July 2021

EMPOWERING TIMES

THINKING ALOUD
The Exciting - and Perilous - Valuation Game!
Jay

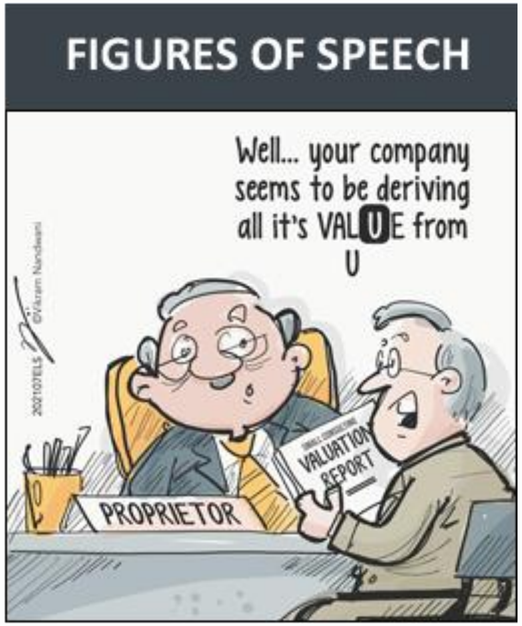
PODIUM
Prof. Kirron Bindu
Director of International Relations at ISBR

WE RECOMMEND
Samsung Rising
Geoffrey Cain

Dear Reader,

The Indian start-up ecosystem was unperturbed by the last two waves of the pandemic. According to data from the Ministry of Corporate Affairs, the monthly registrations hit a fresh high of 17,324 companies in March 2021 and stood at 10,915 companies in May 2021.

Business owners are looking at the pandemic very optimistically and are spending considerable time and energy to enhance their company value by developing growth plans with well-defined goals. Here is where valuations play an important role to guide entrepreneurs to know the company's financial standing and the way forward. A valuation also serves as a reality check for owners as this process exposes areas of the business which actually take away value, such as weak financial and accounting controls, among other factors.



ET this month looks at **'Enterprise Valuation of MSME Firms: The Entrepreneurial Dilemma'**. On the **Podium**, Finance professional and Director of International Relations at ISBR, **Prof. Kirron Bindu** elaborates on the importance of valuation of firms.

In the **Thinking Aloud** segment, **Jay** shares his views of the valuation game through examples in the Indian start-up ecosystem. In the **We Recommend** section, author Geoffrey Cain gives an account of the rise of electronics brand Samsung in his book, **Samsung Rising** and what makes it a brand that has become a household name today.

In **Figures of Speech**, **Vikram's** toons spot the real 'value' of an enterprise!

Please also **Click Here** to check out our Special issue of ET, which is a collation of selected themes that were featured over the years highlighting the changing landscape of the business world. This special edition has been well received and can be **Downloaded Here** for easy reading and is a collector's item.

It's been 15 months since the pandemic interrupted our lives without warning. This crisis is no ordinary interruption; it is an event so implausible and unexpected that we are still trying to make sense of what is happening.

You're invited to join our CEO, Prasad Deshpande in conversation with Michael Morgan, CEO of Herrmann International Asia to discuss how Whole Brain® Thinking can help individuals, teams, and organisations make sense of change and adapt to continuously evolving situations by thinking differently.

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Thursday, 5th August 2021

1:30 PM AEST (9:00 AM IST)

In this webinar, they will explore a three-part approach in how to think differently and adapt quickly in a hybrid working world. It will interest anyone who wants to make sense of their situation and would like to practically learn how to deal with change in the short and long term.

I hope you can join us.

As always, we value your opinion, so do let us know how you liked this issue. To read our previous issues, do visit the Resources section on the website or simply **Click Here**. You can also follow us on **Facebook**, **Twitter** & **LinkedIn** - where you can join our community to continue the dialogue with us!

THINKING ALOUD

The Exciting - and Perilous - Valuation Game!

Jay

The big payday for start-ups is coming!

Zomato is ushering in a new era for app-based consumer platforms as it goes public in July 2021. Verily, there is a gold rush on the cards as it will be followed soon by others including Paytm, Nykaa, PolicyBazaar, Lenskart, Delhivery, Flipkart, etc. The rumor mill has been working overtime and if one were to believe all the half-announcements (which is frankly what they are - "yes, we intend to list, yes, it is happening very soon...in 6-9 months...") then more than the monsoon floods, this year will see a rush to the stock market. Call it a 'revenge IPO surge', if you wish, but the dry run of 2020 caused by the Covid-19 pandemic has given way for a rush to the markets much like the old days.

The twist in the tale is that the newbies are seeking unheard of valuation. Take Zomato for instance, which has a valuation of USD 7.6 billion with a revenue of USD .37 billion and a loss of USD .32 billion! But then if Airbnb (which listed in December 2020 at USD 47 billion and is today worth USD 75 billion), and Uber which listed in May 2019 at USD 82 billion and is now worth USD 90 billion) and several other start-ups could list at crazy valuations when they were in the red, why should Indian start-ups be far behind, one could argue! Tell that to the old economy folks who are still figuring out why Indian Hotels (with its fancy hotel rooms and restaurants) has a valuation of Rs. 18K crores when food delivery firms like Swiggy & Zomato (who pile up losses year after year) are valued at billions!

If all this seems like a new form of accounting, it indeed is so. Experts have been crying themselves hoarse over the last 5 years and more calling the valuation exercise as hyperbole and a bubble waiting to burst. Yet, even in the face of the dark days of the pandemic, the optimism surrounding the start-ups has held strong. Figures for the first half of 2021 already indicate that the start-ups in India have raised USD 12 billion so far (as against the overall sum of USD 11 billion last year). With the unending flow of Private Equity money ever ready to push up valuation of a firm with every round of capital infusion (think Byju, Dream 11, Flipkart, et al), the doomsday in the market is still seen as far away, even with analysts calling this the new sub-prime ticking bomb. Even valuation doyens like Aswath Damodaran have gone public with their skepticism calling such firms as 'collectively over-valued' declaring that the 'size of the macro story may not justify the micro-valuations'. Be that as it may, the party is in full swing and no one is complaining...yet.

The ordinary investor is always the lame duck in the stock market. The fear of missing out on a good stock pick makes him jump on the band wagon fuelled by financial writers who champion a new narrative every season. Spotting a trend is never easy so the lazy option is to go by popular by-lines. The very same writers change the storyline a few months later and the hyped up companies and business heroes come crashing down. Few, if any, have ever learned that investments need homework and the case of WeWork can be repeated again. To paraphrase Prof. Damodaran with his take on the dark side of valuation, some moderate financial numbers combined with good story-telling can create a heady concoction as a narrative can be recycled well from one round to the other till Softbank picks you up! It is difficult to say whether the case of Adam Neumann and the USD 47 billion meltdown of WeWork has become a cautionary tale as unicorns seem to be exploding in India, and at last count there were 16 born in 2021!

However, for those who still maintain that 'social media or an app is not a business' forget that every up-start - sorry, start-up – firm still believes that if Amazon could do it, so can they. And, therein lies a new valuation tale waiting to be pitched!

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Podium

Prof. Kirron Bindu

Director of International Relations at ISBR

Prof. Kirron Bindu is the Director of International Relations at ISBR, a leading Graduate School for Business Accredited by AICTE , NBA and AIU., Prof. Kirron Bindu has domain expertise in Finance. His areas of interest is Financial Derivatives and Risk Management. Starting in 1995, Prof. Bindu has experience in Accounting and Auditing areas too.

Prof. Bindu has over 12 years of teaching experience in some of the best schools in Bangalore including Christ University, Alliance Business Academy, National School of Business, IBS Bangalore, Symbiosis, NMIMS, Welingkar, PES College, Indus Business Academy, Jain University, Dayanand Sagar University and many more.

Valuation is another area of passion; in the recent past he has valued companies and natural resources like mines for interest groups in the social activism sphere. He has experience in analysing the social cost of PPP and raising pertinent questions before the regulatory authorities in the areas of civil aviation and electric utility companies. He is involved in training executives in IFRS. He is a partner in an investment advisory firm called Mentes Kapital where he provides both investment and trading calls to interested subscribers for various investment packages. Between 2013 to 2016, as a Mentor at a leading Accelerator called Kyron, he has guided the financial projections and valuation efforts of over a dozen promising tech start-ups.

He is a Principal in Mellen Capital which focuses on Advisory in ESOP and M&A transaction advisory. His past corporate credentials include Companies like Indus League Clothing Limited, MCS Software Consulting and System Domain.

ET: How are company valuations done and why is it important in decision making?

KB: A corporate entity would like to know its value for regulatory purposes, for conducting a corporate transaction of raising funds or divesting a division or acquiring a suitable entity. The valuation exercise enables the management to know how the various departments add to corporate value. Valuation with strategic intent can boost today's MSMEs to tomorrows Small Cap Companies and then Mid Cap and so on. Managing key value drivers like revenue, margins, growth and access to low cost funds gives entities a competitive moat, which sustains them through the difficult times and helps flourish when economic conditions are suitable. Managing without having a clue of one's value is like driving without knowing how much fuel is there in the tank or the direction one is driving.

Your value is driven by what assets you have, what cash you generate out of those assets, what your future assets are going to be and how much you are likely to earn on that.

Most managements would love to know where they are. Unfortunately, they turn to the wrong person for help on this. If one has an eyesight problem one would not go to an orthopaedic surgeon. This is what the management ends up doing in the MSME space. For all things to do with money, they turn to their professional who does their taxes. Most MSMEs have an internal financial information system that is good at keeping books required for external reporting to fulfil compliance. That system is not designed to give you the financial information to help you see how the future will pan out for you if interest rates climb 2% or if the Rupee ends this quarter at 76 to a USD.

The financial information system in most MSMEs are already overwhelmed with the compliance burden. Often short staffed, they are unable to devote resources to come up with the valuation of the entity.

The CEO and Board would do well to engage with an experienced professional to provide them with deep insights to help move the discussion in the board room from routine compliance to strategic value creation. The starting point for that is to know what the value of your entity is.

ET: What are the challenges in valuation of an MSME and how does an entrepreneur overcome these?

KB: MSME valuation poses one problem which is less than transparent historical financial information. While to a large extent the GST and the chain of input tax credit and the e-way bill generation and e-invoicing has ironed out this problem, still this problem persists. Financial statements are a result of the back working of how much income tax the entity wants to pay. The starting point for valuing an MSME is to have the best set of financial statements which we can vouch for. The audited financial statements which capture the journey of the entity for the past three to five years, is a good place to start. Next is the tendency of the entrepreneur to pay for a valuation. He will "suggest" what valuation he is looking for. This then becomes an exercise at reverse engineering the books based on how much tax he wants to pay.

ET: Even during the pandemic period we find that valuations of some start-ups have gone through the roof, with India producing a spate of Unicorns. All this while the firms have not shown any profits at all! How do you explain this strange phenomena?

KB: In a few years, we expect about 150 unicorns to emerge from the Indian start-up eco system. Back in 2000, any company with a .com in its name saw its share price go into nose bleed levels. Back then, most were publicly traded and the fallout was a massive financial crisis that led to the destruction of equity wealth. The next bubble we saw was in the housing market fuelled by cheap credit. When the housing bubble burst in 2008, it led to the collapse of some of the most venerable banks and a new set of regulations were imposed to ensure that it never happens again.

The beauty of the financial crisis is that the next crisis won't resemble the previous crisis. We may have a view that the next crisis will emerge in the start-up space. Many start-ups have fallen off the pedestal and multi-billion dollar write offs of a few start-ups involved with space sharing ideas, emergence of Special purpose Acquisition

Companies or blank cheque companies which could raise money from investor with a promise to acquire one of these unicorns, could have led to the year 2000 repeating itself all over again.

Thanks to a new spate of regulations, that danger has been warded off for now. Another reason why valuations are high is because with interest rates being so low, it is easy for funds to flow into any entity that is has an idea which seems promising.

Yes, it is tough to justify the value of entities which have never shown a profit. One just has to appreciate that markets have a long term vision with those entrepreneurs who are solving a problem, real or imagined.

ET: It is believed that professional service firms (including small management consulting firms) cannot be valued in normal financial terms. As an expert on valuations, what is your opinion, and how would you proceed in this matter?

KB: I believe that a small professional services firm can also be valued provided it has documented its business intelligence and has a formal organisation structure. This is where the founder needs to have a vision to allow the firm to grow beyond his shadow. The entity must be capable of generating business and serving the market without his day-to-day presence. The process should be documented so that someone else can come in and run the firm without any glitches. The firm should maintain its client base records and every business transaction. Some clients will require regular professional services and they could be paying a retainer, some could be one time. The challenge is when the founder retains all information to himself and confuses it with competitive advantage. Valuation suffers. A clean account and no violation of tax laws and other laws helps. What cannot be valued is a one-man outfit without a record of accomplishment of client service capabilities. Here we can only value individual files and bundle them to arrive at a value. Here the challenge will be the handover of the client to the buyer. We have to anticipate at least 30% will go to another provider if the original founder is not there. A prolonged handover process will have to be adopted in such cases to minimise client dispersion.

ET: Please share with us more about your work in Mentes Kapital and your valuation consulting practice.

KB: At Mentes Kapital we studied opportunities for value investment and created detailed reports to help our clients make informed decisions. We also provide consulting to start-up entities in the high tech start-up space. We valued entities engaged in raising funds for growth.

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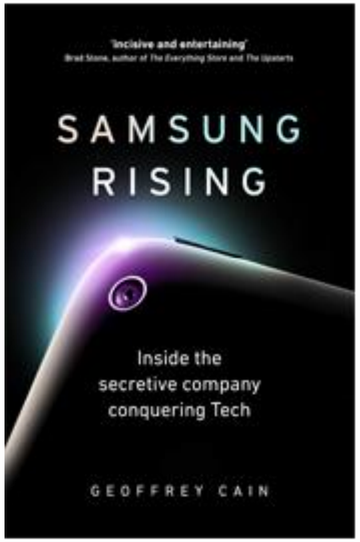
We Recommend

Samsung Rising
Geoffrey Cain



Journalist and author Geoffrey Cain writes an account of Samsung and the family owned conglomerate's (chaebol) ascent to power in the global consumer electronics market. Through insightful research, the book gives readers an in depth analysis of how the Korean conglomerate transformed from a vegetable seller to a global tech brand.

A household name today, Samsung has a market share that competes with Apple in the smartphone arena. The company's business model saw it overtaking Apple in terms of profits in the second quarter of 2017. But its path to the top has been peppered with secret deals, price fixing, bribery, tax evasion among other strategies, to stay at the top.

Founded in 1938 as a shop selling vegetables and dried fish, Samsung's founder, Lee Byung-chul, expanded into sugar, finance, chemicals, electronics and beyond. He not only built an empire but the entire nation of South Korea along the way. By the 1960s, the company was already a symbol for how political connections could lead to great riches. The read highlights the sheer breadth of "the Republic of Samsung" and how Samsung overtook the then best-in-class Sony in the mid-2000s; it also took on Apple - in terms of products and Google!

From the allegations of Kim Yong-chul, a former Samsung lawyer who claimed that Samsung paid annual "donations" to almost everyone who was anybody in South Korea in the 2000s to the South Korean courts' ruling of 2017 that the company had bribed the country's president to win support for a corporate takeover, the author leaves no stone unturned in unraveling the inside story.

The read does keep one hooked on till the end akin to a murder mystery movie that awaits justice for the accused and some learnings & food for thought. However, Samsung's inability to learn from its mistakes is the biggest flaw according to the author; products are still rushed to the market before they are ready. Case in point is the breaking of the foldable phones first launched in 2019 along with price and initial availability issues. Early this year also saw the sentencing of Samsung Electronics' Vice Chairman Jay Y. Lee to two and a half years in prison, which could delay the group's ownership restructuring following the death of his father in October. The ruling is also a welcome shift of South Korea's view on wrongdoings committed by chaebol owners, which led to the country's economic rise after the Korean War.

Geoffrey Cain, a journalist for The Economist and the Wall Street Journal also balances Samsung's journey with insights about smartphone marketing strategy in the US. While the company is facing trying times with production and supply chains challenges due to the pandemic, it is also looking at the future. Case in point is the latest launch of the foldable smartphone, with a lead so strong other manufacturers can only hope to catch up any time soon. Whether Samsung can shake off these challenges and keep rising the right way is something we will have to wait and watch.

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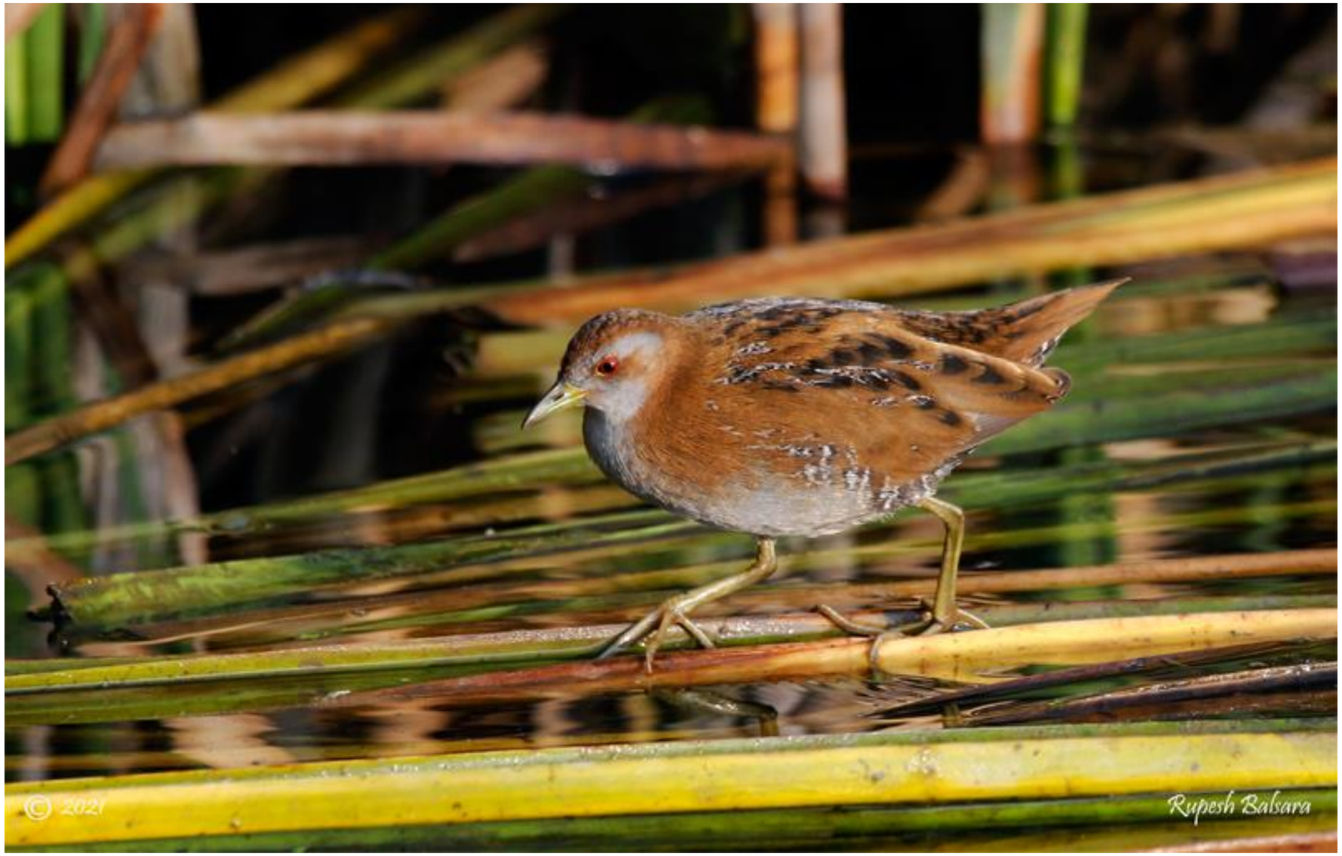
THROUGH THE LENS



Nature enthusiast, **Rupesh Balsara** identifies a Baillon's Crake, which is largely found across Africa, Eurasia and Australasia. They breed in marshes, shallow swamps and even stream and pond margins. Baillon's Crake, the smallest among the Crakes found in India, is a winter visitor. They feed on small fish, aquatic insects and worms.

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