Analysis of the Indian e-Commerce sector

- Valuation
- Investment Banking
- Advisory Services

Financial Advisory Services – Team RBSA

RBSA Advisors

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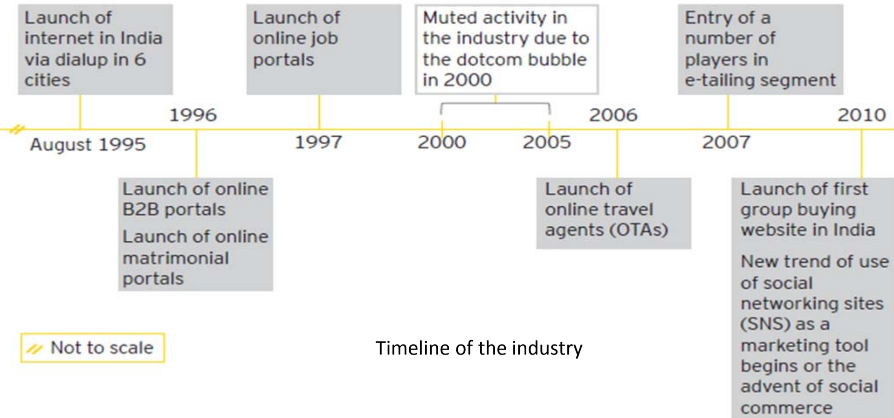
Executive summary

The **e-commerce market in India** has enjoyed robust growth of almost 55 per cent for the last six years. Though e-commerce has been around since fifteen years, the pertinent environs are now finally in place to drive such market ahead.

Nonetheless, the technological advancement in Internet-enabled handheld devices has made them abundantly available. That and an ever growing consumerism are some of the key drivers of growth in the e-commerce sector. Such is the faith of analysts in the sector that money has been pouring in from all corners, albeit Venture Capitalists & Private Equity firms. These e-commerce players will have to manage challenges associated with a diverse supplier & customer base, technological constraints, customer satisfaction, authenticity of information and grievance re-dressal.



Timeline of the industry

One cannot rule out the importance of the facility of Cash-on-Delivery (CoD), currently offered by most e-Retailers, which accounts for almost 60% of all transactions. Another extremely important factor is the co-operation from the Government of India on regulatory fronts. With the advent of the highly-anticipated GST, the e-commerce players are now relieved about having some kind of clarity on the regulatory front, as prior to this, laws regulating e-commerce in India lack clarity & have several layers of unnecessary compliances.

The rapid emergence of e-commerce is radically transforming the business landscape. Start-up firms are capturing new opportunities in the electronic market place through existing or innovative business models. Established firms are racing to transform and adapt their old business models to the new environment.

Introduction

- An e-commerce firm would be any business that derives a substantial part of its total revenue from internet transactions. Additionally, a pure play firm would be one that derives all of its revenue through e-commerce.
- The sector has experienced phenomenal growth, breaking down old shopping habits & inculcating new ones. Also, inspiring a new way that people transact.
- Indians, in a matter of minutes, can literally shop from a wide range of services and goods, from travel, movies, clothes, groceries, pharmaceutical products, gadgets & even handymen services such as plumbers, electricians, etc.
- E-Commerce in India is now characterized by low pricing, fast shipping and a multitude of options to choose from.
- India is home to over 5000 e-Commerce hubs dedicated exclusively to exploiting the burgeoning growth rate of this sector.
- Though, the bug of e-Commerce seems to have been late to catch on in India, it doesn't look very likely to deflate or even disinflate anytime soon.

A summary of the main functionaries of the e-Commerce industry;

Online Travel	E-Retailing	Classifieds	Digital Media	Financial
Customers buy tickets, book hotels and purchase tour packages online. The ticketing services can be for airlines, railways or buses	Online sale of products such as clothing, mobile handsets, electronics and home and kitchen appliances among others, Booking movie tickets	Portals connecting buyers and sellers by providing classifieds space where the sellers can advertise their product	Paid music, videos and games download	Mobile Wallets, Online sale of insurance, loans and mutual funds
Makemytrip, Yatra	Amazon, Myntra, Bookmyshow	OLX, Sulekha	Flipkart, AVS (Amazon Video Services)	Paytm (One97), SBI

Background – Business models

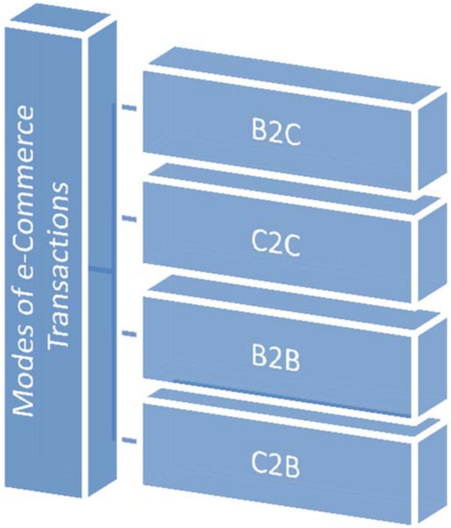
Based on the type of relationship between different sides of a transaction, a transaction can be categorized in different types. There exist different transaction schemas that are forked from different types of e-commerce. Some of the more popular ones have been given below;

- **Business-to-Consumer (B2C) -** Business-to-consumer describes activities of businesses serving end consumers with products and/or services.
  E.g., Makemytrip, Paytm (One97)

- **Consumer-to-Consumer (C2C) -** Consumer-to-consumer electronic commerce involves electronically facilitated transactions between consumers usually through some third party.
  E.g., eBay

- **Business-to-Business (B2B) -** Business-to-business (B2B) describes commerce transactions between businesses, such as between a manufacturer and a wholesaler, or between a wholesaler and a retailer.
  E.g., Snapdeal

- **Consumer-to-Business (C2B) -** Consumer-to-business (C2B) is an electronic commerce business model in which consumers (individuals) offer products and services to companies and the companies pay them.
  E.g., Roundone (Referral)



One should also note that there are several other categories, such as B2E, **B2G**, **G2B**, **G2C** (relating to business & its employees, Government & its citizens). But they do not form a part of the broad classification of the various modes of e-Commerce transactions.

Background – Revenue models

The **revenue model** is a key component of the business model. It primarily identifies what product or service will be created in order to generate revenues and the ways in which the product or service will be sold. Since there are possibilities of multiple variations, many companies do not use one single revenue model. Some of the commonly used models have been enumerated below;

- **Advertising revenue model**
  The advertising revenue model is based on contacts (CPC or CPX) making it one of the indirect sources of revenue.
  E.g., Google, Facebook

- **Subscription revenue model**
  Users are charged a periodic (daily, monthly or annual) fee to subscribe to a service.~
  E.g., Flipkart Media, Nasscom

- **Transaction fee revenue model**
  A company receives commissions based on volume for enabling or executing transactions. The revenue is generated through transaction fees by the customer paying a fee for a transaction to the operator of a platform.
  E.g., Snapdeal, eBay

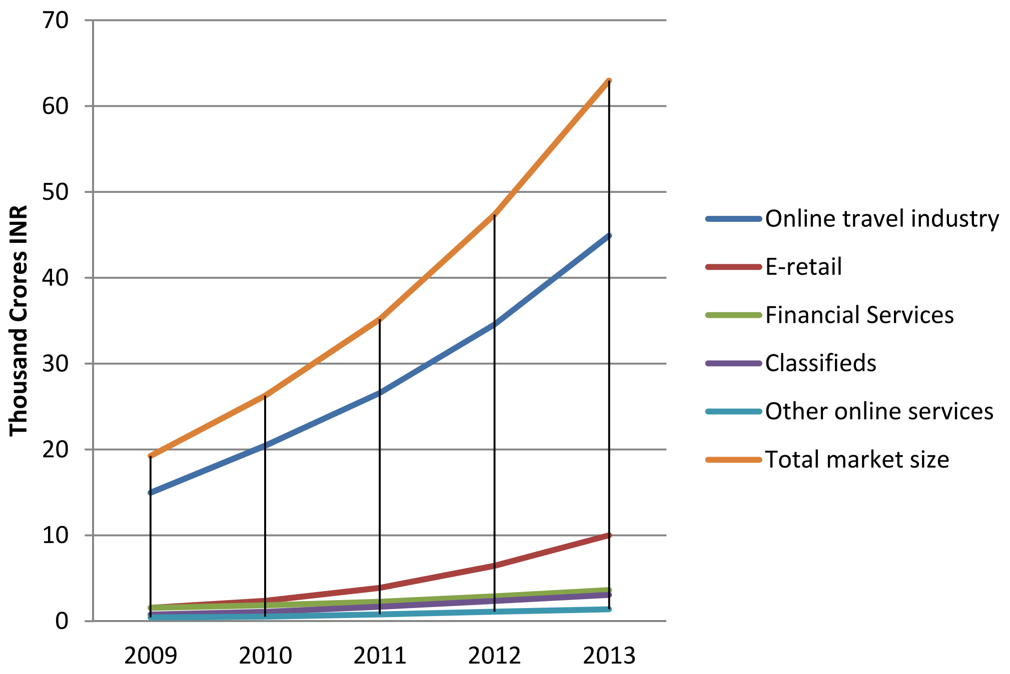
- **Sales revenue model**
  Wholesalers and retailers of goods and services sell their products online. In terms of online sales there are different models such as market places as common entry points for various products from multiple vendors.
  E.g., Flipkart, Urbanladder

There are more variations - for example sponsoring, content-syndication and data-mining. E-Commerce will progress into creating new kinds of revenue models - certainly, new and interesting variations can be expected in the future. Especially big internet companies such as Amazon, eBay, Google and Facebook show their great capabilities to develop new revenue models by combining and constantly improving them.

Background – Sales mix

Under the ambit of e-commerce, there are several products & services to consider. It is important to note that, at times even though the business/revenue model may vary, the commodity/service is grouped along with similar activities.
The following is a graphical representation of historical sales mix;

- Clearly, online travel agencies are the industry leaders, having enjoyed a 5 year handicap.
- Studying the curve, it is easy to tell that the growth of the e-retail sector is far steeper/sharper than the online travel industry.
- Even the financial services are playing catch up by growing at a manifold rate over the years.
- The steep positive curve that represents the total market , grows even sharper over the years. This indicates an increase in the growth rate on a y-o-y basis
- The saturation experienced by the online travel market can be evidently seen in the chart by the stagnating nature of 2nd highest slope



What the above chart primarily denotes is the lack of clear web-based portals & services to avail the presence of such a large Indian audience. Though, the positive to take home would be the steepness of most curves which indicate that people have sat up & noticed the potential of the sector.

Background – Recent M&A activity

Like any high-growth cash-intensive sector, E-Commerce industry has witnessed a burgeoning increase in the amount of funding made available to e-Commerce portals through Private Equity firms or Venture Capitalists.

- This funding is primarily aimed towards consolidation & has been taking place via closures, mergers and acquisitions. Larger players have been acquiring smaller ones to consolidate their position in the sector.
- The main feature of funding received by e-Commerce players in 2014 was the reduction in time (by half) between two rounds of funding against 2013 levels. This is due to the need for funds to scale up rapidly. This can be seen in chart 6.2, by the number of increase in number of deals.
- The average deal size of each round of funding received by e-Commerce players in 2014 was substantially less than that received in 2013.
- The increase in funds parked by VCs, circa 2009, have attracted private equity (PE) funds, which invest in mature companies. Another noteworthy feature is the increase in the fund size of VCs, which gives PE players the flexibility to make large investments in high-return deals outside their focus areas.

A list of recent acquisitions in the e-commerce industry is given in table 6.1, whether strategic or otherwise and Chart 6.2 tracks the inflow of funds from PE Firms & VCs, and the number of deals made

Acquirer	Target
Flipkart	Myntra
Myntra	Exclusively.In
Flipkart	Letsbuy
Snapdeal	Shopo
Flipkart	Ngpay
Paytm	Chhotu.In
Ibibo	Redbus
Healthkart	Madeinhealth
Myntra	Shersingh

Table 6.1
List of recent M&A

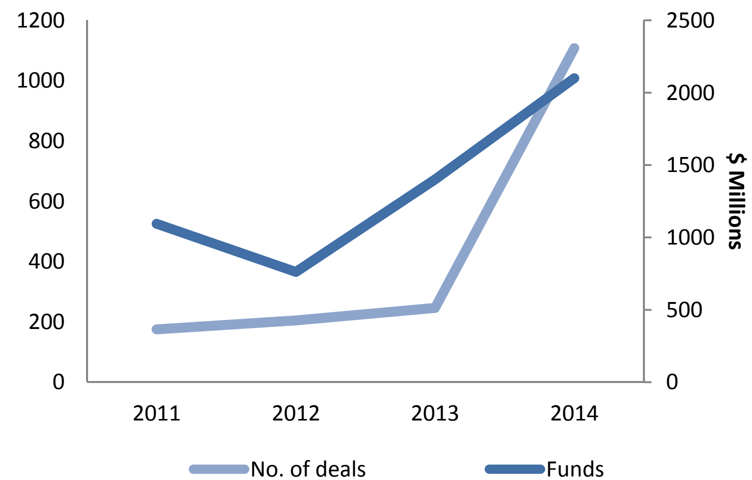
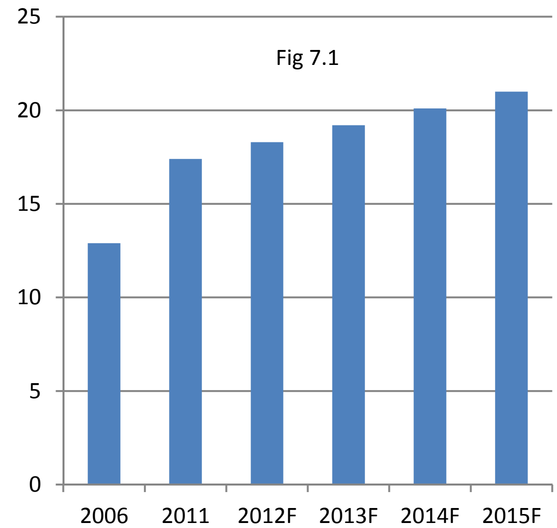


Chart 6.2
Fund receipts &
No of deals

Drivers of growth

The phenomenal growth experienced by the sector is a result of more than several favourable factors in play. Some of which are given below;

- **User Connectivity**
  - Greatly increased internet user base & time spent on the internet (fig 7.1)
  - Abundance of economically viable Internet-enabled handheld devices
  - Increased broadband penetration & launch of 3G services
- **Demographics**
  - Rising disposable income per capita due to rise in middle class
  - Rapid urbanization & modernization of towns & villages alike
  - Clear increase in discretionary income over the years (fig 7.2)
  - Largely untapped market, only about 20% technologically competent users transact online
  - Implementation & heavy endorsement of customer-centric services
- **Evolving payment methods**
  - Multiple payment instruments i.e. Cash, Net Banking, Cards, etc.
  - Increased average transaction value circa 2008, the gateway having become more efficient
- **Easy availability of funds**
  - Risk-Return tradeoff for sector is favorable for PE funds
  - Current market sentiment is conducive for business



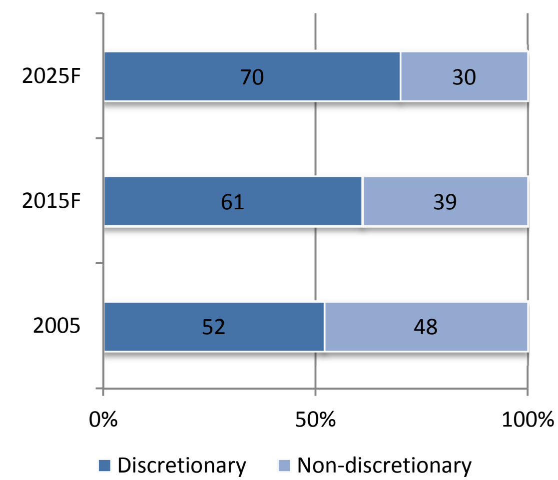


Fig 7.2

Hurdles to the growth story

- **Competition**
  - **Entry barrier** to new entrants, as set up cost is quite reasonable ($5,000-$20,000)
  - Players are indulging in an all out **price war**, to entice footfalls/generate traffic on their respective portals
  - Indian consumers are **fickle in nature**, due to which the customer lifecycle value or ARPU (average revenue per user) is very low
  - E-commerce in India used to primarily be a start-up only industry, which resulted in an extremely **high mortality rate** among such enterprises due to various reasons
  - High **cost of customer acquisition**, and small basket size which stokes competition
- **Operations**
  - **High attrition rate**, as high as 60% for junior employees, combined with shortage of skilled labor, threaten such rapid rate of growth
  - Reach of e-Commerce sector, is still curtailed to the urban regions of India (urban internet penetration rates are also quite dismal). Hence, reducing its **audience to a nominal percent**
  - Although cash on delivery is a favorite amongst its audience, it proves to be quite **expensive, painstaking and risky**
  - The **infrastructure in India** is quite poor, hence the companies have to reply on in-house logistics to suffice their supply chain requirements due to inefficiency of 3PL (3rd party logistics)
  - **Lack of touch-n-feel** factor, which is a must for many shoppers & changing such consumer habits is a long process
- **Legal**
  - **No specific or jurisdictional laws** in existence with respect to e-commerce
  - Loosely governed through IT Act, 2000, which in itself is **quite obsolete** to keep up with constantly maturing e-Commerce sector
  - Most players have to comply with a **myriad of laws** (Indian Contract Act) & regulations to operate within legal framework

Of the 193 e-commerce sites that were operational in India in October 2012, 89 have either shut down or merged with other retailers, essentially wilting under pressure from high operating costs.

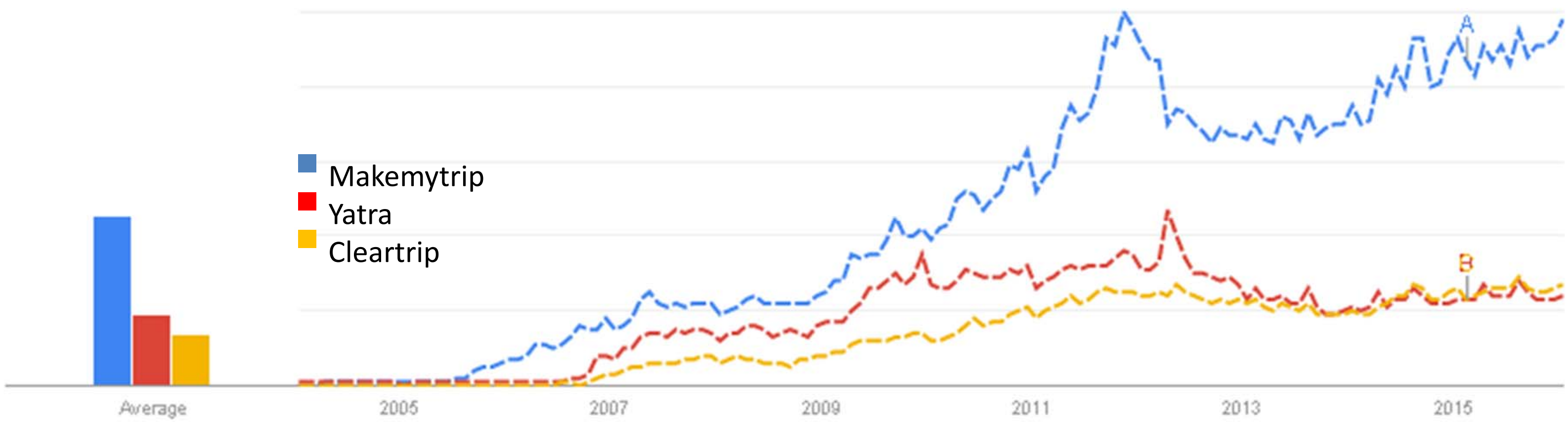
Current trends & analysis – Online travel agencies

- Makemytrip, Yatra & Cleartrip are the major Indian online travel agencies (OTAs)
- Growth in India's travel and tourism industry is the second fastest worldwide
- Largest component of the Indian e-Commerce sector with a market share of about 70%
- India is poised to feature among the top five civil aviation markets in the world over the next decade.
- The entry of low cost carriers (LCC) in the country made air travel affordable for a large number of people.
- Domestic air tickets are driving the online ticketing market.
- India is witnessing the entry of international players and mushroom-ing domestic OTAs.
- OTAs have taken a physical form, with the establishment of new Makemytrip retail outlet in Mumbai, to leverage their brand
- There is a clear perceived change in the approach of the OTAs, from e-Travel to m-Travel
- Emergence of Meta search engines which enable consumers to view & compare tariffs across different portals

Snapshot of the online travel industry;

Particulars	Makemytrip	Cleartrip	Yatra
Year founded	2000	2005	2006
Unique monthly visitors	83 lakhs	85 lakhs	55 lakhs
Employee strength	1000+	450	1000
Funding	Public in 2010	$45mn*	$56.40mn*

Search interest generated over the internet



Source : Google trends

From the chart given above, one can clearly see the first mover advantage that Makemytrip enjoyed for a year before other firms forayed into this segment. Despite being a market leader, its position is constantly under threat due to innovative marketing techniques & erratic client-base. Both Yatra & Cleartrip can be seen as having eaten in to the market share of MMT.

Current trends & analysis – E-retail

- There are many players in this segment, but the bigger players are notably Flipkart, Amazon & Snapdeal
- Online retailers are moving to the marketplace (consignment) model from the inventory-holding model`
- Online retailers are developing in-house logistical capabilities
- Complex tax structures are making decisions relating to warehouse locations difficult for online retailers
- COD has emerged as a preferred payment choice for customers, accounting for at least 60% of transactions
- Due to the cap of 51% FDI allowed in B2C sector, dilution or complete exit is prohibited, which proves to be a hindrance to foreign investors or buyers
- It has attracted investments of over $3bn due to the promising high growth nature of the business from PE Funds &VCs (domestic & international)
- Underpenetrated segments, such as groceries, PCE (plumber, carpenter & electrician) services are expected to grow

Snapshot of the e-retail industry;

	Flipkart	Amazon	Snapdeal
Net Revenue (in Crores)	179	169	154
Loss (in Crores)	400	321	265
Loss per Rupee (2014)	2.23	1.90	1.72
Year founded (India)	2007	2013	2010
Notable Investors/Backers	Tiger Global, Accel Partners	Parent Company	SoftBank, Blackrock
Latest Market Value	$11bn	N.A	$2bn
Model	Inventory	Marketplace	Marketplace
Funding so far	$1.76bn	$2bn*	$866mn
Head Office	Bangalore	Hyderabad	New Delhi
Employee Strength	15000+	8000+	2000+

Search interest generated over the internet

Source : Google trends

The above graph defines a battleground, between the three largest e-tail players in India. Clearly, Flipkart had an upper hand going in, but the coffers of Amazon & Yes Bank backed Snapdeal have flattened the playing field. The constant spikes are explained by the large scale sales that the portals have in place. One can say that Flipkart set in place a red carpet welcome for the other two.

Current trends & analysis – Classifieds

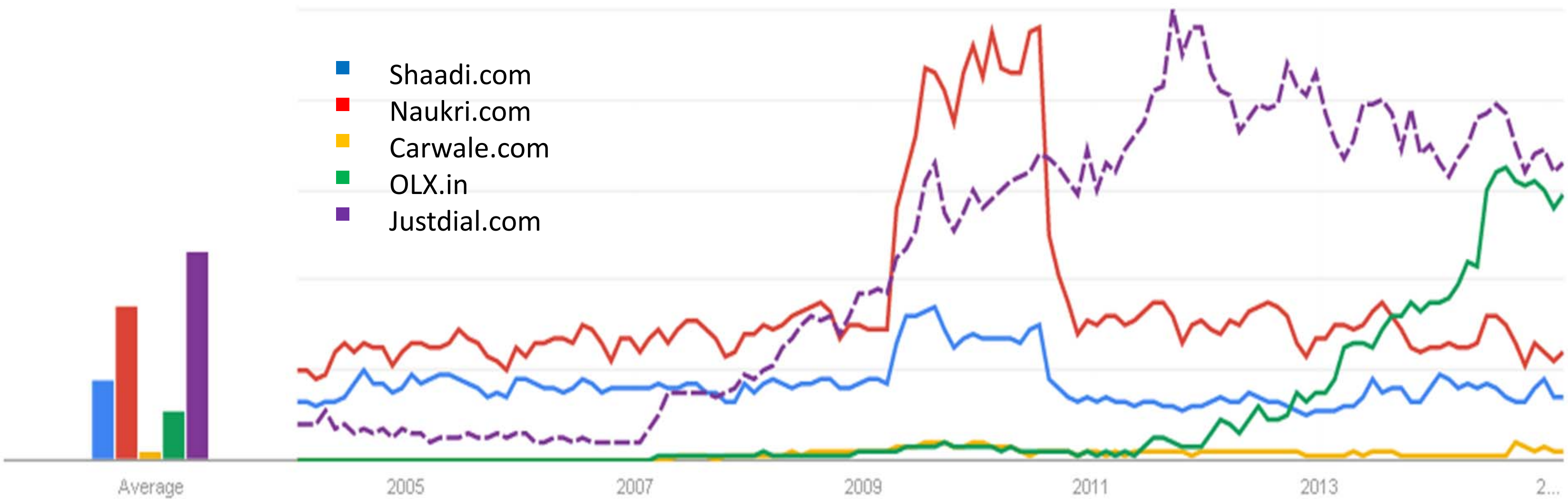
- There are many players in the said segment, the noteworthy ones being OLX, Naukri, Cardekho & Shaadi.com
- The online classifieds segment has overtaken the offline segment in 2013
- Subscription revenues constitute the main source of revenues for the online classifieds segment
- Online recruitment is the largest category in the online classifieds segment, followed by online matrimonial
- Online recruitment players are increasing their focus on providing enhanced search functionalities and value-added services
- The evolution of the real estate classifieds segment is dependent on how well it piggybacks the growth in Indian real estate
- The Indian auto classifieds market is still at its nascent stage
- The primary target of the classifieds market is restricted to urban areas due to location of both, the buyer & the seller
- Leading newspaper dailies are launching their own classifieds sites to leverage their own brand image & reader base
- Most players are now making content available in local vernacular languages to engage a wider audience
- A wider audience is also targeted by localizing the content available online to ones city or locality, etc.

Given below are comparable of two peers listed on the BSE;

INR Crores	Just Dial						Info Edge					
	2014	2013	2012	2011	2010	Total	2014	2013	2012	2011	2010	Total
Net Sales	501	376	275	188	135	1,475	549	484	417	322	264	2,036
Expenditure	319	262	194	138	100	1,013	339	287	233	194	164	1,217
PBDT	182	114	80	49	34	460	208	194	182	126	99	808

From the above, its very clear that the strategies of both the companies are quite different. JustDial is clearly scaling up. This is evident by the fact that over just 5 years, JustDial's Net Sales have increased almost four fold while Info Edge's have only just doubled. This can be attributed a higher outlay (expenditure) as a percent of Sales. JustDial's expense to sales ratio is seventy percent overall, while InfoEdge's is about sixty percent. This justifies the aggressive approach used by most brands to obtain as much market share as possible.

Search interest generated over the internet



Source : Google trends

- Shaadi.com has had a steady search interest over the years due to regular advertising.
- Carwale.com also has a steady but low interest due to lesser advertising.
- Naukri.com has had a steady search interest, which had a spike during 2009-11 when the unemployment rate had risen from 6% to 11% due to the economic scenario.
- Olx.in has been steadily rising and becoming a preferred choice for advertisement of used goods as they have been aggressively marketing recently.
- Justdial.com has too been steadily capturing user interest as it aggressively began campaigning using Amitabh Bachchan as its brand ambassador and after it went public in 2012

Current trends – Miscellaneous

Entry of corporates;

- Mukesh Ambani's Reliance Retail, India's largest offline retail chain, is planning to enter ecommerce space, according to a recent report in The Economic Times.
- The USD 40-billion Aditya Birla Group will launch a project to identify opportunities in the ecommerce space, the Economic Times said in a recent report.
- The Mahindra Group, which has a presence in the retail sector through a few offline specialty retail units, is looking at small steps to build its presence in the online retail market, Anand Mahindra told CNBC-TV18 recently.
- The pioneer of organized offline retailing in India is not too far behind. Future Group's Kishore Biyani plans to launch Big Bazaar Direct, which will launch all of Big Bazaar's products on an online platform by 2014.

Rising number of niche e-commerce players;

- HealthKart, a Gurgaon-based niche e-Commerce player in the healthcare space, is betting big on the multi-billion health and nutrition market in India, since increasing number of people are now going online to buy products like health supplements and testing kits.
- Delhi-based FabFurnish, which retails furniture, kitchenware and home décor products online, was started by Vaibhav Aggarwal, Vikram Chopra and Mehul Agrawal in March 2012.
- Bangalore-based BigBasket.com is yet another start-up in the online food and grocery space. The start-up is also present in Mumbai and Hyderabad. BigBasket.com has shown huge growth potential and is aggressively planning to expand its presence in major metro cities in the country.
- Launched three years ago, Bluestone.com is based on the concept of virtual jewelry mall for brands and vendors to market their products.
- TinyOwl, a food ordering app, launched in Mumbai leads the home delivery segment, in direct competition with the Rocket Internet group's Foodpanda.in

The growth rate experienced by a niche player is far more phenomenal than any other sector, primarily because the models are extremely differentiated & they aim to appease its customers by offering a unique experience.

Financial analysis

An analysis of the major e-commerce players in the industry reveals poor profitability figures. This is down to the extreme expansionist policies currently implemented as market penetration & customer loyalty are top priorities.

For any e-Commerce firm, there are ‘levels’ of profitability in the consumer internet space as follows;

Covering cost of goods sold

Institute a positive gross margin

Gaining unit customer profitability over short term

Achieve positive EBITDA

The following is a snapshot of the expenditure vis-à-vis the sales for some varied players in the e-commerce industry;

INR Crores	Flipkart*	Makemytrip	Snapdeal*	Myntra*	InfoEdge	JustDial	Jabong*
Expenditure	3,228	1,174	431	341	339	319	203
Sales	2,846	1,115	154	212	506	461	203

The above clearly indicates that the newer industry players can barely cover the cost of the merchandise they sell, though the older ones have now slowly stabilised and have a sound revenue model in place.

Flipkart, Snapdeal & Myntra are evidently at a stage of risky expansion, clearly indicated by an average expense ratio of 1.85.

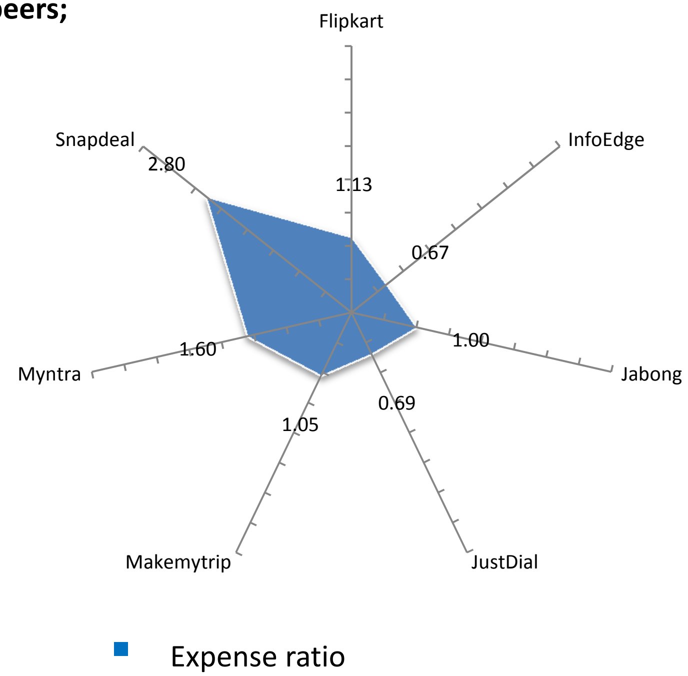
Jabong, owned by Rocket Internet, who’s typical strategy is to clone their website in different markets, invest massively to aggressively acquire customers to raise their valuations, then sell and exit.

InfoEdge & JustDial are established industry players whose focus on sustainability is not surprising at all.

Makemytrip, though quite old, is now engaged in a turf war with other new players, hence the negative profitability.

As can be seen below, the expense to sales ratio is more than 1 in most peers;

In the defense of the e-commerce industry, much of the initial investment was used to overcome a lack of general infrastructure in the country and awareness amongst the consumer. Also, the current strategy indicates that most players ignore sustainability in the hunt for greater market share & valuation and that doesn't do much to aid the bottom-line. This is because Internet commerce, in India, is about new technology and having no entrenched competition. In this backdrop the modus operandi is 'land grab'. The objective, therefore, is to get as many customers as quickly as possible, so that later competitors will have a serious barrier to entry.



Valuation analysis

- The second wave of e-Commerce has witnessed the introduction of new business models and the rapid growth of players in the domain. Most e-Commerce players in this wave are startups that are on a steep growth curve.
- However, these players need additional capital to scale up and maintain the pace of this growth. The need for capital, coupled with the growth potential of the sector, has made it a favorite among VCs.
- However, most of these companies are not yet profitable and are only growing on volumes. This raises concerns relating to a valuation bubble.
- Such valuations have been arrived at using indicators & market research. Also, putting a number on the potential of e-Commerce is a difficult. The growth potential is what is enabling such high valuations. Markers or indicators of such high valuations;

1. **Scarcity of genuine business potential**
   There is a shortage of high quality companies which have at least a sizeable presence. Multiple investors chasing said companies drive up the value by offering plump deals, pushing the sentiment & general valuation up.

2. **Potential market size**
   The market size of India is barely at 1-3% of the entire retail sector, which is valued at $500bn. About 20 million people out of a potential 120 million people. Fig 13.4 shows the e-commerce forecast

3. **Favourable demographics**
   Due to India being so geographically diverse, e-Commerce to far flung tier 2 & tier 3 cities is a very attractive prospect, and possibly prosperous too. Also, as seen in fig 13.2, there is significant increase in the disposable income.

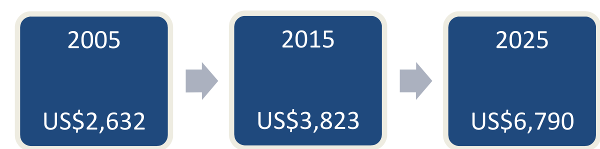


Fig 13.2
Annual disposable income per household is expected to increase at a CAGR of 5.1% from 2005 to 2025

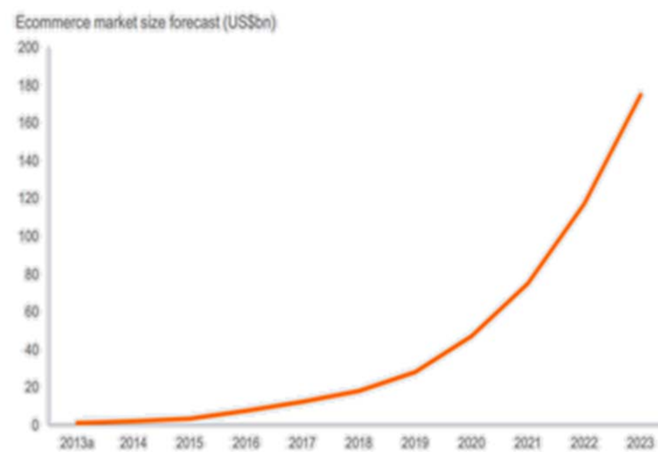


Fig 13.4

4. **Technological advancements**
   Due to recent innovations in the handheld & PC market, internet-enabled mobiles & tablets have become accessible to most. Hence, increasing the reach of e-Commerce enterprises. As seen in fig 13.1, the difference in sales of units of PCs & handheld devices is increasing. Fig 13.3 is the users transacting online.
5. **Internet coverage**
   Internet penetration in India among lowest in the world. The current internet user base and penetration levels in India are similar to those of China's in 2005, and that seems to indicate that India's growth story will be akin to China's. Also, given is table 14.1, which shows the past, present & future scenario with regards to the internet coverage.

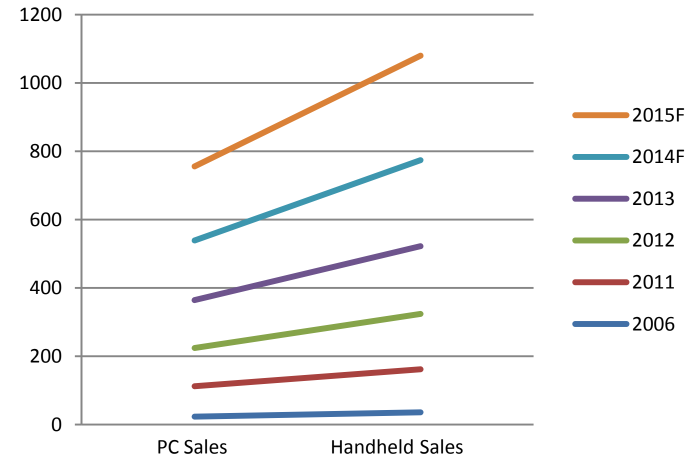


Fig 13.1

	Early 2000's	Now	Early 2020's
Internet users	5.5mn	121mn	400mn
Broadband users	51000	12.8mn	150mn
Plastic Cards	4.5mn	246mn	550mn
Cellular Internet	N.A	Auction	303mn
Users transacting online	3mn	11mn	50mn
Internet time per month	12.9	17.4	25

Table 14.1
India's growth story

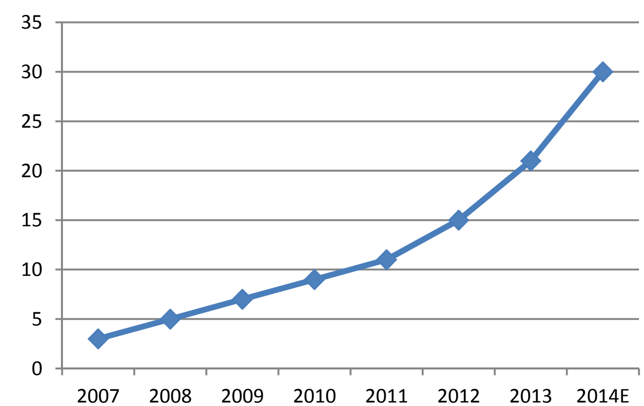


Fig 13.3
Users transacting online (in millions)

6. **Surge of funds**

   Over 14 PE firms or VCs back 2 or more e-Commerce enterprises. Such inflow is on a steep growth trajectory, since 2008. A list of given foreign body corporates & the number of e-commerce enterprises backed by the same is given in table 14.2 Also, there have no notable exits that have been made in the recent past, which shows the confidence in the sector. This build up, results in more active funding rounds witnessed by investees.

6. **Exit Strategy**

   So far, no major exits by VC/PE Funds have been recorded in the industry so far. Currently, it is under the process of consolidation. Exits in the e-commerce sector are most likely in the form of IPOs or a takeover by a larger company. But larger companies like Flipkart, Snapdeal can now only solely rely on IPOs as they're now valued in billions & any form of exit is unlikely in the coming years. The ecommerce market in India is not for the faint-hearted or those looking for an ROI in a short timeframe. It is also not without its share of challenges. However, for the top three or four companies (and their investors) that manage to ride out the next 3–4 years, there are fruits to be borne out of the potentially large and profitable oligopoly that could be established in the coming years.

Venture Capitalist	Firms backed
Accel Partners	18
Sequioa	16
Helion	14
SAIF	14
IDG	12
Tiger Global	10
IDG Ventures	10
Nexus	7
Kalaari	6
NVP	6
Intel	3
Lightspeed	3
Naspers	2

Table 14.2
List of PE/VCs

Case study – horizontal consolidation

In a **big consolidation mov**e for the burgeoning Indian e-commerce market, the poster boy of Indian online retail — Flipkart.com — had **bought out electronics retailer Letsbuy.com** for an estimated $25 million, in a combined cash & equity deal.

On February 9, 2012, everybody, insiders included, was taken aback when Sachin Bansal announced Flipkart's acquisition of Letsbuy.com. A rival e-commerce website, it sold consumer electronics. He said it would allow Flipkart build a dominant share in the space.

Since the time it started **operations in 2009**, Letsbuy deployed heavily discounted prices and extensive product catalogues as strategies to acquire market share. By January 2011, it had enough heft to convince Helion Venture Partners, Accel Partners and Tiger Global to **invest USD 6 million**.

But it **burnt nearly all of it in less than a year**. By the end of the year, it started knocking on investor doors for a fresh round of funds. Nobody uttered a peep. Instead, co-founders Hitesh Dhingra and Amanpreet Bajaj were told by **Tiger Global and Accel to sell their business to Flipkart**. From an investor's perspective, it made no sense to fund two companies competing in similar spaces. The Bansals were told much the same thing and had no option but to acquiesce.

According to company spokesperson, Letsbuy, along with its 350-member team, would continue to function independently, and it could access Flipkart's technology platform and supply chain capabilities.

In a few months, practically all of Letsbuy's 350 employees were **quietly let go** and its infrastructure, including the warehouses, dismantled. Accel and Tiger Global, however, **salvaged all of the cash investments in Letsbuy and got additional stock in Flipkart**.

Though, this transaction was heralded as a first among many of the consolidation process by the investors, it turned out to be a dud, for both Letsbuy.com & Flipkart.

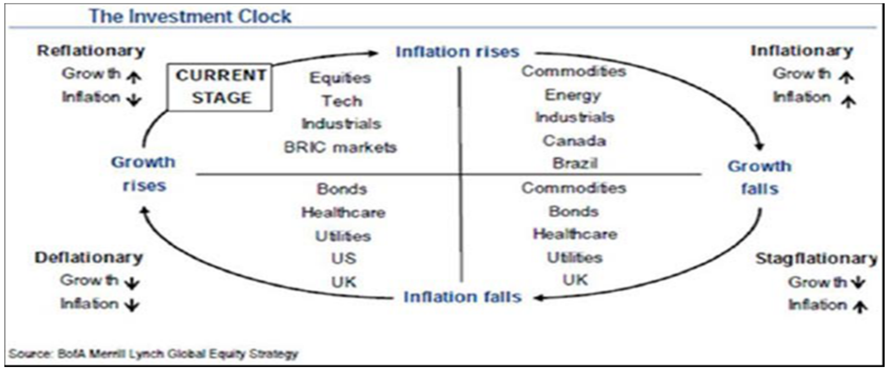
The flip side of the acquisition is that the funding partners **have also taken out a chunk of their investments in Indian retail**, using the Flipkart and Letsbuy deal **as a conduit**!

Though this is only example of such a consolidation, among many others (Flipkart – Myntra & the rumoured Amazon – Jabong). It is an example of how investors are consolidating and hedging their investments in India. The **absence of any indication of synergy is a stigma** that most companies at this stage should avoid, to make better use of the resources available. Also, India is at a phase where the **priority is to shift offline buyers to online** shopping and not just mere token consolidation.

Clearly, the math of successive higher valuations is indicative of the potential that the sector faces, but one cannot deny the plausibility that such sky high valuations are also the creativityof close door boardrooms.

If one were to juxtapose the given model onto the India startup ecosystem, and it becomes clear we are in Quadrant III. There have been talks of a frothy investment environment, a bubble even, especially in sectors like e-commerce. Larger investors are visibly concentrating their exposure to the top 2-3 companies in each category (Flipkart, Snapdeal).

But like any framework, this one is simplistic. And this is precisely the reason why at least half the bubbles have not eventually turned out to the bubbles. The more sensible way to view this, is that when a large new opportunity opens up, one, despite years of conditioning, needs to stop thinking in terms of cycles and think in terms of wealth maximization.



Economic/business cycles are artifacts of a mature system. Nascent sectors and opportunities are marked by secular growth, not cyclical growth; and risks that are structural, again not cyclical. Of course, in the final analysis, everything – sales, funding, traction, valuation – is influenced to some extent by the general economic cycle, but, in the context of early stage investing, these factors pale in comparison to technology risk, competitive pressure, regulatory hurdles and various other structural risks that a start-up deals with.

Arguably valuations will rise and fall with the prevalent sentiment, but can anyone credibly argue against the fact that e-commerce in India is currently barely scratching the surface of its potential today? There will be a variety of different kinds of companies that will inevitably crop up in the next 10 years to cater to this opportunity, not only horizontals like Flipkart, Snapdeal and Amazon, but verticals with well-defined niches as well, and many more we cannot imagine. This argument, in my view, holds true for a wide spectrum of technology related businesses that are still at an early stage in India.

To answer the crazy e-commerce valuation part of the title, given we are in Quadrant III, there is a definite concentration of capital as the 'winners' of the e-commerce horizontals space appear to be emerging. Which implies they will likely be the first to achieve a successful exit for their investors. Depending on their risk-return appetite, many investors have taken a calculated call that they are willing to settle for lower returns (i.e. 'crazy valuations') with the expectation of shorter-term and surer exit.

Conclusion

After having been in the nascent stage for the longest time, the e-commerce industry is finally starting to enter the mainstream. The major entrants in this sector have primarily been start-ups, which need an influx of money to follow their business model. Here, the demand for non-gearing funds comes in, the supply of which, a VC or PE firm can best assuage. Hence, there is a need to establish the value of such enterprise, using one or more means which are indicative of the actual value.

The e-commerce space in India is still evolving and companies have limited history. Many of them function at negative operating cash flows and are dependent on investments from venture capital firms. Using traditional valuation methods like DCF Valuation and Relative Valuation remain a challenge in this segment.

According to Grant Thornton, the nearly Rs 20,000 crore investment activity that e-commerce saw this year so far was driven in part by sky-high valuations.

The commonly used valuation method is the annualized Gross merchandise value (GMV). As most of the E-commerce firms haven't made any profits and do not have a positive cash flow, this is used as an approximate estimate for valuation. The GMV is multiplied by about 2-2.5 times to get the valuation of the firm.

But, as witnessed in the sector in India, even a GMV multiple of five-ten is not unusual as seen in the case of Flipkart, Myntra, etc. This is primarily because the Indian market is nowhere close to being saturated & can be exploited by the existing & new players. This is very good for the sector & even economy for a short term, but if successful exits cannot be made by the VCs & PE funds, it may spell doom for the sector, as in the current momentum, any shortage of funds would hurt the operations of these players.

Recent estimates suggest that leading Indian e-tailers are valued at about four-to-six times their revenue (on an annualised net run-rate basis). This pre-IPO multiple seems fairly low in comparison with the 28-times revenue multiple that Amazon generated at the time of its IPO (and has since justified). It needs to be noted that Amazon at the time was generating a mere USD16 million in revenue (while the top India e-tailers are much larger), but then we are comparing a 28-times multiple to a 4–6-times multiple.

The Indian e-tailers' revenue multiple still looks reasonable in comparison with Amazon's current multiple of two, when their respective revenue growth rates are taken into account. Amazon's revenue has grown by 30–40% over the past few years, whereas Indian e-tailers have achieved more than 200% growth in the past two years and still have most of their growth ahead of them.

Finally, any comparison would need to take India's status as a growth market into account. The growth in India's Internet industry commands at least a two-to-three times higher multiple than the multiples recorded in mature markets. By this measure, the four-to-six revenue multiples (compared with the 2-times multiple for Amazon) again seem reasonable.

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Interesting facts

- Myntra has planned to shut its web portal by the year end, hence making its mobile app as its sole point of contact with its users
- The North Eastern states of India contribute to almost 20% of e-Commerce transactions
- The e-Commerce industry is slated to hire over 1,00,000 professionals in the current calendar year
- Flipkart has experienced a growth in revenue of 5x, and Snapdeal – 6x in 2014
- M-Commerce or e-commerce over mobile amounts to over a quarter of all e-Commerce transactions
- Contribution from tier 2 & tier 3 cities, exceed the contribution by tier 1 city, indicating the outreach of e-Commerce
- For every Rs 100 spent on e-tailing, Rs 35 is spent on supporting services like warehousing, payment gateways, and supply chain management
- Flipkart is no longer an Indian company, having its entity registered in Singapore

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