nexdigm

Case Study

A leading Indian classifieds portal

Service(s) offered: **Due Diligence & Valuations**

Sector/Industry: **IT/ITeS**

Fair Valuation of an Online Classifieds Service Provider for a Multi-billion Dollar Hedge Fund

Our Client is a leading India-focused hedge fund making concentrated long-term investments in public and private equity, focusing primarily on technology-oriented businesses. As part of their portfolio, the Client has multiple investments in the Indian e-commerce industry, including investment in a leading classifieds portal (Company).

For financial reporting, the Client engaged Nexdigm to determine the fair market value of their investment in the Company.

Approach

Our approach was bifurcated into the following phases:

1. Understanding the Business & Industry Dynamics
2. Evaluation of Valuation Approaches/ Methodologies
3. Valuation of the Company
4. Allocation of the Equity Value

Phase I - Understanding the Business & Industry Dynamics

Discussions with the Client and an analysis of their business model gave us valuable insights into their operations, performance, and future business plans. The monthly MIS of the Company was also analyzed to evaluate the Company's key performance indicators. This aided us in understanding their service offerings, target market, growth opportunities.

We referred to proprietary databases and research reports to understand the online classifieds sector better. We understood that the online classifieds business generates revenue from three verticals – premium listings, lead generation, and advertising. Online marketplaces charge their seller customers for listing their products. They also charge for premium listings and placing their products/services higher on search results on the app or the web page. They also monetize the traffic to the platform through banner placements/advertisements. The seller customers play an important role in generating this revenue as they expand the listings available on the platform, thereby attracting more users.

We then adopted a top-down approach in order to understand the future outlook of the online classifieds sector. Knowledge of the Company's business plan helped us narrow down our analysis of the online classifieds sector and identify peers that operated with a similar business model.

Phase II - Evaluation of Valuation Approaches/ Methodologies

As is the case with the fair market valuation for financial reporting; the possibility of applying the Price of Recent Transaction (PORT) methodology to value the investment was first evaluated but found unsuitable due to a few factors, namely:

- Changed business dynamics since the last transaction
- Lower than expected performance

After analyzing the Company's performance, we concluded that the Company had not been performing well over the last couple of years, and the Company's transaction multiple wasn't reflective of its current performance. Thus, it was necessary to peg the Company's value to the market multiples. We considered other traditional methodologies used for fair valuation of a business and identified the following options:

- Comparable Companies Multiple (CCM) method
- Comparable Transaction Multiple (CTM) method

Comparable Companies Method (CCM)

We conducted a comprehensive search to identify publicly traded companies within India and overseas based on industry focus, company size, growth characteristics, etc. In the given case, we first identified listed companies that provide online classified services in cars, real estate, jobs, consumer goods, etc. Then, we verified if their stocks were freely and frequently traded on the recognized stock exchanges. Thereafter, we analyzed the selected peers' financials to understand the business's fundamental changes before arriving at the base valuation multiples for these peers.

Furthermore, the following adjustments were made to rationalize the multiples:

- **Segment Specific Adjustment:** The peers selected operated in different segments compared to the Company. For instance, some peers only catered to cars/jobs. To consider the impact of segment specific multiples, weights were attached to each multiple. These weights were dependent upon the business segments the peer companies operated in, vis-à-vis the revenue contribution of these business segments to the Company's overall revenue.
- **Country Adjustment:** This adjustment was undertaken to account for the macroeconomic differences between India and the country where the peer was based (Peer's country). These differences arise due to growth potential, future economic prospects, disparities in inflationary rates, addressable market size, etc.

Furthermore, we applied a discount for lack of marketability to the peer multiples, considering the Company is privately-owned, closely-held, and has no access to an active market. This adjusted multiple was then applied to the Company's Trailing Twelve Months (TTM) revenue to arrive at the Company's Enterprise Value (EV).

Comparable Transaction Method

We analyzed the most recent transaction in the online classifieds market globally and computed the relevant valuation multiples. We identified transactions from New Zealand, South East Asia, and China.

Thereafter, the following adjustments were made to rationalize the multiples:

- Calibration: We calibrated these multiples to consider the changes in the market perception about the industry between the transaction date and the current valuation date.
- Country Adjustment: This adjustment was undertaken to account for the macro economic differences between India and the country where the peer was based (Peer's country). These differences arise due to growth potential, future economic prospects, disparities in inflationary rates, addressable market size, etc.

These adjusted multiples were then applied to the TTM revenue of the Company to arrive at the EV of the Company.

Phase III - Valuation of the Company

After broadly understanding the reasoning for the differences between the valuations under the above methods, we concluded that both methods were suitable for arriving at the Company's fair market value.

Appropriate weights were assigned to the values to arrive at the EV on a non-controlling and non-marketable basis. The weighted average EV was adjusted for cash, debt, investments, and minority interest.

In the absence of complete information about the subsidiary in which the minority interest existed, we first valued that subsidiary by allocating the overall EV of the Company proportionately by considering the revenue it contributed to the Company's overall revenue. The minority stake percentage was then applied to this value to arrive at the value of the minority stake.

Based on the above method, we arrived at the Company's fair market value of equity.

Phase IV - Allocation of the Equity Value

As the Company had several classes of shares, we had to allocate the Company's overall value to the various share classes. We selected the Black-Scholes-Merton Option Pricing Model (OPM) to allocate the equity value.

To use the OPM, we had to consider the various terms in the shareholders' agreement that would affect the distributions to each share class, such as the seniority level, dividend policy, conversion ratios, etc. The relevant clauses in the share subscription agreement and shareholders' agreement were vetted to be well-versed with the rights and other conditions that may have a bearing on the allocation.

In addition to the value of the Company and shareholders' rights, we estimated the following inputs that were needed for the OPM:

- **Time to Liquidity:** Time to liquidity, which constitutes the time until the Company issues an IPO, is acquired, or liquidates assets through a dissolution sale, was estimated based on the guidance received from the Client.
- **Risk-free rate:** We estimated the risk-free rate, which was consistent with the time to liquidity based on the Company's reporting currency.
- **Volatility:** We used the historical volatility of comparable companies as a proxy to estimate the volatility for the Company's common stock. The period for which the stock prices of these comparable companies were considered were consistent with the Time to Liquidity.

Using the above-mentioned inputs in the Black-Scholes-Merton OPM, we arrived at the value of the classes of shares in the Company that our Client had invested in.

Impact

We presented our findings along with the valuation conclusion to the Client in a detailed valuation report which resulted in the Client reporting its funds' NAVs in a timely manner to its investors and ultimately, the convenient closure of books.

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