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 Micro 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 & 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 also planned to further penetrate the micro and small lending segment by investing in an upcoming **technology-driven micro lending business** (the Target) that primarily focuses on micro enterprises.

The Target, a Mumbai based **FinTech start-up**, tied up with **merchant aggregators** to provide loans to its customers, which included local convenience stores, shopkeepers, traders, etc. These aggregators give relevant information to the Target, based on which the eligible merchants are identified using predefined criteria. The Target uses a technology platform for **credit-scoring** and **loan management** that comprises of decision engines, aggregator APIs (partner integrations) and money movement APIs (bank integrations). The Target also **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 acquired a non-deposit accepting **Non-Banking Financial Company (NBFC)** through which it planned to disburse loans.

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

Approach

Our approach was subdivided into three 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 coupled with an **analysis of the business model and operations** of the Target gave us valuable insights about the **future business plans** of the Target and aided us in understanding their product offering, ticket size, target market, recourse mechanism, etc. Understanding these factors along with 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 micro lending industry. Knowledge of the Targets' business model helped us narrow down our analysis of the micro lending industry and identify peers which operated with a similar business model.

Phase II - Evaluation of Methodologies

We started this phase by evaluating the various factors that determine the valuation of a start-up, such as number of users of the platform or product, revenue forecasted, market size, technology, etc. **Traditional valuations** are usually based on **forecasted revenue** and **profit** that the Target can achieve. **Due to the uncertainty** with which the **Target operated** and **generated cash flows**, **traditional methods** of valuation were **ruled out**.

Furthermore, valuations of these kinds of acquisitions or investments are usually arrived 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 the perceived strength of the management team, location of the Target, recent successful exits in the sector and perception of sector's future.

Phase III - Valuation

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 cannot 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 syndicates through its partnership with other NBFCs). The **total loan book** (own and off-book) along with the **potential growth** would give us a **fair estimate** of the value of the Target. Accordingly, we identified the **Price to Loan Book** as a suitable basis to arrive at the value of the Target. **Price to Sales ratio** is a generic valuation metric which is used to value companies and accordingly, we also used Price to Sales as a suitable basis to arrive at the value of the Target.

We then analyzed the **recent transactions** that were undertaken within 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 the loan book size had on the valuation multiples.

A similar approach was also followed to map the valuation of the Target's peers to their revenues.

Basis our analysis of the Loan Book size and sales to the valuation of peers, we arrived at the **broad Price to Loan Book range** as well as the **Price to Sales** for the Target. The average Price to Loan Book and average Price to Sales multiples were applied to the loan book and sales of the Target respectively to arrive at a **broad valuation range**.

Impact

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:

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

www.nexdigm.com