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Global Fashion Group (Germany: GFG) is a Luxembourg company that owns several fashion e-commerce operations across emerging markets as well as Australia and New Zealand.

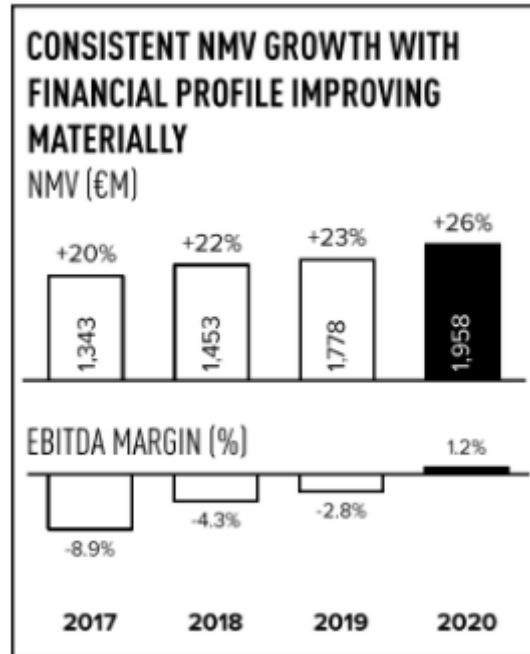
GFG owns Dafiti in Latin America (Brazil, Chile, Argentina, Colombia), LaModa (Russia/CIS), Zalora (Southeast Asia), and The Iconic (Australia, New Zealand). It operates in seventeen countries across those four regions, and its marketplace penetration is ~40% (up from 10% in 2017).

In 2021, the company had net merchandise value (NMV) of €2.3 billion, revenue of €1.5 billion, gross margin of ~45%, and gross profit of ~€675 million. The business is ~40% marketplace, with the remainder from first-party sales (marketplace was 10% in 2017 and 31% in 2020). EBITDA is positive and growing.

The business recently traded at an enterprise value of €500 million (equity market cap of €800 million, less net cash of €300 million), implying an enterprise valuation of 0.75x gross profit, 0.33x revenue, and 0.22x NMV, based on LTM figures.

Forward multiples are even more attractive, as the company has been growing NMV at a CAGR of ~25% since 2017, and there appears to be no reason for the long-term growth trajectory to stop. Fashion and lifestyle online penetration is 13% in the countries in which GFG operates, as compared to 31% in the US, 22% in the EU, and 30% in China.

The two co-CEOs, the CFO, and a member of the board of directors recently purchased shares in the open market (around the end of December 2021) at prices above the recent market quotation.



Source: Company's presentation.

In addition, tax loss carryforwards amount to €2.8 billion, of which €2.7 billion are indefinite in duration. At a weighted-average tax rate of 22%, that amounts to roughly €600 million. Assuming a present value of €200 million appears conservative, making the valuation of the shares even more attractive (adjusted EV of ~€300 million).

In €m	2020	2019
Tax loss carry forward expiring by the end of:		
Within one year	8.5	10.4
After one year but not more than five years	58.1	52.0
More than five years	53.8	86.2
Indefinite	2,714.4	2,885.2
<b>Total tax loss carry forwards</b>	<b>2,834.8</b>	<b>3,033.8</b>

Source: Company's presentation.

Let's dig deeper into GFG.

The company was established in 2014 through the consolidation of the above-mentioned companies. The four companies were incubated by Rocket Internet starting in 2011 and had several investors in common (mainly Rocket Internet and Swedish investment firm Kinnevik, which still own 14% and 36% of GFG, respectively).

Rocket is a German incubator that had adapted successful American business models across Europe and other non-US markets. The most successful companies coming out of Rocket were Zalando, a European fashion e-commerce leader with GMV of ~€14.5 billion (essentially the GFG of Europe); HelloFresh, a European meal-kit company recently trading at a market cap of €10 billion; Delivery Hero, an online food delivery player; Jumia, an African e-commerce leader; Westwing, a home and living design marketplace; and numerous other companies. Rocket's involvement in most of these companies has decreased substantially as Rocket has changed its business model to focus less on incubation and more on investing. Rocket has also divested its stake in numerous companies.

Similar to Zalando, GFG has a huge brand portfolio, carrying 41 of the top 50 global fashion brands in addition to many other brands. The company has recently been executing on a marketplace model, with marketplace now accounting for around 40% of NMV (up from 10% in 2017). With the growth of marketplace, gross margin has increased from 39.4% in 2017 to 43.1% in 2020 and 45.8% in Q3 2021.

Marketplace services range from "fulfilled by GFG" to cross-docking and drop shipment. Slightly more than 70% of marketplace shipments are fulfilled by GFG, i.e., the service with the highest take-rate.

GFG also offers platform services, which include: marketing by GFG (more than 1,200 marketing campaigns in 2020), data by GFG (an intelligence subscription service for brands), operations by GFG (end-to-end operations, with the potential of enabling a brand's brand.com channels). Platform services only make up 1.5% of revenue, with an ambition to grow this proportion to 5-10% of revenue.

Of the top 20 brands by NMV — including Nike, Levi's, Emporio Armani, Ralph Lauren — 90% are both on marketplace and retail (first-party), and 90% use GFG's platform services.

The marketplace strategy is different from that of Asos, another large European player, which has focused more on selling its own brands, including the recently acquired Topshop, and targeting a younger crowd.

Marketplace likely represents a superior model and creates the widest moat over time. The marketplace model represents even more of a competitive advantage in emerging markets as compared to developed countries, because fashion brands need more support to launch and operate in a specific market, deal with fulfillment and logistics, and test the tastes of different customer segments.

GFG markets are significantly more complex than developed markets and are often non-core

for many of the international brands they serve which means that brands are even more willing to partner up with a local player.

In their recent capital market presentation, GFG outlined its goal of reaching €10bn NMV within the next 7-9 years with Marketplace representing at least 50% of NMV. This does not seem far-fetched given the current pace of growth and considering where Zalando currently stands (€14Bn GMV in 2021) and the relative maturity of the markets where GFG operates (as a note, active customers as a % of addressable population are 1.6% for GFG vs 8.4% for Zalando).

The company sees a path towards 10%+ EBITDA margin (6% in 3-4 years) through an increase in Gross Margins (about 30 bps per 1% of Marketplace NMV share increase), higher share of platform services (5-10% from 1.5%), lower marketing costs as % of NMV and lower fulfillment costs and overhead as % of NMV.

When looking at some of the business' KPIs, one of the most impressive things to note is the dollar retention across cohorts sitting at around 80%. So for example, of 2020's €2bn NMV, 69% (or €1.38bn) came from customers from previous cohorts (2019 and behind). €1.38bn of €1.8bn NMV of 2019 is 77%.

Another very interesting data point is that marketing payback time is around 12 months (with CLV / CLC ratio at 1x, 1x and 1.1x in 2017, 2018 and 2019 respectively (2020 data is not available yet)).



Source: Company presentation.

The competitive position of the company is that of leadership in the markets where it operates. Companies like Shein are more significant competitors to businesses operating with the Asos model, whereas GFG's customers are more brand-driven and the marketplace model creates a much wider moat, as mentioned.

GFG works with 41 of the top 50 fashion brands, spanning from fast fashion to lifestyle,

premium and luxury. NVM from premium brands grew 46% from 2019 to 2020.

When looking at valuation on a comparative basis, the discount appears pretty obvious.

Here are some similar companies using the marketplace model:

- Zalando trades at 2x EV / LTM revenue, 4x EV / LTM gross profit
- Mercado Libre trades at 9x EV / LTM revenue, 19x EV / LTM gross profit
- Sea Limited trades at 12x EV / LTM revenue, 31x EV / LTM gross profit
- Jumia trades at 5x EV / LTM revenue, 7x EV / LTM gross profit

Although some of these companies are not pure marketplace plays, as a reminder, GFG trades at 0.33x EV / LTM revenues and 0.75x EV / LTM gross profit.

All but Zalando and GFG trade on the NYSE.

One might wonder if there are advantages in being traded on the New York Stock Exchange vs. Europe. But I don't think so... markets are efficient so it really can't be!

Jokes aside, I do believe trading on the German stock exchange, with very few analysts covering the stock and a really tight float, is giving a real disadvantage in terms of discoverability (but a huge advantage for whoever is willing to look deeper).

After a successful run to €14.96 in the first half of 2021, the stock has been selling off to the recent price of €3.70, below the IPO price of €4.50, despite being a significantly larger and more profitable business than when it was listed and with a much more sustainable focus on marketplace.

The stock is quite thinly traded (average volume of 500,000 with 220 million shares outstanding!) and there have been days (e.g. November 11th 2021) where the stock price went down 20% on a little more than 2M shares traded (or around 1% of the shares outstanding).

Just a few months ago, it was speculated that Renner could be interested in buying Dafiti for \$R6-7bn (€1-1.15bn or 1.7x Dafiti's GMV).

Selling one of the businesses could indeed help unlock some value.

Side Note: Kinnevik invested around €630M for its 37% stake in GFG (which is currently selling in the market for significantly less). On the other hand, Kinnevik's €790M investment in Zalando had become €5.5bn when they distributed Zalando's shares (representing around 20% ownership) to their shareholders in mid-2021.

Making continuous parallels with Zalando is not random! Let's not forget that GFG and Zalando were initially started by the same investors, the founders of the original venture (Dafiti in Brazil) and Zalando are all Germans who know each other well and Kinnevik was Zalando's largest shareholder as well before the distribution.

I believe Zalando provides a clear snapshot into the future of what GFG can look like in a few years.

To conclude, you have the chance to invest in a very undervalued and underfollowed growing company with a clear moat and concrete prospects.

Assuming €3bn revenues in 2024 and 6% ebitda margins by then (10%+ later on) puts ebitda at €180M or more than half current NOL-adjusted enterprise value.

#### Risks

Competition is certainly a risk but all the four companies are quite dominant in their region and compete less directly with price-driven no-brand competitors. The marketplace model is giving them a very strong relationship with brands and creating a sustainable long term competitive advantage.

In terms of liquidity, the company has plenty of cash to sustain future plans (€689M of cash in the balance sheet). Their debt is particularly favorable as they have issued around €370M of convertible bonds maturing in 2028 with conversion price of €17.95 (current stock price is €4.10) and a 1.25% interest rate.

Capex requirements are limited (around €60M a year needed) and mostly related to opening of new warehouses / distribution centers (they have 9 fashion-centric fulfillment centers with current capacity of about €4bn NMV). With the growth of the marketplace, inventory risk is also lower and working capital even more favorable than it already is.

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