nexdigm

Case Study

Singapore’s Top Online Marketplace Classifieds Provider

Service(s) offered: Due Diligence & Valuation

Sector/Industry: IT & ITeS

Identification and valuation of intangible assets to determine the Purchase Price Allocation (PPA) for Financial Reporting

A Singapore web-based Consumer-to-Consumer (C2C) and Business-to-Consumer (B2C) Marketplace Company (Client) had acquired another Singapore-based online marketplace classifieds company (Company) with subsidiaries in Malaysia, Vietnam, and Myanmar (the Subsidiaries). The Client acquired 100% of the Company in an all-stock deal with the entire purchase consideration satisfied by issuing equity shares in the Client to the seller (the Transaction).

The sources of revenue for the Subsidiaries included classified revenue and display revenue.

Classified Revenue

Primarily includes listing fees and fees for premium services. The total classified revenue primarily comprises revenue from vehicles, property, jobs, services, and certain other general categories. The listings in each category are limited to keep it free for C2C sellers and monetize B2C sellers. B2C sellers also pay for premium services to list their products above all app/web page listings.

Display Revenue

Primarily includes programmatic revenue. It reaches users through programmatic advertisements (Google, networks, etc.). The Subsidiaries monetize the traffic to the platform through banner placements on desktop, mobile web, Android, and iOS. The C2C sellers play an important role in generating this revenue as they expand the listings available on the platform, thereby attracting more users.

The Malaysian Subsidiary was Malaysia’s largest e-commerce platform that had classified listings on its website, with more than 5.2 million unique visitors a month. The Vietnamese Subsidiary was also the leading online classifieds marketplace in Vietnam, with over 1.3 million visitors each day and 1.2 billion page views per month. The Myanmar Subsidiary was recently incorporated and was still in the pre-revenue stage.

The Client approached Nexdigm to assist with the identification of intangible assets acquired as part of the Company’s acquisition and the Purchase Price Allocation (PPA) of the consideration paid for financial reporting purposes.

Approach

Nexdigm’s approach was divided into the following phases.

1. Understanding the Business & Industry Dynamics and Preparing a Purchase Price Allocation (PPA) Note for the Auditors
2. Evaluation of Valuation Methodologies/Approaches and Valuation of Intangible Assets
3. PPA - Audit Review and Accounting

Phase I - Understanding the Business & Industry Dynamics and Preparing a PPA Note for the Auditors

The transfer of stake holding in the Company resulted in the transfer of beneficial ownership in the Company's Subsidiaries to the Acquirer. Though the Company, on a standalone basis, did not generate material value, the Company derived all of its value from investments in its wholly-owned Subsidiaries situated in Malaysia, Vietnam, and Myanmar.

The purchase consideration was truly paid for the acquisition of these three Subsidiaries. Hence, we first had to bifurcate the total purchase consideration paid for the Company's acquisition into the purchase consideration paid to acquire the Subsidiaries based on each Subsidiary's valuation.

Due to the complex structure of the Transaction, we scrutinized the Share Purchase Agreement, the Shareholding Agreement, and the Share Subscription Agreement. We used these to analyze the rights and obligations being transferred.

Based on an in-depth understanding of the business and the agreements, we identified trademarks, internally developed software, customer relationships, and workforce as Intangible assets held by the Subsidiaries.

- **Trademark:** All revenue-related inflows were attributable to the trademark of the Subsidiaries as of the date of the Transaction. The Acquirer had avoided the cost of obtaining the trademark directly or paying a royalty for its use and hence, trademark was integral to the Transaction. It would take significant time and cost to develop a similar trademark/domain name in the relevant geographies where the Company was operating.
- **Internally Developed Software:** Software including service platforms, mobile applications, and platform data, which the Subsidiaries owned, was pertinent to revenue generation activities. This technology enabled the customers to list their products on the website/app and sell it to the public through its interface. It would take significant time and cost to develop similar technology, and hence that technology was integral to the Transaction.
- **Customer Relationships:** These include relationships that cause customers to do business with an entity on an ongoing basis. Such existing customers were perceived as valuable. They provide the Acquirer with continuing business opportunities with low or no additional cost of marketing and sales that would normally be incurred to attract new customers. Over the years, the Malaysian and Vietnamese Subsidiaries built a relationship with B2B and B2C sellers who continued to list products on the website. They also generated revenue directly through fees for listing as well as premium services and indirectly through attracting consumers, thereby generating more traffic. Customer relationships were not identified as intangible for the Myanmar Subsidiary as the Company was recently incorporated and was at a pre-revenue stage.

Thereafter, we evaluated legal precedents to assess the eligibility for tax benefits on such intangible assets under the respective countries' Income Tax Laws.

Based on the above observations, we prepared a PPA Note for the Company's Auditors which summarized the business understanding, transaction understanding, and proposed methods to value the identified intangible assets to help minimize audit queries during the Audit Review.

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Phase II - Evaluation of Valuation Methodologies/Approaches and Valuation of Intangible Assets

- **Trademark**

We considered various methods and applied the Relief from Royalty Method to value the trademarks held by the Malaysian and Vietnamese subsidiaries. As the subsidiary in Myanmar was recently incorporated and was still in the pre-revenue stage, the cost approach was considered for arriving at the value of the trademark for the Myanmar entity.

The Relief from Royalty Method included:

- Estimating the portion of revenue attributable to the trademark
- Conducting a search on international databases such as RoyaltyStat, RoyaltySource, etc. for similar trademark licensing agreements in similar industries and also for estimating a Royalty Rate based on the 25% Profitability Rule of Thumb
- Assessing the required return on trademark (discount rate)
- Calculating tax savings associated with amortization (Tax Amortization Benefit or TAB), wherever applicable

The Replacement Cost Method included:

- Costs incurred to recreate the trademark
- Income taxes

- **Internally Developed Software (IDS)**

We applied the Replacement Cost Method, which involved:

- Estimating the number of employees and time required to develop the software
- Estimating the average annual salary cost per employee
- Estimating the obsolesce/decay rate
- Estimating the remaining useful life of the software
- Calculating the tax savings associated with amortization (TAB), wherever applicable

- **Customer Relationships**

We applied the Multi-Period Excess Earnings Method, which involved:

- Apportioning the revenues, expenses, and margins attributable to the existing customer base
- Estimating the customer attrition rate based on historical customer-wise revenue data
- Allocating selling and marketing expenses to the existing customer base
- Calculating contributory asset charges
- Assessing the required rate of return (discount rate)
- Calculating the tax savings associated with amortization (TAB)

- **Workforce**

We applied the Replacement Cost Method, which involved:

- Estimating the average training and recruitment expenses per employee for each functional category
- Estimating the average starting efficiency for each identified functional category, as well as the time it takes for employees to achieve full productivity
- The workforce of the Client supported the operations of the Subsidiaries. Hence, we allocated the assembled workforce of the Client to the Subsidiaries based on the valuation of the respective Company

Apart from the value of tangibles and intangibles of the Subsidiaries, the Client, on a standalone basis, did not have any operations and only supported the Subsidiaries in their operations. Hence, corporate assets and liabilities were identified and features as part of the acquisition. Hence, these were allocated to these Subsidiaries on a reasonable basis.

We calculated the Weighted Average Return on Assets (WARA) for the given mix of assets and reconciled the WARA with the Weighted Average Cost of Capital (WACC) and the Internal Rate of Return (IRR) for each Subsidiary. We also reconciled the IRR for the acquisition of each Subsidiary with the IRR at a consolidated level for the Transaction.

The excess purchase consideration for each Subsidiary was calculated as the difference between the purchase consideration paid for each Subsidiary and the total of net identified tangibles (including the allocated assets of the Client) and intangible assets acquired.

Phase III - PPA - Audit Review and Accounting

Once the intangible assets were identified and valued, the excess purchase consideration paid by the Acquirer was identified as goodwill. We presented our analysis to the Client in the form of a detailed Purchase Price Allocation Report.

We also helped the Client satisfactorily address the queries of the statutory auditors for the Transaction and the PPA. After that, we assisted the Clients accounts and finance team in accounting for the Transaction.

Conclusion

Nexdigm's holistic solution assisted the Client right from the identification stage of intangible assets up till the audit review. Our proactive approach in preparing a PPA note in Phase I streamlined the audit process and facilitated the Audit Review by minimizing audit queries.

Our client-centric approach assisted the Client with the PPA and analyzed the implications of the PPA from a tax and accounting laws perspective to provide the Client with the most robust solution.

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