



# The Great E-Commerce Valuation Crash of 2018 ?

May 2015

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RBSA  
Research Initiative





# Valuations Galore

**Ola**  
USD 20 Mn  
April 2012

USD 30 Mn  
July 2013

USD 85 Mn  
Nov 2013

USD 170 Mn  
July 2014

USD 650 Mn  
Oct 2014

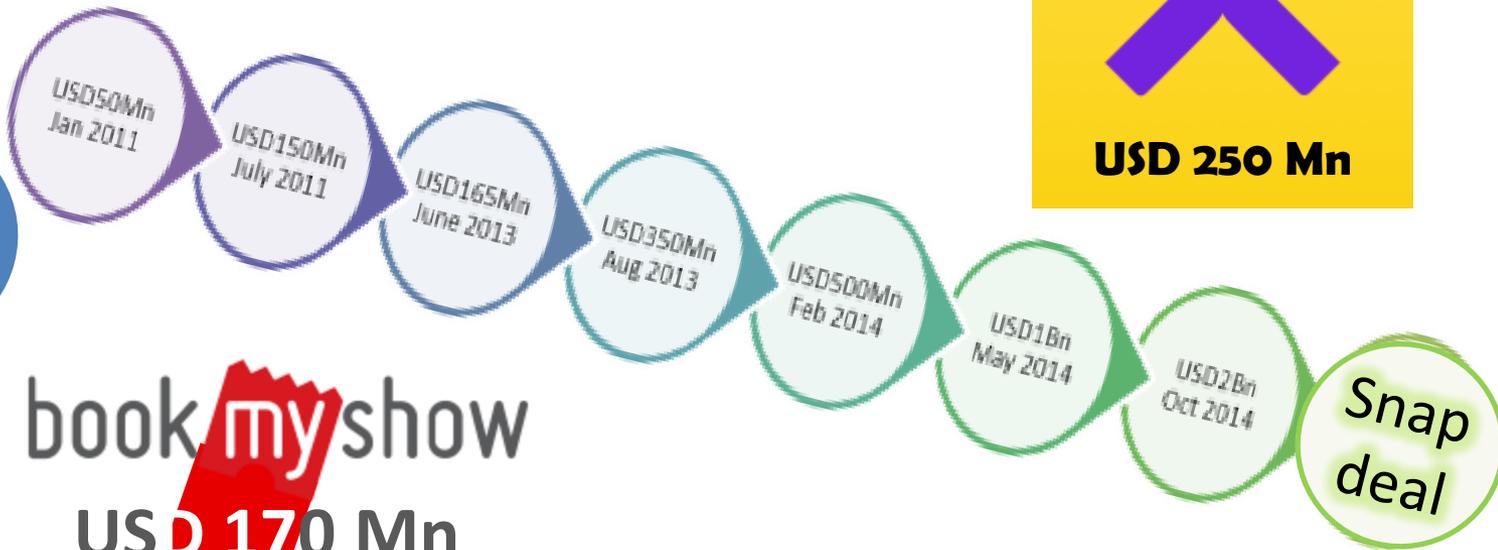
USD 2.4 Bn  
April 2015

**Zomato**  
USD 600 Mn

**Urbanladder**  
USD 150 Mn

Flipkart USD 5 Mn USD 100 Mn USD 250 Mn USD 900 Mn USD 1.5 Bn USD 3 Bn USD 7 Bn USD 11 Bn

**Housing.com**  
USD 250 Mn



**book my show**  
USD 170 Mn

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# Executive Summary

The revelry came to a close in March 2000. In a matter of just one month, the NASDAQ lost a little over \$1 trillion of market value. Dot-coms began going belly up—Pets.com, WebVan.com, eToys.com and, most famously, Go.com.

Fast forward to 2010s, internet companies have once again cemented their eminence as **PEs/VCs/darlings**, not just in the US but even in India, drawing parallel with the dot-com

- **Rising valuations around the globe, especially for e-Commerce firms**
- **A possible buildup of an Asset bubble**
- **New valuations methods adopted**
- **Mind share is the main game being played**
- **Momentum investing has led to an epidemic of flawed valuations**
- **Exposure is limited to the private sector**

bubble. Just last year, investors ploughed in more than \$4 bn in Internet businesses, and that figure is expected to be pointedly higher in 2015. This race is **flanked & fueled** by the seemingly infinite resources of the Private Equity players & the Venture Capitalists.

Traditional valuation methodologies are now being **discarded for modern methods**, which are fairly

convenient for the parties involved.

There is a clear cut **strategy of mind share** being employed to be able to sum up the numbers required in the **new valuation metrics**, customer base & gross merchandize value.

Many of the PEs & VCs seem to be guided by the principle of **momentum investing**, which hexes the the demand supply curve. One needs to remember the difference between

the **value of an object as against its price**. Valuing such businesses at astronomical figures is sure to create an **asset class or business units which cannot be serviced** & are bound to be on a straight downward journey. Or the **bubble bursting**.

This time though, it's the **private enterprises & businesses** getting eye popping valuations.



# Introduction

**“Of recent, the valuation game has turned into a ‘black magic art’ more than a science,”**

**– Ravi Gururaj, Chairman of Nasscom**

A big question in investors' minds is whether e-Commerce is a bubble in India. Valuations are on the rise for the better part of two years due to the **excess supply of monies** from the PEs & VCs. This questions the **veracity of the valuations & its metrics** employed to arrive at the enterprise value.

India is experiencing a wave of **prefix investing**, which involves a market bias for companies with an ‘e-’ as a prefix or ‘.com’ as a suffix. To keep up with growth experienced, there is a need for **endless innovation** to engage and exploit said market/audience.

Still, drawing comparisons between the present-day funding/valuation boom and the dot-com bubble infers notable similarities: extraordinary rates of **cash burn**, colossal losses, ambitious assurances of a steep growth trajectory and **feeble due diligence** by investors under the **fear of missing out (FOMO)**.

- One of the reasons that justify this apprehension is that companies are acquiring customers by selling at a discount. They are **competing on price** to overcome competition.
- The second reason are the accounting methods adopted by some companies. They are **amortizing discounts** that they provide on sales as capital expenditure, instead of accounting for this in the year of sale. This leads to **inflation of their balance sheets**.
- The third reason is the **dismal success rate** of tech start-ups world over, which is bound to blight the Indian success story. Valuation is no longer a metric that denotes the absolute true & fair value of the company, but a plethora of macro & micro factors.

$$\begin{aligned} & \text{Valuation} \\ & = \\ & \text{(Founder's aspirations * Near term Revenue Growth)} \\ & * \\ & \text{(Investor FOMO * Downside protection)} \end{aligned}$$

# Undoing the façade

## Flipkart

- GMV – INR 24,000 Cr.
- Loss of Rs 2.33 for Re. 1 in net revenue
- Funding received to the tune of INR 14,400 Cr.

**Value  
Rs. 60 -  
65k Cr.**

## BHEL

- 50 years since inception & over 40 years of profitability
- One of India's largest engineering company
- Cumulative profit of INR 27,500 Crores for last 5 years

## Ola

- Radio taxi service, founded in 2010
- Sustainability is a big ask, as operations are bolstered on VC money
- No major underlying asset i.e automobiles

**Value  
Rs. 15k  
Cr.**

## JSW Energy

- Gross turnover of INR 29,000 Cr.
- Increasing EBITDA margins
- Total net generation in FY 2013 – 14 17,061 Mn units

## Snapdeal

- GMV Rs. 18,000 Cr
- Incorporated in 2009, but yet to yield any profits
- Funding rounds have triplicated value in 2 years

**Value  
Rs. 11k  
Cr.**

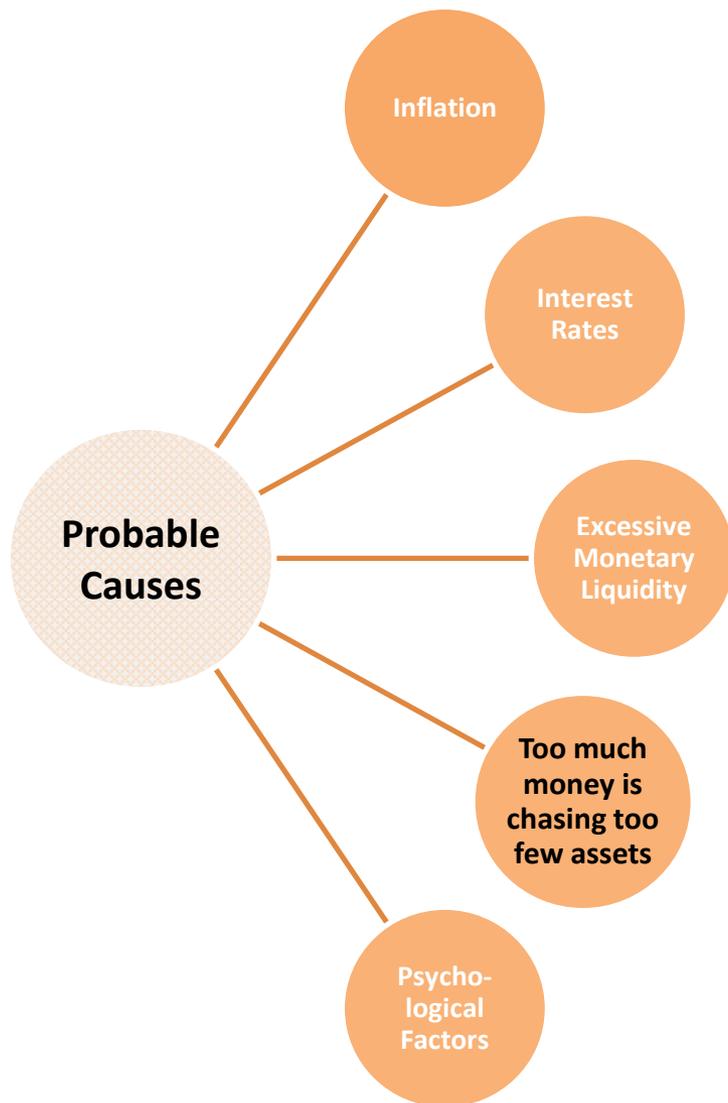
## Amara Raja

- 2<sup>nd</sup> largest lead acid battery player
- Sales of 3,436 Cr. in March 2014
- Sales CAGR of 27% for last 5 years
- Has provided capital appreciation at almost 14000% (10 years)

Source : Media Reports & Annual Reports



# An Asset Bubble



An asset bubble, a periodic phenomenon, is when the value of assets increases much faster than its real underlying value. Sooner or later, the high prices become unsustainable and they fall dramatically until the item is valued at or even below its true worth. In this case, because the e-Commerce companies are still not publicly listed, the underlying is the book value of the business as against the sky high valuations that are doing the rounds today.

**“If a company is losing money on every transaction, then the business model is not sustainable,”**  
- Devangshu Dutta,  
Chief Executive Third  
Eyesight

**“Nobody looks at the fundamentals of valuations anymore,”**  
- Karthik Reddy,  
Managing Partner  
Blume Ventures

# An Asset Bubble

This time, since the bubble is prevailing in privately held Indian e-commerce companies and that the valuations here are also closely linked to the soaring valuation of US tech start-ups, three types of events may result in an investor pullback.

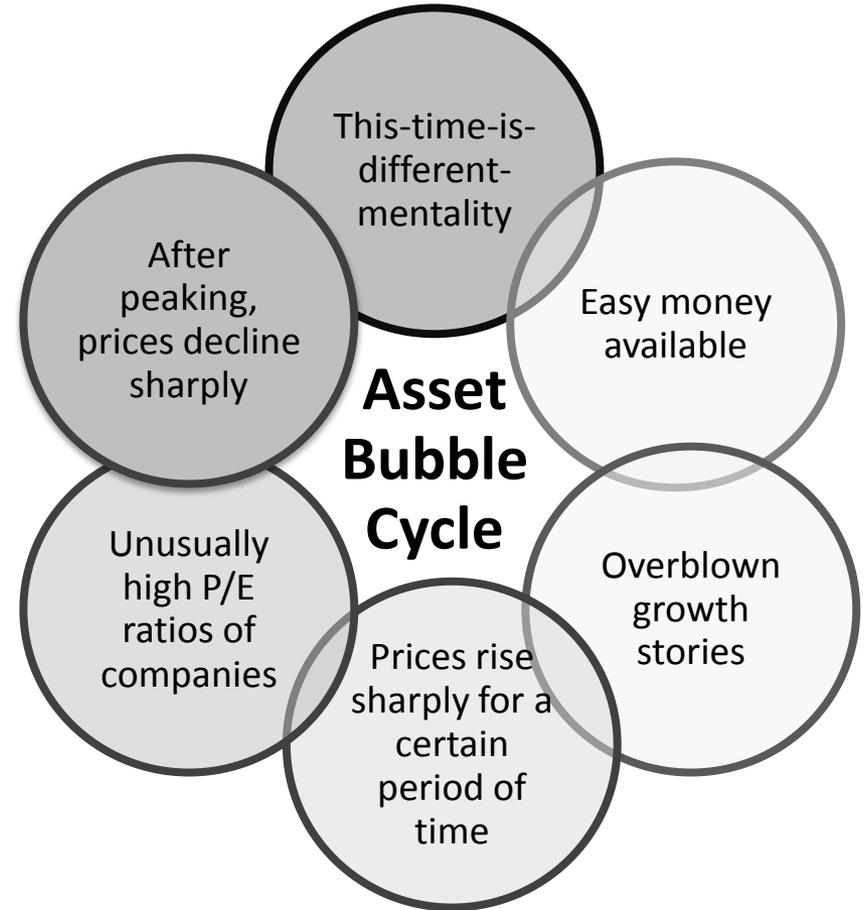
**One;** a macroeconomic event

**Two;** declining valuations of US-based private companies such as Uber and Dropbox

**Three;** if a big Indian Internet company struggles to raise cash

## Impact points

- Founding team & its credibility
- Traction & near term expected revenue
- Potential market size
- Growth & engagement
- Competition, market forces & multiples



Lifecycle of an Asset Bubble

# Valuation Analysis – Offline v/s Online Retail

## Publicly Listed Offline Retail Companies *(All figures are in INR Crores)*

Company	Net Sales (FY 13-14)	FY 14-15 Avg. Market Cap (EqV)	EqV/Net Sales
Future Retail	11,690	3,209	0.27
Pantaloon Fashion & Retail	1,661	1,099	0.66
Shopper's Stop	3,984	3,742	0.94
Trent	2,498	4,297	1.72
Future Lifestyle Fashions	2,907	1,474	0.51

## Unlisted Online Retail Companies *(All figures are in INR Crores)*

Company	GMV (FY 14-15)	Net Sales (FY 13-14)	Equity Valuation (EqV)	EqV/Net Sales
Flipkart	24,000	3,036	66,000	21.7
Snapdeal	18,000	168	18,000	107.1
Jabong	3,600	439	6,000	13.7
Shopclues	2,400	46	2,100	45.7
Urban Ladder	NA	65	900	13.8

- The EqV:Net Sales of the prominent listed offline retailers in India is found to vary between 0.27 to 1.72, averaging at 0.82
- All of these players are making operational profits, however only two of them are making post-tax profits
- The sector is currently seeing a consolidation after the merger of Madura Garments with Pantaloon and Future Retail with Bharti Retail.



“  
*...this is not the end,  
 it is not even the beginning  
 of the end. But it is perhaps,  
 the end of the beginning...*”

- The online retail companies rely on a different metric for valuations – GMV
- However, GMV is not reflected on their financial statements; there is little co-relation between the GMV and the Net Revenues of the Company as seen in the table above.

Source : Ace Equity & Media reports

# Fund Raising or Valuation Bubble Creation ?

- A typical fund raising process today involves several rounds of funding depending on the stage of the start-up.
- As the business grows, the company will raise funds at higher valuation in subsequent rounds.
- The investors look to exit after a period of 3 years, generally during the public offering.
- Over the past few years, it has been relatively easy for startups to raise money from venture capitalists. Some of them have raised hundreds of millions of dollars just to keep their companies afloat.
- But behind the scenes, they're plowing through that money either on marketing, overhead, or some other expense, which results in high cash burn rates.



Company	Estimated Monthly Cash Burn (INR Crores)	Fund raised in latest Round (INR Crores)
Flipkart	300	4,200
Snapdeal	150	3,800
Ola	125	1,300
Housing	50	540

- Some of these startups currently are being valued at more than 100 times their annual revenues, despite making EBITDA level losses.
- Almost all of the major online players are looking at filing an IPO in the coming 12-24 months, thereby seeking a much higher valuation than what they currently command.
- Current valuations of these companies are driven by sentiments and speculations rather than market fundamentals and earnings potential.

Source : Media reports



# More Fab.coms in the making?

## THEN

- June 2011 saw the launch of Fab.com – A design centric e-commerce store, built around Flash Sales.
- Within 6 weeks and hitting 400,000 users, it reports profitability and raises US\$ 8 million in Series A funding.
- 6 months after launching, it reaches more than 1 million users and raises US\$ 40 million in Series B funding, being valued at US\$ 200 million.
- In 2012, Fab.com begins acquiring other companies and spreads across multiple countries. It had more than US\$ 115 million in annual revenues and raised more than US\$ 100 million in the third round of funding, valuing the company at US\$ 600 million.
- By 2013, it transitioned into a traditional retail store, expanded to 26 countries and was burning almost US\$ 14 million per month. It raises US\$ 150 million at a US\$ 1 billion valuation.
- By Feb 2015, the company had burned through most of its US\$ 335 million funding and laid off the majority of its employees. It was eventually sold off for a mere US\$ 15 million.

## NOW

- Low barriers to entry and easy availability of capital have promoted the birth of thousands of internet startups in the past 3 years.
- During FY14-15, more than INR 30,000 crores investment was made in tech startups in over 200 deals in India.
- Startups today are burning a lot of cash on advertising, marketing, customer discounts and on hiring against the rivals.
- Some companies may see these cash windfalls as permission to burn through money at an excessive rate, rather than spending at a level justified by their own realistic earnings potential.
- E-commerce space globally is a winner-takes-all arena. It is game of burning cash unless you become the absolute leader of the pack. It is only then that they can start making any money.
- However at some point, the money will dry up and the market will witness mass acquisitions (Eg: TaxiForSure, Letsbuy) and the gradual demise of many cash starved startups.

**“ Topline is Vanity, Bottomline is Sanity, Cash Flow is Reality ”**

Source : Media reports



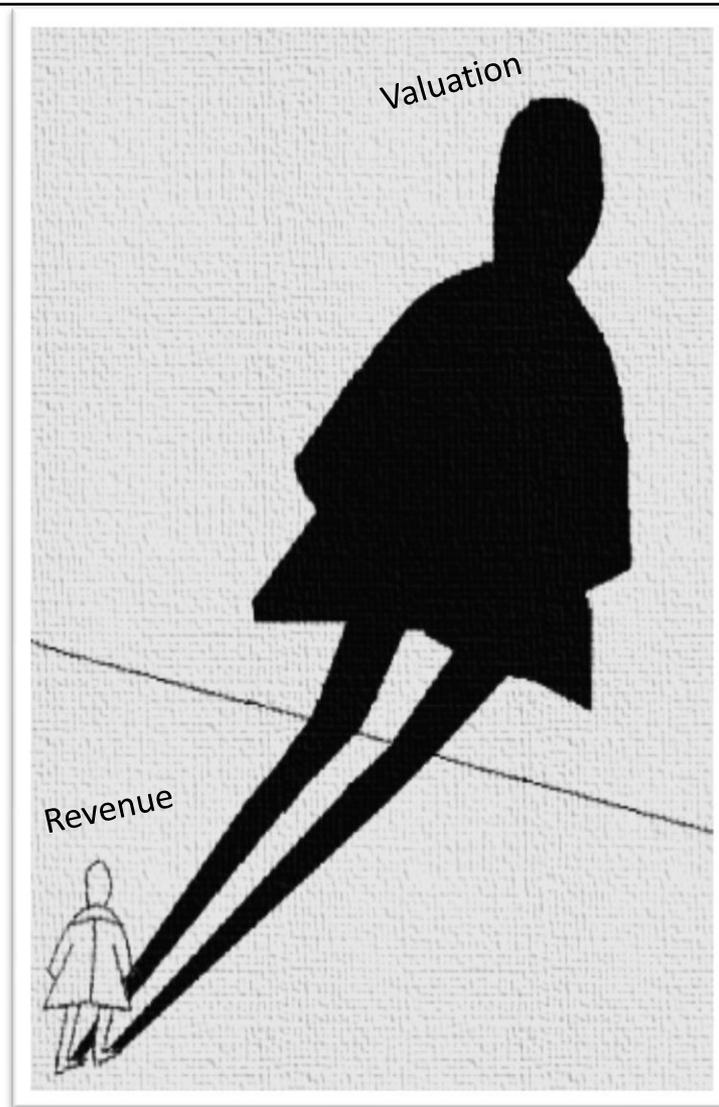
## Valuation Hacks

### Gross Merchandise Value (GMV):

- GMV is a term used in online retailing to indicate a total sales value for merchandise sold through a marketplace over a period.
- GMV for e-commerce retail companies means sale price charged to the customer multiplied by the number of items sold.
- For E.g., if a company sells 10 articles at Rs. 1,000 each, the GMV is Rs.10,000.
- The GMV is then multiplied by a Multiple (x times) to get the Valuation of the entity.

**“Where is Flipkart's complete business model? Forget about valuation. I want to know Flipkart’s business model. I want to know how you will be profitable?”**

**- Rakesh Jhunjhunwala**



## Other Valuation Methods

Other uncertain valuation techniques include:

- **Cost Per Impressions – (Ad Spend/(Impressions/1000))**: It is commonly used to measure the rate you would pay for a online banner ad campaign or other online advertising campaign. An Impression refers to the times the ad is served on a webpage (how many times the ad is seen).
- **Cost Per Click (CPC) – (Ad Spend / Clicks)**: This is most commonly used to measure the rate you would pay for a search engine ad campaign. CPC can also be referred to as PPC (Pay Per Click).
- **Cost per Acquisition (CPA) – (Ad Spend / Orders)**: This is most commonly used to measure the rate you would pay for a new order or customer. CPA is often used when measuring the rate you would pay an affiliate for referring an order to you.
- **Revenue Per Click (RPC) – (Revenue / Clicks)**: This is the amount of revenue you can expect for each click you receive to your site.
- **Cost of Sale (COS) % – (Ad Spend / Revenue)**: This is the portion of your revenue that goes to your ad spend and is measured in percent.
- **Customer Lifetime Value (LTV)**: This is the projected revenue that a customer will generate during their lifetime.
- **Customer Acquisition Cost (CAC) (Total Costs Associated with Acquisition of Customer/ Total New Customers)**: This is the price you pay to acquire a new customer. This cost is incurred by the organization to convince a potential customer.

## Possible Endgame Scenarios

### 2015 :

- Industry saturation & consolidation underway
- Substantial customer acquisition costs (“CASH BURNS”) to increase awareness & footfalls

### 2016 :

- Successive rounds of fund raising to be done through venture debt & through more mature investors
- Abundant amount of start-ups conceived with the strategy of being absorbed by a bigger player

### 2017 :

- Investors start exiting smaller players to corporate houses & other HNIs
- Planned & strategized growth to show maximum underlying value to be able to get listed
- Smaller players will eventually run out of cash and shut operations

### 2018:

- Upon going for an IPO, company’s listed price shall not match the company’s valuation at the last round of funding. This is going to cause a major crash where early exits will be lauded & a lot of investors are going to be an unhappy lot.
- Though, one or two major players will make successful IPO exits for their investors & founders and eventually turn into Industry stalwarts



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