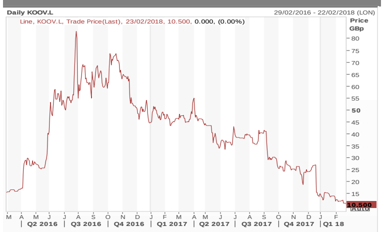
hardman&co

General Retailers



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**KOOV**
Price (p)	10p
12m High (p)	57p
12m Low (p)	10p
Shares (m)	175
Mkt Cap (£m)	18
EV (£m)	16
Free Float*	31%
Market	AIM

**As defined by AIM Rule 26*

Description

Koovs is an online retailer of western fashion across India. It has an experienced management team, growing brand awareness and the highest Net Promoter Score in its vertical.

Company information

CEO	Mary Turner
CFO	Rob Pursell
Chairman	Waheed Alli

+44 20 7151 0170
www.koovs.com

Key shareholders

Waheed Alli (Dir)	19%
Anant Nahata (Dir)	23%
Michinoko	11%
Ruffer	11%
Hindustan Times Media	5%
Times of India	4%

Next event

Apr-18	Trading update
Before end-Sept-18	Prelims

Analysts

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Koovs plc

Poised to clean up – the emerging ASOS of India

Koovs sells affordable western fashion online in India. It has an established customer base of half a million active users and has been growing brand recognition rapidly. It has achieved the highest net promoter score (NPS) across its vertical. Its success will come on the back of the growing Indian economy breeding millions of online shoppers. Having spent a few days with Koovs in Delhi, we believe all the ingredients are in place; only the pace is uncertain. To exploit this opportunity, Koovs needs to raise a substantial amount of capital.

- **Strategy:** Koovs has been honing its digital strategy: it now has 1.9 million followers on Facebook and 0.5 million on Instagram. It has a new, flexible tech platform and takes 80% of its orders through its mobile app. The success of its work is measured in the high NPS and 40% repeat customer orders.

- **Setback:** The 2016 demonetisation punctured the hyper-growth of India's online businesses but it has begun to recover strongly in the past six months. We have every reason to believe that India's retail e-commerce business will multiply many times over from here.

- **Valuation:** Conventional valuation metrics are unhelpful. We take our forecast EBITDA for Dec-22, apply a Boohoo /ASOS multiple and discount the value back to today. Even at a 25% discount, the EV comes out at £357m including the funds to be raised. The current price is a poor indicator of the inherent value.

- **Risks:** The company needs to raise more finance; it has been diligently preserving cash but it needs ca.£50m to flourish. Once refinanced, we see the two key risks being slower uptake of e-commerce in India than we forecast and damaging discounting by Koovs' indirect competitors.

- **Investment summary:** Before the new capital is raised, Koovs is a short-dated call option on the financing happening. Once the money is raised, it is an exciting way to play the last big world market to move online. The prize, if it gets it right, is a billion-pound company and more. It is likely to be a bumpy, exciting ride but investors have the reassurance of a highly experienced management team in charge.

Financial summary and valuation

Year-end Mar (£m)	2017	2018E	2019E	2020E	2021E	2022E	2023E
Visits (m)	79	65	116	166	246	312	302
Conversion (%)	1.6%	1.4%	1.4%	2.3%	2.8%	3.5%	4.0%
No. of orders (m)	1.25	0.89	1.62	3.74	6.75	10.93	15.62
AOV (£)	14.75	16.37	16.74	19.00	20.58	23.29	25.56
GOV	18.5	14.5	27.2	71.1	139.0	254.6	399.1
Net sales	12.5	9.6	16.9	44.3	86.6	158.6	248.7
Weighted margin	43%	46%	49%	53%	57%	61%	62%
Trading profit	0.3	1.2	3.6	12.1	25.8	70.4	114.1
Trading margin	2%	11%	21%	27%	30%	44%	46%
EBITDA	-20.0	-14.4	-19.4	-18.9	-7.8	17.2	49.2
No. of shares (m)	175	175	398	398	398	398	398
EV/sales (x)	1.1	1.5	0.8	0.3	0.2	0.1	0.1

Source: Hardman & Co Research

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Executive summary

Indian e-commerce play

The Indian online shopping market is in its infancy. Internet penetration has reached about 30% of the population but the number of online shoppers, always lagging behind, has reached only about 1% of the 1.3 billion population. The bull argument is that within "x" years, India's large middle class will have moved online and be doing a substantial amount of shopping there, and clothing is typically a large proportion of what they will likely be buying. We think the bulls are right, with the only real doubt being how long "x" years is.

It is difficult to find consistent estimates for the rate of growth of both internet access and e-commerce. We have produced our own forecast for internet subscribers, which puts India squarely in the middle of the trend for 80+ other countries that are ahead of it in their development. It sees the 50% penetration threshold crossed in 2021 – 4.5% of the population added each year.

The expansion of the internet will be driven mainly by mobile access, encouraged by the Government, whose stated aim is to get the whole of India online quickly. Currently, there are around 450 million Indians online and 300+ million smartphones. Not all smartphone owners have continuous access as they may purchase limited-length contracts and dip in and out, but this is just another area where economic growth and development will feed the number of online shoppers.

Newbies to the internet tend to go through various phases before building sufficient trust to start buying goods remotely, but every other major economy has done it and it seems highly unlikely that India won't follow. Curiously, one of India's quirky characteristics – cash on delivery – we see as an aid to moving customers online, not a hindrance. By waiting until the goods have arrived before paying for them, they automatically remove one huge area of distrust. With familiarity, and Government encouragement, payments will move online and make the distribution process cheaper but it is not necessary for our investment case.

Core assumptions

	Dec	2016	2017E	2018E	2019E	2020E	2021	2022E	2017-22E CAGR
Online users	(m)	391	455	521	589	660	736	817	12%
Online shoppers	(m)	59	91	130	177	231	294	367	32%
Consumer spending	(USD bn)	1,426	1,600	1,807	2,042	2,308	2,608	2,947	13%
Online retail	(USD bn)	15	18	25	33	42	50	59	27%
Online spend per shopper	(USD)	256	209	194	185	180	168	160	-5%
Apparel online market	(USD bn)	3.8	4.0	6.3	8.2	10.4	12.4	14.7	30%
Koovs' addressable market	(USD bn)	1.5	1.9	2.7	3.5	4.6	5.6	6.8	28%

Source: Hardman & Co Research, various sources

Our base assumption has the number of online shoppers growing from 20% of online users today to 45% in 2022. China passed this level in 2013 and all major European economies did before 2007 (with the exception of France, 2009).

Our most conservative estimate regards the amount they will each spend per year. We have spend per head falling from around $200 today to $160 in 2022. This is derived from various reports. In all other countries, spend per head rises remorselessly. We suspect that the forecasters have become over-cautious, having previously been over-optimistic. Typical hyper-growth rates of early-stage internet adoption were thrown out by a Government initiative in November 2016: demonetisation. This attempt to force the black economy into the light hit confidence and consumption hard and stopped online sales growth overnight. Recent evidence suggests that growth is back to an annualised rate of ca.40% but our base assumption has just 27% annual growth between now and 2022, meaning that just 2% of shopping will have moved online compared with 17% in the UK, 16% in China and 8% in the USA .

This macro picture drives a forecast that predicts that Koovs' addressable market – namely online western clothing, footwear and accessories – will grow from around $2bn today to $7bn in 2022.

Koovs' positioning

Is Koovs well placed to exploit this opportunity? We believe so. Since taking over as CEO two years ago, Mary Turner has made significant progress. First, she has been instrumental in raising brand awareness from 1% two years ago to 18%-21% today. Second, all but the design team was moved from London to Delhi. Having buying, merchandising and marketing close to the home market is not only cheaper, but it also makes much better commercial sense. Design must stay in London as that is the crucial selling point of Koovs' own label brand.

The combination of these changes and a focus on customer service has driven Koovs' NPS to the highest in its vertical, beating not only its vertical specialist rivals but also the huge online marketplaces including Amazon.

Koovs has also focused on improving product profitability. We anticipate that trading margins will have risen from ca.2% to ca.11% in FY18.

The technology has been updated, the customer service and the distribution are both designed to be scaled rapidly, and the marketing team has been calibrating which campaigns are most effective. Koovs has 500,000 active customers and a 40% repeat customer rate. All it now needs is money.

Until now, Koovs has been funded on an *ad hoc* basis. When the slowdown hit after demonetisation, the funding all but dried up – just £9m was raised in 2017 in Convertible bond form. Subsequently, Koovs has had to rein back on spending, which has meant less marketing and narrower product ranges with the inevitable impact on sales that will now be lower in FY18 than they were in FY17. This is in no way a reflection of Koovs' operating abilities but a direct function of the available finance, in our view.

Investment conclusion

It is not possible to value Koovs conventionally, because its need of new capital and because it will be several years before it reaches EBITDA profitability.

We have built a central case assumption that forecasts EBITDA of £17m in FY22 and £49m in FY23. Even at that stage, Koovs will still be in an immature market with much to play for. Taking a line from the current valuation of similar businesses operating largely in the UK, ASOS and Boohoo, we then apply an EBITDA multiple to derive a future value that is then discounted back to today. That derives a value for Koovs that implicitly includes the capital it needs to raise.

In our range of values for Koovs, including £50m of new equity (assumed to be raised at 25p per share), using a 35x EBITDA multiple on Dec-22 estimated EBITDA of £31m (i.e. a very conservative discount on our £49m forecast for FY23), we derive a value of £1,089m in Dec-22, which equates to £357m today or 90p per share. In other words, there is very substantial upside from the current share price and then 25% compound growth to look forward to. The risks are, however, significant.

Risks

The overriding risk is that Koovs fails to raise the capital it needs. If it raises just enough to keep it alive, we would not see any sustainable upside in the current price as the listed equity would simply remain a call option on uncertain future fundraising.

We believe the story is easily strong enough to justify investors committing the necessary capital.

The other risks are clear. At the macro level, our forecasts could prove to be too optimistic whether because the Indian economy fails to grow, unhelpful government intervention, the failure of banks and/or telecom companies, or simply reluctance by the Indian population to follow the rest of the world online.

These risks are real but we believe the forecasts for online spending in India are now too low, having once been over-optimistic.

At the Koovs level, there could, of course, be any number of things that could go wrong, including our over-optimism about how much market share it can take. Our visit to Delhi convinced us that this was a smooth operation, which is ready to scale up. However, fast growth is difficult to manage and causes its own problems. Koovs is fortunate in having in its CEO, Mary Turner, who has successfully managed a series of new industry businesses, including Tiscali UK, until it was sold to Carphone Warehouse in 2009.

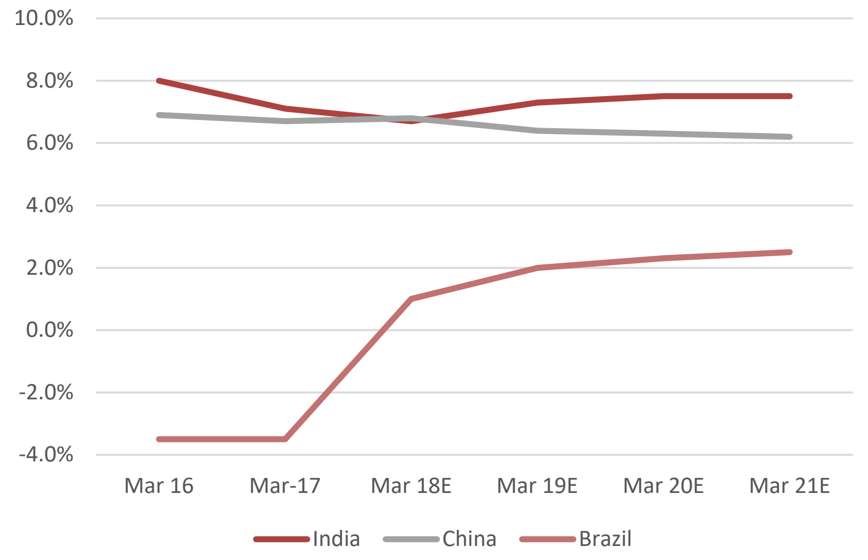
The bigger risk at the operational level is the competition. There are some very big players scrapping to win a prized hold in the Indian e-commerce market. Most of the skirmishing is taking place among the giant marketplaces, currently dominated by Amazon and Flipkart. Much of this is beneficial for Koovs – driving people online, investing in infrastructure – but some is harmful, in particular feeding the craving for discounts. Koovs does not want a business built on discounting and has worked hard to build up its gross margins, but it would be naïve to think it can operate in a vacuum. Its core strength here is that it is focused on western fashion and is in neither the ethnic market nor at the unbranded, commodity end of the market where the discounting tends to be at its fiercest.

This report is split into two parts: the first deals with the opportunities in India as a whole; and the second with how Koovs might exploit those opportunities.

India – land of opportunity

The overall Indian economy is expected to grow by more than 7% in each of the next three years. With population growth of around 1.2%, that implies GDP per capita growth in excess of 6%. This is notably faster than China and much faster than Brazil.

India, China, Brazil GDP growth forecasts, 2016-21E



Source: World Bank

The growth rate fell in the years to March 2017 and 2018. The slowdown, which included consumer spending actually falling in calendar 4Q 2016 after demonetisation, spooked some investors but was caused by policies that should be beneficial in the medium term. As the OECD noted in its November 2017 report,

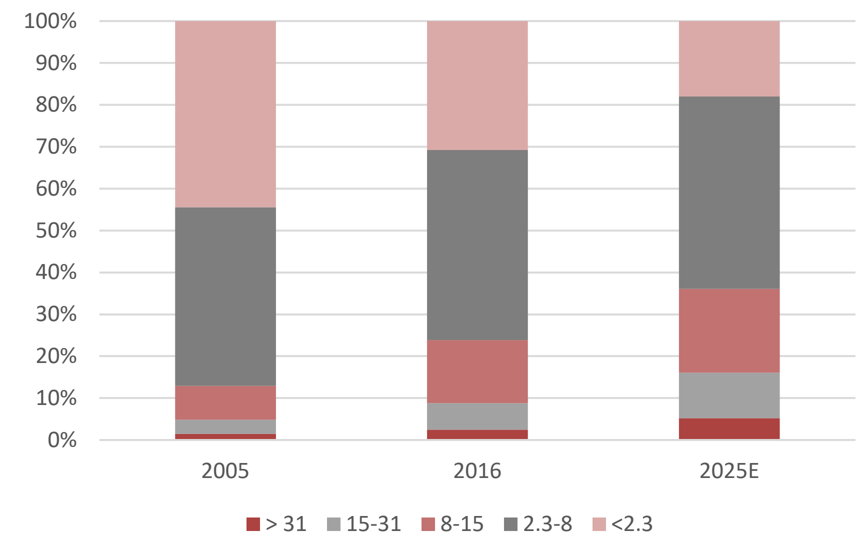
"Economic growth is projected to strengthen to above 7%, gradually recovering from the transitory adverse impact of rolling out the Goods and Services Tax (GST) and measures to choke off the black economy, including demonetisation. In the longer run, the GST will boost corporate investment, productivity and growth by creating a single market and reducing the cost of capital equipment."

Of course not everything is rosy – the country is highly indebted and the banking sector is suffering from a rise in non-performing loans – but these factors are taken into account when arriving at the forecasts.

Growing the middle class

Consistent, high economic growth eventually builds a middle class with money to spend and aspirations to fulfil. Data from Boston Consulting Group show that the proportion of households with income in excess of $7,700 nearly doubled from 12.5% in 2005 to 24% in 2016. By 2025, this number is anticipated to rise to 36%. $7,700 is the equivalent, in purchasing power parity terms, of $30,000.

India income distribution, 2005-25E ($000)

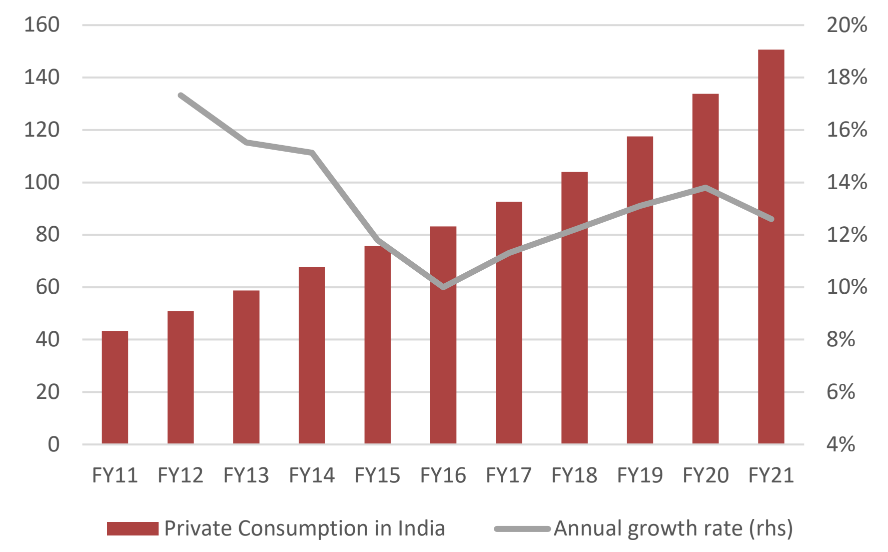


Source: BCG

Consumer spending

Nominal consumer expenditure is expected to grow at between 13% and 14% over the next three years. That might sound high but it is lower than the rate achieved between 2012 and 2015.

Indian private consumption, FY11-FY21E (INR tr)



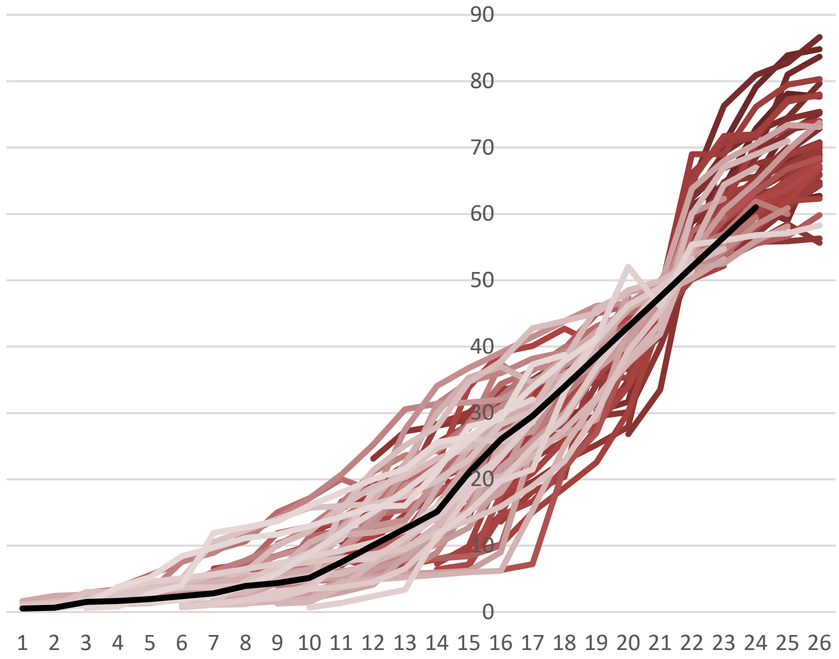
Source: MOSPI, RBI, Ken Research

For our purposes, we are most interested in how much of this expenditure will be spent online and in the clothing market in particular.

Spread of the internet

For Koovs to be successful, several developments have to take place. The first is the spread of the internet through India. This, we would argue, is inevitable; the only question is how fast the spread will be. In the chart below, we plot internet penetration rates in 80+ countries from around the world. The chart is drawn so that each goes through 50% penetration in the year marked “22”. India is represented by the thick black line. The y-axis is set at year “17”, which is where India was in 2016 – 29.6% penetration. So the penetration rate after that is forecast, and for all the other countries it is historical.

Internet penetration by year for 80+ countries (%) – year "22" is when each country passes 50%

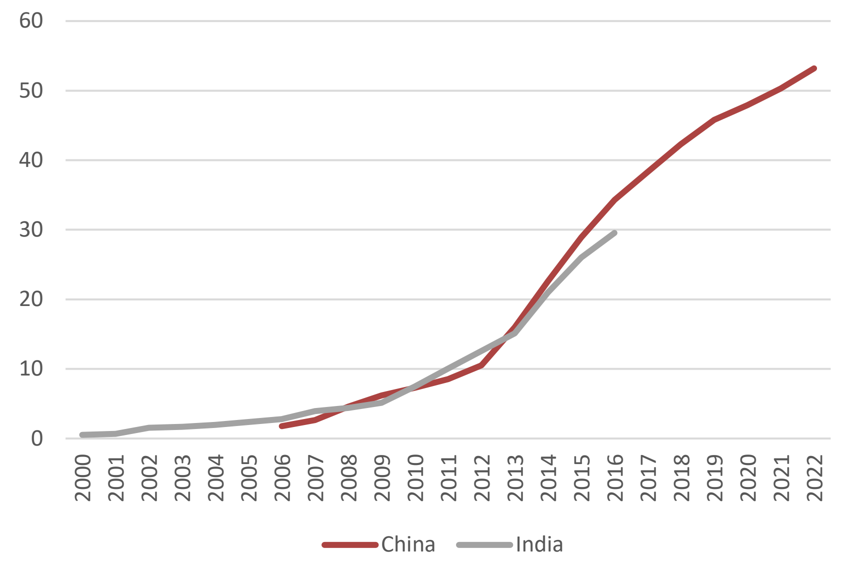


Source: Intl Tel Union and Hardman & Co Research
Note: thick black line is India and is Hardman & Co forecast data from year 18 onwards

Of course, each country is different but the pattern of growth is similar. The estimate for the rate of growth of the spread of the internet seems very plausible and would see India hitting 50% penetration in 2021 with about 650 million users.

For a more conventional chart, we have plotted China and India penetration rates together, with China lagged by six years. The growth paths overlap closely.

China and India penetration rates, % (China -6 years)



Source: International telecommunication union

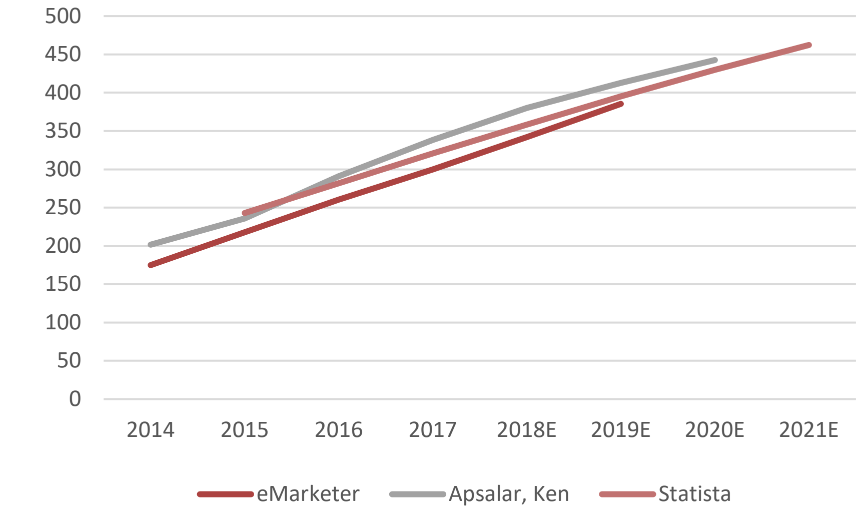
Growth through mobile

As with other countries that did not already have advanced infrastructure, India's population largely accesses the internet through mobile devices, rather than desktop or laptop computers.

Indians love their mobile phones: there are already over 700 million of them – the highest population of mobiles in the world after China. Of these, around 300 million are smartphones, and it is the growth in smartphones that will push internet penetration rates to 50% and beyond, in our view.

Our chart for smartphone growth uses three different sources as the data varies (even historically), but there is a clear trend that shows 450m smartphones being reached between 2020 and 2021.

Number of smartphones (m) in India, 2014-21E



Source: as per caption

The actual outcome will depend on all sorts of variables, including the pricing strategy of the major players and the rollout of more 4G and even 5G coverage. It is beyond the scope of this report to analyse the Indian mobile market but we suspect that few would argue with the likely growth in internet access, with only the exact timing of penetration being uncertain.

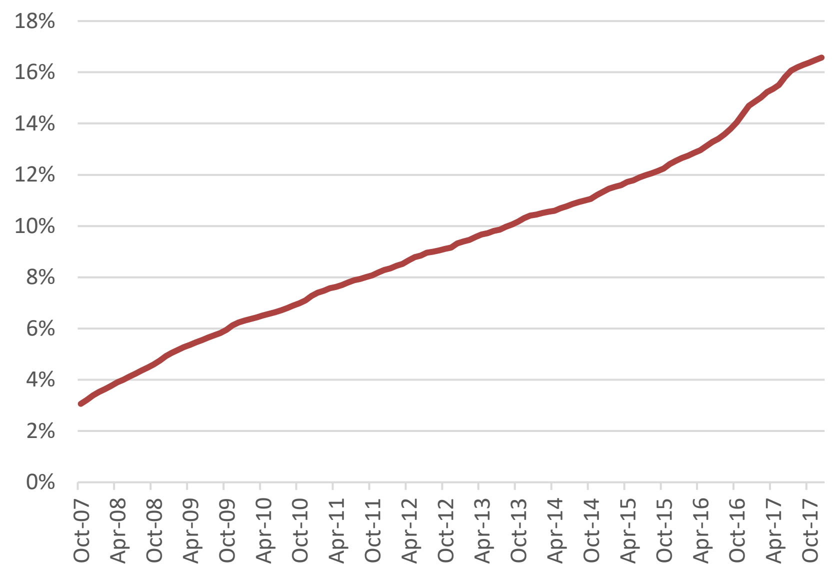
For Koovs, broader access is a necessary development but not sufficient for its success. In addition to access to the internet, the population needs to become comfortable conducting transactions online.

Online retailing

Various factors determine the speed of the growth in online shopping. Once the internet is widely available, there are several other key developments. First and foremost is trust. People who are used to seeing and touching before buying, and who can then take away with them what they have just purchased, are reluctant at first to give up some of these obvious advantages. Online retailers need to become smart at e-tailing: delivering the promised product swiftly and handling mistakes efficiently.

The UK is the most developed retail e-commerce market in the world with 16.6% of all retail sales now online. There has never been a sudden spurt in penetration; it has simply been a steady build-up over 20 years.

UK internet retail sales as % of total retail sales (rolling 12 months)



Source: ONS.

At the beginning of 2007, less than 3% of retail sales were online. The progression has been steady with only a small acceleration noticeable in 2016.

India, though, is not the UK. There are substantial differences between the two markets.

In favour of faster growth

India has a much less well-developed retail market in the physical world. Only 9% of retail is organised: that is goods sold through retail chains. The vast majority of India's shopping is done in informal malls and markets comprising numerous individual outlets with no recognisable retail brands and where prices are negotiable. So, arguably, the offline competition is much weaker than a developed economy like the UK.

India has a very young population that is likely to be more open to new ways of buying things, and the government is very keen to drive the development of online transactions. (See Digital India on p19.)

In addition, as a later developer, the e-commerce operators have plenty of examples from elsewhere in the world from which to learn.

The risks of slower growth

As a relatively poor society, Indians spend a much higher proportion of their income on food, and food has proved fairly resistant to moving online. In the UK, only 5% of food sales are online while 17% of clothing is sold online. So while this would not affect the rate of growth of non-food categories, it will likely have an impact on the overall growth rate of e-tailing.

Indians like to bargain and are unused to fixed price retailing. Furthermore, there has been a long history of commerce avoiding officialdom: the vast majority of transactions are in cash with no formal record kept. Consequently, many Indians have not traditionally had bank accounts. The impact of demonetisation (see p.19) has begun to address this issue.

Cash on delivery

One distinct characteristic of the Indian online market – the prevalence of cash on delivery (COD) – is widely seen as restraining expansion in e-commerce. We believe it is actually an advantage when the market is in the phase of building trust. No-one has to give up financial details or commit to handing over money until the product is actually delivered. In essence, this is one aspect of a shop that is brought to one's own door. Once buying online becomes second-nature, then this advantage becomes more of an inconvenience, but by then the buying population will probably have also got used to online payments.

In the meantime, there is an intermediate step that has emerged: credit card on delivery. It has all the advantages of COD, is less hassle, and is cheaper for the e-tailer to manage.

Currently, around 70% of Koovs' business is COD, with a higher percentage from Tier 2 and Tier 3 cities. This is far from unusual: in 2015, Flipkart – one of the two largest players in Indian retail e-commerce – reported that 72% of its orders were COD, rising to 90% from Tier 2 cities.

Delivery

India is a very large country and the infrastructure is sub-optimal. Koovs aims to deliver within five days; Flipkart says its delivery times will vary from two to six days, where a standard courier service is available, or one to two weeks for other areas. The faster this can be brought down to one to two days, the faster e-commerce will really take off. It is possible to have a two-day delivery but at the moment it is a premium service.

There is another irony here too: while Amazon and Flipkart may be thought of as competitors to Koovs, in practice it is the giants that will make the difference when it comes to distribution and online payment developments. They have the scale to drive improvements across the country – Koovs can ride on their coattails. And it is not just the online giants themselves: there are also very significant investments being made in logistics by new entrants backed by international finance (e.g. Dehlivery (Carlyle Group), Ecom Express (Warburg Pincus) and XpressBees (Alibaba)); and by the traditional international players such as DHL and Blue Dart.

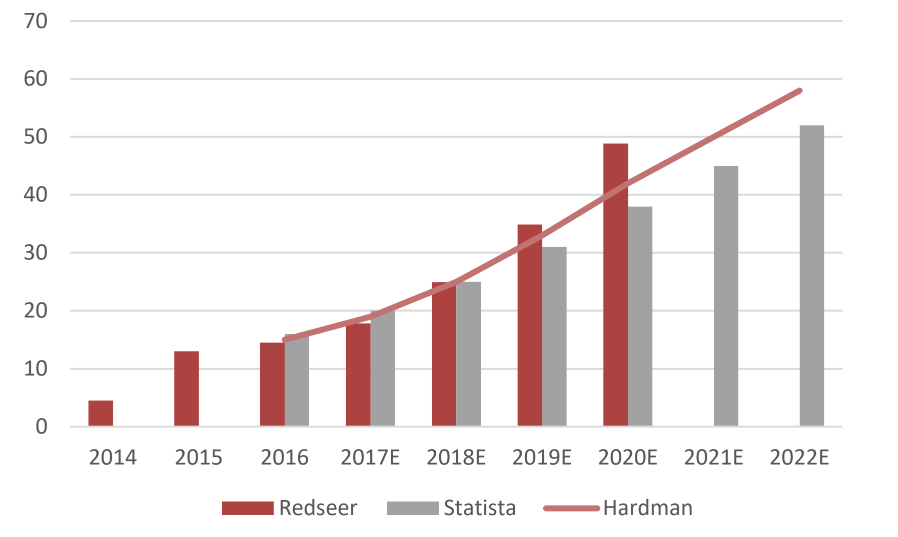
Online retail sales forecasts

Forecasts for the retail e-commerce market had been over-optimistic, thrown, we believe, by two factors: demonetisation and misunderstanding the structure of the market. We discuss demonetisation later. The structural mistake was not recognising the importance of the size of the food component in offline sales. Food sales in India account for around 70% of consumer spending and are unlikely to move online in a substantial way anytime soon, in our view.

There are many and various forecasts for online retail spending, and they vary depending on definition and timing, as well as underlying assumptions. There is a frustrating mix of calendar years and fiscal years (which end in March), and there is no clear terminology to determine whether services (in particular travel services) are included or not. We want to focus on goods delivered online and in calendar years.

In the chart below, we have plotted two different forecasts: one by Redseer, an Indian online consultancy, and one by Statista. Redseer data are particularly up-to-date.

Retail e-commerce of goods in India ($bn)



Source: Statista and Redseer and Hardman & Co Research.

They both agree that the market will be about $25bn in 2018, and then diverge on their growth rates from there. We have plotted a line between the two that produces an estimate of the future online e-commerce market reaching $42bn by 2020 and $58bn by 2022. This translates to only about 1.8% rising to 2% of total retail sales. By comparison, the UK is at 17%, China is estimated to be around 16% and the USA 8%.

Of all the various forecasts in this report, 2% of retail sales going online in India by 2022 looks to us to be the most conservative. Forecasts were much higher a few years ago. The setback in 2016/17 from demonetisation, etc., has injected caution into new forecasts – possibly too much. The implicit annual growth is just 25%. Redseer recently reported that it estimated that 4Q'17 was the second successive quarter of growth, returning to year-on-year rates of 40%.

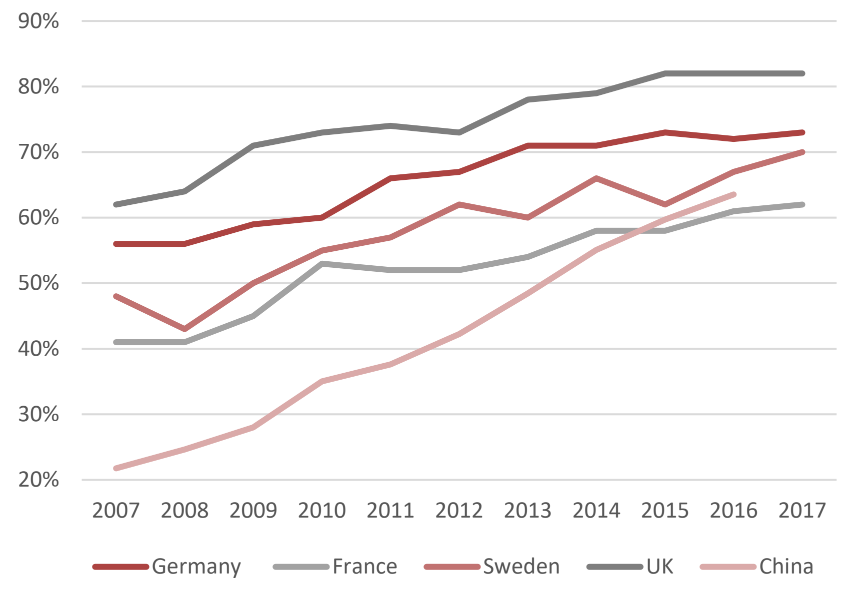
Growth factors

The growth of e-commerce will be determined by a number of factors, not all of them independent of each other.

1) The number of online users who convert to online shoppers

This is usually a function of time. It takes familiarity to bring confidence. People usually start with social media apps and then graduate to using Google, Wikipedia etc., before moving on to some from of basic banking or services like recharge, before finally taking the plunge and buying something remotely. Online shopping and the number of shoppers have grown consistently all around the world; there is no reason to suppose India will be different. The chart below shows how quickly China caught up the various European nations having started years behind.

Percentage of online users who are online shoppers



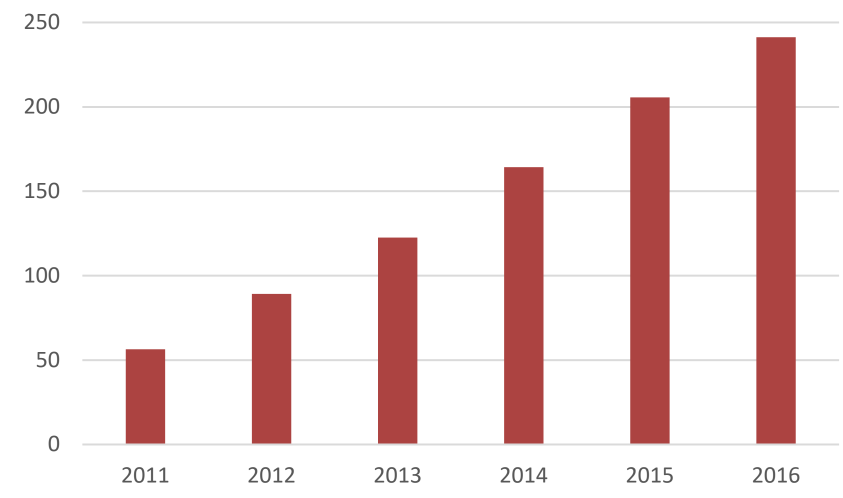
Source: Eurostat, Statista.

The rate at which they convert will, we believe, be a function of two competing factors: wealth and youth. India's population is poor but getting richer; but it is very young and therefore more open to new ways of doing things.

Another dynamic is the rise of social media and the impact of the internet in bringing the outside world into the Indian home. Traditional media is dominated by Indian culture but social media has a much greater influence from the West, both directly and through Indian celebrities. The exposure to western values and designs prompts new and aspirational desires for, among other things, western clothing, which is largely only available online.

There are more Facebook users in India than in any other country in the world.

India social network users (m)

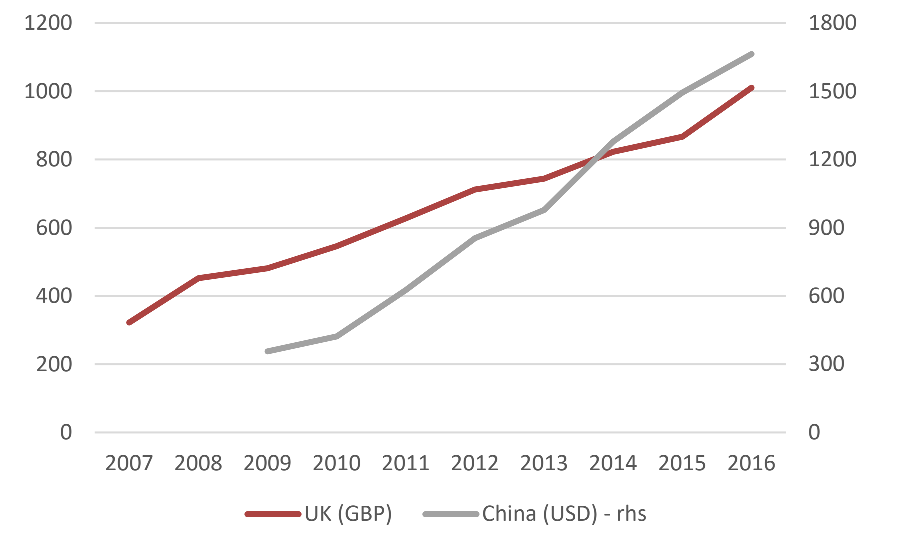


Source: Ken Research.

2) Spend per customer

The current spend per online customer in India is around \$200. This is partly a function of the wealth of the customers – which we expect to be above-average as early adopters of internet shopping and may de diluted as the numbers spread – and partly a function of lots of newbies just dipping their toes in, which should see a countervailing upward force on the spend per head as they get more comfortable. In other markets, the spend per head tends to rise remorselessly. In the chart below, we have plotted the figures for the UK (in £) and for China (in \$).

Online retail spend per shopper



Source: Eurostat, Statista

Spend per head in the UK continued to rise throughout the financial crisis and its aftermath. In our base case, we have annual spend per head in India falling from \$200 today to \$160 in 2022. For it not to fall, either the number of internet users (or shoppers) would have to grow much more slowly (while the online spend remained the same) or the online spend could be expected to be much higher. We favour the latter explanation.

3) The marketing tactics of the big players

India is a very price-sensitive market – the customers love a bargain. Most, if not all, online retailers are running at negative gross margins and regularly run big promotions. This activity draws back new purchasers and old ones to buy. There is no reason to expect this activity to cease while there is still so much growing to be done. In practice, we don't see Koovs as having any real competitors at this stage of development – all the competitive activity by the other players is helping to develop the market and drive more consumers online. There will come a point where the e-commerce players have to monetise their customer base and wean shoppers off huge discounts but, for the next few years, it is all about winning over new customers. And Amazon and Flipkart, the two giants of the Indian online market, have billions of dollars to spend.

4) The customer experience

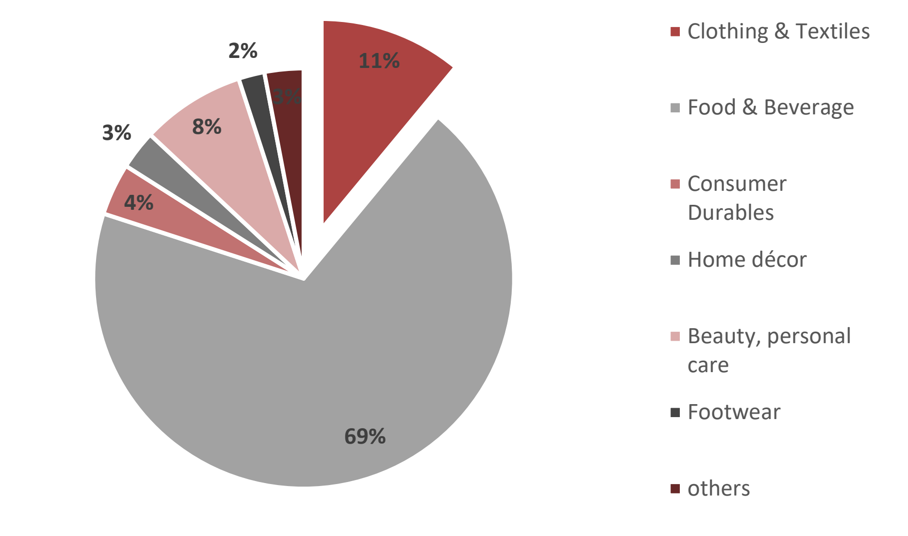
From the reliability of the mobile connection, to the availability of stock, to pricing, packaging and delivery – all the factors that make up the soup to nuts of e-commerce – all will have an impact on the rate of penetration. If the rural communities in particular have poor internet speeds and consistency, and slow or failed deliveries, it will inevitably take longer to get more of them online. The well-financed players are essential to delivering and constantly improving the e-commerce experience.

The mobile phone operators have invested around $23bn so far in the Indian market, and will have invested around $34bn by 2020 according to the GSM Association. The spread of reliable 4G and later technologies will be a key determinant of the spread in online shopping, in our view. At the moment, there are serious reliability issues and, when you are trying to buy something, you don't want to keep losing your connection.

Apparel market

The next stage down the funnel to get to Koovs is the proportion of online sales that are for apparel – that is clothing, accessories and footwear[1]. In India, apparel is about 11% of consumer spending – the largest category after food and beverages.

India total retail spend split by category

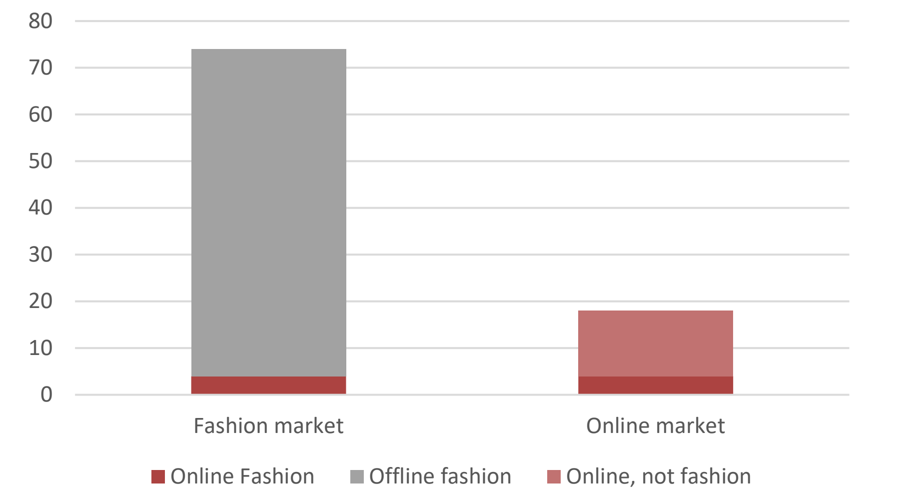


Source: Indian Ministry for Statistics

We estimate that the total clothing market in 2017 was therefore worth around $75bn, of which around 5% or $4bn was sold online, making up about 22% of an estimated $18bn of online retail sales.

[1] Generally, in this report, we use "apparel" and "clothing" interchangeably. Readers should assume that "clothing" usually includes shoes and accessories.

Indian fashion market in context (USD bn)



Source: Ken Research

In most recent quarters, there has been a surge of buying in consumer durables online, especially of mobile phones that have been heavily discounted. We expect apparel to go back to around 23% of online sales and stay there for the forecastable future. Clothing is typically one of the first things that a new consumer on the internet purchases. According to a BCG survey in 2016, 28% of first purchases were for clothing or footwear.

First online purchase by Indian shopper

Apparel & footwear	28%
Mobile phones	20%
Travel	18%
Mobile services	10%
Entertainment	3%
Other	21%
	100%

Source: BCG survey 2016

According to another survey, conducted by PwC in 2015, once an online shopper, a typical customer will purchase at least half his/her apparel needs online, with a quarter making "most or all" of their purchases online.

Currently, the metro areas of India are responsible for about 40% of online fashion sales and Tier 1 cities another 25%, leaving Tier 2 and the others with the final third.

Western vs. ethnic

From Koovs' point of view, the split between ethnic sales and western fashions is critical. Koovs sells only western fashion. For men, something like 90% of all clothing is western or of western appearance. Ethnic wear is reserved for formal occasions. The trend for women is heading that way, but it is a far from mature trend. With a bias towards younger purchasers, online sales of western womenswear are about half those of women's ethnic wear.

The BCG 2016 survey estimated that ca.15% of online apparel sales were western womenswear and a further 28% were casual menswear, making the Koovs target market about 43% of the whole.

Split of online fashion sales in India	2016	2020E	2020 ($bn)
Women's ethnic wear	26-28%	30-32%	4.1
Women's western wear	14-16%	16-18%	2.2
Kids' wear	8-10%	9-11%	1.3
Men's formal wear	21-23%	18-20%	2.5
Men's casual wear	27-29%	21-23%	2.9
Total			**13.0**

Source: BCG survey 2016

By 2020, the survey had western womenswear up to 17% but men's casual wear slipping to 22%. We have assumed, in our base case, that Koovs' addressable market remains at 43%. We would expect the western womenswear share to grow faster than the BCG survey. As it happens, the same survey put some absolute numbers on the market size and had Koovs' market coming out at $5.1bn in 2020; our base case has it at $4.5bn.

Conclusion

The Indian online economy is very immature, with only around 1% of retail spend currently spent online. Our base forecast has this rising to 2% in 2022 – still a small fraction of where other economies are today. All the ingredients for growth are in place: rich players investing billions in both physical and electronic infrastructure; a Government keen to have the whole economy digitised; a young population eager for new technology; and the highest forecast economic growth of any major country.

The setbacks in 2016/17 were one-off and designed to help move India into a modern age. Observers and investors were thrown by the setback to usual internet-fuelled hyper-growth, but there are clear signs that growth in online retail in the second half of 2017 was back to 40% year-on-year, and we believe it is quite likely that forecasts will prove too cautious from here.

The apparel market is a natural sector to move online and western apparel in particular. With a very underdeveloped retail sector, few retail chains and little choice in western womenswear, as well as a huge and growing youthful population, India looks set to be an exciting opportunity for Koovs for years to come.

While it is clearly very difficult to forecast this kind of growth, we believe there is little doubt about the future size of the opportunity; the uncertainty is really only about timing and, from Koovs' point of view, whether it can successfully seize it.

Supplement

Below, we briefly address three big Government initiatives: Digital India; demonetisation; and Goods and Service Tax (GST).

Digital India

The government is helping too. India is very serious about moving the country online. The overall project – Digital India – is a plan to give every citizen a digital identity, to spread the internet across the whole country and to transfer much government business online. It is supported by other initiatives:

- Skill India – training the population for the connected world
- Start up India – helping start-ups, especially in the fields of logistics and online payments
- India Innovation Fund – funding technological developments
- Foreign Direct Investment – relaxation in some investment rules

Other government initiatives have proved to be disruptive but should ultimately benefit the economy as a whole, as well as encourage digital growth.

Demonetisation

India had a thriving black economy based on cash transactions. Overnight, in November 2016, the government made 86% of the circulating currency (1000 and 500 Rupee notes) no longer legal tender. People had to queue up at banks (for hours) in order to change old and useless notes into the new currency. It had an immediate and damaging effect: people spent less because they simply didn't have access to their money, and this had a huge impact on "confidence".

The consultants Forrester saw online growth falling from 100%+ in the years 2013 to 2015 to "flat" in 2016 and 2017. Another observer, ENTracker, observed growth falling from 133% to just 26% in 2017. The numbers are all over the place, but the impact was clear and very substantial. Redseer, another consultant, cut its forecast for the e-commerce market in 2020 from $80bn to just less than $50bn.

By August 2017, 97% of the old currency had been converted, which suggests that the exercise did not penalise illicit cash hoards to the extent the government had hoped, but it did nevertheless drive people to use more digital payments – debit cards, credit cards and e-wallets – at least for a period.

It also meant that everyone had to "touch" a bank. Now the authorities know who had large sums of cash to exchange, tax collectors will be able to carry out their function more efficiently in future. Already, tax revenues have risen sharply, and the new regime will mean a fairer market for those operating above board.

Impact on Koovs

From registering growth of 50%-60% half-on-half in previous periods, this fell to +25% in the half to September 2016 and +18% in the half to March 2017. This slowdown also had a direct impact on Koovs' ability to raise new capital.

GST – Goods and Service Tax

A second, big government initiative came into effect in July 2017: Goods and Service Tax, or GST. Unlike demonetisation, this was not a surprise: it had been years in the planning and implementation. Somewhat similar to VAT in the UK and elsewhere, GST standardises sales taxes across the whole country. It will have a profoundly beneficial impact on commerce generally in India. In replacing each of the individual state's different tax regimes, it removes the administrative headaches for companies operating across borders. It also removes the need to negotiate and pay taxes when goods cross state borders.

The introduction of such a major change inevitably had an effect on business and activity in its immediate aftermath. Following on so closely from demonetisation, it was not helpful. Nor is the tax entirely straightforward – there are many different bands and exceptions – but it has one additional benefit for Koovs: since it is a single tax for goods and services, Koovs will be able to offset tax on its marketing expenditure against its total GST bill.

Koovs

The koovs.com website was launched in September 2012 with the objective of becoming the leading fashion e-tailer in India. The company was listed on AIM in March 2014, and it reported just £632k of revenue in the year to March 2014. By March 2107, revenue had grown to £8.7m, but the reported trading margin was -39% – albeit an improvement on the prior two years. With £16m of overheads, it reported a net loss of £19.3m for the year.

These are not unusual metrics for a dotcom start-up but they do require a pile, or stream, of capital to fund the progress towards market share and eventually profitability. At the time of the listing, the company thought it had raised enough capital, £20m net, to fund it through to profitability. Two things upset the calculations, both under the heading "competition".

Early setback

Originally, the Indian market was full of tiny minnows but then the big beasts arrived – Amazon, Flipkart and Snapdeal. They did two things: they bid up the price of media very substantially, increasing Koovs' marketing costs but also diluting the impact of its message; and they discounted. The level of discounting could reach 80%, even 90%. The result was that it was harder to grow and even less profitable to sell.

There was a third, lesser, factor: some western fashion brands, notably Zara and H&M, opened retail stores in the metro cities, providing some direct competition with exactly the sort of apparel that Koovs itself was selling.

These developments were not all bad. The advent of the large players with their huge budgets inevitably helped develop the market faster than it would have done otherwise. And the arrival of the likes of Zara also helped whet the appetite for affordable western fashion. But it did mean more money was required to develop the strategy.

Fundraising

Since the AIM listing in 2014, Koovs has raised an additional £45m of equity and £9m of convertible debt, making £75.5m in total.

Koovs' fundraising record

Share issues	Shares issued (m)	Price (£)	Raising (£m) gross
10/03/2014	14.67	1.50	22.00
16/10/2015	2.97	0.37	1.10
28/01/2016	17.80	0.25	4.45
29/04/2016	87.60	0.25	21.90
08/06/2016	13.20	0.25	3.30
07/07/2016	4.00	0.25	1.00
17/11/2016	25.70	0.50	12.85
	165.94	**0.40**	**66.60**
Convertible issue	Potential issue (m)	Conversion price (£)	Raising (£m) gross
18/08/2017	22.25	0.40	8.9

Source: Koovs plc

As at the half year ending September 2017, it had around £9m of cash or equivalents. In order to preserve funding, Koovs has had to slash its marketing budget from around £600k per month to around £150k per month and shrink its clothing range from 10,000 units to 5,000 or fewer. This inevitably has an impact on sales, and so we expect reported plc sales in 2H to fall to £2.6m, making £6.5m for the year to March 2018, a reduction on the year before of 25%.

Critical development

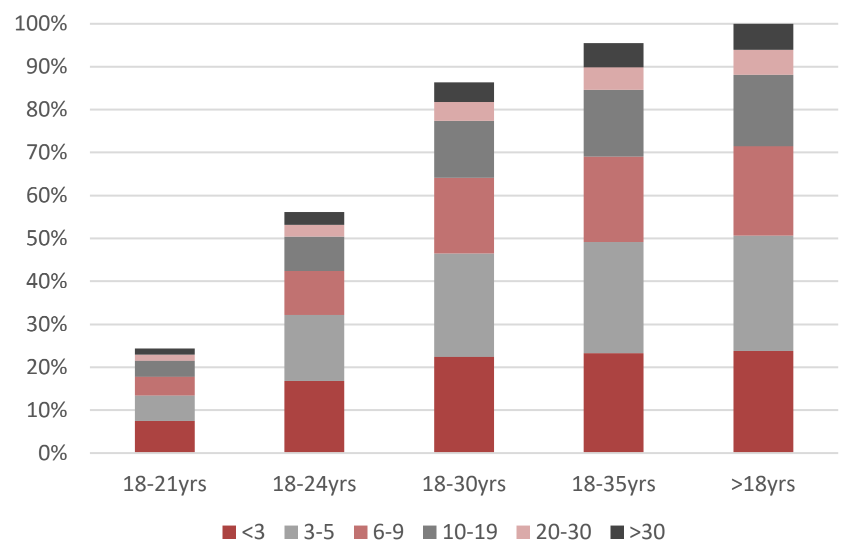
The hard data belie the true story, though. Since Mary Turner's appointment as CEO from October 2015, there have been major changes to the structure of Koovs and the way the business is operated. These developments leave Koovs in a very strong position to grow its share of the Indian online western fashion market very robustly once the business has access to more capital. There were three key changes: branding and marketing; staff reorganisation; updating of the technology platform.

Branding and marketing

One of Koovs' big successes in the past two years has been its brand awareness. By 2015, it had virtually no brand recognition in India at all (ca.1%). By September 2017, this had risen to 21% according to Campaign Watch and 18% according to a Redseer survey. There is no life in the online world unless your customers know who you are; so this is a critical development.

The Koovs brand stands for aspirational, affordable, western fashion. It is targeted squarely at the younger age demographic: from 18 to 30. It has to be "affordable" as half of Koovs' customers earn less than $9,000 per year.

Koovs' customer base by income (lakhs per year) and cumulative age



Source: Koovs survey data
Note: 1 lakh is equal to about USD1,500

Marketing has focused on a digital strategy – largely through social media. On Facebook, Koovs has 1.9m followers and on Instagram it has 0.5 million followers – more than all its competition and three times its smaller rivals. In the year to March 2017, it took 1.25m orders from 500,000 active customers. The number of orders will have slipped below one million in FY18 due to the lack of marketing and narrower ranges, but this remains a very decent base on which to rebuild the business.

Staff reorganisation

The second key change was to redistribute the staff. In 2015, the buying, merchandising and marketing were all done from London. Mary Turner recognised that the only operating function that needed to be done from London was the designing. Having the buying and merchandising done remotely from the customer base was not only expensive, but was leading to over-ordering and poor bargaining with manufacturers (who are all based in India). There is a clear advantage in having the buying and merchandising teams close to the customer, while it is crucial to Koovs' proposition that its designs genuinely come from London. It also makes obvious sense that the marketing strategy must be close to the customer and in touch with local sentiment.

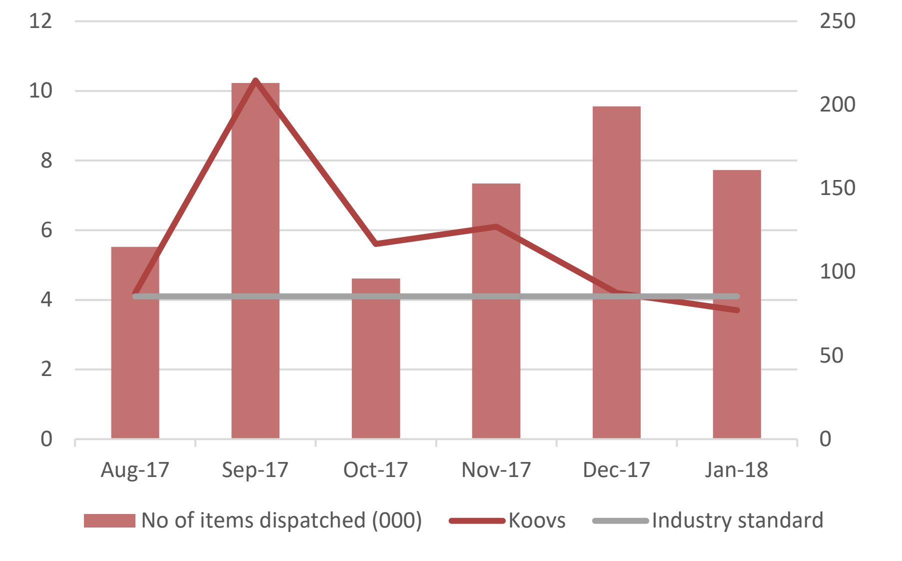
Technology platform

The third change was the updating of the tech platform, which was out of date. In particular, the customer-facing operation had been web-based, when the vast majority (70%+) of e-commerce in India is conducted on mobiles. Koovs introduced a new app in 2016, and it was last updated six months ago. Now, 80% of orders come through the app. It has also moved to a microservices platform that enables modular updating rather than having to overhaul the whole system every time an upgrade is necessary.

Other changes

Koovs outsourced its warehouse and distribution, having previously set up to do it all in-house. This was achieved in two stages, with the menswear being outsourced first and, when that proved successful, moving the rest of the operation in September 2017. Everything is handled by one warehouse, where Koovs has dedicated storage capacity. It has nine staff based on location supervising the operations and four key managers based in the Koovs office. There were a few teething problems immediately following the move, but these were quickly resolved and, by January, the order to delivery time was down to an average 3.7 days, beating the industry standard of 4.1 days.

Koovs' delivery record cohort



Source: Koovs plc

When volumes pick up substantially, Koovs might well bring back the operation in-house, but with the current levels, it is much more efficient to outsource. The current arrangements can easily handle double the current volumes and more. An ERP system has also been installed to smooth the interaction of the various parts of the order chain. This is another example of the scalability of the operation that has already been designed and built in anticipation of substantial growth.

The company has a customer care centre dedicated to responding to customer queries and complaints, whether they come in by email, by phone or even on Twitter or Facebook. It has a core staff and an external resource it can call on at extra-busy times. This too can be readily scaled up.

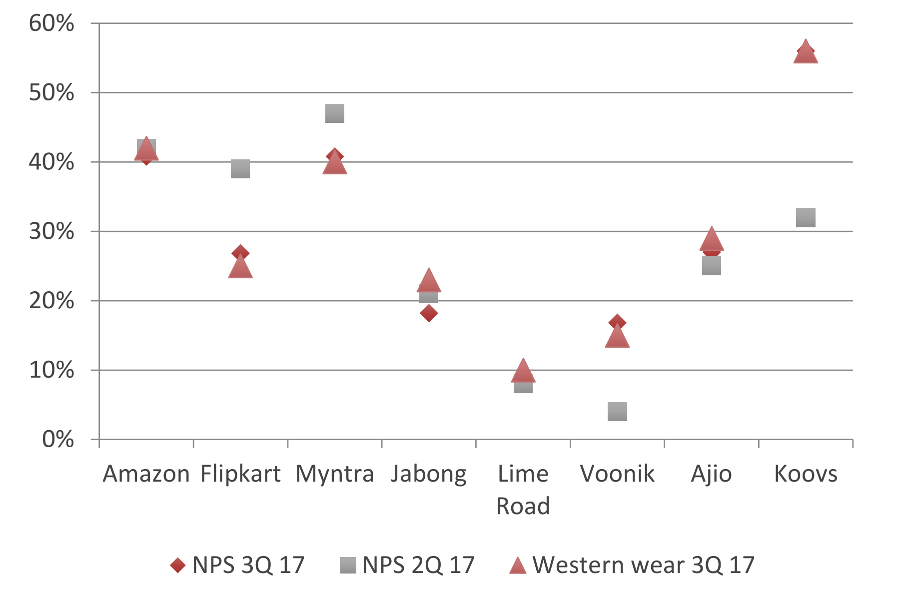
All members of the local senior management team have substantial experience in large businesses within (and across) India. The company claims that it is relatively easy to recruit staff as Koovs is seen as a very 'cool' and attractive place to work.

Proof of the pudding

While the sales experience may be disappointing, due to the lack of available cash to fund both the range and the marketing, the performance of the company has been exceptional. In addition to boosting the brand recognition, Koovs has increased the number of repeat customers to 40% – another useful metric when considering the impact of turning up the marketing budget again.

However, the most impressive data come from the latest survey conducted by the consultants Redseer, which covered the third quarter of 2017. Koovs had the highest NPS of all the Indian clothing e-tailers at 56%, up from 32% in the previous quarter when it had beaten all the smaller players but was then behind the behemoths.

NPS for online clothing e-tailers

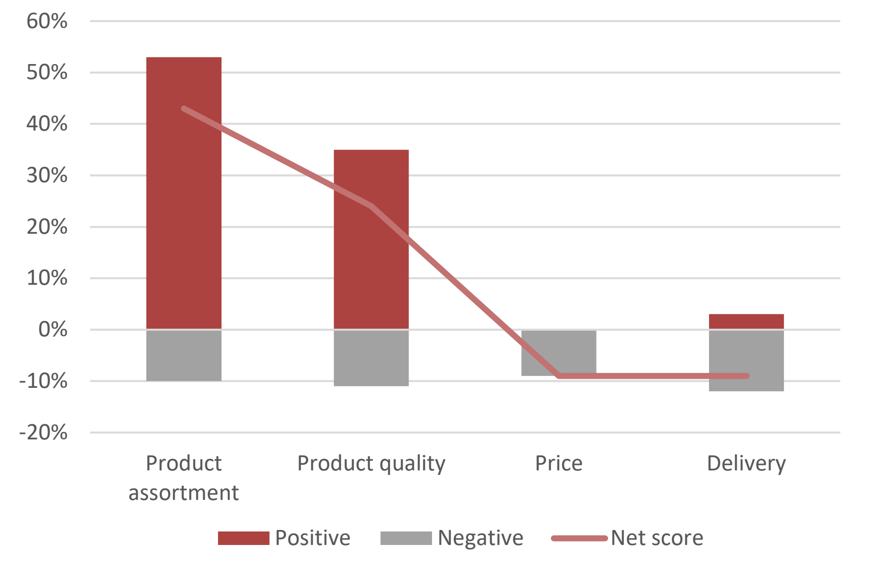


Source: Redseer

Koovs also retains the top spot when only western-wear shoppers are included in the survey.

The components of the NPS where Koovs scores highest are "Product Assortment" and "Product Quality". It loses points on "Price" and "Delivery". Since the period included the poor month of September, when it changed warehouse, we might reasonably expect the delivery score to improve in the next survey.

Most liked/disliked aspects of Koovs' NPS



Source: Redseer

Koovs has won other awards too, including "The Most Popular Fashion Portal with Youth" by the Global Youth Marketing Forum. Forrester, in a survey from November 2017, ranked it number one for best customer experience.

Price, discounts and margin

Koovs might not be too unhappy to score lowly on "Price". The Indians, with their culture of unorganised retail, love to bargain, and the way most online businesses have chosen to sell themselves and win market share has been through heavy discounting. Koovs cannot afford to ignore the pricing pressure, but through clever and careful merchandising, through curating unique content and through building an attractive brand, the worst of it can be avoided.

We expect that the trading margin for FY18 will have improved from 2.2% in the previous year to 11.5%. The trading margin is after accounting for discounts and returns but before delivery and warehouse costs. If right, this would prove to be a substantial achievement, especially against the background of falling volumes.

One of the ways of defending margin is focusing on the lower end of the range, where Koovs expects to make 60% of its sales in the future. For the past two years, it has been around 50%.

Koovs splits its range into three price points: Good, Better, Best. Good is £6-£12, Better is £12-£24 and Best is £24-£59. The expected blended price is around £14, with 30% Better and 10% Best.

It expects to sell around a quarter at the full price – rising to 35% over time. The rest is discounted with an average reduction of around 50%. The net achieved price, after tax and returns, should be around £8 per item in FY18. This is expected to fall to around £6 over the next few years as a higher proportion of Best is sold. Nevertheless, with higher volumes and a steady increase in the proportion of own label, the net margin per unit is expected to rise from 80p progressively towards £3.

Good, Better, Best Mix and gross order value

	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Basket mix								
Good	48%	50%	47%	60%	60%	60%	60%	60%
Better	41%	43%	46%	30%	30%	30%	30%	30%
Best	11%	7%	7%	10%	10%	10%	10%	10%
Price (INRs)								
Good	619	649	698	700	700	700	700	700
Better	1,504	1,483	1,506	1,500	1,500	1,500	1,500	1,500
Best	3,323	3,369	3,618	3,400	3,400	3,400	3,400	3,400
Avg.	1,279	1,198	1,274	1,210	1,210	1,210	1,210	1,210
Gross order value (£m)								
Sold at full price	5.6	7.1	5.6	9.6	30.4	66.7	126.5	192.5
Sold at promotion	2	6.5	5.8	10.4	23.1	40.8	63.2	96.3
Sold marked down	2.6	4.9	3.1	6.5	14.2	37.5	72.3	110.0
Total GOV	10.2	18.5	14.5	26.5	67.7	145.0	261.9	398.8
Sales tax	7%	7%	10%	11%	11%	11%	11%	11%
Returns	26%	28%	26%	30%	30%	30%	30%	30%
Net sales	7.0	12.5	12.3	16.5	42.2	90.3	163.2	248.4
Avg. selling price per unit (£)	8.86	8.02	9.74	9.30	9.50	10.00	10.35	10.65
Net margin per unit (£)			0.81	1.26	1.63	2.28	2.86	2.96

Source: Koovs plc and Hardman & Co Research

Own label

The own label business is the heart of an operation like Koovs. It tends to have not only much higher margins but it is, by its nature, exclusive. Koovs is looking to make a gross margin of ca.50% in FY18, rising in increments to 70% by FY22 on its own label clothes. By contrast, the "brands" margin is expected to be 43% this year but rise to just 49% by FY22. The blended margin is thus expected to rise from 46% in FY18 to 62% FY23. This compares with a current margin at ASOS of 49% and 56% at Boohoo.

Weighted average margin

	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Percentage own label	39%	39%	37%	40%	45%	50%	55%	60%
Own label margin								
Good	34%	50%	52%	55%	60%	65%	70%	70%
Better	37%	48%	51%	55%	60%	65%	70%	70%
Best	39%	44%	46%	55%	60%	65%	70%	70%
Total	36%	49%	51%	55%	60%	65%	70%	70%
Brands margin								
Good	31%	40%	43%	45%	47%	50%	50%	50%
Better	30%	41%	43%	45%	47%	50%	50%	50%
Best	29%	36%	37%	39%	41%	42%	43%	44%
Total	31%	40%	43%	44%	46%	49%	49%	49%
Weighted margin	33%	43%	46%	49%	53%	57%	61%	62%

Source: Koovs plc and Hardman & Co Research

It is not all about margins, either. Koovs has been designing "hybrid wear" – western styles with ethnic-friendly fabric – as a way of encouraging new but timid customers into its "foreign" clothes.

Product range

In any retailing operation, choice is critical. In fashion, it is doubly so. There needs to be a wide range of styles and patterns as well as variations in size and colour to cater for as many customers as possible. With money tight, Koovs has had to cut back its number of lines radically. After marketing spend, the next use of additional funds will be to expand the range again.

Competition

Marketing, product and systems are all within Koovs' control; the competition is not. The competition splits into two: the giant marketplaces and the specialist clothing retailers.

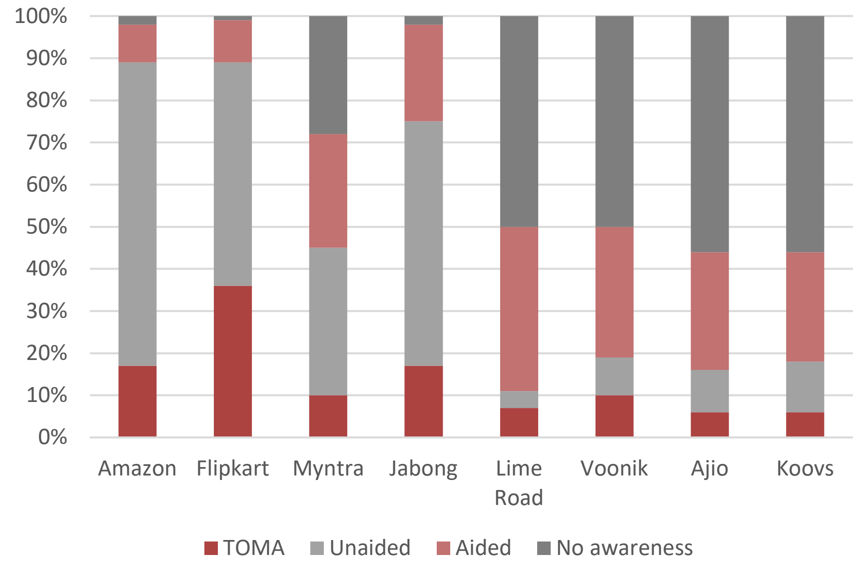
Marketplaces

The two biggest players in India e-tailing are Amazon and Flipkart (funded by Softbank among others). Amazon operates as a pure marketplace selling third-party goods. Flipkart does that too and it has also acquired two specialist clothing e-tailers: Myntra and Jabong. Both behemoths use price as a main weapon.

At the end of December 2017, Myntra held an "End of Reason sale" where it sold 5 million products to 1.7 million people over three days. The gross margins on this extravaganza are not disclosed, but discounts of 80% were common and 90% not rare. Much of the clothing sold will have been "commodity" rather than "fashion", and Myntra traditionally sells about 25% ethnic clothing, so it is not all direct competition for Koovs, but the heavy discounting can make undiscounted items look comparatively expensive.

The same pattern – having one or two large, nationally recognised, marketplaces and then a raft of specialist e-tailers – is seen all over the world. Analysis by Technopak, an Indian consultancy, sees the following split in the market: 80% the top two to three marketplaces, 15% vertical specialists and 5% multi-channel players (e.g. offline shops with an online presence). We believe that there is certainly room for a specialist or two and that Koovs has what it takes to become one of the leading independent fashion players in the Indian online space.

Brand awareness



Source: Redseer
Note: TOMA = Top of mind awareness

Specialists

Other than Koovs, there are only three other recognised specialist clothes e-tailers since the fourth one, Abof, pulled out last year. Two of them, Lime Road and Voonik, sell two-thirds ethnic clothing, and the fourth, Ajio, is of a similar size to Koovs.

The competition – data covering 3Q'17

	Amazon	Flipkart	Myntra	Jabong	Lime Road	Voonik	Ajio	Koovs
Market share	16%	26%	25%	7%	2%	3%	1%	1%
No. of transactions (m)	8	12	11.5	2.3	1.1	1.4	0.21	0.26
Shipped GMV (USD m)	130	195	196	53	17	23	7	5.4
Avg. selling price (USD)	11	11.5	14	16.5	9	12	15.5	13.6
No. of items per basket	1.6	1.6	1.5	1.5	1.7	1.5	2.4	1.8
Ethnic %	20%	25%	25%	17%	60%	65%	25%	0%
Private label %	3%	7%	20%	na	30%	45%	30%	37%
From Tier 2+ cities	35%	40%	30%	20%	30%	65%	20%	48%
Returns	20%	32%	24%	18%	25%	17%	25%	26%
Gross revenue (USD m)	20.8	27.2	37.2	8.4	2.7	4.3	1.3	3.1
Margin (USD m)	-7.2	-13.8	-5.1	-1.7	-0.5	-0.1	-0.1	0.1

Source: Redseer

The gross revenue figure is a small fraction of the GMV (Gross Merchandise Value) because the marketplace players book only their ca.16% take as revenue.

Ajio is supported by the giant, Reliance Group. Voonik's principal investors are InnoVen Capital and Sequoia Capital. Lime Road is supported by Tiger Global Management, which is also a big investor in both Flipkart and, originally, in Myntra.

Strong financial backing is critical in this business but of itself is not sufficient to guarantee success. Investors can be swift to pull the plug if they cannot see a path to success.

Conclusion

Despite the setbacks of the demonetisation shock and the scarcity of resources to invest in growing the business, Koovs has made substantial progress in the past two years. It is a significant player in the nascent online retailing sector in India and has all the operational parts in place to become the dominant specialist in its vertical: western clothing.

The strength of the business is demonstrated by the increase in brand awareness, the improvement in operating margin, the increase in repeat customers, and the investment in process and systems to make a truly scalable platform. The proof of its success so far is in the NPS it has achieved: the highest of any of the online players in online apparel retailing.

There are signs that the growth in e-tailing in India has returned to a high growth trajectory. Koovs is in a very strong position to take advantage of the resurgence, but it does need the funds to invest in marketing and broadening the product.

Financials and investment case

In the model below, we look at Koovs as a whole, i.e., as though it were to own the whole operation right out to the customer. As explained in the "Marble" box, Koovs has to operate at arm's length, and so the statutory accounts are reported on a separate basis.

We have split the income statement into three parts: the revenues and product costs; the other costs down to the operating line; and below the EBIT line.

Trading profit components

Working from the top, the marketing spend drives the number of visits to the Koovs app (and website). The visits are then converted to orders – this is a function of having an attractive range of products at the right prices.

The number of orders is then converted into the number of units sold. The value of units sold is determined by several metrics: the proportion of own label vs. branded; the price basket (good/better/best); the proportion sold at a discount or "promoted" at a lower price; and, finally, the level of returns. This mix drives the net sales figure.

To drive the trading profit, we need to take into account the brand mix and the price mix, as each may have a different margin.

Trading profit calculation (£m)

Marketing	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Marketing spend	7.737	8.188	5.891	**10.5**	**14**	**17**	**19**	**21**
Visits	44.2	78.5	65.0	116	166	246	312	390
Conversion (%)	1.51%	1.60%	1.36%	**1.40%**	**2.25%**	**3.00%**	**3.50%**	**4.00%**
No of orders (m)	0.669	1.253	0.886	1.622	3.744	7.368	10.934	15.616
Basket size (units)	1.72	1.84	1.68	1.80	2.00	2.10	2.25	2.40
Units sold (m)	1.2	2.3	1.5	2.9	7.5	15.5	24.6	37.5
Avg. unit value (£)	8.86	8.02	9.74	**9.30**	**9.50**	**10.00**	**10.35**	**10.65**
Avg. order value (£)	15.24	14.75	16.37	16.74	19.00	21.00	23.29	25.56
GOV	10.2	18.5	14.5	27.2	71.1	154.7	254.6	399.1
Sales tax	7%	7%	10%	**11%**	**11%**	**11%**	**11%**	**11%**
Returns	26%	28%	26%	**30%**	**30%**	**30%**	**30%**	**30%**
Net sales	7.0	12.5	9.6	16.9	44.3	96.4	158.6	248.7
Basket size (value £)	15.25	14.72	16.37	16.74	19.00	21.00	23.29	25.56
Cost per visit (p)	17.51	10.43	9.06	9.06	8.41	6.92	6.08	5.38
Marketing as % of GOV	75.8%	44.4%	40.6%	38.7%	19.7%	11.0%	7.5%	5.3%
Cost per order (£)	11.6	6.53	6.65	6.76	3.94	2.49	1.69	1.33
Own label margin	36%	49%	51%	**55%**	**60%**	**65%**	**70%**	**70%**
Brands margin	31%	40%	43%	**44%**	**46%**	**49%**	**49%**	**49%**
Percentage own label	39%	39%	37%	**40%**	**45%**	**50%**	**55%**	**60%**
Weighted margin	33%	43%	46%	48.6%	53%	57%	61%	62%
Cost of goods sold	67%	57%	54%	52%	48%	44%	40%	39%
Cost of goods sold	-7.0	-12.3	-8.5	-13.3	-32.2	-60.8	-88.2	-134.6
Trading margin	0%	2%	11%	21%	27%	37%	44%	46%
Trading profit	-0.1	0.3	1.2	3.6	12.1	35.6	70.4	114.1

Source: Koovs plc and Hardman & Co Research

The number of visits is a direct function of the marketing spend. Koovs has taken the opportunity to trial various marketing strategies and believes it has a very good idea of what works most effectively. As part of one of the funding rounds, the *Hindustan Times* and *Times of India* invested in Koovs. Koovs committed to spend substantial sums in advertising with them at heavily discounted rates. As at September 2017, £5.9m of the commitment was unspent and available for future campaigns.

Our model assumes steadily rising spend. The rate of spend will depend on the cash available and whether the conditions are fertile. The brand will need some supporting, but the hard work has been done on that, and now the money can be used directly to generate orders.

The conversion rate of hits to orders will largely be a function of consumer confidence: do they trust the site, do they have the money, is the right product available?

Similarly, the basket size and the average order value should be driven upwards with the maturing of the online retailing market. Higher-quality broadband (both speed and reliability) will make a huge difference here.

The Koovs plan is to drive higher the proportion of own label from just under 40% by 5ppts each year to reach 60% in 2023. The margin on both branded and own label will increase with volume. At the moment, Koovs is limited to largely ordering minimum quantities (say 50 items of each product).

In the year to March 2018, we are expecting a trading margin of around 11%. In the model, this is expected to grow steadily, to reach 44% in FY22 and 46% in FY23. This compares with the current margin at ASOS of around 50% and 55% at Boohoo.

Other costs

Below the trading margin, things become more straightforward: delivery costs, warehouse costs and platform costs. All have a fixed element and a variable element, and so all benefit from scale – partly by the fixed element getting smaller and partly by being able to drive harder bargains with suppliers as higher volumes are achieved.

This produces the bottom line of EBITDA. Both depreciation and capex are modest in this business.

Our model has Koovs reaching a positive gross margin next year – the year to March 2019.

EBITDA calculation (£m)	Mar-16	Mar-17	Mar-18E	Mar-19E	Mar-20E	Mar-21E	Mar-22E	Mar-23E
Trading profit	-0.1	0.3	1.2	3.6	12.1	35.6	70.4	114.1
Delivery costs per order	2.3	2.58	2.56	**2.15**	**2.05**	**1.95**	**1.85**	**1.75**
Delivery costs	-1.5	-3.2	-2.3	-3.5	-7.7	-14.4	-20.2	-27.3
Delivery costs	-1.5	-3.2	-2.3	-3.5	-7.7	-14.4	-20.2	-27.3
Gross profit	-1.6	-3.0	-1.1	0.1	4.5	21.2	50.2	86.8
Warehouse costs								
Cost per transaction (INR)			**6.0**	5.7	5.4	5.1	4.9	4.6
Cost per transaction (p)		**0.85**	7.1	6.7	6.4	6.1	5.7	5.5
Cost per order (p)			16.0	15.4	14.7	13.9	13.2	12.6
Storage costs per order (p)			**32**	**23**	**22**	**18**	**18**	**20**
Warehouse costs per order (p)			48.0	38.4	36.7	31.9	31.2	32.6
Total warehouse costs	-0.5	-0.4	-0.4	-0.6	-1.4	-2.4	-3.4	-5.1
	-4.9%	-2.4%	-3.0%	-2.3%	-1.9%	-1.5%	-1.3%	-1.3%
Platform costs								
Security and distribution				**-0.2**	**-0.3**	**-0.4**	**-0.5**	**-0.6**
Hosting				**-0.3**	**-0.4**	**-0.4**	**-0.5**	**-0.6**
			-0.4	-0.5	-0.6	-0.8	-1.1	-1.2
Marketing	-7.7	-8.2	-5.9	-10.5	-14.0	-17.0	-19.0	-21.0
Warehouse	-0.5	-0.4	-0.4	-0.6	-1.4	-2.4	-3.4	-5.1
Platform	0.0	0.0	-0.3	-0.5	-0.6	-0.8	-1.1	-1.2
Staff	-4.1	-5.2	-4.1	**-4.4**	**-4.9**	**-5.3**	**-5.8**	**-6.3**
Other	-3.2	-3.1	-2.6	-3.0	**-3.3**	**-3.5**	**-3.7**	**-3.9**
Total costs	-15.5	-17.0	-13.3	-19.0	-24.2	-29.0	-33.0	-37.5
EBITDA	-17.1	-20.0	-14.4	-18.9	-19.7	-7.8	17.2	49.2

Source: Koovs plc and Hardman & Co Research

Koovs plc numbers

From here, we move to the PLC accounts. All the marketing, warehouse and delivery costs are borne by Marble. The cost of promotional discounts (as opposed to markdowns) is also borne by Marble. The revenues reported by Koovs plc are those paid by Marble for the clothes it purchases from Koovs to deliver to the koovs.com customers. These are, necessarily, lower than the revenues booked by Marble, which have to cover all its other costs, as well as its "cost of goods". Marble should make a small profit.

Marble

Koovs is not allowed, under Indian foreign direct investment (FDI) rules, to own a stake in a multi-brand e-commerce retailer (sometimes called a warehouse retailer). The rules are different for marketplace retailers such as Amazon.

To comply with these rules, Koovs wholesales products, on an exclusive basis, to an independently owned and managed company called Marble E-retail Private Ltd (Marble).

Marble operates the Koovs.com website and the e-commerce retail distribution business under a licence granted by Koovs. Marble carries the stock and consumer credit risk. It is deemed to be operating as principal, not as an agent, for Koovs.

There is a put and call option, at fair market value, for Koovs to acquire Marble, which is triggered, should the law change, to allow Koovs to operate in India directly.

Income statement (£000)	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18E	Mar-19E	Mar-20E	Mar-21E	Mar-22E	Mar-23E
Revenue	632	2,075	5,198	8,680	6,532	12,628	35,843	81,228	137,604	220,539
Cost of sales	-107	-2,944	-7,581	-12,034	-8,500	-13,282	-32,188	-60,801	-88,210	-134,589
Gross profit/loss	525	-869	-2,383	-3,354	-1,968	-654	3,655	20,427	49,394	85,950
Operating expenses	-2,612	-9,932	-14,738	-16,258	-12,610	-18,335	-23,471	-28,301	-32,267	-36,817
Operating loss	-2,087	-10,801	-17,121	-19,612	-14,578	-18,989	-19,816	-7,874	17,127	49,133
Finance income	101	1,442	485	394	150	1,000	100	100	100	100
Finance expense	-1	-17	-105	-75	-400	-100	-100	-100	-100	-100
Loss before tax	-1,987	-9,376	-16,741	-19,293	-14,828	-18,089	-19,816	-7,874	17,127	49,133
Tax	-88	0	0	0	0	0	0	2	4	6
Profit or loss	**-2,075**	**-9,376**	**-16,741**	**-19,293**	**-14,828**	**-18,089**	**-19,816**	**-7,872**	**17,131**	**49,139**
Minorities	-65	-2,728	-6,139	-328	0	0	0	0	0	0
Equity holders	-2,010	-6,648	-10,602	-18,965	-14,828	-18,089	-19,816	-7,872	17,131	49,139
Profit or loss per share (p)	**-27.2**	**-27.6**	**-37.2**	**-12.8**	**-8.5**	**-4.5**	**-5.0**	**-2.0**	**4.3**	**12.4**
No. of shares (m)										
Period end	24.11	24.11	44.88	175.38	175.38	398	398	398	398	398
Weighted	7.40	24.11	28.48	148.48	175.38	398	398	398	398	398
Potential dilution					22.25					
Revenue growth		228%	151%	67%	-25%	184%	127%	69%	60%	184%
Gross margin	83%	-42%	-46%	-39%	-30%	10%	25%	36%	39%	10%
Operating margin	-330%	-521%	-329%	-226%	-223%	-55%	-10%	12%	22%	-55%

Source: Koovs plc and Hardman & Co Research

Cashflow (£000)	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18E	Mar-19E	Mar-20E	Mar-21E	Mar-22E	Mar-23E
Loss before tax	-1,987	-9,376	-16,741	-19,293	-14,828	-18,089	-19,816	-7,874	17,127	49,133
Depreciation and amortisation	12	102	116	135	150	165	180	200	240	300
Working capital changes	-65	-45	1,281	-6,374	500	-2,000	-2,000	-2,000	-3,500	-6,000
Net interest income/expense	-101	-1,425	-381	-320	150					
Other operating cashflows	51	130	131	384	500	150	150	150	150	150
Tax paid	-88	0	0	0	0	0	0	0	0	0
Net cashflow from operations	**-2,178**	**-10,614**	**-15,594**	**-25,468**	**-13,528**	**-19,744**	**-21,486**	**-9,524**	**14,017**	**43,583**
Purchase/sale of assets	-31	-121	-137	-109	-100	-100	-200	-300	-400	-500
Acquisitions	864	0	0	-9,921	0	0	0	0	0	0
Interest income	101	577	484	394	200	200	100	100	100	100
Deposits		-12,439	11,391	-3,867	5,000					
Net cashflow from investing	**934**	**-11,983**	**11,738**	**-13,503**	**5,100**	**100**	**-100**	**-200**	**-300**	**-400**
Share issues	22,417	0	5,270	40,510	0	48,800	0	0	0	0
Convertible loan					9,284					
Repayment of debt		-8	630	-877	-297					
Interest and finance expense	-1	-16	-82	-75	-20	-10	-10	-10	-10	-10
Net cashflow from financing	**22,416**	**-24**	**5,818**	**39,558**	**8,967**	**48,790**	**-10**	**-10**	**-10**	**-10**
Net change in cash	**21,172**	**-22,621**	**1,962**	**587**	**539**	**29,116**	**-21,596**	**-9,734**	**13,707**	**43,173**
Cash at start	139	21,731	-592	1,340	1,615	2,574	32,110	10,934	1,621	15,752
FX effects	420	298	-30	-312	420	420	420	422	424	426
Cash at end	21,731	-592	1,340	1,615	2,574	32,110	10,934	1,621	15,752	59,351

Source: Koovs plc and Hardman & Co Research

Balance sheet (£000)

	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18E	Mar-19E	Mar-20E
Intangible assets	6,239	6,751	6,543	7,736	6,736	5,736	4,736
PP&E	219	240	265	228	178	113	133
Non-current financial assets	124	94	91	107	107	107	107
Total non-current assets	6,582	7,085	6,899	8,071	7,021	5,956	4,976
Inventories	1,089	2,115	2,891	2,316	6,000	10,000	13,000
Receivables	621	697	656	8,762	5,000	1,500	2,500
Bank deposits	0	14,210	1,105	5,492	0	0	0
Cash	21,731	507	1,984	2,472	2,574	32,110	10,934
Total current assets	23,441	17,529	6,636	19,042	13,574	43,610	26,434
Total assets	**30,023**	**24,614**	**13,535**	**27,113**	**20,595**	**49,566**	**31,410**
Trade payables	-1,070	-2,146	-3,236	-3,824	-12,134	-11,853	-13,513
Borrowings	0	-1,099	-1,318	-600	-600		
Total current liabilities	-1,070	-3,245	-4,554	-4,424	-12,734	-11,853	-13,513
Long-term liabilities	-34	-79	-116	-144	-144	-144	-144
Total non-current liabilities	-34	-79	-116	-144	-144	-144	-144
Total liabilities	**-1,104**	**-3,324**	**-4,670**	**-4,568**	**-12,878**	**-11,997**	**-13,657**
Net assets	**28,919**	**21,290**	**8,865**	**22,545**	**7,717**	**37,569**	**17,753**
Equity share capital	245	265	471	2,071	2,071	3,400	3,400
Share premium	22,711	24,580	29,071	76,388	76,388	123,000	123,000
Other reserves	-75	-99	-16	-97	-97	-97	-97
Retained earnings	-2,033	-9,284	-20,771	-55,817	-70,645	-88,734	-108,550
Minority interest	8,071	5,828	110	0			
Total equity	**28,919**	**21,290**	**8,865**	**22,545**	**7,717**	**37,569**	**17,753**

Source: Koovs plc and Hardman & Co Research

Cash, sensitivity and valuation

Our model has the whole business not making an EBITDA profit until FY22 and having absorbed ca.£47m in EBITDA losses up until then. The EBITDA line is a good proxy for actual cashflow, with capex requirements running at about £0.5m per year. Therefore, on the model assumptions, it is clear that Koovs needs at least £50m in capital.

In the past, it has run on the basis that it could raise money each year as and when it needed it. That strategy has proved damaging in the past year, as spending had to be slashed when the cash proved difficult to secure.

We would prefer to see Koovs raise the £50m and probably more in one go and upfront. This has two distinct advantages: it frees up the top management to focus on running the business, rather than continuously trying to raise fresh funds; and it gives the company a cushion should the growth rate falter. As can be seen in the valuation section below, there is huge potential value here, even if the success date is pushed back a year or two. However, while the value is still theoretically there, the company might not be if it runs out of cash before the safety of cashflow positivity is reached.

Model summary

In the table below, we summarise our base case. In the top half of the first section, it summarises the macro assumptions and, in the bottom half, it summarises Koovs' performance. Then, in the second section, it shows what the growth or market share assumptions are. Finally, at the bottom, it illustrates the implicit returns on a theoretical adjusted EV that includes £50m of additional equity.

The future EV is discounted back to today at 25% to provide a current value. In this case, the £1.1bn future valuation is worth around £357m. We have then added a few variations where the final outcome is delayed by one, three or five years. We assume each year requires an additional £20m of equity and derive new present values. This is probably on the high side, but the cause of the delay is unspecified.

For the December 2022 EBITDA figure we have used a conservative 15% margin to reach £31m compared with our forecast of £49m at a 20% margin for FY23.

Top-down model summary								
	Dec	2017E	2018E	2019E	2020E	2021E	2022E	CAGR
India metrics								2017-22E
Online users	(m)	455	521	589	660	736	817	12%
Online shoppers	(m)	91	130	177	231	294	367	32%
Consumer spending	(USD bn)	1,600	1,807	2,042	2,308	2,608	2,947	13%
Online retail	(USD bn)	18	23	33	42	50	59	27%
Online spend per shopper	(USD)	209	180	185	180	168	160	-5%
Apparel online market	(USD bn)	4.0	5.4	7.5	9.6	11.4	13.6	28%
Koovs metrics								
Koovs addressable market	(£ bn)	1.4	1.7	2.3	2.9	3.5	4.2	25%
Koovs GMV	(£ m)	15	19	55	117	210	333	87%
Koovs sales	(£ m)	10	12	35	73	131	208	84%
Koovs EBITDA	(£ m)					13	31	
Koovs EV	(£ m)					654	1,089	
Growth								
Online user growth		*16%*	*14.5%*	*13.0%*	*12.0%*	*11.5%*	*11.0%*	
Online shopper growth		*55%*	*43.1%*	*35.6%*	*30.7%*	*27.4%*	*24.9%*	
Online shoppers as %		*20%*	*25%*	*30%*	*35%*	*40%*	*45%*	
Total consumer spending growth		*12%*	*13.0%*	*13.0%*	*13.0%*	*13.0%*	*13.0%*	
Online retail growth		*27%*	*30.5%*	*39.1%*	*27.1%*	*19.3%*	*18.9%*	
Online retail as %		*1.2%*	*1.30%*	*1.60%*	*1.80%*	*1.90%*	*2.00%*	
Apparel as % of online retail		*22%*	*23%*	*23%*	*23%*	*23%*	*23%*	
Apparel online growth		*27%*	*35.1%*	*39.1%*	*27.1%*	*19.3%*	*18.9%*	
Koovs addressable market share		*41%*	*43%*	*43%*	*43%*	*43%*	*43%*	
Koovs market growth		*30%*	*19.3%*	*39.1%*	*27.1%*	*19.3%*	*18.9%*	
Koovs share		*1.1%*	*1.15%*	*2.40%*	*4.00%*	*6.00%*	*8.00%*	
Koovs GMV growth		*2%*	*29.5%*	*190.2%*	*111.9%*	*78.9%*	*58.6%*	
Koovs net sales/GMV		*66%*	*62.3%*	*62.3%*	*62.3%*	*62.3%*	*62.3%*	
Koovs EBITDA margin						*10%*	*15%*	
EV/EBITDA multiple						*50x*	*35x*	

Source: Hardman & Co Research

NPV calculation				
Koovs current EV	(£ m)	16		
Fundraising	(£ m)	50		
Adj. EV	(£ m)	66		
Discount rate	(£ m)	25%		
NPV on 2022E	(£ m)	357	CAGR =	40%
delayed 1 year	(£ m)	278	CAGR =	27%
delayed 3 years	(£ m)	210	CAGR =	18%
delayed 5 years	(£ m)	130	CAGR =	8%

Source: Hardman & Co Research

To clarify, the numbers in the top half of the table are in US dollars and are calculated to the calendar year-end. We then translate the addressable market into sterling at a constant £1 = $1.40 rate, and the numbers in the (shaded) Koovs section are then in sterling to align with the Koovs model still in a calendar year.

Sensitivity

We have made a myriad of assumptions about the next five years to produce the forecasts that we have. None of them will be right. In the tables below, we show the outcome with some less optimistic assumptions. We have not bothered with more optimistic ones, as we believe the upside is already significant enough to satisfy any investor.

In scenario 1, we have made much more cautious macro assumptions but left Koovs' performance unchanged.

Scenario 1

	2022E	Base case	Change
Online users	817	817	
Online shoppers	265	367	-28%
Consumer spending	2,576	2,947	-13%
Online retail	52	59	-13%
Online spend per shopper	194	160	21%
Apparel online market	9	14	-35%
Koovs addressable market (£bn)	*2.3*	4.2	*-46%*
Koovs GMV (£m)	*180*	333	*-46%*
Koovs sales (£m)	*112*	208	*-46%*
Koovs EBITDA (£m)	*17*	31	*-46%*
Koovs EV (£m)	*589*	1,089	*-46%*
Growth/share in 2022			
Online user growth	*11.0%*	*unch*	
Online shoppers as %	*33%*	*45%*	*Much slower growth*
Total consumer spending growth	*10%*	*13.0%*	*Slower consumer spending*
Online retail growth	*15.8%*		*23% CAGR vs. 27%*
Online retail as %	*2.00%*	*unch*	
Apparel as % of online retail	*17.0%*	*23.0%*	*Apparel falling as % of e-wallet*
Apparel online growth	*9.4%*		*17% CAGR vs. 27%*
Koovs addressable market share	*36%*	*43%*	*Declining proportion*
Koovs market growth	*6.4%*		*10% CAGR vs. 25%*
Koovs share	*8.00%*	*unch*	
Koovs GMV growth	*41.9%*	*unch*	
Koovs EBITDA margin	*15%*	*unch*	
EV/EBITDA multiple	*35x*	*unch*	
NPV (£m)	*193*	*357*	*46% fall in value*
CAGR return	24%	40%	

Source: Hardman & Co Research

In scenario 2, we have left the macro assumptions unchanged but assumed a much worse performance from Koovs.

Scenario 2

	2022E	Base case	Change
Online users	817	817	
Online shoppers	367	367	0%
Consumer spending	2,947	2,947	0%
Online retail	59	59	0%
Online spend per shopper	160	160	0%
Apparel online market	14	14	0%
Koovs addressable market (£bn)	4.2	4.2	0%
Koovs GMV (£m)	125	333	-63%
Koovs sales (£m)	78	208	-63%
Koovs EBITDA (£m)	8	31	-75%
Koovs EV (£m)	272	1,089	-75%
Growth/share in 2022			
Online user growth	*11.0%*	*unch*	
Online shoppers as %	*25%*	*unch*	
Total consumer spending growth	*13.0%*	*unch*	
Online retail growth	*18.9%*	*unch*	
Online retail as %	*2.0%*	*unch*	
Apparel as % of online retail	*23.0%*	*unch*	
Apparel online growth	*18.9%*	*unch*	
Koovs addressable market share	*43.0%*	*unch*	
Koovs market growth	*18.9%*	*unch*	
Koovs share	*3.00%*	*8.00%*	*Less than half market share*
Koovs GMV growth	*43%*	*59%*	*53% CAGR vs. 87%*
Koovs EBITDA margin	*10%*	*15%*	*Two-thirds of the margin*
EV/EBITDA multiple	*35x*	*unch*	
NPV (£m)	*89*	*357*	*75% fall in value*
CAGR return	*6%*	*40%*	

Source: Hardman & Co Research

Finally, in Scenario 3, we have both macro and Koovs as worse than the base case but neither as bad as Scenarios 1 and 2. We have also reduced the EBITDA multiple.

Scenario 3			
	2022E	**Base case**	**Change**
Online users	817	817	
Online shoppers	306	367	-17%
Consumer spending	2,757	2,947	-6%
Online retail	55	59	-6%
Online spend per shopper	180	160	12%
Apparel online market	11	14	-21%
Koovs addressable market (£bn)	3.1	4.2	-26%
Koovs GMV (£m)	154	333	-54%
Koovs sales (£m)	96	208	-54%
Koovs EBITDA (£m)	12	31	-62%
Koovs EV (£m)	359	1,089	-67%
Growth/share in 2022			
Online user growth	*11.0%*	unch	
Online shoppers as %	*22.4%*	45%	*27% CAGR vs. 32%*
Total consumer spending growth	*11.5%*	13.0%	*Slower consumer spending*
Online retail growth	*17.4%*		*25% CAGR vs. 27%*
Online retail as %	*2.0%*	unch	
Apparel as % of online retail	*19.5%*	23.00%	*Apparel falling as % of e-wallet*
Apparel online growth	*14.4%*		*22% CAGR vs. 27%*
Koovs addressable market share	*40.0%*	43%	*Flat share at c40%*
Koovs market growth	*14.4%*		*17% CAGR vs. 25%*
Koovs share	5.00%	8.00%	*Just more than half market share*
Koovs GMV growth	43%	59%	*58% CAGR vs.87%*
Koovs EBTIDA margin	12.5%	15%	*Lower margin*
EV/EBITDA multiple	30x	35x	*Reduced*
NPV (£m)	118	357	*67% fall in value*
CAGR return	12%	40%	

Source: Hardman & Co Research

In each of these scenarios, the cash consumed arriving at profitability would be slightly higher than in our base case, depending on whether the shortfall was caused by volume or margins or lower marketing spend.

Valuation

Koovs is way past being a start-up company, but it is still several years from making a profit, and so we believe the best way to look at the valuation is to look at a future date – in this case, calendar 2022 – when it is making a profit, although still far from mature. In our base scenario, there are still only 800m internet users out of a population of what will be ca.1,400m, and only 45% of them are assumed to be shoppers. In addition, the Indian economy and the wealth per capita will still only be in the economic foothills. If Koovs is as successful as we think it can be, then it will be a highly prized company.

We have looked at the two comparable players listed in London: ASOS and Boohoo. We do not formally follow either but, based on our estimates, Boohoo is currently trading on a February 2017 EV/EBITDA of 52x (using a FY-end share price of 167.5p), falling to 38x in 2018 (using a current price of 191p). ASOS, the big daddy of the UK sector, is trading on 38x August 2017 (using a share price of 5,681p as at its year-end) and 37x August 2018 (using a current price of 7,512p).

Comparator multiples

	Price (p)	Mkt Cap (£m)	Net cash (£m)	EV (£m)	EBITDA (£m)	EV/EBITDA (x)
ASOS FY17	5,681	4,756	160	4,596	122	38
Boohoo FY17	168	1,899	58	1,841	36	52
ASOS FY18E	7,512	6,288	160	6,128	167	37
Boohoo FY18E	191	2,166	119	2,047	53	38

Source: Hardman & Co Research

We have used a 35x multiple in our central expectation; however; it is worth noting that both companies are more mature than Koovs will be in Dec-22.

Sensitivity to EBITDA assumptions

In the table below, we have produced a variety of values in 2022 dependent on different EBITDA outcomes and different multiples. Then, we have taken the values and discounted them back to today at a discount rate of 25% to provide a valuation today.

NPV of 2022 values discounted at 25%

	Multiple					
EBITDA (£m)	25x	30x	35x	40x	45x	50x
15	123	147	172	197	221	246
20	164	197	229	262	295	328
25	205	246	287	328	369	410
30	246	295	**344**	393	442	492
35	287	344	401	459	516	573
40	328	393	459	524	590	655

Source: Hardman & Co Research

The value necessarily includes an implicit assumption that sufficient capital was raised today to fund Koovs' development. So, for example, if you take the central highlighted value of £344m – 35x EBITDA of £30m – that is what Koovs would be worth today after raising £50m.

Purely for illustrative purposes, if the £50m were raised at 25p per share – Koovs has raised equity in the past at between 50p and 25p and we do not believe the current share price is a fair indication of the value inherent in the business platform that has been built – there would then be 398m shares in issue. Using the £357m of NPV from our base case that would equate to 90p per share.

Discount rate

There is no straightforward discount rate to apply to such circumstances. The assumption is that the money is raised so that risk is removed. All the other risks remain and profitability lies a few years off. We have chosen to use 25%, which we would argue is at the top end of what is appropriate. In practice, we believe the right discount rate is not a constant number but a steadily declining one, as the milestones in development are met.

Below is a table that shows the sensitivity of various discount rates at different levels of Dec-22 EV. The final, 25% column, ties in with the £30m EBITDA row in the table above.

Valuation based on different discount rates

Dec-22 EV (£m)	Discount rate					
	10%	12.5%	15%	17.5%	20%	25%
750	466	416	373	335	301	246
900	559	499	447	402	362	295
1050	652	583	522	469	422	**344**
1200	745	666	597	536	482	393
1350	838	749	671	603	543	442
1500	931	832	746	670	603	492

Source: Hardman & Co Research

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Chairman ASOS plc, 2000-12

Chairman Silvergate Media

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Risks

The risks with Koovs are, we believe, fairly self-evident. The overriding concern is the current state of the finances. The company will not survive very long without a further injection of funds. While sufficient funds to keep it going for another year would be beneficial, our whole investment thesis is based on it having sufficient capital now to reach profitability within four or five years.

The business is beginning to suffer from a lack of marketing investment. The silver lining of this cloud is that the value of much of any marketing investment made in the past 18 months would have been heavily diluted by the disruption caused by demonetisation; better to be spending it this year than last.

There is no obvious sign of any decline in staff morale in the company, despite its current state and a number of layoffs that had to be made last year.

The other risks are put simply:

- The Indian online market does not grow as predicted
- The online growth doesn't turn into as many online shoppers as expected
- The online shoppers don't spend as much as forecast
- The shoppers don't buy their clothes from Koovs
- Koovs has to spend more than it anticipates generating the traffic
- Koovs has to discount more heavily than expected to generate sales
- The competition is even fiercer in its discounting and marketing spend
- Costs are higher (in particular product returns may be higher)
- The Indian government introduces more disruptive measures

In addition, there are a number of other generic business risks.

There is no doubt this is a highly risky venture. Koovs has achieved a lot in its short existence and, in particular, in the past two years, but it is still years from profitability and many things can go wrong along the way.

We believe, with the single exception of its financing, that Koovs is in an excellent position to make the best of the enormous opportunity that online Indian clothes retailing represents.

Notes

Notes

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