Case Study

A multi-billion dollar Indian e-commerce giant

Service(s) Offered: **Fair Market Valuation for Financial Reporting**

Sector/Industry: **Retailing**

Fair Valuation of an Online Retailer for a leading Hedge Fund

Our client (Client) is a leading India-focused hedge fund making concentrated long-term investments across diverse sectors. As part of their portfolio, they have multiple investments in Indian e-commerce, including India's largest online retail marketplace.

The Client engaged Nexdigm to determine the **fair market value** of their investment in the said e-commerce company for the purpose of **financial reporting.**

Approach

Phase I - Understand the key **business drivers**, relevant **markets** and **micro/macro economic factors** that influence the online/offline retail business (Research)

Phase II - Proceed to identify suitable **valuation methodologies** for the business (Preparing Valuation Models)

Solution

Phase I - Research

We started with a preliminary understanding of the industry by referring to proprietary databases and research reports. An analysis of the historical and projected mix of online and offline business in the Indian retail industry was carried out.

Through our research, we deduced that the Indian E-tail industry was at a very nascent stage and had tremendous growth potential.

We then scrutinized the minutes of the meetings with the management team, ex-employees and experts to gain the following insights on the company:

- Roadmap to achieve the desired goals
- Product mix and revenue distribution
- Supply and distribution chain
- Competitors and market share

The relevant clauses in the share subscription agreement and shareholders' agreement were vetted to be versed with the rights and other conditions that would have had a bearing on the valuation. The monthly MIS of the company was also analyzed to evaluate the company's key performance indicators.

Phase II – Preparing Valuation Models

As is the case with fair market valuation for financial reporting; the possibility of applying Price of Recent Investment (PORI) methodology to value the investments was first evaluated, but found unsuitable due to a change in business dynamics since the last funding round and lower growth (compared to expectations).

We then considered the use of traditional methodologies. We realized a need to modify traditional methods to encompass the present and future potential of the business due to a few factors namely the nascent stage of the Indian e-commerce market and the unconventional nature of operations of e-commerce ventures where there are high burn rates, regular capital raising, dilutions, and dynamic business models.

Nexdigm identified and evaluated the following options for valuing the company:

1. Comparable Companies Method (CCM) using Enterprise Value (EV) to Stabilized Gross Merchandise Value (GMV) multiple
2. Capitalized Earnings using Steady State EBITDA
3. Comparable Transaction Method (CTM)

Comparable Companies Method (CCM) - EV to Stabilized GMV

This method values a company using metrics of other businesses of a similar size in the same industry.

Nexdigm initiated the process by initiating a comprehensive search for comparable public companies across domestic and international databases, identified suitable peers and computed their valuation multiples.

Conventionally, for the e-commerce industry, the current or one year forward EV to GMV multiple is considered a suitable valuation matrix. Due to the factors discussed earlier and considering that the identified global peers were relatively mature, Nexdigm modified the methodology to incorporate a Stabilized GMV. We estimated the GMV of the company when the business was expected to start maturing, taking into account present and potential economic factors, suitable growth rates, etc.

To the Stabilized GMV, we applied the average EV to GMV multiple of peers to arrive at the estimated EV. This EV was then discounted at an appropriate cost of capital to arrive at the present value of EV.

After adjusting for cash in hand, the EV was further adjusted to factor in the discount on account of likely dilution needed to fund the cash burn till the company matures, and also due to lack of marketability.

Capitalized Steady State EBITDA

This method determines business value using a single measure of the expected economic benefits divided by the capitalization (cap) rate which represents the risk associated with receiving this benefit in the future.

Conventionally, the normalized post-tax EBITDA of a business is calculated using historical performance and then divided by an appropriate cap rate.

However, as the company was pursuing rapid growth at the expense of profitability, it was more prudent to evaluate the company at a stage when it started maturing rather than at the current stage. We modified the methodology to incorporate a Steady State EBITDA margin, i.e., expected EBITDA margins when the business starts maturing.

Nexdigm analyzed the margins of mature offline and online retailers to estimate a Steady State EBITDA margin. This margin was applied to the Stabilized GMV to arrive at the future Steady State EBITDA. This EBITDA was then capitalized at the cap rate to find out the estimated EV which was then discounted back at an appropriate cost of capital to arrive at the present value of EV of the company.

After adjusting for cash in hand, the EV was further adjusted to factor in the discount on account of likely dilution needed to fund the cash burn till the company matures and for lack of marketability.

Comparable Transaction Method

The Comparable Transactions Method involves obtaining operating and financial data from similar transactions and applying it to the target company.

Nexdigm analyzed the most recent transaction in the Indian e-commerce industry and computed the relevant valuation multiples. Thereafter, we made fundamental adjustments to these multiples to account for:

- Enhanced competition
- Increased cash burn
- Slower than expected growth

The adjusted multiple was applied to the existing GMV to arrive at the EV. After adjusting for cash in hand, the EV was further adjusted to factor in the discount due to lack of marketability.

Impact

After reconciling the valuations under the various methods, Nexdigm concluded that the CCM method using the EV to Stabilized GMV multiple was most suitable to arrive at the fair market value. We presented our findings along with the valuation conclusion to the Client in a detailed valuation report.

Nexdigm's passion, commitment and innovation, enabled us to develop a strong partnership with the Client based on trust and reliability.

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