Case Study

A Leading Indian FinTech Company

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

Sector/Industry: **IT & ITeS/BFSI**

Valuation of investments in a financial technology company for Financial Reporting and Closure of Books of Accounts

Our client (Client) is a leading Asia-focused investment firm that makes concentrated long-term investments in public and private equity, focusing primarily on technology-oriented businesses. The fund has a crossover structure with over USD 5 billion in Asset Under Management (AUM).

For financial reporting, the Client engaged Nexdigm to determine the fair market value of their investment in a financial technology company operating in the payments and lending space (the Company).

The Company developed a QR code-based payment application. It serves restaurants, grocery stores, canteens, cafes, salons, mobile stores, etc. They provide payment services via mobile applications, such as PayTM, PhonePe, Google Pay, WhatsApp, Amazon Pay, BHIM, Mobikwik, Freecharge, and True Caller. They also offer a range of fintech products including interoperable QR codes for UPI payments, POS machines for card acceptance, and small business financing.

Approach

Our approach was bifurcated into the following phases:

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

Phase I - Understanding the Business and Industry Dynamics

Detailed discussions with the Client and subject matter experts helped us understand their service offerings, target market, and growth opportunities. Conversations with the Client coupled with an analysis of the business model and operations gave us valuable insights into the performance and future outlook of the Company. The monthly MIS of the Company was also analyzed to evaluate the Company's Key Performance Indicators (KPIs). We also referred to proprietary databases and research reports to better understand the online payments and lending sector.

This analysis enabled us to understand the value drivers of the business. We understood that the payments business, though resulting in a higher volume of transactions, forms a very thin part of their total revenue since margins here are very low or zero in some cases. However, this helps businesses create a customer base for the lending business that generates the majority of the revenue.

Phase II - Evaluation of Valuation Approaches/Methodologies

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

The following methods were adopted for the fair valuation:

- Comparable Companies Multiple (CCM) Method
- Comparable Transaction Multiple (CTM) Method
- Price of Recent Transaction (PORT) Method

Comparable Companies Multiple (CCM) Method

We conducted a comprehensive search to identify publicly traded companies within India and overseas based on industry focus, company size, growth characteristics, etc. We first identified listed companies that provide payment and lending services to merchants. We then verified if their stocks were freely and frequently traded on recognized stock exchanges. Thereafter, we analyzed the selected peers' financials to understand the business' fundamental changes before arriving at the base valuation multiples for these peers.

Furthermore, the following adjustment was made to rationalize the multiples:

- **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 factors such as the growth potential, future economic prospects, disparities in inflationary rates, addressable market size, etc.

We then 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 Trailing Twelve Months (TTM) revenue of the Company to arrive at the Company's Enterprise Value (EV).

Comparable Transaction Multiple (CTM) Method:

We analyzed the most recent transaction in the online payments and lending market globally and computed the relevant valuation multiples. We identified suitable transactions from the United Kingdom and India.

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

- **Calibration:** We calibrated these multiples to consider the changes in market perception about the industry between the transaction date and the current valuation date.
- **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 factors such as the growth potential, future economic prospects, disparities in inflationary rates, addressable market size, etc.

This adjusted multiple was then applied to the TTM revenue of the Company to arrive at the EV.

Price of Recent Transaction (PORT) Method:

For unlisted companies, a recent investment or transaction in the firm's equity shares at arm's length can be considered under this method if the transaction has resulted in a change in the company's shareholding structure. PORT calculates the implied total value of an enterprise by accounting for all share class rights and preferences as of the date of the latest financing.

In order to determine the value of the Company, the Company's latest round of funding was used. The arrived EV was then used to determine the relevant multiple. We calibrated this multiple to consider changes in the market perception about the industry between the transaction date and the current valuation date.This adjusted multiple was then applied to the TTM revenue of the Company to arrive at the EV of the Company.

Phase III - Valuation of the Target

After broadly understanding the reasoning for the differences between the valuations under the above methods, we concluded that all 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. Based on the above method, we arrived at the fair market value of the equity of the Company.

Phase IV - Allocation of the Equity Value

As the Company had several classes of shares, we had to then 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 class of share, such as the level of seniority, dividend policy, conversion ratios, etc. The relevant clauses in the Share Subscription Agreement and Shareholders' Agreement were vetted along 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 Initial Public Offering (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 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 of the Company's common stock

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

Impact

We presented our findings to the Client in a valuation report that detailed the different valuation methodologies, the peer selection process, and the valuation conclusion which helped the Client report the fair value of their investments to investors and close their books of accounts in a timely manner.

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