

## Case Study

# A Leading Online Poker Company in India

Service(s) Offered: **Buy-side Valuation for a Transaction**

Sector/Industry: **Consumer Services/Software and Services**



## Buy-side Valuation of an Online Poker Company for an International Investment Group

Our client (Client), an international investment group was planning to invest in the Indian online gaming market. The target company provided an online platform for poker gaming using real and virtual money.

The Client engaged Nexdigim to determine the **broad level valuation of the online poker gaming company** (Target Company).

### Approach

Our approach was divided into the following phases:

#### Phase I – Research

Gaining insight into India's Online Gaming Industry with respect to the country's prevailing industry dynamics along with the socio-economic and legal ambiguities with respect to poker in India.

#### Phase II - Understanding the Target Company

Understanding the Target Company's business model and identifying the key factors influencing its valuation.

#### Phase III – Evaluation of Valuation Methods

Evaluating valuation methods and applying suitable methods to arrive at a valuation range.

#### Phase I - Research

We started by conducting a preliminary research of the Indian Online Gaming industry to gain insights into the sector. This was completed by referring to

**proprietary databases, prominent research reports, and discussions with subject matter experts.** In order to understand the industry-specific trends, we conducted an exercise to identify the **Target Company's key peers in India** as well as **overseas.** We also referred to demographic studies to gauge the future potential of poker in India.

Considering the **legal ambiguity surrounding poker in India,** our next step was to study and understand its legal status.

We studied verdicts already passed in courts and current legal opinions to understand the applicable legal framework by primarily referring to:

- Distinguished judgements by various High Courts across India
- Legal opinion obtained by the Target Company from a retired High Court Chief Justice
- Applicable laws governing gaming in India

We were able to infer that online poker was legal in India, with the exception of two states - Orissa and Assam. We also studied the FDI norms applicable to online poker.

On this basis, we concluded that the industry is at a **nascent stage** in India, and the present socio-economic and legal forces, though evolutionary by nature, **favor the future prospects of the industry**

## Phase II – Understanding the Target Company

In order to gain insights into the **business model** and to evaluate the **future outlook** of the Company, we held extensive discussions with the Target Company and the Client. We used inferences from our analysis of **key operating performance parameters** of the Target Company vis-à-vis its peers in India and overseas.

We identified the following Revenue and Cost Drivers pertaining to the Target Company:

### Revenue Drivers

**Rake:** This was the **single largest revenue driver** for the Target Company. Rake was charged to the player based on a percentage of the pot value. In order to comprehend the revenue model of the Target Company, we **scrutinized the rake calculation process**.

### Cost Drivers

**Business Promotion:** In order to attract **more users**, they incurred expenses towards multiple **promotional activities** and other events such as promotional money, online advertisements, image branding, poker tournaments, etc.

**Employee Costs:** In the initial years of operations, the directors of the Target Company were the only employees. However, the costs scaled up as the Target Company started their hiring process from FY 16.

**Payment Gateway Charges:** They incurred regular payment gateway charges from multiple service providers for **processing all online payments**.

By the end of this phase, we were able to collate and analyze key value drivers of the Target Company.

## Phase III – Evaluation of Valuation Methods

Considering the early emergence of the market in India, the nascent nature of the industry, availability of the data, etc. we identified two methods to value the Target Company:

- Comparable Company Method (CCM)
- Comparable Transaction Method (CTM)

For these two methods, we applied the following valuation multiples subject to certain adjustments:

## EV/EBITDA

Though the Target Company spent a considerable amount on business promotion, the EBITDA of the entity served as a **barometer to measure**

**operating performance**. The current EBITDA based valuation served as the baseline.

## EV/Steady-state EBITDA

The Target Company was a start-up in a budding industry, which aimed at rapidly growing its user base and nurturing the nascent Indian online poker market. In its pursuit for rapid growth, the Target Company **invested significant portions of its earnings towards marketing and sales**. Thus, current margins of the Target Company were not a true representation of its earning potential, which advocated the use of Steady-state EBITDA.

The Steady-state EBITDA is a product of the sales and the estimated stabilized EBITDA margins of the industry after analyzing domestic peers, in essence **reflecting the actual earning potential of the Target Company** once it matures.

## EV/Sales

Sales, being a function of Rake, was a relevant barometer to evaluate the value of the Target Company.

The revenue recognition policy followed in this industry **differs from conventional norms**, owing to the **multifaceted nature of transactions**. For instance, the promotional expenditure incurred and the commission (Rake) earned on promotional expenditure may not be netted off against the recorded revenue by some of the comparable peers and would be classified as expenditure.

## Comparable Company Method (CCM)

In order to find a suitable peer, we conducted a comprehensive search for **listed peers within India and overseas**. Considering the emerging nature of the Indian Online Gaming Industry and the lack of suitable listed peers, we selected a **global comparable peer**, situated in a well-established market. The selected peer, being a global leader in the Online Poker Industry, served as an appropriate benchmark.

We arrived at the valuation multiples by using financial data provided by the Client. In order to eliminate abnormalities, the multiples were taken as an average of last two year's data.

The following adjustments were made to rationalize the multiples:

**Country Adjustment:** In order to account for the **macro economic differences** between India and the country where the peer is based (Peer's country), this adjustment was undertaken. These differences arise due to factors such as the growth potential, future economic prospects, disparities in inflationary rates, etc.

**Fundamental Discount:** In order to adjust for the fundamental differences between the Comparable Peer and the Target Company, a fundamental discount was applied to adjust for the difference in size, maturity of operations and quality of earnings.

#### **Comparable Transaction Method (CTM)**

We analyzed recent transactions in the Indian Online Gaming Industry and identified a **recent transaction** where a **listed Indian entity acquired India's largest online poker company**.

Based on this deal size, we estimated the Implied Enterprise Value after adjusting it for cash and non-trade investment.

The Implied Enterprise Value (EV) was used to derive the valuation multiples. These valuation multiples were subjected to a fundamental discount on account of size of operations and quality of earnings.

The adjusted multiples were then applied to the EBITDA, Steady-state EBITDA and the Sales of the Target Company respectively to arrive at the EV. This EV was further adjusted for cash, debt, downstream investments, and adjusted for lack of marketability/control.

**Appropriate weights** were assigned to the values to arrive at the value of equity for a non-controlling, non-marketable stake.

#### **Impact**

Based on the two methods mentioned above, we arrived at a valuation range for the Target Company. We presented an appropriate valuation range to our Client, equipping the Client to effectively negotiate and close the deal.

For more information on this case study, please write to us at:

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You can also visit our website to know how our services resulted in tangible business benefits:

[www.nexdigm.com](http://www.nexdigm.com)