Have Unicorns reached their tipping point?

Looking beyond sky-high valuations of Unicorns in South East Asia

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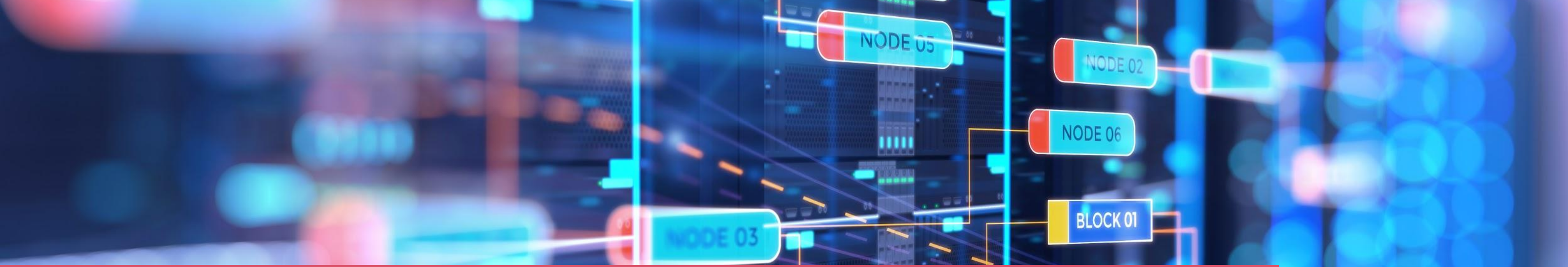


SEA is becoming a Unicorn hotbed

South East Asia ("SEA") is increasingly becoming a Unicorn hotbed, producing more than 14 privately held companies valued at over US$1 bn in the past six years. In 2019 alone, SEA minted 4 Unicorns[1], since the initial batch of Unicorns in 2014 - VNG Corporation, Garena (now known as Sea Limited), Grab, Lazada and Razer.

The rapid growth of internet connectivity in the region has been a key catalyst for startups. In a region with rapid urbanisation, rising youth population and a digitally-savvy community, startups are innately well-positioned to thrive in a digital economy.

Most importantly, digital-first startups have transformed the way services are delivered to consumers. Disruptive innovations in business models have revolutionised industries, placing the customer at the core of everything they do. The widespread acceptance of online marketplaces, freemium subscription models, sharing economy models and the like, have created new opportunities for businesses to succeed even in tepid market conditions and in new frontier markets.

New world. New skills. Market realities and opportunities for Tech companies

Inevitably, every industry sector and market has been impacted by the global economic and health crisis. Supply chains have been disrupted, and businesses have had to reimagine future possibilities and innovative ways of reaching customers to sell their products and services.

Digital channels have provided accessibility and convenience to consumers. Companies such as Zoom and Microsoft Office 365 have witnessed a surge in demand as companies increase their remote-working capabilities.

While the current market environment may be challenging for startups, it does however, present an opportunity for Tech companies to validate their business model and customer proposition in order to stay relevant in the future economy.

Tech companies need to create sustainable competitive advantage, and future-proof their business models to prosper in the new world.

Digitalisation and the emergence of the internet economy has created new verticals in SEA

Industry[2]	Financial Services	Retail & Logistics	Travel & Leisure	Automotive & Transport	Food & Beverage	Healthcare	Education
Emerging Industries[3]	● Digital payments	● E-Commerce platforms	● Online hotel/ flight bookings	● Ride-hailing	● Online food delivery	Telehealth	Online learning
	Peer-to-peer lending	On-demand delivery	Room rental platforms	Car-sharing platforms	Cloud kitchens	Health booking platforms	Marketplace for tutors
	Robot wealth advisors	POS[4] software-as-a -service		Marketplace for used vehicles		Virtual patient care	
	Virtual banking						

Technology has disrupted traditional businesses in various industry verticals

● Unicorn(s) | Growth | Nascent

Notes:
[1] BIGO Technology (social media), OVO (fintech) , Zilingo (e-Commerce), Trax (artificial intelligence)
[2] Key industries with greatest potential for change as a result of services offered by startups in the region
[3] Examples provided are not a collectively exhaustive list of new verticals
[4] Point-of-Sale
Source: Crunchbase, World of Startup Report 2014, WSJ Billion Dollar Club, various articles from TechInAsia and TechCrunch

What makes a Unicorn successful?

Not all startups are created equal and only a select few outpace their competitors to become Unicorns. As they race to meet business milestones and attempt to scale, the challenges they face become increasingly complex. However, there are certain characteristics common of successful Tech companies.

	Key success factors observed	Some noteworthy examples
Proprietary technology	• Companies with proprietary technology, either developed in-house or by purchasing licence(s), can benefit from exclusive use and gain a competitive advantage over rivals • Custom application of a proprietary technology in business can enhance efficiency by optimising workflow, which translates into enhanced client experience	**Customer-centric technology** A Singapore-based automotive marketplace's proprietary pricing algorithm allows them to offer competitive prices to car sellers; while their vehicular telematics technology that tracks distance driven each month, subsequently led to the launch of Singapore's first 'pay-as-you-drive' car insurance
Understanding customer needs	• A successful go-to-market strategy leverages data analytics and machine learning to uncover insights on customers and their behaviours • A focus on customers enables companies to adapt their products and services to fulfil unmet needs and access an untapped market overlooked by competitors	**Hyper-localisation strategy** A regional ride-hailing platform localised its service based on transportation needs in each country. In Cambodia and Thailand, *tuktuk* services are an option available to customers, while in Vietnam and Indonesia, motorcycles are a popular transport mode
Scale & diversity	• First-mover advantage and strategic geographical expansion enable companies to achieve scale and rapid growth, by leveraging network effects • Diversification into new industry verticals and expansion of service offerings which are complementary to their core business; whilst offering customers convenience through a one-stop solution platform	**Vertical and horizontal expansion** A Malaysian consumer-to-business (C2B) online used car marketplace expanded its operations to the wider SEA region. Ancillary services such as financing, insurance and warranty enabled them to capture additional value from each customer
Strategic alliances	• Strong partnerships enable startups to expand quicker and roll out new services more efficiently via an ecosystem • Where startups are supported by an underlying core business, many of them have anchored their technology offerings on their core services	**Partnership strategy** A popular messaging app in Thailand partnered with a Hong Kong logistics company to launch on demand delivery service to its users while providing the latter an opportunity to expand into the Thailand market

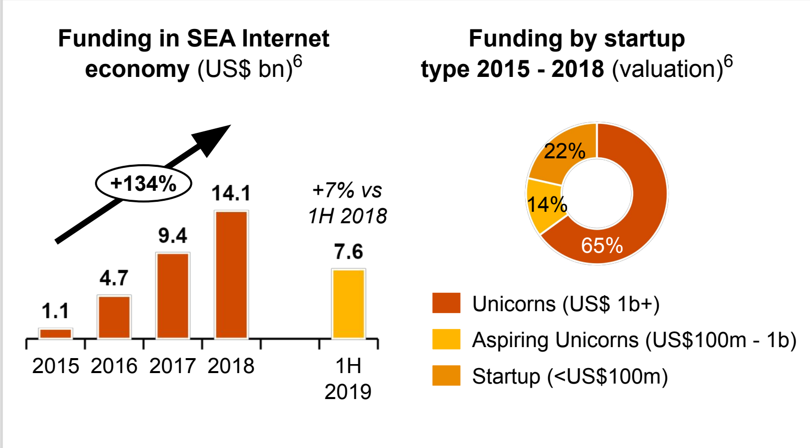
Source: PwC research and analysis

In search of the next Unicorn

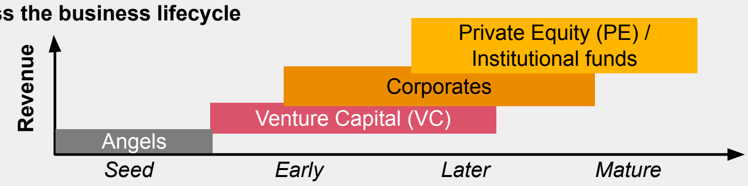
Investors' sentiment bullish in SEA

In the last few years, Unicorns in SEA have raised capital from investors who have backed successful companies with a **proven track record** in **growing market share, expanding into new markets or verticals, clear business propositions and ability to monetise their services on their platforms.**

In spite of recent headwinds, the SEA internet economy raised close to US$37 bn between 2015 and the first half of 2019, with 65% (or US$24 bn) of funds backing Unicorns[5], 14% (or US$5 bn) going to Aspiring Unicorns[5] and the remaining to smaller startups.



Although investors across the business lifecycle have diverse sets of risk-return objectives, they can be divided into two broad categories: Investment firms and Corporates



INVESTMENT FIRMS

- VCs, PEs and Institutional Funds are entrusted to maximise their investors' long-term wealth creation
- VCs are raising larger funds to continue supporting their portfolio companies, while Institutional Funds and some PEs that traditionally invest only in established companies, are now turning to promising Tech companies in search of greater alpha

CORPORATES / INCUMBENTS

- Corporates and incumbent internet companies are investing for strategic reasons to **diversify their revenue streams, consolidate** and **create synergies** with their existing businesses. For sunset industries, investing in startups could help secure their long-term survival.

Most investors ask:

"How do we justify lofty valuations for Unicorns? Does Growth or Profitability matter more?"

- Many aspiring startups in the region have presented outstanding investment opportunities for investors across the value chain
- The SEA growth story is at the forefront of most investors' minds (and portfolio allocation) but recent high profile headlines like WeWork's scrapped IPO and OYO's missed targets have led investors to increasingly emphasise the importance of young Tech companies' ability to demonstrate a clear plan to achieve profitability

Notes: [5] Unicorns are companies valued at US$1 bn+ while Aspiring Unicorns are valued between US$100 mn and US$1 bn
Source: [6] Google & Temasek / Bain, e-Conomy SEA 2019, PwC research and analysis

What do investors typically consider in a startup?

In spite of differences in investment objectives and risk appetites, there are strategic commercial considerations that most investors assess when evaluating Tech investments. In more recent times, focusing on the path to profitability is an anchor to their investment thesis.

MANAGEMENT

Besides a great product or service, investors place high importance on the talent, integrity and experience of the management team, favouring track record in executing growth plans

CUSTOMER

Knowledge of customers' purchasing behaviours and understanding of potential trends help investors gauge a startup's ability to grow its market and customer base

MARKET

Estimating the addressable market and understanding how key trends will evolve help investors assess the potential scale and growth of the business

COMPETITION

Understanding the competitive landscape and relative strengths and weaknesses of competitors enable investors to assess the Tech company's competitive advantage

PATHWAY TO PROFITABILITY

A startup's path to profitability has become a mainstay for continuous support from investors. They are not only drawn to companies that have **strong value propositions** and the **ability to scale quickly**, but are increasingly focused on how they can achieve **stable recurring revenue streams to sustain operating cash flows**

Few Unicorns have proven to be financially and commercially sustainable. A clear competitive advantage with sustainable growth and profits will be the litmus test to assess the real value of the Tech business.

"Chasing growth without strong underlying fundamentals won't lead to long-term value creation and that sentiment is something that the ecosystem is cognisant of

– Co-founder of a B2B startup[7] "

"The narrative on the distance to profitability and the path to profitability becomes a bigger part of the story versus growth at all costs…

– Founder of a VC firm[8] "

"I have no problem with companies investing for future growth and profitability down the road but you have to make sure you're operating in a sound model which can become profitable

– Founder of a FinTech Unicorn[8] "

"We need to ideally see profitable unit economics or a clear pathway to get there... We drill companies on how they can serve customers sustainably while also maintaining healthy financials

– Global Head of a VC firm[9] "

Source: [7] Economic Times (2019), [8] CNBC (2019), [9] GOGLA webinar (2019), PwC research and analysis

Unlocking the pathway to profitability

Once elusive and rare, Unicorn Tech companies are becoming more common as investment capital floods the market, encouraging sky-high valuations.

However, recent headlines around WeWork, Uber and OYO have prompted investors to take a closer look at their investments, with their search for the next profitable billion-dollar Tech startup becoming more challenging.

The *'grow-or-die'* mindset of a company chasing the Unicorn status is now being replaced with, *'what does it take to become profitable'* as Unicorns become investors' new focus in their next big bet.

In addressing concerns of sustainable profitable growth, these are a few key indicators of a company heading in the right direction.

VALUE CREATION

Is the Tech startup's product or service reinventing the way we live or fulfilling an unmet need?

Companies with a compelling value proposition to solve customers' pain points are able to focus their resources into building a stronger product-market-fit instead of burning through capital quickly to grow their customer base with free/subsidised products.

CUSTOMER RETENTION

Are there recurring revenues to sustain costs?

Recurring revenues are an indication of a resilient and sustainable business. Companies should sign on customers quickly for repeat purchases, multi-month subscriptions or long-term contracts. Ancillary products can also increase customer stickiness, help expand market share and sustain profits.

UNIT ECONOMICS

Is the startup able to achieve positive unit economics?

Products or services should be scaled at a relatively lower cost through optimisation. A company with the potential to generate revenue without additional significant investment or sales effort presents a lower risk to investors.

TECH-ENABLED BUSINESS MODEL

Is the business operation optimised?

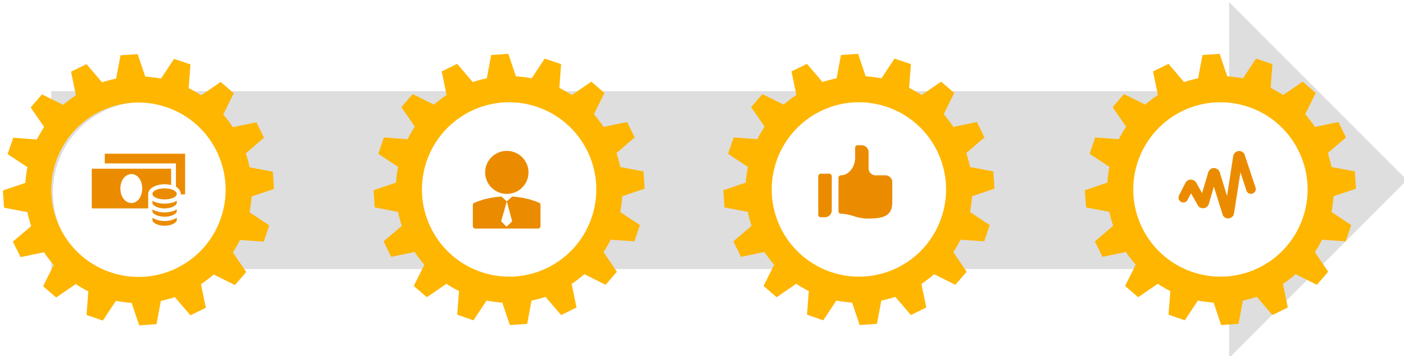
Availability of high quality data harvested with the power of technology can give greater insights for leaders/business owners to make sound business decisions. From AI technology assisting in customer service to robotic processing automation in warehouses, efficiency, productivity and profitability can be further enhanced through technology.

Source: PwC research and analysis

What do investors typically value in a Tech business?

The valuation of a Unicorn is neither truly a science nor an art, but rather a craft. While there are many considerations when valuing a Tech startup, investors always consider the uniqueness and appeal of the platform and its ability to disrupt, attractiveness of the industry sector, viability of product or service value proposition, sustainability of competitive advantage and growth prospects, and depth of management talent when evaluating the investment's future potential.

What are some key indicators investors look for when valuing Tech startups?



Hot sectors

- Investors who are "late to the game" in a high-growth sector may be more likely to pay a premium and channel capital into industries with strong growth prospects
- Investors are less likely to pay a premium in highly commoditised sectors with thin margins and low growth prospects

Strength of management

- Seasoned entrepreneurs backed by a strong management team with a proven track record can command a better valuation from investors

Competitive advantage

- Investors look for a functional product and service with a sustainable value proposition that drives customer usage
- Investors are in favour of Tech companies that demonstrate defensive growth and a clear competitive advantage to create substantial long-term value

Scale & growth

- More than just a "proof of concept", traction of a product or service is important in validating the viability of the product or service offered
- Growth in metrics such as daily active users, monthly active users and signups as well as the decrease in churn rates, are typical indicators considered

Source: PwC research and analysis

Supporting you in this exciting journey

Differentiating between a Unicorn and black hole is no easy task. Corporates and investors can leverage our deep technology sector experience when evaluating the commercial potential and risks of a Tech startup company

Assess ways to unlock the full potential of your Tech investment or business

- We help clients develop a holistic and commercial view on Tech businesses and its future potential, leveraging our sector experience and global network of experts
- We offer an independent "outside-in" view, combining inputs from key industry opinion leaders, customers, vendors, competitors and partners
- We assist clients in developing options to evaluate businesses' pathway to profitability, consider various scenarios and quantify the financial impact of investments
- We have a strong foundation to support robust technology valuations. Key assumptions for the valuation framework will be supported by independent insights from the market and industry.
- We will additionally help you identify potential value creation opportunities post-investment, to enhance scalability of your platform

How we can help

Leveraging our Tech commercial experience and global network of digital experts

Outside-in perspective on the market and validity of the business

Assessing the Tech startup's potential path to profitability

Robust technology valuation framework with defensible parameters

Identifying additional value creation opportunities for the platform

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