

Empirical analysis of observed discounts in secondary transactions of new-age companies

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New-age companies have complex capital structure

1

Most companies are predominantly funded by ordinary equity, occasionally supplemented by minor convertible instruments.

2

However, most new-age companies tend to have complex capital structures, with a mix of equity and convertible instruments, incorporating diverse investor preferences. The equity capital is relatively a small portion, mainly held by founders, as against a series of convertible preference shares, held by the investors who have come in at various stages of fundraising.

3

Preference shareholders typically have certain downside-protection rights that are not available to equity shareholders. These rights often include liquidation preference and anti-dilution rights, which help investors protect the original investment, especially useful in scenarios with high execution uncertainty.



A liquidation preference represents an investor's right to get his or her money back before the holders of common stock, which typically includes company's founders and employees.



Anti-dilution rights protect the ownership percentage of a shareholder from being diluted by future rounds of financing happening at a lower price per share than the original issue price to the investor.

Example of fundraising through convertible preference shares

CPS Fund Raise: CRED

In September 2018, CRED raised INR1,800 million through the issuance of Series A CPS at a pre-money valuation of INR2,400 million.

In July 2019, CRED raised INR8,300 million through the issuance of Series B CPS at a pre-money valuation of INR19,000 million.

In January 2021, CRED raised INR6,200 million through the issuance of Series C CPS at a pre-money valuation of INR47,500 million.

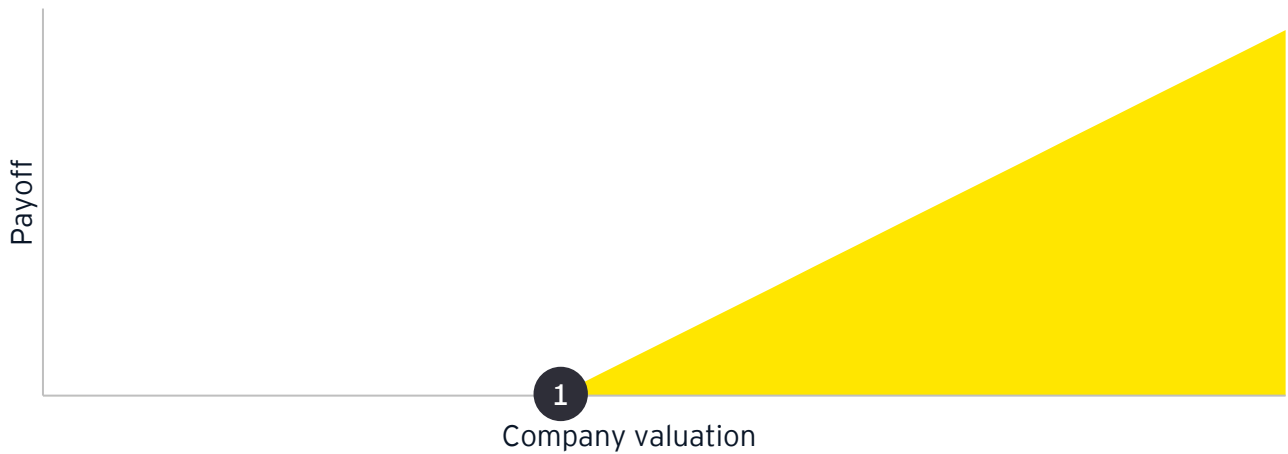
In May 2021, CRED raised INR15,600 million through the issuance of Series D CPS at a pre-money valuation of INR128,900 million.

In May 2022, CRED raised INR12,700 million through the issuance of Series E1 CPS at a pre-money valuation of INR260,500 million.

In June 2022, CRED raised INR6,200 million through the issuance of Series F CPS at a pre-money valuation of INR416,900 million.

Payoff for various shareholders (for illustration purposes)

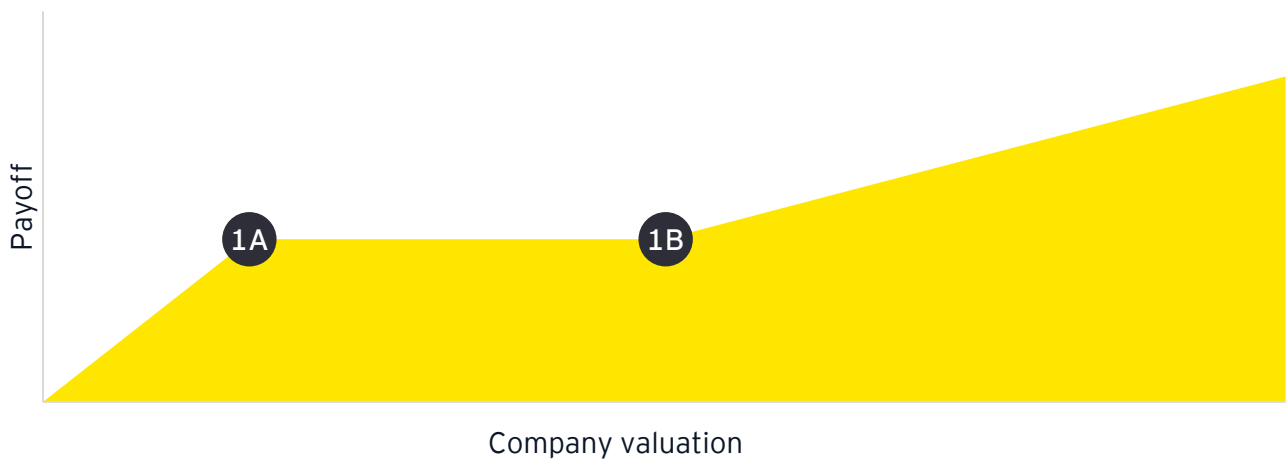
I. Payoff for equity shareholders



Inflection point 1:

Proceeds received by equity shareholders after paying out debt holders

II. Payoff for preference shareholders



Inflection point 1A:

Valuation up to which preference shareholders' payoff increases, till they receive their original amount invested (i.e., liquidation preference)

Inflection point 1B:

Valuation after which the preference shareholders will give up their liquidation preference rights and convert their preference shares into common equity

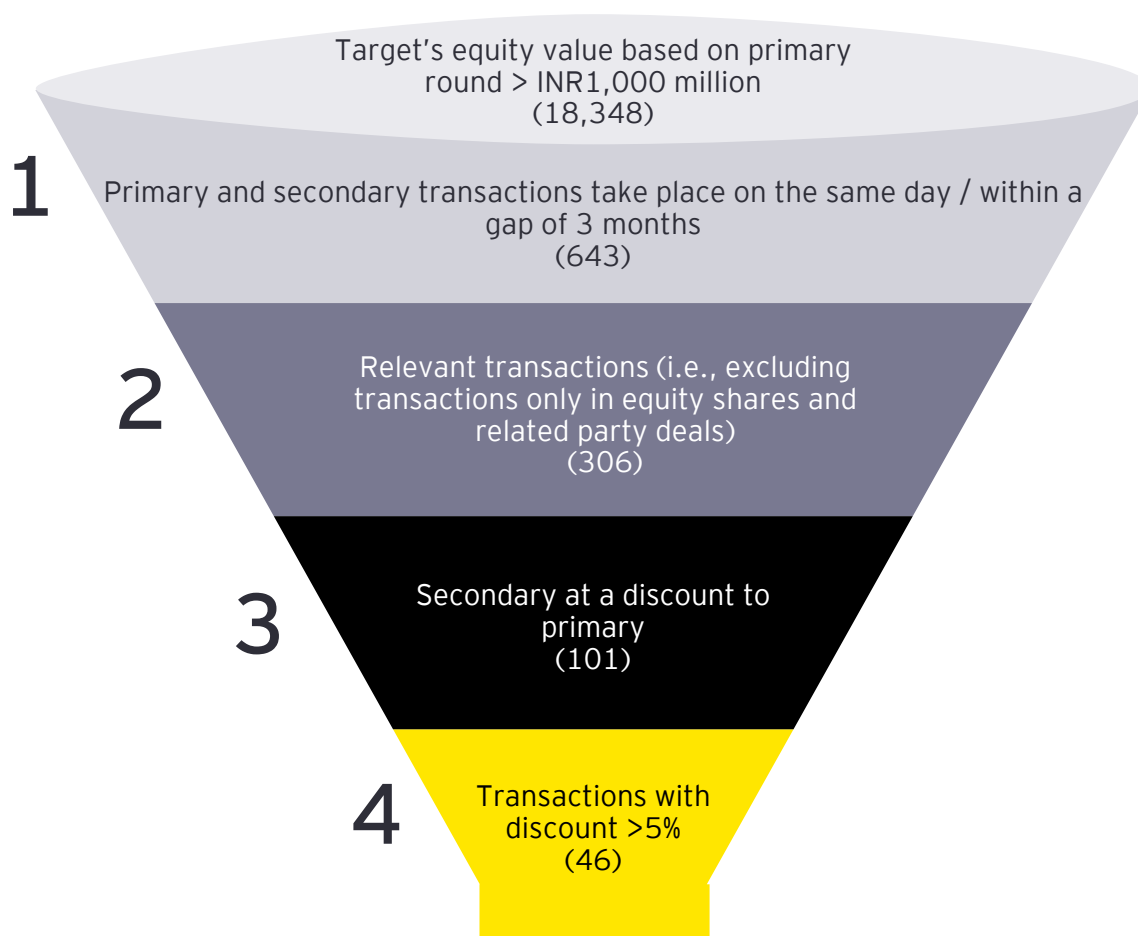
Note: Simplistic payoff chart assuming only equity and debt in case of I and only 1 series of convertible preference shares in case of II

Objective of the study

Objective: Do secondary transactions take place at a discount to primary transactions?

Approach: Selection criteria for concurrent primary and secondary transactions

- Period: 01 January 2019 to 31 December 2025
- Considered all types of transactions excluding M&A, IPO, primary and secondary transactions, both classified as strategic transactions, debt funding, companies issuing ESOPs to their employees and secondary transactions between related parties
- Target's equity value more than INR1,000 million based on primary round
- Value of transaction (primary and secondary) more than INR10 million
- Primary and secondary transactions occurred on the same day or within a three-month gap
- Combined various primary (or) secondary transactions with the same price that took place within a gap of three months
- Transactions with <5% discount is considered as no discount to factor data discrepancy and materiality



*Primary transaction: Involves issuance of new series of shares to investors to raise capital. | Secondary transaction: This is between two parties involving sale of existing shares of lower series or common equity, with no fund flows into the target company
Source: Private Circle, EY Analysis

Summary results

1

Out of 306 transactions, ~85% of secondary transactions happened at the same or higher value as concurrent primary investments, i.e., no discount

2

Average discount of remaining 46 concurrent primary and secondary transactions at 19%

3

Discounts had reduced during COVID years: The mean discount of 18% during 2020 and 2021 vis-à-vis 21% in other years

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Discounts were witnessed across all valuation sizes of the companies; albeit lower for smaller companies

5

Discounts did not vary on the basis of the percentage stake transacted or the size of the transaction

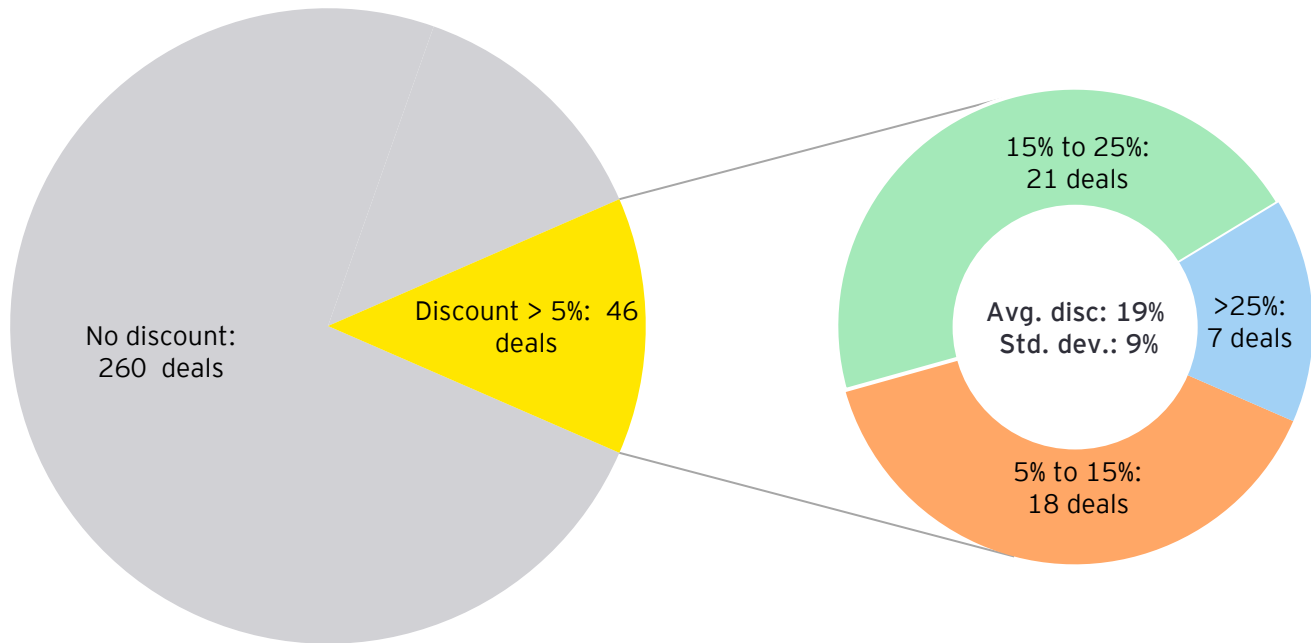
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Profile of buyer (same vis-à-vis different) did not materially impact the discount

Minor discounts of up to 5% ignored

Average discount of 46 concurrent primary and secondary transactions (Post-Jan 2019) is 19%

Number of instances where primary transactions occurred in preference shares and secondary transactions happened in equity or lower series instruments



*No Discount includes secondary transactions which are up to 5% discount or at a premium over the concurrent primary transaction

**Standard Deviation of 9% implies the discount in transactions are in a narrow range

Source: Private Circle, EY Analysis

Reasons for transactions indicating no or minimal discount



Binary outcome

Expectation of the eventual outcome is binary - either a successful high-value exit or complete failure (i.e., no mid-value exits where liquidation preference becomes relevant). This is typically seen in early-stage companies.



The probability of exit is higher than the fund raised

Exit is imminent at a value higher than the total funds raised till date. This is typically seen in late-stage companies.



Investors have better liquidation preference but lack adequate control

Late-stage investors having better liquidation preference do not have an adequate stake to control the timing of exit event; hence, they cannot enforce the mid-value exit that could be beneficial to them.



Steady increase in valuation

The value is changing over the years, evolving smoothly rather than a sudden spike (e.g. no riskier bets by later investors), thus reducing the possibility of subsequent down rounds.



Pro-rata liquidation preference

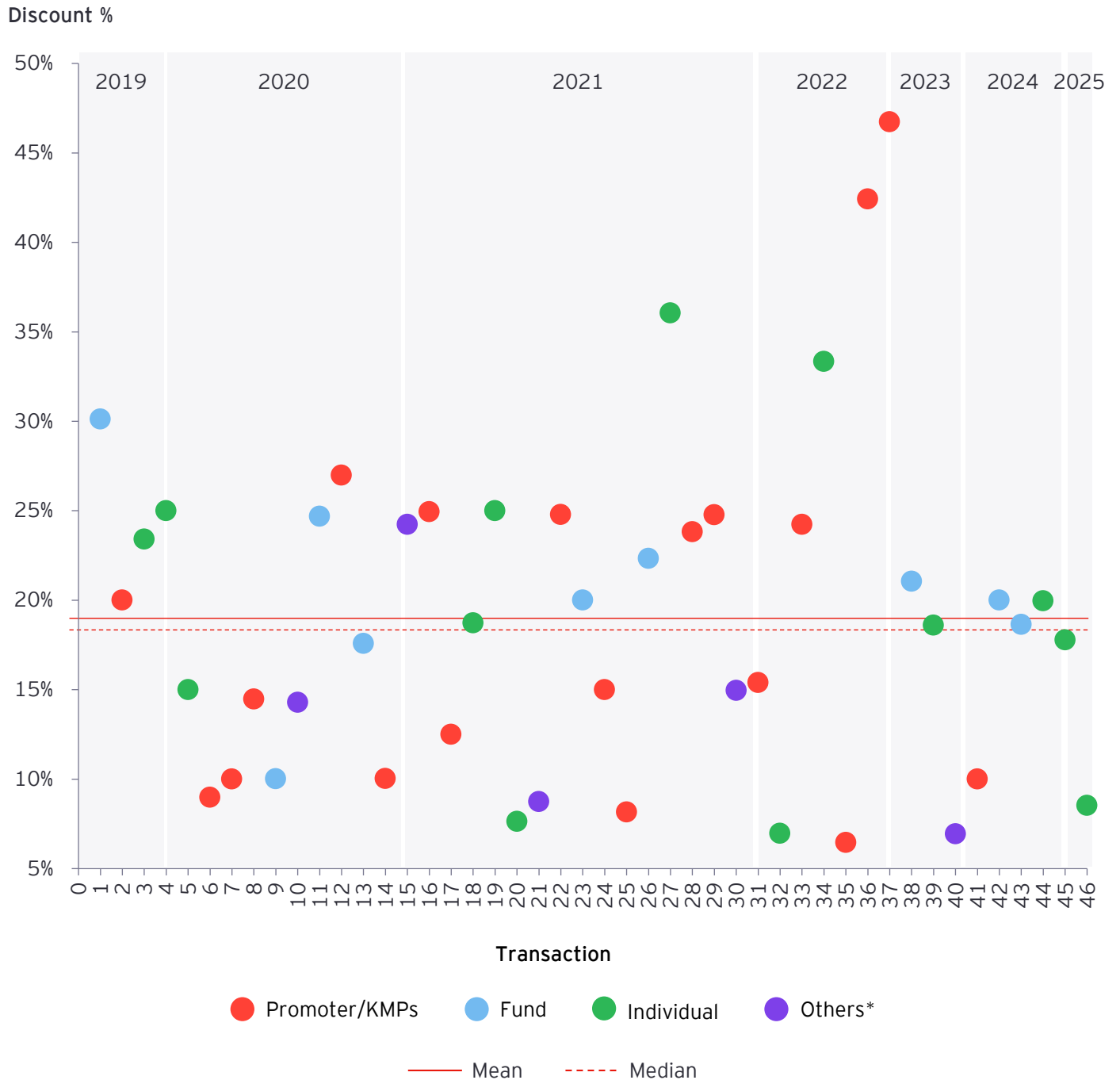
Pro-rata liquidation preference is preferred rather than liquidation preference with seniority, therefore reducing volatility and perhaps making liquidation preference rights immaterial.



Negotiation dynamics

Investors with lower liquidation preference may still have a better negotiation position in the liquidation event.

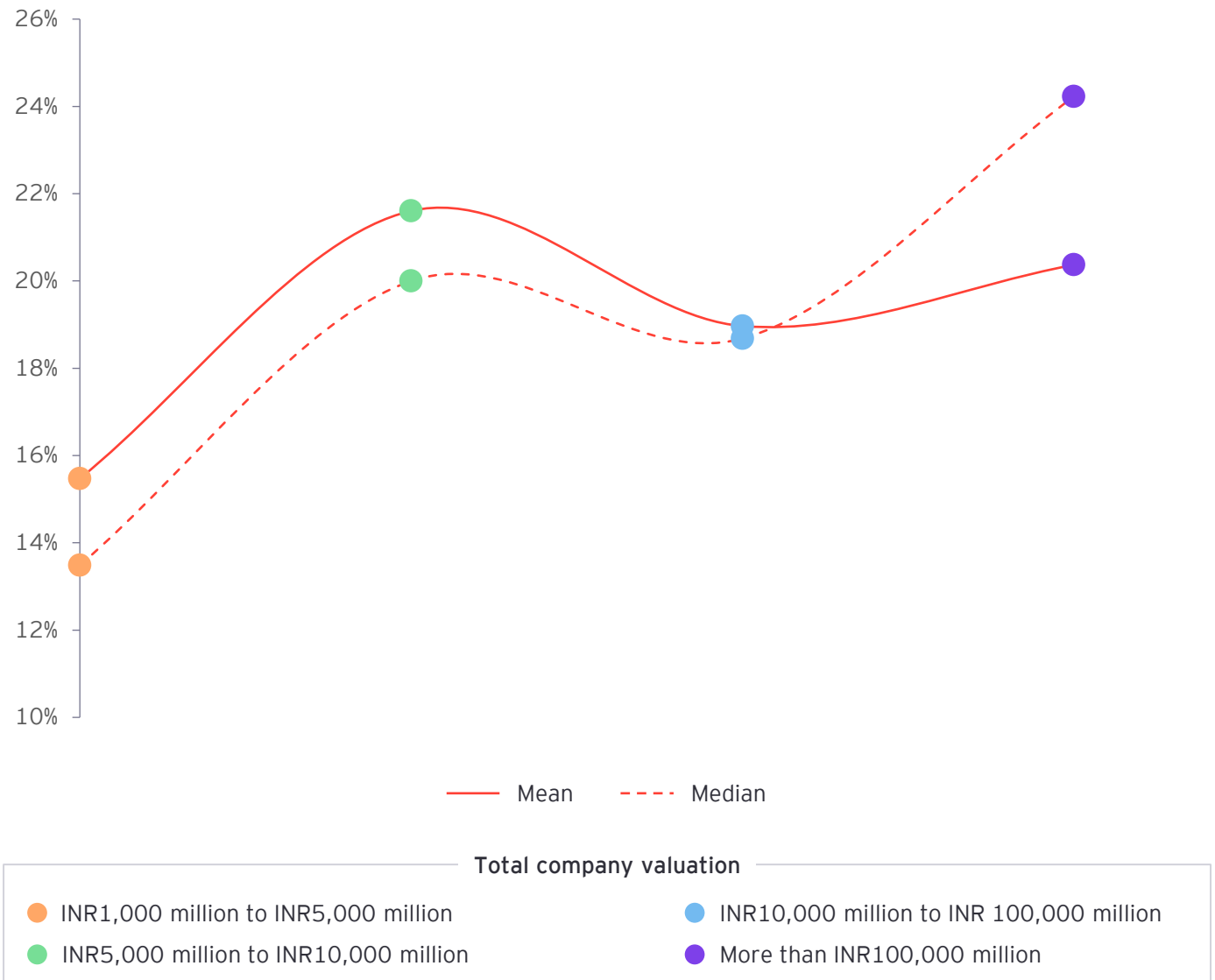
Discounts had reduced during COVID years: The mean discount of 18% during 2020 and 2021 vis-à-vis 21% in other years



*Others include deals where the seller consists of corporate investors and deals where the details of the sellers were not available
Source: Private Circle, EY Analysis

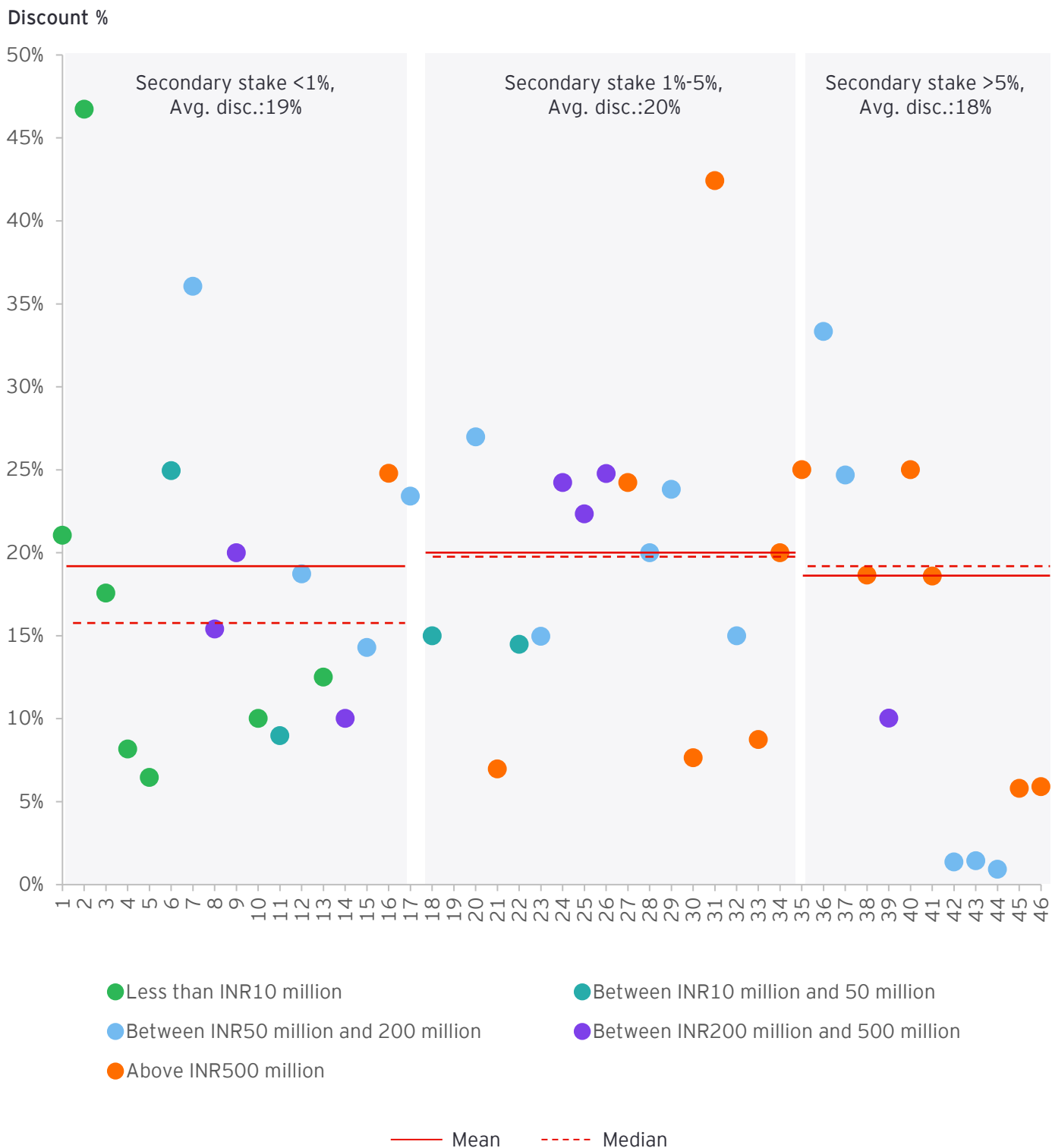
Discounts were witnessed across all valuation sizes of companies; albeit lower for smaller companies

The average discount is lower for smaller companies, likely due to the higher probability of binary outcomes



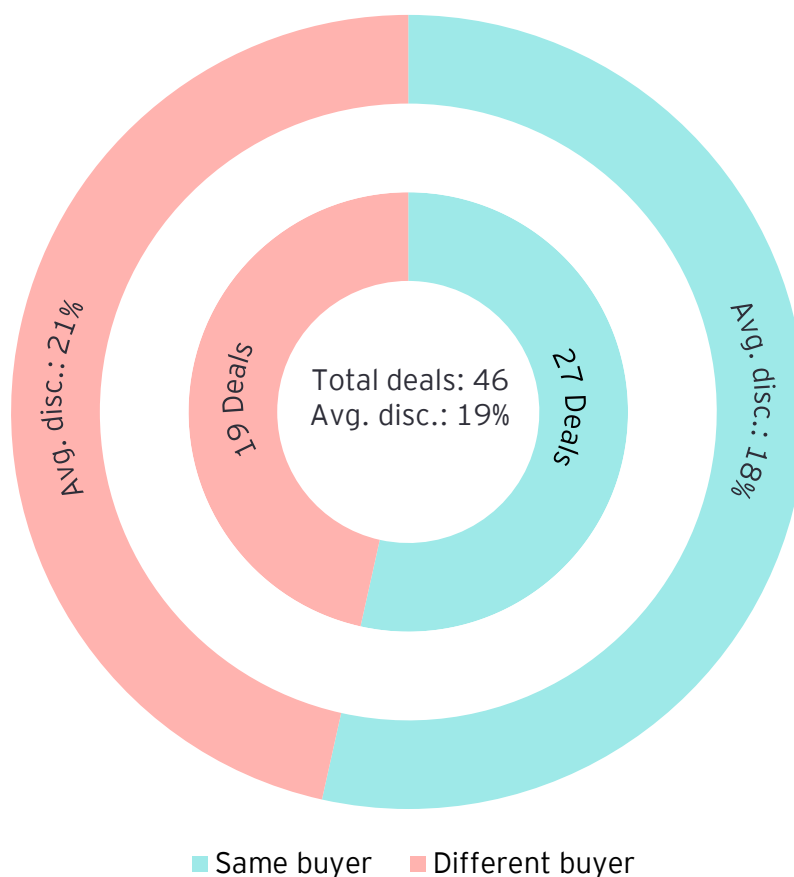
Source: Private Circle, EY Analysis

Discounts did not vary based on the percentage stake transacted or the size of the transaction



Source: Private Circle, EY Analysis

Profile of buyer (same vis-à-vis different) did not materially impact the discount



- Transactions involving at least one common investor in both primary and secondary deals were more in number than those with different buyers
- The discount was only 3% lower in case of existence of a common buyer vs. different buyers in primary and secondary transactions

*Note: Same investors refers to at least one investor who participated in both Primary and Secondary transactions
Source: Private Circle, EY Analysis

Contact us

Navin Vohra
Partner
Direct: : +91 22 6192 0930
E-Mail: navin.vohra@in.ey.com

Parag Mehta
Partner
Direct: +91 22 619 21335
E-Mail: parag.mehta@in.ey.com

Amish Mehta
Partner
Direct: +91 22 619 20217
E-Mail: amish.mehta@in.ey.com

Nilesh Jain
Partner
Direct: +91 22 619 21259
E-Mail: jain.nilesh@in.ey.com

Vipul Agarwal
Partner
Direct: +91 22 61922193
E-Mail: vipul.agarwal@in.ey.com

Pradeep Gupta
Partner
Direct: +91 124 464 4693
E-Mail: pradeep.gupta@in.ey.com

Mihir Kenia
Partner
Direct: +91 22 619 21137
E-Mail: mihir.kenia@in.ey.com

Raghav Khera
Partner
Direct: +91 11 47318236
E-Mail: raghav.khera@in.ey.com

Venu Yadav
Associate Partner
Direct: +91 22 619 22126
E-Mail: venu.yadav@in.ey.com

Contributors

Hardik Shah
Director
Mb. : +91 9833383983
E-Mail: Hardik10.Shah@in.ey.com

Shraddha Singhi
Senior Associate
Mb. : +91 7003907670
E-Mail: Shraddha.Singhi@in.ey.com

Vihaan Shah
Intern
Mb. : +91 9833038388
E-Mail: Vihaan.Shah@in.ey.com

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