Case Study

An Eminent Micro Lending Business

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

Sector/Industry: **Diversified Financials/Software and Services**

Fair Valuation of a FinTech Lending Business for a leading Indian Financial Institution

Our client (Client) is a leading Indian financial institution, specializing in providing **debt financing** to self-employed entrepreneurs, **Micro, Small and Medium Enterprises (MSME)** and consumers in India. The Client had successfully used technology-led models to finance MSMEs and Indian consumers in **unbanked and under-penetrated segments**. They planned to further penetrate the micro and small lending segment by investing in an upcoming technology-driven SME lending business (the Target) that primarily focuses on small and micro enterprises.

The **Target**, a Mumbai based **FinTech start-up**, built a strong technology platform that enables **instant credit decision-making** using **proprietary scorecards** and **predictive algorithms** assisted by machine learning. The Target tied up with lending institutions to provide loans through their balance sheets. Though the loans sit in the books of the partnered lending institutions, the Target conducts the entire process involved in the lifecycle of a loan from origination to collection. The Target also made an **application to the Reserve Bank of India** to register itself as a non-deposit accepting **Non-Banking Financial Company** (NBFC) to transition into an on-books lender.

The Client engaged Nexdigm to assist them in arriving at the **broad valuation** of the Target for their planned investment.

Approach

Our approach was subdivided into three major 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

Discussions with the management team coupled with **analyzing** the **business model** and **operations** of the Target gave us valuable insights about the **future business plans** of the Target. The discussions also aided us in understanding their product offering, ticket size, target market, recourse mechanism, etc. An analysis of the **probable lending** and **borrowing rates** gave us a broad picture of the **revenue model** of the Target.

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 SME industry.** Knowledge of the Targets' business model helped us narrow down our analysis of the SME lending industry and identify peers which operated with a similar business model.

Phase II - Evaluation of Methodologies

We started by evaluating the various factors that determine the valuation of a start-up, such as number of users of the platform or product, forecasted revenue, market size, use of technology, etc. Traditional valuations are usually based on the forecasted revenue and profit that the Target can realize. **Due to the uncertainty** in the way the Target would operate and **generate cash flows**, **traditional methods** of valuation were **ruled out**.

Furthermore, in the current age, valuations in these kinds of acquisitions or investments are usually arrived at based on various **operational factors**, and all these factors cannot be scientifically quantified. **Valuations of start-ups** may also vary based on **qualitative factors** such as perceived strength of the management team, location of the Target, recent successful exits in the sector, and perception of the sector's future.

Phase III - Valuation

Price of Recent Investment (PORI)

Since a sizeable transaction had recently taken place in the Target, **PORI was a suitable measure** of its value. As the recent transaction involved marquee investors in the company, the value arrived at as per PORI was a reasonable measure of the floor price of the Target.

Comparable Transaction Method (CTM)

Selection of the relevant **valuation matrix** or **multiple** depends on the type of industry in which the Target is operating. Generally, **Price to Book ratio** is used to compare banks/NBFCs because most **assets and liabilities** of banks/NBFCs are constantly valued at **market values**. Considering the Target's nature of business and the early stage of operations, Price to Book ratio could **not be effectively used** (as this ratio does not factor in the **high growth potential** and the performance impact of off-book loans that the Target will syndicate through its partnership with other NBFCs). The total loan books (own and off-book) along with potential growth gave us a **fair estimate** of the value of the Target. Accordingly, we identified **Price to Loan Book** as a suitable basis to arrive at the value of the Target.

We then analyzed the most recent transactions that were undertaken among the peers identified. Based on these transactions, we mapped the valuation of these peers over the past few years to their loan book growth to **analyze the impact** that **loan book size** had on the **valuation multiple**.

Basis our analysis, we arrived at the broad Loan Book to Price range for the Target. This multiple was applied to the average loan book of the Target to arrive at its value.

The valuations as per PORI and CTM provided a range bound conclusion.

Impact

With the **post money PORI valuation forming the lower band** and the **post money CTM valuation forming the upper band** of the valuation of the Target, we presented our findings to the Client in the form of a valuation note detailing our **valuation approach**, **peer selection process**, and **valuation conclusion**.

.

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

ThinkNext@nexdigm.com

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

www.nexdigm.com