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# Valuing E-commerce Businesses As the Industry Booms

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WITHIN THESE PAGES:



## Executive Summary


The online retail market had been growing explosively over the past two and a half decades before getting an additional boost from the pandemic, as millions of consumers and businesses worldwide were locked down and forced to shop from home. While the world has gradually returned to normal and more people return to physical stores, the shopping experience has been permanently transformed, and e-commerce promises to grab a larger and larger share away from traditional stores in the years ahead. That means the value of e-commerce companies will likely continue to increase tremendously.

This paper explores the recent growth trends in e-commerce, expectations of future growth, and what's behind that growth. In addition, we will examine recent trends in e-commerce company valuations, what's driving them, and how companies are valued. We will also look at what potential acquirers are looking for in e-commerce companies, in particular the role of aggregators in the Fulfillment by Amazon (FBA) market. We will also look at how e-commerce companies are sold and the role of investment bankers in the process.

# How to Value an E-Commerce Business

**Industry Overview**

The online retail market has grown sharply over the past 25 years, since the introduction of the internet and the meteoric rise of Amazon. While the vast majority—about 80%—of U.S. retail sales are still conducted "offline" and in traditional brick-and-mortar stores or by phone, its share is falling, both in actual and relative terms, while e-commerce's share has grown tremendously over the past 10 years.

> *At the height of the COVID-19 pandemic, 10 years of e-commerce growth happened in just 90 days.*

In particular, "at the height of the COVID-19 pandemic, 10 years of e-commerce growth happened in just 90 days" in 2020, according to Shopify. "2020 has accelerated the industry by a decade, permanently altering the way entrepreneurs start, run, and grow businesses, as well as how consumers choose to shop and pay. We're on the brink of a new era of commerce."

That trend is unlikely to abate as world economies reopen and shoppers return to stores. "E-commerce as a percentage of total global retail sales will continue to grow over the next five years," Shopify believes.

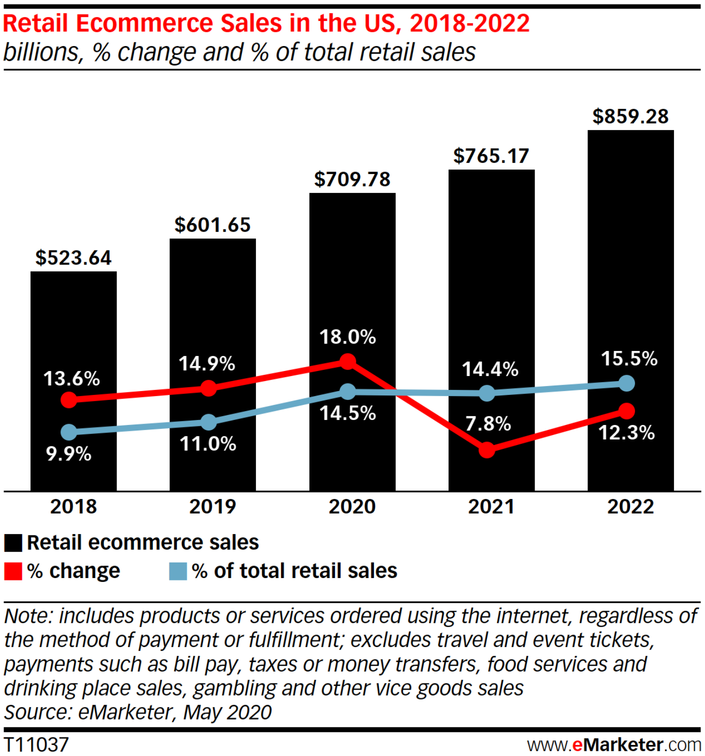
The growth in the value of online retailers has largely tracked that of e-commerce's market share. Witness the rise in the value of Amazon's market capitalization. The company's market cap at the end of September 2021 was about $1.8 trillion. In 2005, it was worth less than $15 billion. The company went public in 1995 at a price of $18 a share; at the end of September 2021 the stock closed at $3,285.

While few e-commerce companies—either publicly traded or privately held—have performed as well as Amazon, many have increased sharply in business valuation in recent years, many for their promise of future gains as well as current performance, and the voracious appetite from investors. "Online businesses are in high demand with the recent shift towards e-commerce, and many traditional blue-chip investors are looking to expand their portfolios by acquiring digital companies," Retail Touch Points says.

However, simply being an e-commerce company doesn't guarantee success, or riches, as it sometimes used to, such as during the 2000 "dotcom" boom. Indeed, as Shopify also notes, the growth trend in the sector "is not only a tailwind for digital brands, but also a headwind as the world of e-commerce becomes more crowded and competitive than ever." While private equity investors and aggregators have bid up the price of e-commerce companies in recent years, they have also gotten more demanding and discriminating in what they will buy and what they will pay.

## Growth dynamics

U.S. consumers spent more than $791 billion online in 2020, up 32.4% from $598 billion in 2019, the "highest annual U.S. e-commerce growth in at least two decades," according to a recent report from Digital Commerce 360, a leading research and media organization, that analyzed U.S. Department of Commerce data. By comparison, total retail sales through all channels, both online and offline, increased 6.9% in 2020, to $4 trillion from $3.8 trillion in 2019 and $3.6 billion in 2018. That marks the highest growth in total retail sales since 2004.




Source: https://www.emarketer.com/content/us-ecommerce-2020

This means e-commerce now accounts for 19.6% of total retail sales, up from 15.8% in 2019 and 14.3% in 2018, according to Digital Commerce 360. Ten years ago, online sales accounted for only about 7% of total retail sales.

According to Insider Intelligence, American consumers spent $709.78 billion on e-commerce in 2020, an increase of 18.0%. "Brick-and-mortar retail spending, however, is expected to decrease 14.0% to $4.184 trillion."

There are nearly 273,000 e-commerce businesses in the U.S., generating more than $546 billion in revenue, according to figures from Peak Business Valuation. "This industry has been growing at nearly 14% over the last five years – an outstanding rate," the company said.

## Expectations for the next few years

While e-commerce got a big boost from the pandemic lockdown, as many people were forced to shop online for necessities as well as discretionary items, those habits are unlikely to change.

"It's not just Gen Z and millennials driving this trend—older shoppers have also moved online," Shopify says. "Over half of consumers (54%) shifted more of their spending to online shopping since the pandemic was declared." According to a global survey across 11 markets by the company, 84% of consumers have shopped online since the pandemic, compared to 65% who shopped in-store. Moreover, 79% said they will shop online regularly in six months' time, compared to 57% who said they will shop in-store regularly in the next six months.

## Why now may be the best time to sell your e-commerce business

While growth in e-commerce shows no sign of peaking any time soon, valuations of online retailers may have. So cashing in now, with valuations at record highs, may be a smart decision. The bull market in e-commerce companies may not last forever, even if the industry continues to grow.

One reason is simple supply and demand. While prospective buyers—mainly private equity investors, other e-commerce companies and aggregators—are flush with cash and eager to put it to work, the supply of good companies to choose from isn't infinite. The growth prospects for e-commerce seem realistic, but it's more difficult to know if valuations can follow that same path. Asset valuations don't always track the level of underlying business activity and even profitability.

One factor that could negatively impact future e-commerce valuations is higher interest rates. The Federal Reserve has already indicated that it will likely start tapering its purchases of government and mortgage bonds before the end of this year. While that has had only a minimal effect on bond rates so far, that could change as the tapering program progresses and the Fed removes some of its support for the economy. The Fed has also indicated it plans to raise its benchmark interest rate starting sometime in 2022. Higher rates could pinch company profits.

Another thing that could affect the valuation of companies is higher taxes. The Biden Administration has made no secret that it wants to raise both corporate income and capital gains taxes to pay for its massive government spending programs. E-commerce owners currently on the fence about selling might therefore be better off exiting now at today's low tax rates rather than waiting, which could have a big effect on how much they would walk away with in a deal.


Source: https://www.marketplacepulse.com/articles/amazon-lost-covid-boost

## The role of aggregators and the FBA market

The market for e-commerce companies is currently being driven by so-called aggregators, who are buying up companies that sell on Amazon's third-party marketplace. Aggregators—often backed by investment banks, venture capital and private equity firms—buy up promising mom-and-pop sellers with the goal of "transforming them into global brands," according to Bloomberg.

"Amazon aggregators acquire and incubate e-commerce brands through innovative partnerships with entrepreneurs, with the goal to scale the acquired Amazon brands and gain revenue for their investors," JungleScout explains. "Aggregators seek out Amazon sellers they deem have great sales potential so they can consolidate and operate a portfolio of e-commerce businesses."

Third-party FBA (Fulfillment by Amazon) companies are now responsible for more than half of all goods sold on Amazon's site, generating more than $300 billion in annual sales in 2020, up from $200 billion a year earlier, and $25 billion to $39 billion in profits for the company in 2020. Third-party sales on Amazon are expected to reach $500 billion within the next five years.

Some of these FBA companies are quite large. JungleScout says 19% of Amazon sellers have reached "Million-Dollar Seller" status, meaning they've made over $1 million in lifetime sales on Amazon. 70% of online product searches begin on Amazon.

Since the beginning of 2020 through September 2021, aggregators have raised nearly $10 billion from investors. The most acquisitive FBA aggregator is Thrasio, a Walpole, Mass.-based company that has acquired over 100 Amazon businesses since its founding in 2018 and currently has a valuation of over $1 billion. It has raised nearly $2.5 billion, or about a quarter of all money raised by aggregators over the past two years.

Other big aggregators include Boston-based Perch, which has raised nearly $1 billion, and Miami-based Unybrands, which has attracted $325 million. But the FBA aggregator market isn't just an American phenomenon—far from it. Germany-based Berlin Brands Group has raised $1.2 billion, second only to Thrasio; Razor Group, also based in Berlin, has raised $447 million. According to Bloomberg, about 40 Amazon aggregators have emerged in recent years, based everywhere from Boston to Berlin to Beijing.

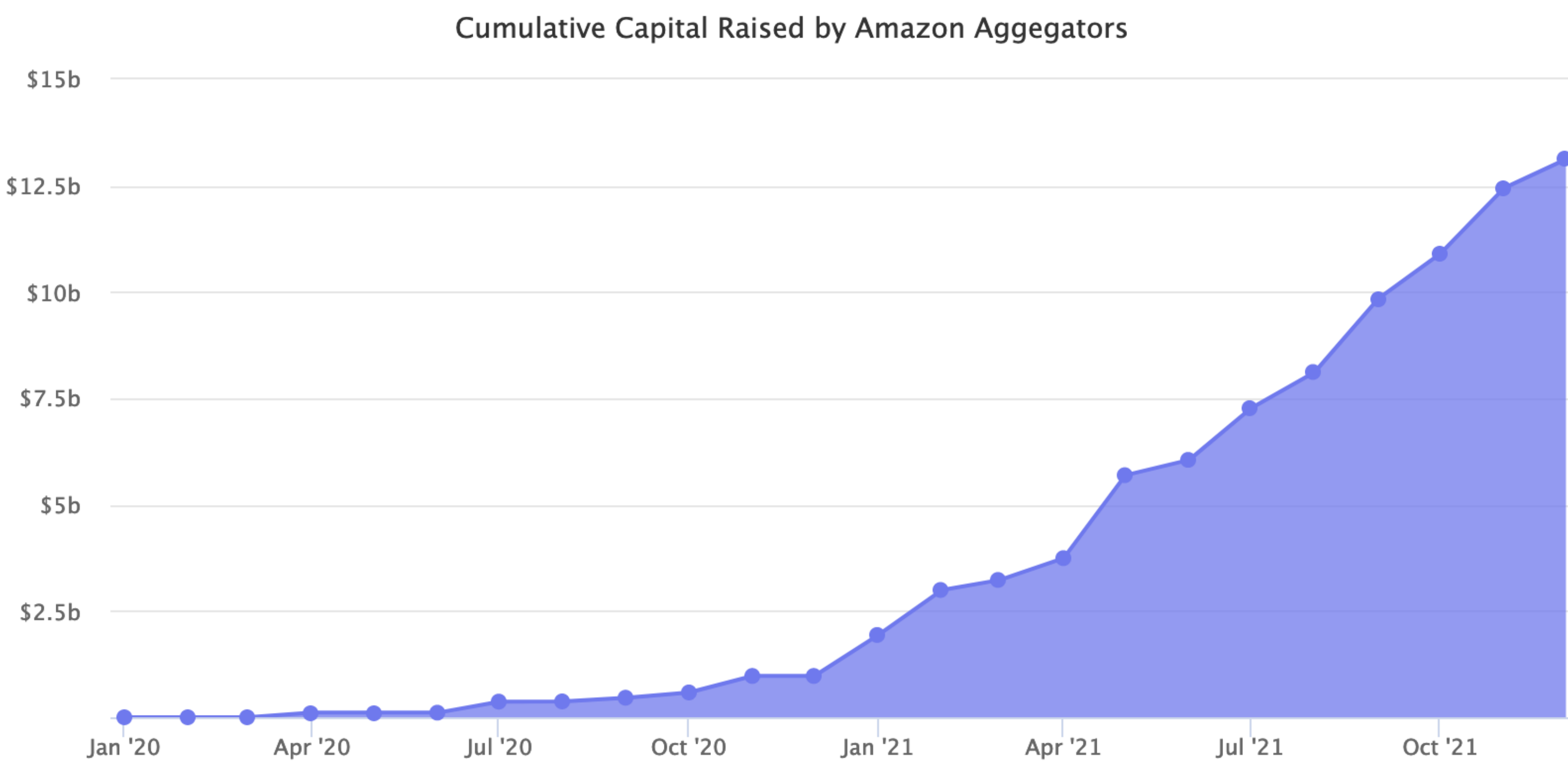
Hong Kong-based Nebula Brands, which calls itself "China's Thrasio," said it has raised more than $2 billion in the past two years and has acquired or plans to buy more than 150 brands on Amazon and other e-commerce platforms. "Over 40% of third-party sellers and 70% goods on Amazon are from China and many brands are taking the lead in their categories relying on their advantages of manufacturing," co-founder William Wang said in a press release.

Aggregators provide two very important functions. First, as more experienced in marketing and internet sales—and with more money behind them—they help boost revenue at promising small e-commerce companies.

"Aggregators give venture capitalists a foothold in the mom-and-pop world of Amazon sellers, which until now has largely been dominated by individual entrepreneurs and brands," CNBC explains. "Usually the aggregator buys out the seller and then tries to boost sales with large-scale marketing and software solutions."

Aggregators "tend to pick businesses whose products are established and will continue to be popular in their respective category, instead of chasing quick hits or fad-based products like fashion. Aggregators also tend to be generalists instead of focusing on a product vertical or category," according to Axios.

"Aggregators are also attracted to proprietary products that have strong profits and good reviews, as they know customers can't get these products elsewhere," JungleScout says.




Source: https://www.marketplacepulse.com/aggregators

## The aggregator exit strategy

Secondly, aggregators "provide an exit path—and crucially, liquidity—to the entrepreneurs whose businesses they're buying," Axios says. "For these small-business owners, this is likely the only kind of exit even available for them."

Indeed, "selling to an FBA aggregator has become an instant source of revenue for many owners," Entrepreneur says. It advises companies to "create a business idea from the onset that has the potential to be sold. This will make your job easier when you do decide that you want to sell. Have your exit in mind from the get-go."

"In many cases, FBA business owners earn multiple years' worth of profit when they sell their business to an aggregator," JungleScout says.

However, an article on Sifted, a website that covers the European startup market, warns in an article with the ominous headline, "In 18 months, There Will Be Bloodshed," that the market for FBA companies may have reached bubble proportions and may not be sustainable.

According to Sifted, these aggregators and other acquirers have driven up valuations of e-commerce companies to as much as 8x EBITDA (earnings before interest, taxes, depreciation, and amortization), up sharply from less than 2x when Thrasio started three years ago. Some buyers are even throwing in perks like cash and cars to get deals done.

The question is, is that sustainable?

**SDE**
=
Revenue – Cost of Goods Sold
– Operating Expenses + Owner Compensation

**EBITDA**
=
(Revenue – Expenses)
+ Depreciation + Amortization

**VALUATION OF BUSINESS**
=
Earnings x Earnings Multiple

## Valuing an e-commerce business

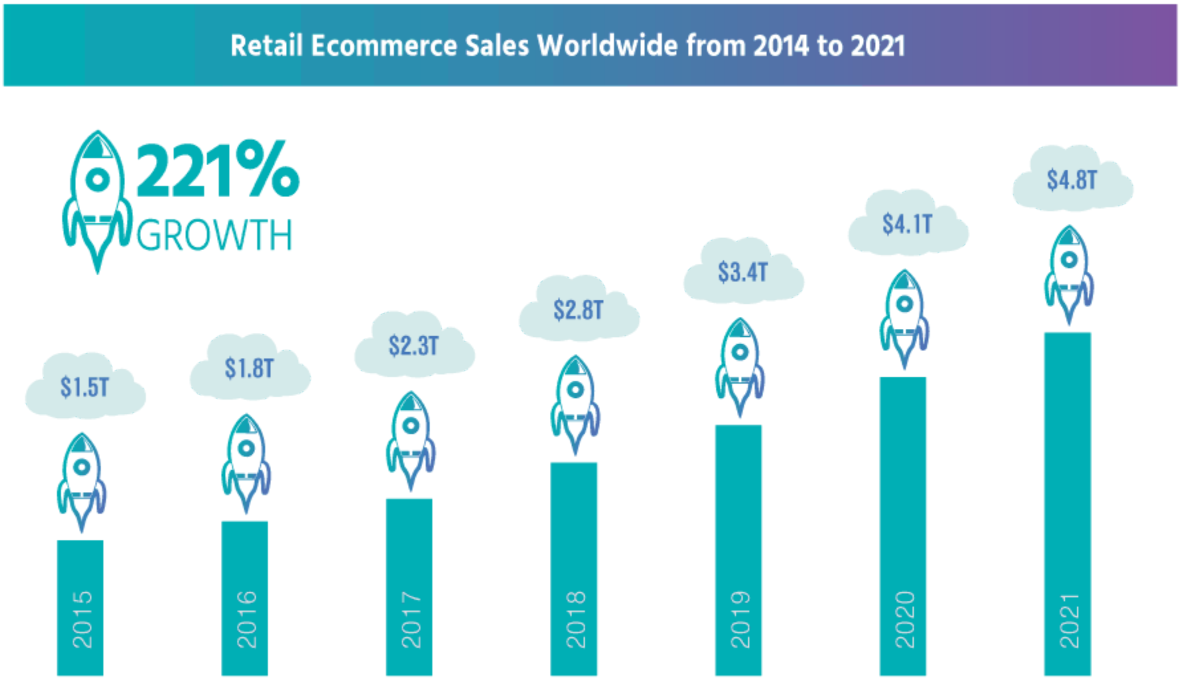
In general, the larger the business, the more it is worth. But size isn't everything. Investment bankers calculate the value of a business using several different formulas. Here are the most common ones.

### EBITDA

Many large private companies, and some public ones, calculate their earnings using the EBITDA method. It stands for earnings before interest, taxes, depreciation, and amortization. This method is used frequently by analysts and investors as an alternative to net income because it focuses on the profitability of a company's core operations. Essentially, EBITDA measures a company's return on investment (ROI) and helps normalize differences in capital structure, taxation, and fixed assets to allow comparisons for similar businesses. It also more accurately represents the company's future earnings capability. As a result, valuing a company using the EBITDA method generally earns a higher multiple.

Valuations of a business are usually derived as a multiple of EBITDA. For example, an e-commerce business with an EBITDA of $250,000 and a multiple of 4x would be worth $1 million. In 2020, the most commonly seen multiples for e-commerce businesses ranged from 3x to 8x EBITDA.

The exact multiple is a product of current market conditions, branding, unique products, competitive advantages, patents, niche, and other factors. This holds true for the other valuation methods as well.



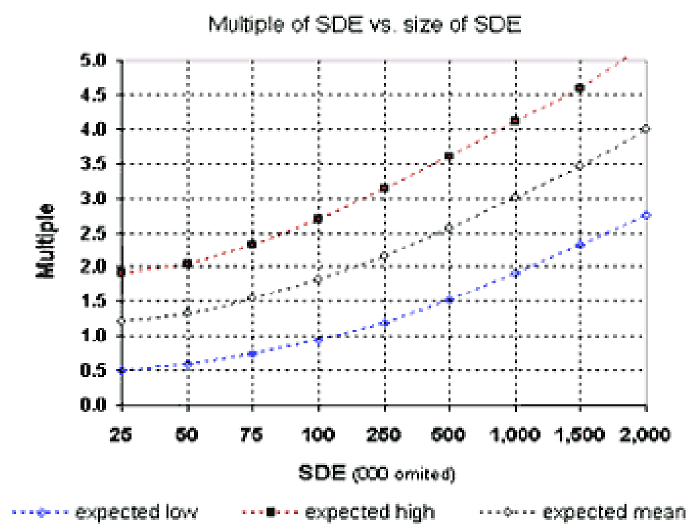

Source: adscholars.com

## Seller's Discretionary Earnings (SDE) and "Add Backs"

Another common valuation method, generally used with smaller companies, is based on the Seller's Discretionary Earnings (SDE). Generally, companies using the SDE model attract a smaller multiple, about 2x to 4x in 2020. So, a company with $1 million in SDE with a 2x multiple would be worth $2 million.

SDE is calculated by taking the company's profit as shown on its tax return and adding back any expenses ("add backs") that may not be incurred by the new owner and so are considered optional. Add backs enable the buyer to determine what profits they can truly expect from the business and therefore arrive at a more accurate valuation of the company.

Common add backs include the current owner's compensation and personal expenses, such as travel, company-paid car, entertainment expenses and the like. Add backs may also include the salaries of family members on the payroll. Add backs also include one-time expenses, such as some litigation costs, marketing promotions and the like.




Source: https://www.choicebizops.com/small-business-valuation/multiple-of-sde/

Add backs can increase or decrease the valuation of the business based on whether they are added or taken away. So negotiating add backs is important, but they can be a sticking point in the valuation process. Needless to say, sellers want the highest possible SDE, so they have an incentive to include as many add backs as possible because it increases the company's valuation. By contrast, buyers want the lowest possible SDE and are incented to remove add backs.

## Revenue

As the name implies, the REV model is based on the company's revenue, not its earnings. Since sales can fluctuate a great deal from year to year, and the volume of sales doesn't necessarily translate into profit, this method is used less often. It also generally garners a lower multiple. The valuation from a revenue model is more volatile and depends on specific characteristics of the business, ranging from less than 0.5x multiple upwards to 0.7x - 1.3x multiple depending on branding, unique products, profitability, scalability, competitive advantages, patents, niche, buyer acquisitiveness, and other factors.

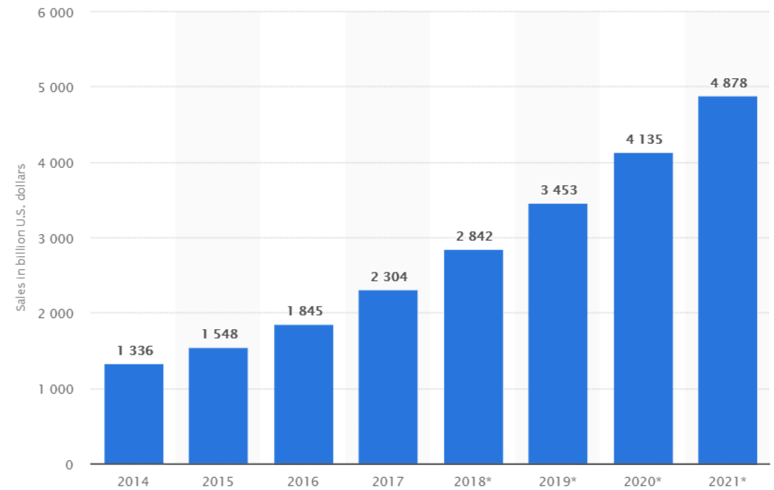
For example, a company with $500,000 in sales with a 0.5x multiple would be valued at $250,000.

## Discounted Cash Flow Analysis

Discounted Cash Flow Analysis determines the present value of a company based on its estimated future cash flows. It's the approximate return on investment for buying the company, adjusted for inflation and time. While Discounted Cash Flow Analysis isn't the most common method for determining an e-commerce company's value, it can be a helpful tool.

Traditional companies with a long track record are a better fit for a DCF review and valuation. Since online retailers' future profits involves making a lot of assumptions about the future, which may or not be accurate. However, it can help indicate what an organization may be worth in the future.

Retail E-commerce Sales Worldwide from 2014 to 2021




Source: www.statista.com/

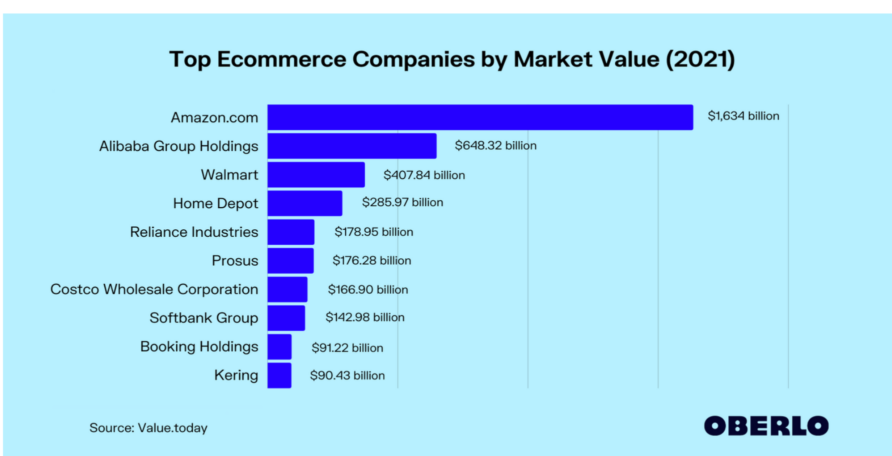
## Precedent Transactions

This method—also called comparable company analysis—values a company based on recent sales of similar businesses. It starts with research and determining what exactly is a "similar" or "comparable" company. This may include things like revenue, product niche, business size, years in existence, number of employees, growth rate, and profitability. Precedent transactions can provide both the buyer and the seller a ballpark estimate and make both parties comfortable with what a realistic and reasonable valuation expectation is.

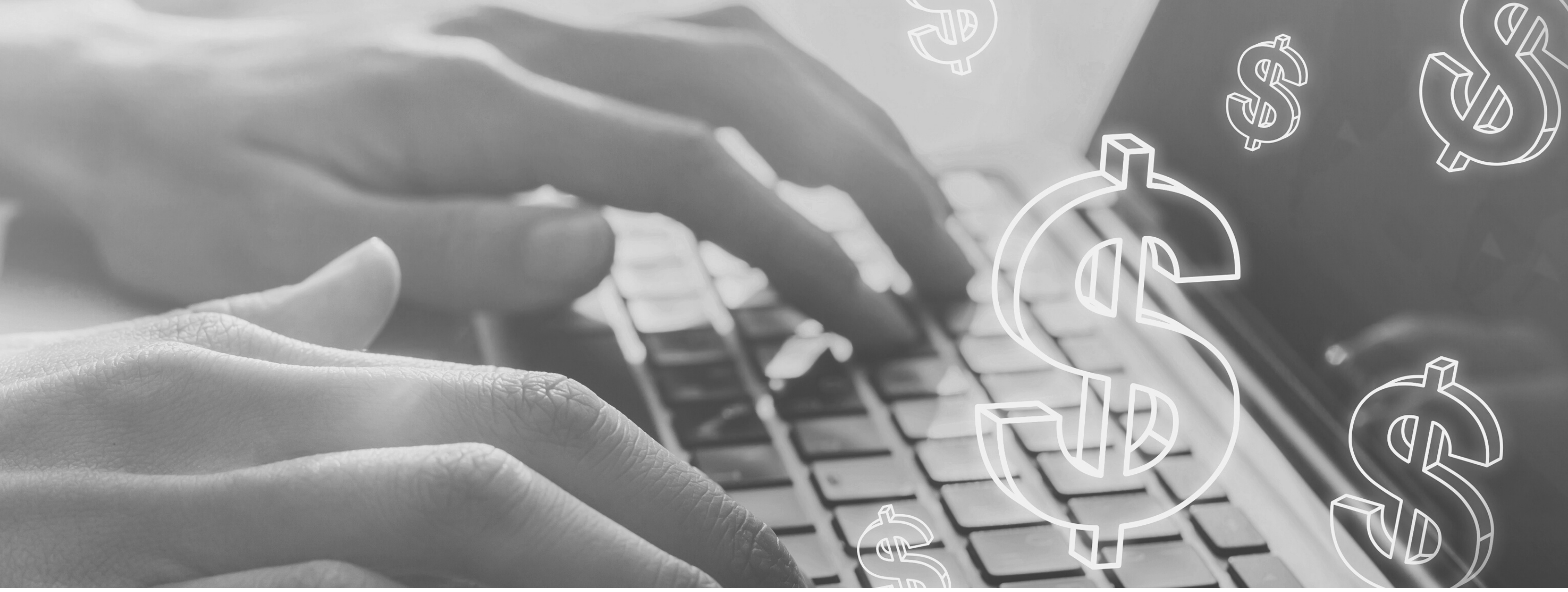
## Selling your e-commerce business

The selling process generally begins with a decision by the owners.

At FOCUS Investment Banking, we offer a free confidential business valuation to e-commerce owners with over $5 million in annual revenue. You may elect to receive a valuation because it may be the right time to exit, you want to pursue other interests, or you've heard e-commerce companies are fetching record valuations and you want to see how much your business may be worth. Or maybe you've been approached by another company or investment banker about interest in selling and become intrigued. Whatever the motivation, the selling process is fairly straight-forward, and it is best to receive a professional valuation from a credible investment bank first. The best part of selling an e-commerce company is when the money is in your bank account and you are happy with the valuation and result.




Source: https://id.oberlo.com/statistics/top-ecommerce-companies



### What to expect in the selling process

There are many ways to sell an e-commerce business: through an auction, a marketplace, an investment bank specializing in mergers and acquisitions (M&A), or on your own directly to the acquirer, be it another online retailer, an aggregator, or an investor, such as a private equity firm. Generally speaking, investment banks tend to get the best results for their clients—whether it's the seller or the buyer—especially for larger companies. That's because an investment bank creates competition between buyers, which results in creating a bidding war to sell your business at the optimal valuation.

FOCUS Investment Banking helps companies with $5 million to $300 million in annual revenue in three primary areas: advising on selling your company, acquiring a new company, and raising capital.

Although investment bankers tend to charge higher fees, they also do a lot to earn that money, usually enough to more than cover their cost: They have a much higher success rate, are generally able to fetch a higher price for the seller, get the deal done faster, and perform most of the work involved in the process, including negotiations, well beyond simply finding a suitable buyer. They also complete deals in a fraction of the time compared to other sales methods.

They generally put the marketing and financial materials together, create the offering circular, and do much of the legal and financial work. Most importantly: buyer outreach, negotiations, and consulting.

"The truth is the average business owner does not have the skills or background necessary to secure the maximum value from an M&A transaction by themselves," an article in Retail Touch Points says. "However, an experienced investment banking professional possesses the acumen to help you market your business to the most qualified buyers and guide you through each stage of the transaction. An experienced investment banking professional can assist you in calculating the truest estimate of your company's value. As experts in the M&A process, they have their finger on the pulse and know how similar businesses are valued and sold. Your intermediary can also fight on your behalf, helping you earn the maximum value for you company at a sale."

"With the help of an experienced investment banking professional, you can position your business to pique the interest of sophisticated buyers with capital at their disposal," the article continues. "Investment bankers know all the right buyers for your particular business and can field offers on your behalf. Then, they will leverage their deep understanding of transaction structures to advise you which offer will best empower you to pursue your post-exit goals."

## E-COMMERCE INDUSTRY OVERVIEW

**0.5-1.3x**
**AVERAGE REV MULTIPLE**

**2.0-4.0x**
**AVERAGE SDE MULTIPLE**

**5.0-8.0x**
**AVERAGE EBITDA MULTIPLE**

## What do M&A firms do to earn their money?

- Prepare an offering memorandum, which includes a description and history of the company, an organizational chart, corporate infrastructure, product and sales information, marketing materials, etc.
- Prepare clean and accurate financials that demonstrate the health and condition of the business, including growth trends, costs of doing business, marketing and advertising strategies, customer analytics, supplier information, and the like.
- Assemble and organize relevant legal documents, including business licenses and permits, lease agreements, employee contracts and other legal papers.
- Calculate an accurate value of the business, which we discussed in a previous section.
- Find the right buyer for your company, which doesn't necessarily mean the one that's offering the most money. A lot of other things—many of them intangible—go into finding the right partners. According to Harvard Business Review, between 70% and 90% of mergers and acquisitions fail, for a variety of reasons. "Mergers and acquisitions fail more often than not because key people leave, teams don't get along or demotivation sets into the company being acquired," Forbes says.
- Negotiate the terms of the deal. Deals can take anywhere from a few weeks to several months, possibly as long as a year, depending on the circumstances.

## FOCUS's Methodology

FOCUS Investment Banking advises clients who are looking to sell their business through industry expertise, research capabilities, and a highly developed network of national and international contacts to provide a solid base for initiating transactions. FOCUS is experienced in all phases of the M&A process and can provide a wide range of services, including market analysis, financial analysis, capitalization structure, due diligence, memorandum preparation, structuring of transactions, negotiating, and closing financial terms tailored to the client's need and capital market demands.

The FOCUS Investment Banking Process works. In our long history as a firm we have developed a core strategy to analyze and approach the market to find an ideal candidate to best meet the client's needs. We engage clients as peers and understand the technical and operational nuances of the client's business as well as those of the M&A process. We lead and execute every deal from start to finish, giving our clients the advantage of continuity and experience. Our disciplined Buyer Auction will deliver the highest valuation that the market will pay.

## FOCUS Contacts

For more information on how FOCUS can help you get the most money for your e-commerce business, contact our e-commerce team led by Principal Leah White at Leah.White@focusbankers.com or 724-448-6180, or Galen Pyle at Galen@focusbankers.com or 503-867-2413.

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## About FOCUS Investment Banking LLC

With more than three decades of experience, FOCUS Investment Banking is a trusted name in M&A advisory services worldwide. FOCUS works to understand each client's strategic and financial objectives, craft the best plan to achieve these goals, and deliver success. Whether helping to sell,buy, or raise capital, FOCUS strives to maximize the value of every transaction to the benefit of its clients. FOCUS bankers are seasoned operating and financial executives with extensive transaction experience. Securities transactions conducted by FOCUS Securities LLC, an affiliated company,registered Broker Dealer member FINRA/SIPC. For more information on FOCUS, please visit http://www.focusbankers.com/.



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