nexdigm

Case Study

A Rapidly Growing Enterprise Solution Provider

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

Sector/Industry: **Software and Services**

Fair Valuation of an Enterprise Solution Provider for an Indian Financial Institution

Our Client (Client) is a leading Indian financial institution listed on NSE and BSE. The Client specialized in providing **debt financing** to self-employed entrepreneurs, Micro, Small & Medium Enterprises (MSME) and consumers in India using technology led models.

As part of their **strategic initiatives**, the Client was planning to invest in a Bangalore-based enterprise tech-product company (Target). The Target developed software to **digitize banking operations** and offered value-added services. Our Client was familiar with the software as they were already an active user of the Target's solutions. Though the Target's platform was built for banking & non-banking financial institutions, microfinance institutions, etc., the platform itself was **industry agnostic** and the Target had recently signed up clients within the telecommunication sector.

The Client engaged Nexdigm to assist in arriving at the broad valuation of the Target for the strategic investment.

Approach

Our approach was divided into the following phases:

- Phase I - Understanding the Business and Industry Dynamics (Research)
- Phase II - Evaluation of Valuation Approaches/ Methodologies
- Phase III - Valuation of the Target

Phase I - Research

We started off by conducting discussions with the Management while **analyzing the business model** and operations of the Target. This gave us valuable insights about the **future business plans** of the Target and helped us understand their product offering, target market, growth opportunities, etc. We started our preliminary understanding of the industry by referring to **proprietary databases** and **research reports**. We then adopted a **top-down approach** in order to understand the future outlook of the enterprise technology industry. Knowledge of the Targets' business model helped us narrow down our analysis of the enterprise technology industry and identify peers which operated with a similar business model.

Phase II - Evaluation of Methodologies

We evaluated the various factors that determine the valuation of a software company, including **financial factors** such as revenue, net earnings, cash flow and the balance sheet as well as the size of the **potential market** for products, the Target's market share, **competition, customer base**, technology and distribution channels, the skill of the workforce, and a host of other factors.

Since the Target was a **start-up**, current performance was not an adequate measure of the businesses value. The solutions offered by the Target were dynamic (as they started catering to the financial services sector as well as telecommunication sector). The Management did not have clear visibility on the future of the business beyond the next few years. Thus, using **forecasted performance** for valuing the business was **untenable**.

Considering the challenges involved in applying traditional methodologies, we used a blend of Discounted Cash Flow and Comparable Company Multiple to arrive at the value of the Target.

Phase III - Valuation

Modified Discounted Cash Flow Method

Cash Flows

The Management had an **estimate** of **income** and **expenses** as well as capital expenditure and **net working capital** for the next three years. The estimate gave us a fair representation on the quantum of cash burn expected in the coming years.

Terminal Value

A traditional terminal value was not possible as the Target only expected to **break even** by the end of the third year and continue the fast-paced growth. Accordingly, we used the **Market Approach** to derive the terminal value using an EV to Sales multiple.

The estimated cash burn and terminal value were discounted to arrive at the value of the Target.

We presented our findings to the Client in the form of a valuation note detailing our **valuation approach** and conclusion.

Impact

After factoring in discount for lack of liquidity and control and the dilutive impact of the Employee Stock Ownership Plan (ESOP) pool on the Target's valuation, we **recommended a valuation** which was **20% lower** than the Target's asking rate.

The Client was able to **close the deal** at 1% above our recommended price.

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