeting their standards even though the advocate for more sustainability related initiatives. Specifically, Volkswagen has had a damaging scandal where it tried to cheat emission tests with its new vehicles in 2015³⁰. In addition, Honda has not committed to large scale production of EVs yet even though it has sold hybrid vehicles. In addition, many other company's reports are not as comprehensive as Ferrari's, as they not included environmental measures but also measures related to its employees, governance, and its strategy to build relationships with its community³¹. Therefore, Ferrari is performing above average from a sustainability perspective, which translates into a stronger business model overall and supports the value of the company. As a result, it would be good to hold or even buy the stock based on these factors.

Overall conclusion:

Ferrari has demonstrated that it has a strong business model and a sustainable competitive advantage. While valuation models have shown mixed results for its financial performance, I believe that the business has significant financial strengths, as well as sustainability, governance, and risk management strengths on top of that. Therefore, I would recommend a **hold** option to be prudent due to the amount of uncertainty during these times, as it is unclear how much more upside the company can have until more information is provided, such as following the release of the Q2 2021 report.

²⁸ CSR information for Ferrari SpA. CSRHub. (n.d.).

https://www.csrhub.com/CSR_and_sustainability_information/Ferrari-SpA.

²⁹ Automotive World. (2020, December 23). Ferrari ranks among Sustainability leaders according to CDP report. Automotive World. <https://www.automotiveworld.com/news-releases/ferrari-ranks-among-sustainability-leaders-according-to-cdp-report/>.

³⁰ Northrup, S. (2019, January 17). Reviewing the automakers' sustainability and ev commitments. TriplePundit. <https://www.triplepundit.com/story/2019/reviewing-automakers-sustainability-and-ev-commitments/81991>.

³¹ Ferrari. (2021). 2020 20-F form. https://corporate.ferrari.com/sites/ferrari15ipo/files/ferrari_nv_20-f_2020.pdf

Appendix

Appendix 1: Key Ratios & KPIs

Key Ratios	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Net profit %	15.6	22.9	18.4	17.5	18.2	21.6	24.7	28.5	31.5
Asset turnover ratio	0.86	0.76	0.73	0.59	0.64	0.73	0.75	0.80	0.85
Leverage ratio	7.21	4.23	3.64	3.58	3.55	3.02	3.62	3.44	3.45
Return on equity (ROE) %	96.26	73.59	48.98	37.15	41.28	47.29	67.25	78.56	92.87
Return on assets (ROA) %	13.35	17.41	13.46	10.36	11.62	15.68	18.57	22.82	26.91
Times interest earned (TIE)	26	35	28	15	23	26	30	39	44
Days A/R	26	24	21	22	24	23	23	23	23
Days Inventory	79	88	82	96	83	84	83	84	84
Days A/P	130	142	136	151	136	138	137	137	137
CCC	-24	-30	-32	-33	-29	-30	-31	-30	-30
Current ratio	1.72	1.93	1.88	1.65	1.88	1.93	1.91	1.89	1.88
D:E ratio %	232	143	137	149	139	128	131	131	131
Debt%	70	59	58	60	58	56	57	57	57
Equity%	30	41	42	40	42	44	43	43	43

Appendix 2: Standardized Income Statement

Income Statement Forecast	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Revenue	3674	3902	4144	4401	4674
COGS	-1765	-1772	-1776	-1771	-1773
SG&A	-348	-347	-350	-348	-348
Other operating expense	-717	-725	-738	-727	-730
Net interest expense	-36	-40	-43	-40	-41
Other income	3	3	4	4	4
Other expense	-3	-4	-2	-3	-3
Income tax expense	-135	-170	-207	-254	-298
Net income/ loss	668	842	1024	1254	1474

Appendix 3: Standardized Balanced Sheet

Balance Sheet Forecast	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Assets:					
Cash and cash equivalents	875	942	925	897	877
Accounts receivable	285	300	306	329	345
Inventory	402	410	405	406	407
Other current assets	908	954	964	947	961
Total current assets	2470	2607	2600	2578	2589
Net PPE	800	855	851	835	847
Goodwill	785	785	785	785	785
Intangible assets	820	878	892	864	878

Deferred tax asset	79	77	84	90	94
Other long-term assets	285	297	318	301	305
Total assets	5240	5500	5530	5455	5499
Liabilities:					
Accounts payable	657	670	664	664	666
Current portion of LT debt	355	369	375	366	370
Other current liabilities	303	315	324	333	345
Total current liabilities	1315	1354	1364	1364	1381
LT debt	1664	1694	1716	1691	1700
Deferred tax liability	63	79	79	74	77
Other non-current liabilities	738	750	773	748	753
Total liabilities	3780	3876	3933	3876	3911
Shareholder's equity:					
Common stock	3	3	3	3	3
Paid in capital	5769	5769	5769	5769	5769
Retained earnings	-4798	-4735	-4768	-4747	-4762
Other equity	481	581	588	550	573
Total shareholder's equity	1454	1618	1592	1574	1582
Minority Interest	5	6	6	6	6
Total liabilities & shareholders equity	5240	5500	5530	5455	5499

Appendix 4: Standardized Cash Flows Statement

Cash Flow Forecast	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Net income	671	845	1028	1258	1479
Depreciation and amortization	349	378	385	392	404
Non-operating gains	-4	-4	-4	-4	-4
Other operating activities	72	92	64	73	75
Net investments in working capital	-54	-3	-12	-23	-14
Net investments in other operating assets	-512	-152	-407	-618	-820
Cash from operating activities	523	1156	1055	1078	1120
Capital expenditure	-349	-379	-408	-426	-456
Sale (purchase) of assets	-345	-348	-348	-347	-348
Other investing activities	0	0	0	0	0
Cash from investing activities	-694	-728	-756	-774	-804
Interest received (paid)	0	0	0	0	0
Dividends received (paid)	-178	-193	-193	-188	-191
Net debt issuance (repayment)	66	77	74	72	74
Net share issuance (repurchase)	-206	-241	-192	-213	-215
Other financing activities	-2	-2	-3	-2	-2
Cash from financing activities	-319	-360	-313	-331	-334
Other Adjustments					
Foreign Exchange Rate Adj.	-1	-2	-3	-2	-2
Net change in cash	-492	67	-17	-28	-20

Appendix 5: List of Comparable Companies

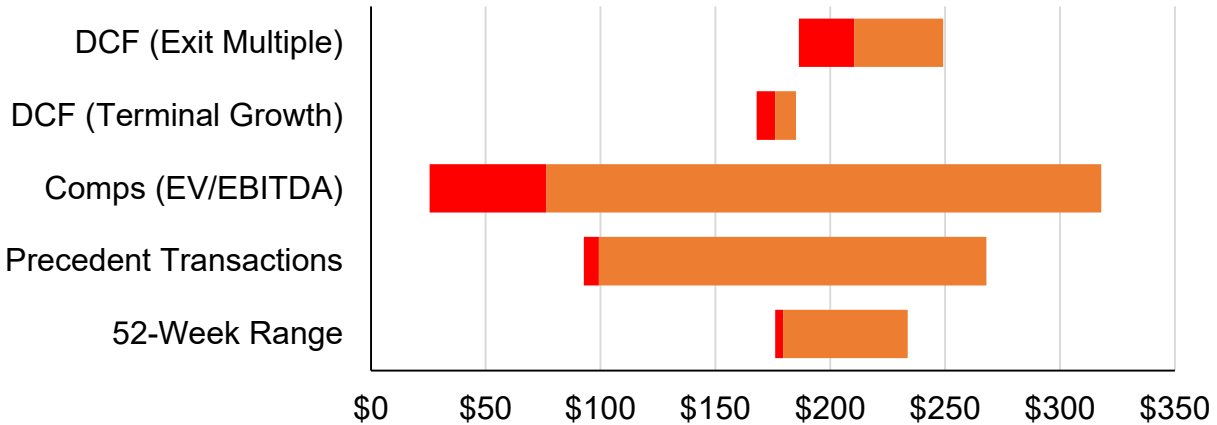
Chief Executive Officer Peer Group	
Aston Martin Lagoonda	Brembo
Bayerische Motoren Werke	Burberry
Compagnie Financiere Richemont	Daimler
Harley-Davidson	Hermes International
Kering	LVMH
Moncler	Pirelli
Renault	The Estée Lauder Companies
Volkswagen	

Appendix 6: Precedent Transactions

Close Date	Target Company	Buyer	EV/Rev	Implied EV (in MMs)	EV/EBITDA	Note
2019-10-28	Tiffany & Co.	LVMH Moët Hennessy - Louis Vuitton, Société Européenne (ENXTPA:MC)	4.86	17876.06	16.75x	
2018-10-01	Luxottica Group S.p.A.	EssilorLuxottica Société anonyme (ENXTPA:EL)	2.84	28596.09	13.59x	
2019-12-18	Fiat Chrysler Automobiles N.V.	NewAge Inc	0.224	26885.56	2.27x	<i>Inappropriate EV/ EBITDA Size</i>
2018-12-14	Belmond Ltd.	LVMH Moët Hennessy - Louis Vuitton, Société Européenne (ENXTPA:MC)	5.59	3193.9	43.39x	
2019-10-30	SHOWA Corporation	Honda Motor Co., Ltd. (TSE:7267)	0.702	1463.16	7.16x	<i>Inappropriate Transaction Size</i>

Appendix 7: Football Field for Valuations

Weighting	Variable			Price		
	Low	Median	High	Low	Median	High
0.0% 52-Week Range	N/A	N/A	N/A	\$176.03	\$179.50	\$233.66
20.0% Precedent Transactions				\$92.69	\$99.32	\$267.91
20.0% Comps (EV/EBITDA)				\$25.59	\$76.22	\$317.97
30.0% DCF (Terminal Growth)	1.75%	2.00%	2.25%	\$167.92	\$176.06	\$185.10
30.0% DCF (Exit Multiple)	16.0x	18.3x	22.0x	\$186.35	\$210.42	\$249.12
Total					\$ 151.05	
Implied Upside					-15.8%	



Appendix 8: Gordon Growth Method

Gordon Growth Method	
Terminal Growth	2.0%
Terminal Value	\$39,724.25
PV(Terminal Value)	\$29,063.12
Sum PV(FCF)	\$4,745.33
Enterprise Value	\$33,808.46
Less: Net Debt	\$1,237.11
Implied Equity Value	\$32,571.34
#of Shares (millions)	185
Implied Share Price	\$176.06
Current Price	\$179.50
Implied Upside	-1.9%

Q1 2021

July 26th, 2021

Appendix 9: Exit Multiple Method

Exit Multiple Method	
EV/LTM EBITDA	18.7x
Terminal Value	\$49,489.75
PV(Terminal Value)	\$36,207.77
Sum PV(FCF)	\$4,745.33
Enterprise Value	\$40,953.11
Less: Net Debt	\$1,237.11
Implied Equity Value	\$39,715.99
#of Shares	185
Implied Share Price	\$214.68
Current Price	\$179.50
Implied Upside	19.6%

Appendix 10: Sensitivity Analysis

CAPM WACC Model					
RACE: Ferrari N.V.			211.39 USD		
			Stock Price		
Metrics	Range	Conclusion			
Selected Beta	0.73 - 0.87	0.80			
Cost Equity	7.5% - 8.8%	8.1%			
Tax Rate	18.0% - 18.0%	18.0%			
Cost Debt Aftax	3.3% - 3.7%	3.5%			
			7.2%	7.8%	8.3%
			WACC Low	WACC Mid	WACC High
Gordon Growth Share Price					
List of WACC ranges	1.50%	1.75%	2%	2.25%	2.50%
6.40%	175.16	183.94	193.73	204.69	217.06
6.80%	160.54	167.92	176.06	185.10	195.19
7.20%	147.99	154.26	161.13	168.69	177.06
7.60%	137.10	142.48	148.34	154.75	161.78
8.00%	127.56	132.22	137.27	142.76	148.74
Exit Multiple Share Price					
List of WACC ranges	14.0x	16.0x	18.7x	20.0x	22.0x
6.40%	168.37	189.67	218.42	232.27	253.57
6.80%	165.43	186.35	214.60	228.20	249.12
7.20%	162.55	183.11	210.86	224.22	244.78
7.60%	159.74	179.93	207.20	220.32	240.52
8.00%	156.98	176.83	203.61	216.51	236.35

*Orange indicates ranges that is above the current price of 179.50

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