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This presentation was made in December 2016 in Mumbai.

Challenges in Valuation of Business

Presented at
Seminar on Changing
landscape of banking and
financial services

Organized by
WIRC - ICAI

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Mumbai



Humans are the only specie known as of now who are able to analyse and adapt their responses to the same situation differently in different context. Eg:

- Marriage of self or others.
- Marriage of boy vs girl
- Arranged vs love
- Color code of dress while attending marriage under various customs.
- Usage of accessories in marriage based on customs.

Every aspect we are able to differentiate. Basic human feeling of love – Love for own child to that for others. Love of one's spouse to that of others. This ability to differentiate is the root cause of human progress and also will ultimately lead to decimation of our race.



Business Valuation is also a matter of perspective arising out of human beings able to differentiate between various positions of Investing.



Evaluation is integral to human nature.

Evaluation involves an assessment of a parameter and its relevance to the evaluator.

We would restrict our conversation to evaluation of incorporated entities in business.



**Coverage –
Valuation of Business.**



Valuation

What is leading to increased focus on valuation as practice area.

- Four major factors have played a role in the ascendancy of shareholder value:
 - The emergence of an active market for corporate control in the 1980s, following the apparent inability of many management teams to respond effectively to major changes in their industries. (Discuss LBO's)
 - The growing importance of equity-based features in the pay packages of most senior executives in the United States and many in Europe as well.
 - The increased penetration of equity holdings as a percentage of household assets, following the strong performance of the U.S. and European equity markets since 1982.
 - The growing recognition that many social security systems, especially in continental Europe and Japan, are heading for insolvency.

Change in Narrative in 12 months



September 2015

- Flipkart USD 16 billion. Snapdeal USD 5 billion. Other Indian startups in the unicorn club include mobile advertising technology company InMobi (\$2.5 billion), taxi consolidator Olacabs (\$5 billion), mobile payments company Paytm (\$2 billion), online restaurant guide Zomato (\$1 billion), online classifieds firm Quikr (\$1 billion) and data analytics outsourcing company Mu Sigma (\$1 billion). Promising candidates are Oyo Rooms (currently \$400 million), Bigbasket (\$400 million) and Grofers (\$100 million).
- “FOMO” driven valuation was very evident.

Present times

- Flipkart USD 5.58 billion. Snapdeal USD 4 billion. Other Indian startups in the unicorn club include mobile advertising technology company InMobi (\$0.8 billion), taxi consolidator Olacabs (\$2.4 billion), mobile payments company Paytm (\$5 billion), online restaurant guide Zomato (\$0.5 billion), online classifieds firm Quikr (\$1 billion) and data analytics outsourcing company Mu Sigma (\$1 billion). Promising candidates are Oyo Rooms (currently \$400 million), Bigbasket (\$400 million) and Grofers (\$100 million).
- Cutting down on burn rates and Unit economics have to be visible. **“There is a strong focus on capital efficiency and moats around the business.”**

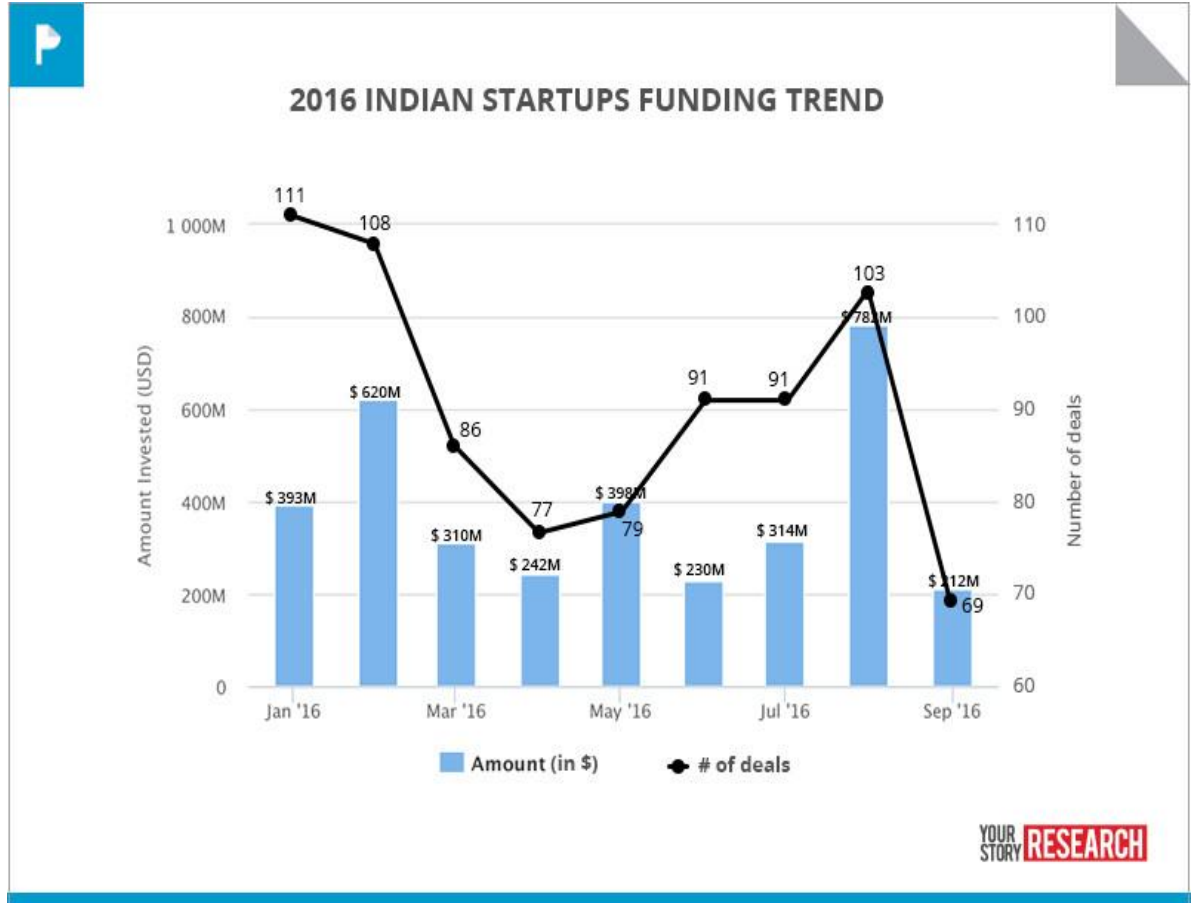


Deals are becoming slower

Value per deal

No of deals

Domain of deals



Some brief background on deals

Business Model

The Ask

Particulars	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Rs. Crore	A	A	U/A	P	P	P	P	P
Income statement								
Total Revenue	20.21	26.47	39.86	100.10	180.15	322.15	460.20	614.20
Existing business	20.21	26.47	39.86	95.10	120.15	142.15	160.20	214.20
New Brand (XYZ)	-	-	-	5.00	60.00	180.00	300.00	400.00
EBITDA	0.37	0.86	1.34	(16.36)	(24.18)	39.60	83.26	121.18
Interest	0.17	0.49	0.81	2.57	5.55	6.07	6.03	6.00
Depreciation	0.01	0.13	0.11	0.29	1.59	1.33	1.13	1.09
PBT	0.19	0.24	0.42	(19.22)	(31.32)	32.20	76.10	114.09
PAT	0.19	0.24	0.42	(19.22)	(31.32)	32.20	53.58	75.34
Gross Cash Accruals	0.20	0.37	0.53	(18.93)	(29.73)	33.53	54.70	76.43
Financial Position								
Net Worth	1.27	1.36	1.51	8.18	37.71	68.71	121.08	205.21
Total Debt	2.84	5.87	8.68	31.29	46.78	46.45	46.14	45.86
Net Fixed Assets	0.13	0.67	0.66	3.57	10.98	9.65	8.52	25.19
Receivables	5.54	7.52	5.25	11.07	28.00	40.59	51.50	72.00
Loans and advances	0.53	0.82	0.82	6.17	11.35	13.39	59.27	95.45
Inventory	6.38	9.42	12.32	26.00	42.43	62.00	74.00	101.00
Cash & bank	0.14	0.40	0.10	0.08	0.18	0.27	0.43	0.43
Current liabilities & provisions	8.61	11.60	8.96	7.42	8.45	10.74	26.50	43.00

^Net worth includes funding of Rs.26 crores in FY17 and Rs.61 crores in FY18

Business Model

The Ask

Particulars	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Rs. Crore	A	A	U/A	P	P	P	P	P
Key Ratios								
Growth in Total revenues (%)		30.96	50.59	151.13	79.97	78.82	42.85	33.46
Growth in EBITDA (%)		131.00	56.24	NM	NM	NM	110.25	45.54
Growth in PAT (%)		24.08	75.53	NM	NM	NM	66.40	40.61
EBITDA / Total revenue (%)	1.84	3.24	3.36	NM	NM	12.29	18.09	19.73
PAT / Total revenue (%)	0.94	0.90	1.04	NM	NM	10.00	11.64	12.27
ROCE (%)		55.29	85.44	NM	NM	71.92	62.82	49.86
RONW (%)		18.02	28.99	NM	NM	60.51	56.46	46.18
Net Debt Equity Ratio (x)	2.13	4.02	5.68	3.82	1.24	0.67	0.38	0.22
Interest Coverage (x)	2.18	1.75	1.65	NM	NM	6.52	13.81	20.20
Current ratio (x)	1.46	1.57	2.06	5.84	9.70	10.82	6.99	6.25
Avg. Collections (days)		88.81	57.67	29.35	39.04	38.32	36.02	36.19
Avg. Inventory (days)		107.44	98.17	68.91	68.37	58.35	53.19	51.29

Total Revenue in FY21	Rs.614.2 crore
Sales Multiple	3x
Future Equity Value	Rs.1842.6 crore
Discount rate	25.0%
Post money Value	Rs.603.78 crore
Investment	Rs. 87 crore
Pre money Value	Rs.516.7 crore



Few quotable quotes for Finance professionals

Few jargons which raise red flag:

Pivoting
Innovation
Disruption
Agility
Scalable
unit economics

Economic view

- Its not about return on capital but about return of capital

Philosophical view:

- Life is long enough to be experienced with patience rather than greed



impact of firms valuation

Quick views on each of
the situations
mentioned in this slide.

Discuss this in context of :

- **Life cycle-**
 - Young Growth business
 - Growth companies
 - Mature Companies
 - Declining & distressed companies

- **Special Situations:**
 - Financial services company
 - Cyclical / commodity companies
 - Intangibles play in company



How do we address?

Established business have predict-ability of cashflows

When the business is nascent or in the ideation stage, valuation becomes a difficult proposition.

Few approaches often used are described in this slide.

All these approaches get refined with every incremental deal.

Valuation Approach	Principle
Berkus	Based on assessment of 5 key success factors
Risk factor summation	based on a base value adjusted for 12 standard risk factors
Scorecard	weighted average value adjusted for similar companies
Comparable transaction	based on rule of 3 with a KPI from similar company
discounted cash flow	Sum of present value of future cash flows
Scenario Analysis	weighted average of 3 valuation scenarios
Venture capital	based on ROI expected by investor



BERKUS Method

The Berkus Method is meant for pre-revenue startups.

Most often “pre-revenue” valuation to a start-up that has potential of reaching over \$20 million in revenues within five years will be dependant on the 5 parameters.

Once a company crosses pre-revenue stage, this approach would be inappropriate to apply

- The premise is that it establishes a ceiling of USD 2.5 million
- Every element of business adds additional comfort and thereby better valuation.

If Exists:	Add to Company Value up to:
Sound Idea (<i>basic value</i>)	\$1/2 million
Prototype (<i>reducing technology risk</i>)	\$1/2 million
Quality Management Team (<i>reducing execution risk</i>)	\$1/2 million
Strategic relationships (<i>reducing market risk</i>)	\$1/2 million
Product Rollout or Sales (<i>reducing production risk</i>)	\$1/2 million



Risk Factor summation

Refined and evolved version of Berkus model

The base value is the value of similar businesses in similar geography. This is the most tricky part of the approach.

The premium or discount is generally in multiples of an amount based on high or low risk rating.

The Risk Factor Summation Method

INITIAL VALUE			\$1,500,000
1. MANAGEMENT RISK	<i>Very low</i>	+\$500,000	\$2,000,000
2. STAGE OF THE BUSINESS	<i>Normal</i>		
3. LEGISLATION/POLITICAL RISK	<i>Normal</i>		
4. MANUFACTURING RISK	<i>Normal</i>		
5. SALES AND MANUFACTURING RISK	<i>Normal</i>		
6. FUNDING/CAPITAL RAISING RISK	<i>Normal</i>		
7. COMPETITION RISK	<i>Very high</i>	-\$500,000	\$1,500,000
8. TECHNOLOGY RISK	<i>Low</i>	+\$250,000	\$1,750,000
9. LITIGATION RISK	<i>Very low</i>	+\$500,000	\$2,250,000
10. INTERNATIONAL RISK	<i>Normal</i>		
11. REPUTATION RISK	<i>Very low</i>	+\$500,000	\$2,750,000
12. POTENTIAL LUCRATIVE EXIT	<i>Normal</i>		
BOX VALUATION			\$2,750,000



Scorecard Valuation

Some criteria's used for evaluation:

- Management (30%),
- Size of opportunity (25%),
- Product or Service (10%),
- Sales channels (10%),
- Stage of business (10%) and
- Other factors (15%)

Weight is arrived based on what is expected out of similar business and Vs. Average project is the readiness of the project being evaluated vs other projects.

The Scorecard Valuation method

	Weight	vs. average project
1. TEAM CAPACITY	40%	125%
2. PRODUCT/TECHNOLOGY READINESS	30%	100%
3. MARKET SIZE	20%	15%
4. COMPETITION	10%	75%

INITIAL VALUE	\$1,500,000
MULTIPLIER	117,5%
BOX VALUATION	\$1,760,250





Comparable transaction method

Similar to PE / PBV / Evby EBITDA

Monthly Recurring Revenue (Saas), HR headcount (Interim), Number of outlets (Retail), Patent filed (Medtech/Biotech), Weekly Active Users or WAU (Messengers)

The Comparable Transactions Method

	<i>Sold for</i>	<i>Revenue multiple</i>	<i>WAU multiple</i>
SIMILAR BOX #1	\$957	3,0 x	2,3 x
SIMILAR BOX #2	\$647	3,3 x	6,4 x
SIMILAR BOX #3	\$327	1,9 x	1,5 x
SIMILAR BOX #4	\$737	5,4 x	0,2 x
SIMILAR BOX #5	\$6,248	8,6 x	5,7 x
SIMILAR BOX #6	\$39,087	7,3 x	4 x
SIMILAR BOX #7	\$6,576	12,1 x	31 x
SIMILAR BOX #8	\$4,258	8,3 x	3,5 x
SIMILAR BOX #9	\$3,798	3,4 x	1,1 x

	<i>Revenue</i>	<i>WAU</i>
MY BOX INDICATORS	\$900	1,000
WEIGHTED AVERAGE MULTIPLES	7,6	6,7
BOX VALUATION BASED ON...	\$685	\$6,736



