Vijay Shekhar Sharma, MD & CEO, One97 Communications Ltd

PAYTM IS SET TO DEBUT ON STOCK EXCHANGES. SOARING PRIVATE VALUATIONS, DESPITE HUGE LOSSES, INDICATE A BUMPER LISTING. CAN ITS MULTIPLE ENGINES DELIVER?

BY **ANAND ADHIKARI**
ILLUSTRATION BY **ANIRBAN GHOSH**

Corporate

UNTANGLING PAYTM

SVF INDIA	SAIF	ALIBABA
18.3%	17.2.%	7.2%

As on date of draft offer (July 16, 2021)

I**ndia's startup ecosystem** is hogging the stock market limelight. Investors have barely digested food-delivery company Zomato's initial public offering (IPO), and soon they will be served another. This time it will be a super-sized one from Paytm, India's largest fintech and the second-biggest startup by valuation.

The numbers in the IPO prospectus filed by One97 Communications Ltd, which runs Paytm, are staggering. The 11-year-old company plans to raise $2.2 billion, or ₹16,600 crore, which would make it India's biggest-ever IPO, displacing Coal India's ₹15,000-crore offering nearly a decade back. The IPO is expected to value Paytm at between $25 billion and $30 billion. That is not only more than half the market value of State Bank of India, India's largest bank, but also a steep jump from Paytm's $16 billion valuation in November 2019, when it had raised $1 billion from global investment management firm T. Rowe Price and existing investors, the Chinese Ant Financial and Japanese conglomerate SoftBank.

The IPO market capitalisation values Paytm at 66-79 times (66-79x) its operating revenue of ₹2,802.41 crore in the fiscal year ended March 2021. That is a steep premium over the 25x revenue multiple of its global payments peers. It is also manifold higher than the 17x that China's Ant Group, Paytm's top investor, sought in its planned IPO last year.

It's a bold bet by Paytm founder Vijay Shekhar Sharma. But the 43-year-old, who taught himself English by memorising rock songs, has built Paytm by taking audacious steps. He took the Noida-based company from being a digital payments platform for utility bills and mobile top-ups to a digital supermarket selling a host of financial services and products built on top of payments. It has 33.3 crore consumers and 2.11 crore merchants on its platform, with services spanning payments, lending, insurance, banking and wealth advisory.

However, Paytm, like most growth-hungry startups, has been posting losses consistently. Its losses dropped to ₹1,701 crore in FY21 from ₹2,942 crore a year earlier due to lower marketing and promotional expenses, but the company warned prospective investors in its IPO that they should not expect profits anytime soon. Its other key metrics are also not too rosy. Operating revenue slid 14.5 per cent in FY21, partly due to Covid-19 disruption, while adjusted EBITDA — earnings before interest, tax, depreciation and amortisation, a key profitability metric — was a negative 59 per cent.

Nonetheless, while Zomato may have been the first Indian startup to go public, Paytm's listing is set to be a watershed moment in its own right as it will be the first fintech to do so in India's burgeoning financial sector amid a strong bull run in the stock market.

THE VALUATION GAME

BASE CASE SCENARIO

$16
BILLION

BEST CASE SCENARIO

$24-25
BILLION

MOST OPTIMISTIC SCENARIO

$28-30
BILLION

Source: Markets

Paytm executives did not comment on the story citing silent period norms.

"It is a PharmEasy moment in banking," says Abizer Diwanji, Partner, Financial Services, at leading consultancy firm EY India. Diwanji is drawing parallels with an equally pivotal moment in June, when PharmEasy, a seven-year-old e-pharmacy founded by entrepreneurs in their early 30s, acquired Thyrocare, a 40-year-old, publicly-listed diagnostics chain. "Tomorrow, a fintech could buy a traditional bank," he says.

Paytm's listing will act as the benchmark for other fintechs. But before that Paytm has to weather the ultimate test of its valuation — public market scrutiny. As investors peel back the layers from its wide range of operations, there will be questions. How will Paytm move from the low-margin payments business, where it has built scale, to the highly competitive lending, investment and insurance segments? How fast can it switch from being a loss-making private firm to a profitable public company? What will be the key valuation drivers for Paytm to reward shareholders in the future? And finally, does it matter that Sharma, whose name is synonymous with Paytm, has a mere 14.6 per cent pre-IPO stake and is no longer classified as a promoter?

Let's take these questions one at a time.

All Scale, No Money

Over the last decade, Paytm has built

PAYTM'S GROWTH ENGINES — THE JOURNEY

2009
LAUNCH OF PAYTM

2012
PAYMENT GATEWAY

2014
PAYTM WALLET

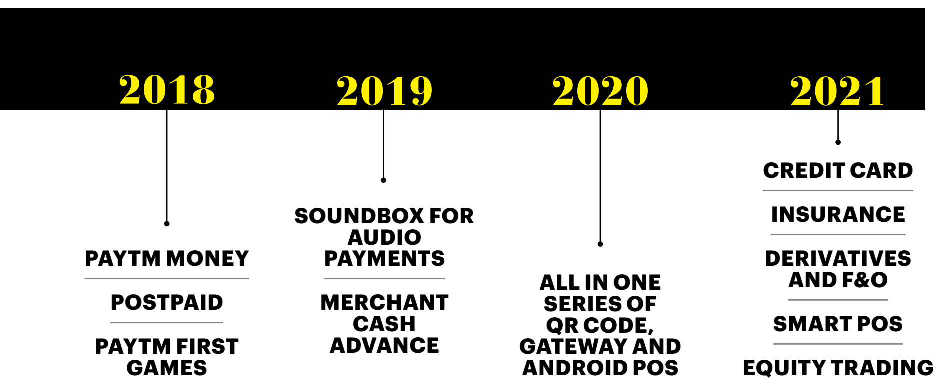
2015
QR CODES
MOVIE TICKETING
BILL PAYMENTS

2016
FLIGHT TICKETING

2017
PAYTM PAYMENTS BANK
PAYTM GOLD
FASTAG
EVENTS TICKETING

> “IT IS LIKE A PHARMEASY MOMENT IN BANKING. SO FAR, THE BUSINESS MODEL IS LARGELY A CUSTOMER ACQUISITION CHANNEL. THE IPO WILL CERTAINLY PUT A LOT OF PRESSURE ON PAYTM TO DESIGN THE PATH TO PROFITABILITY”

ABIZER DIWANJI, Partner, Financial Services, EY India



a vast network of merchants using QR codes, point-of-sale (PoS) terminals and digital payments. Its gross merchandise value (GMV) under all platforms topped ₹4 lakh crore in FY21, which is equivalent to 2 per cent of India's GDP. It makes money in payments through merchant transaction fees, recurring subscription fees for PoS terminals and consumer convenience fees, among others. The likes of Mastercard and Visa, too, have built successful businesses centred on payments, which Dinesh Arora, Partner (Deals) at PwC India, estimates is a $100 billion market globally.

"Payments is a business of volumes, funnel generation, building loyalty and trust and a brand name. There is certainly value which is attached to dominance in creating that market share and mind space. There will be some premium based on the market share," says Anup Jain, Managing Partner of Orios Venture Partners, an early-stage investor.

But Paytm, which for long has ruled the roost when it comes to digital wallet payments, has not fared as well with the Unified Payments Interface (UPI), India's real-time digital payments network. Flipkart-owned PhonePe and Google Pay had a market share of 46.04 per cent and 34.63 per cent, respectively, in terms of the volume of UPI transactions this June. Paytm had a mere 11.63 per cent share, though it is still the market leader in overall digital payments. However, digital payments are a game of scale with no business model per se. A payments company has to burn boatloads of cash on incentives such as cash-backs and discounts to acquire a customer, who may quickly switch loyalty to a rival with better offers. Then there are the high commissions payable to third-party gateways. That's why "it is difficult to predict the profitability of a payments business in the next three-five years," says Rajeev Shah, MD and CEO of transaction advisory firm RBSA Advisors.

The real value comes after acquiring the customer, says Shilpa Mankar Ahluwalia, Partner (Fintech) at law firm Shardul Amarchand Mangaldas & Company. "Once a customer is acquired via a payments product, fintech platforms analyse his data to deliver multiple customised financial products via the same distribution channel." And today Paytm owns the customer, which increases its chances of pushing through other products by cross-selling and building on top of payments.

Call it staying ahead of the competition or the logical next step, but Paytm has launched a slew of such products, including loans, investments and insurance, over the past few years. With Paytm, the Sharma-led One97 Communications is essentially replicating what Jack Ma did with Ant Group's digital payments platform, Alipay.

Ant Group — spun off from Jack Ma's Alibaba Group, one of the earliest investors in Paytm — is the world's leading payments and lifestyle platform today with more than 1.2 billion users. Alipay transformed itself from a digital wallet to a lifestyle player with services that include booking taxis, hotels and movie tickets; paying friends and utility bills; availing loans; investments and insurance; even doctor appointments. More than half of its $17.5 billion revenue comes from credit, investment, wealth management and insurance products.

Paytm is aiming to be a similar one-stop, digital-financial-services shop for India. But the journey to scale up its non-payments business has just begun.

AN EXPENSIVE PROPOSITION

PAYTM WILL BECOME THE MOST RICHLY-VALUED PAYMENTS COMPANY

Companies	EV/ Revenue multiple
Paytm	**42X**
Paypal	**15X**
Visa	**25X**
Mastercard	**24X**
Ant Group	**17-20X**
WEX Inc	**6X**

X times the revenues; Paytm was last valued at $16 billion
Ant's valuation at the time of its proposed IPO in August 2020

STAGNANT REVENUES

Year	2020/21	2019/20	2018/19	2017/18
Total Income	**3,186.80**	**3,540.70**	**3,579.67**	**3,309.61**
Net Loss	**1,701.01**	**2,942.36**	**4,230.90**	**1,604.30**

Figures in ₹crore; consolidated; Source: Annual report

A Lending Hand

The value in the payments business will come from the value-added services Paytm wraps around individuals and merchants. The biggest of these is retail digital lending, which a recent Motilal Oswal report said has delivered more than 40 per cent compounded annual growth over the past seven years. "India is a credit-starved economy," says Jain of Orios Venture Partners. "The traditional banks ask for collateral to give access to credit. Now, based on financial transaction data, a new market for unsecured lending has opened up."

And Paytm has dived headfirst into this market. In 2018, it launched a buy-now-pay-later (BNPL) loan product with Clix Finance, offering instant digital loans to customers during checkouts. As the name suggests, BNPL acts like a credit card with future repayments. Paytm also has co-branded credit cards with Citigroup and SBI Card. It makes money through sourcing fees based on a percentage of the loans, collection fees and upfront distribution fees per credit card.

However, this loan origination, either through BNPL or a credit card, for others, by itself doesn't create a lot of value for Paytm. But when it adds a customer's digital payment footprint to the loan, it changes the value proposition for partner banks and non-banking financial companies (NBFCs) which need such credit models to strengthen their underwriting processes.

BNPL has opened up massive, underserved segments such as blue-collar workers and new-to-credit borrowers. Most banks don't serve these segments because of the risk involved, the high cost of onboarding a customer and the hassle of collection and recovery. "The tie-up with payment fintechs has the comfort of reducing the credit risk and giving banks control over collections. The cost of onboarding an existing payments customer is also very low," says Anubhav Jain, Co-founder and CEO of

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GLOBALLY, FINTECHS’ BETS ON NEW HIGH-MARGIN PRODUCTS TO IMPROVE OVERALL PROFITABILITY HAVE NOT BEEN REALISED AS THE COMPETITIVE ENVIRONMENT, FUELLED BY SURPLUS VENTURE FUNDING, HAS DRIVEN DOWN MARGINS EVEN FOR THE PRESUMABLY HIGH-MARGIN OFFERINGS”

BARNIK CHITRAN MAITRA, Managing Partner and CEO, ADL India and South Asia

Rupifi, a fintech catering to SMEs.

However, fintechs earn only a fee or commission for sourcing these loans, whereas their partner banks pocket the lucrative interest earnings. The competition is also heating up, with the likes of ZestMoney and PhonePe entering the BNPL market. In fact, Mobikwik, which has also filed for an IPO, has emerged as one of the biggest players in the segment. Therefore, experts suggest that the real value for Paytm will come from the direct lending business, where the bigger margins lie.

But for this, it needs a full-scale banking licence. Paytm Payments Bank, which accepts deposits but is not allowed to lend, is already considering converting itself into a small finance bank next year after it completes five years, as is required by the Reserve Bank of India. There is a potential to earn more than a traditional bank’s 3.5 per cent to 4 per cent net interest margin. “The kind of margins lending fintechs are making would be probably double than that of banks and NBFCs because of the different market segment,” says Rupifi’s Jain.

But higher returns come with higher risks. “BNPL profitability in the Indian context is yet to be proven as the credit quality of BNPL customers may be slightly worse than that of a typical credit card customer,” warns Barnik Chitran Maitra, Managing Partner and CEO, ADL India and South Asia, a management consulting firm.

Paytm doesn’t provide a break-up of how much it earns from its lending services. But its revenue from payments and financial services — which include its non-lending services such as investment and insurance — accounts for 75 per cent of the total, up from 58.1 per cent a year ago. However, the road ahead for its non-lending businesses isn’t too smooth.

Losses Ahoy

Paytm Money is an online platform for investing in equities, futures and options and mutual funds. It also offers wealth management services. It had

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PAYTM’S CURRENT VALUATION OF $16 BILLION IN THE PRIVATE MARKET — SECOND ONLY TO EDTECH STARTUP BYJU’S $16.5 BILLION — ALREADY ACCOUNTS FOR THE COMPANY’S CUSTOMER BASE, NETWORK AND POTENTIAL SCALE”

ARIJIT SARKAR, Director, Trifecta Capital Venture Debt

more than two lakh equity trading accounts and ₹5,200 crore assets under management in FY21. Building this on top of its massive payments business has helped Paytm. The customer acquisition cost of Paytm Money is zero. Then there is Paytm Insurance Broking, which aggregates everything from auto to health insurance products.

But again, these businesses earn Paytm only fees, such as on account opening and transactions in equity broking, and commissions, such as on insurance premiums. It is also up against new-age players like Zerodha, Upstox and 5paisa who have, in quick time, built a lending business on margin trading — lending customers money to buy shares — on top of their zero-brokerage model.

When it comes to insurance broking, aggregation services offer razor-thin margins. Paytm, though, has a broking licence and has been selling insurance products through its platform for a while. It is also acquiring traditional general insurance company Raheja QBE. Still, it is up against pure-play digital players like Digit and Acko Insurance, which are backed by deep-pocketed investors and offer a paperless insurance process.

However, Ajit Deshmukh, MD at investment banking firm Equirus Capital, believes Paytm’s bulk in terms of customers and transactions will help it grow. “Payments is a scale business. The pyramid of lending and investment products for Paytm is building up in a nice way. As they keep adding the layers, you will see them making money,” he says.

Paytm also has a commerce and cloud business, which accounted for 25 per cent of revenue in FY21. It offers services like ticketing, entertainment and travel. It also sells merchant software and cloud services for billing, inventory management and real-time bank settlement. Here too it has built scale on the back of cash-backs and discounts, which is neither sustainable nor helpful to profit margins. Moreover, it has to compete with behemoths like Amazon and Reliance, among others.

"Paytm is betting on higher-margin products to offset the low margins in the payments business but the scale in the non-payments business would take time," says an investment banker. Nonetheless, Paytm made it clear in its 497-page prospectus that it would continue pushing the growth pedal after its IPO and use a large chunk of the proceeds to fund business acquisitions and partnerships.

It also had another warning in the risk section of the prospectus. "We have a history of net losses, we anticipate increasing operating expenses in the future, and we may not be able to achieve and maintain profitability." This is not the sort of predictability public markets look for. "The (historical) losses actually don't matter for investors in public markets. They invest based on the guidance of profitability," says Deshmukh of Equirus Capital.

This is very different from investments in the startup world, where growth and market potential are bigger factors. "Every next round is done on a higher valuation, otherwise it will result in dilution of equity for existing investors and founders," says Shah of RBSA Advisors. "There is a perverted incentive for fundraising at higher valuations, which may be unrealistic and not in congruence with the underlying operational performance."

Multiple Problems

Aviral Jain, MD of financial consultancy firm Duff & Phelps, says one way to value the likes of Paytm is using metrics such as subscriber base, number of transactions and gross transaction value. "A digital payment company that is in a rapid growth stage and has experienced significant growth in such metrics, but has not yet turned profitable, can be valued using an adjusted revenue multiple," he says.

Maitra of ADL India says that globally fintechs are valued at 10-30x revenue. "The rumoured public market valuations for Indian fintech players at 25-60x seem richer than their global, more established, peers," says Maitra. Paytm may be even higher, at 66-79x revenue. But, an investment banker managing the Paytm IPO says, "For a fintech operating in a high-growth mode, there are always expectations of growth and profits moving up like a hockey stick."

Jain of Duff & Phelps agrees. "Fintech players have always commanded a premium to traditional financial services businesses due to their ability to leverage technology to grow at a pace not previously seen in financial services," he says. Perhaps, that is why late-stage and mature payments companies do not command high multiples. "If we need to apply these multiples to value fintechs with high- to mid-stage growth, the multiples would be adjusted upwards to price the expected growth," says Jain.

Paytm doesn't lend from its books but if, or when, it does, there is a promise. "Fintechs lending from their own balance sheet will probably be valued as tech NBFCs where loan origination, underwriting and disbursement are completely digital. It is reasonable to value such fintechs based on traditional methods like price-to-book," says Arijit Sarkar, Director, Trifecta Capital Ven-

PAYTM IN NUMBERS

33.3 cr
CONSUMERS

2.11 cr
MERCHANTS

₹4,03,300 cr
TOTAL GROSS MERCHANDISE VALUE

₹9,151 cr
BALANCE SHEET SIZE

₹6,534 cr
NETWORTH

₹3,186 cr
TOTAL INCOME

₹1,701 cr
NET LOSS

FIGURES FOR 2020/21;
SOURCE: PAYTM ANNUAL REPORT

ture Debt. "But you have to add a premium for growth."

Not everyone agrees that such premiums are deserved. "Globally, fintechs' bets on new high-margin products to improve overall profitability have not been realised as the competitive environment, fuelled by surplus venture funding, has driven down margins even for the presumably high-margin offerings," says ADL's Maitra.

Abhishek Agarwal, Managing Partner, Rockstud Capital, lists Paytm's likely competitors. "Paytm is trying to be the super app of India to capture the young, new, digital audience. Looking at Reliance, Tata, Facebook and Google fighting in this space, this IPO valuation definitely is expensive," he says.

The valuation could be put to the test soon as Paytm plans to raise ₹2,000 crore in a pre-IPO placement. While the terms of the offering are not yet decided, it will serve as a benchmark for the upcoming IPO.

A Lot's at Stake

Paytm's current valuation of $16 billion in the private market — second only to edtech startup Byju's $16.5 billion — already accounts for the company's customer base, network and potential scale, says Sarkar of Trifecta. It will have to balance its growth ambitions with public markets' expectations of returns and profitability. "So far, the business model is largely a customer acquisition channel. The IPO will certainly put a lot of pressure on Paytm to design the path to profitability," says EY's Diwanji.

Then there are factors that have not been likely baked into Paytm's current valuation. "A public listing for start-ups would certainly mean taking internal governance and compliance systems to the next level," says Ahluwalia of Shardul Amarchand Mangaldas. That would mean higher expenses.

Then there is regulatory scrutiny. While One97 itself isn't regulated by any entity, its group entities are. Paytm Payments Bank, Paytm Money and Paytm Life Insurance come under the

"THE REAL VALUE COMES AFTER ACQUIRING THE CUSTOMER. ONCE A CUSTOMER IS ACQUIRED VIA A PAYMENTS PRODUCT, FINTECH PLATFORMS ANALYSE HIS DATA TO DELIVER MULTIPLE CUSTOMISED FINANCIAL PRODUCTS"

SHILPA MANKAR AHLUWALIA, Partner (Fintech), Shardul Amarchand Mangaldas & Co

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EVERY NEXT ROUND IS DONE ON A HIGHER VALUATION, OTHERWISE IT WILL RESULT IN DILUTION OF EQUITY FOR EXISTING INVESTORS AND FOUNDERS. THERE IS A PERVERTED INCENTIVE FOR FUNDRAISING AT HIGHER VALUATIONS, WHICH MAY BE UNREALISTIC”

RAJEEV SHAH, Managing Director & CEO, RBSA Advisors

lens of banking, stock market and insurance regulators, respectively. This assumes importance after Chinese regulators scuppered the IPO of Ant Group and went after behemoths like Alibaba in order to break them up. “We have already seen what happened to Alibaba recently and, therefore, one can’t overlook such facts,” says Agarwal of Rockstud Capital.

Moreover, Sharma, the public face of Paytm for years, is no longer identified as a promoter. Sharma, who started his entrepreneurial journey as a college graduate by selling a website he built, is now simply the MD and CEO, with 14.6 per cent stake in the company he founded. In contrast, Jeff Bezos still holds a 10.3 per cent stake in Amazon even after 27 years. Founders Larry Page and Sergey Brin own a combined 11.4 per cent in Google’s parent Alphabet, while Mark Zuckerberg has a 14 per cent stake in Facebook. “All these founders stayed put with a higher stake to build sustainable businesses. Paytm will have challenges with private equity investors holding the majority stake,” warns the CEO of an NBFC.

While foreign investors like Ant Group, SoftBank and venture capital firm Elevation Capital will wield significant influence as majority shareholders, some say that Sharma’s low stake isn’t important as Paytm is now a professionally-run entity. “It is all about the execution. The right management and the board always deliver,” says Deshmukh of Equirus Capital.

One could also point to Paytm’s fellow loss-making startup Zomato’s IPO last month, which was lapped up by retail and institutional investors alike. Then again, it’s not quite fair to compare a fintech company with a food-tech one. Just as Paytm’s IPO may be a watershed moment for startups, it is an equally testing moment for public markets as well.

As ace investor Rakesh Jhunjhunwala often says, “*Bhaav bhagwan hai.*” Or “Price is god.” All that remains to be seen is who finds religion. **BT**

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