Pit-Stop: Valuation in Southeast Asia's Technology Industry

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Southeast Asia's surging internet economy and technology sector will lead to a rapid growth in the demand for valuations, said Ms Srividya Gopal, CVA, Managing Director and Southeast Asia Leader for Valuation Advisory Services at consultancy firm Kroll and former IVAS Council member.

She gave an overview of the potential opportunities and challenges of such valuations at a recent webinar organised by the Singapore Institute of Directors and Institute of Valuers and Appraisers, Singapore, themed "Valuation in Southeast Asia's Technology Sector".

With the Covid-19 crisis spurring more online purchases and remote working and studying, the value of the region's internet economy is expected to soar from US$170 billion in 2021 to US$363 billion by 2025, and reach US$1 trillion in 2030, according to e-Conomy SEA 2021 report.

Furthermore, there have been over 1,200 private equity and venture capital investments into businesses in Singapore, Malaysia and Indonesia alone between 2018 and 2021, with half of the financing going into the technology industry, according to Kroll's analysis.

"We are looking at several hundreds of investments that will be striving for the capital market or transactions in the immediate future. The need for valuations to support these exits and the continued growth of the industry cannot be underestimated," said Ms Srividya, who is Chair of Kroll's Asia Pacific Management Committee and part of its Global Leadership Team.

Valuations on the rise

Private companies considering exit options, especially public listings, will need to prepare or spruce up their three-year historical consolidated financial statements under the relevant accounting standards. Investors into technology companies also require periodic valuations for their board, investor and financial reporting.

Valuation services to support financial reporting include business combination, contingent consideration and asset and liability valuation, intangible asset valuation, goodwill and asset impairment valuation, valuation of stock compensations, share-based payments, employee stock options and restricted stock units, and more.

There are also other specific valuations needed for transactions that involve special purpose acquisition companies (SPACs). These are shell corporations listed on a stock exchange for the purpose of acquiring or merging with a private company, to take the company public without going through the initial public offering (IPO) process. Southeast Asia has seen significant activity in them in recent years.

SPACs have various valuation requirements at different stages. At the pre-merger stage, they must value their warrants for financial reporting purposes. The target private company may also need valuations to prepare financial statements for the business combination and listing.

During the merger stage, the Singapore Exchange mandates an independent valuation of the target company. Exceptions are only granted when the SPAC has issued equity securities to institutional or accredited investors contemporaneous with the business combination, subject to

SGX's discretion.

After the merger, the SPAC becomes an operational company, and is subject to the typical listing and financial reporting requirements for such companies.

Ms Srividya noted that many high-profile transactions have underlined the significance of valuations. She discussed several examples of such significant transactions involving acquisition, merger, capital raise, IPO and SPACs and how valuation was required for each of them at different stages.

The complexities in valuing technology companies

With higher demand for valuations of technology companies, it is more important than ever to separate the myths and misconceptions from the realities of such valuations, Ms Srividya added.

For instance, some people may believe that valuations of technology start-ups can be done by studying transactions involving similar companies. "However, the first successful mover in a field usually ends up with the lion's share of investors and customers. This could lead to a huge difference in value between that mover and subsequent players," she explained.

The idea that technology start-ups with more subscribers and users are always more valuable, regardless of their revenue, is also false. "Cash is king, and companies need to focus on their cash flows in the medium to long run," she said.

She added that traditional valuation approaches may not be well-suited for early stage and high growth technology companies, which tend to have disruptive business models.

In these cases, valuers applying the market approach may have difficulty finding similar firms or transactions, while those making use of the income approach may not be able to determine the reasonableness or achievability of the firm's projections.

Valuers could use other approaches, including the limited or calibrated market approach, venture capital approach, probability-weighted expected return method, contingency claims analysis or milestone-based analysis, which are also based on the fundamentals of the income, market and cost approaches. "They must understand the firm's business, purpose, stage of life, market and previous investments to identify the appropriate approach," she said.

"They should also be aware of what drove the earlier investments, and the considerations at the time, and be cognisant of market misconceptions," she added. "Ultimately, valuers of technology companies must have objectivity combined with the judgement that comes from experience."

She stressed that independence in valuation is crucial, even if it is not explicitly required for the transaction in question. "Independence has to be established in spirit, especially for valuations performed in-house," she said. "Apply prudence in choosing the appropriate firms or professionals with the right accreditation, qualifications and experience for the valuation."