

Startup Finance and Accounting

Afterpay Historical Performance and Valuation Analysis

Student Name:

Student ID:

Executive Summary

This report analyses the performance and acquisition of Afterpay by Square, Inc for \$39 billion in the year 2021. A similar platform Afterpay Operating Company Pty Ltd, one of the leading global BNPL providers saw its revenues increase to AUD 924.67 million in 2021 from AUD 22.9 million in 2017. Although Afterpay's revenues have been on the rise, its profitability was volatile: the highest loss reached AUD 159.4m in 2021. In addition, the rise in the debt- to-equity ratio, which was 2.16 in 2021, highlighted that the firm has financial risk.

By applying the Venture Capital Method, it was found out that Square paid \$30 billion for Afterpay and this was more than the post-money value of Afterpay, meaning that Afterpay was bought at a premium. The reason for buying it was that after getting the Afterpay integration, Square could use it in the services they provided. Moreover, using the Scorecard and Risk Factor Summation approaches, we identified growth opportunities in the BNPL industry but also threats such as competition, regulatory issues, and profitability concerns.

Acquisition cost might look highly expensive, however, makes business sense for Square which looks to leverage on the Afterpay brand as well as the projected global growth of the BNPL industry. The acquisition is another example of long-term strategic partnerships that are likely to offer higher value through the creation of firm specific advantage and market domination.

Table of Contents

Executive Summary	2
Introduction.....	4
Historical Financial Performance Analysis	4
Financial Position Since 2017.....	4
Key Ratios.....	4
Opportunities and Challenges	6
Valuation of Afterpay's Buyout.....	6
Overview of the Buyout.....	6
Valuation Methods.....	7
Risk Assessment - Risk Factor Summation Method.....	7
Conclusion	9
References.....	11
Appendix.....	12
Appendix 1: Revenue Growth	12
Appendix 2: Profit/Loss Analysis.....	12
Appendix 3: Total Assets and Liabilities.....	12
Appendix 4: Debt and Equity	12
Appendix 5: Key Ratios.....	12

Introduction

Afterpay is one of the first and foremost fintech in the 'Buy Now, Pay Later' or BNPL industry, which allows customers to make payments in easy instalments without interest. Launched in Australia in 2014, Afterpay rose rapidly in popularity, especially among the target groups of millennials and Gen Z due to its simplicity and compatibility with online stores (Crunchbase, 2024). The specific objectives of this report include reporting on Afterpay's financial position from the year 2017 to 2021 and evaluating the reasonableness of the acquisition of Afterpay by Square, Inc. at \$39 billion. The evaluation of this acquisition will therefore involve analysing revenue growth and profitability, debt levels besides exploring different valuation techniques to check if the price paid for the buyout warranted.

Historical Financial Performance Analysis

Financial Position Since 2017

1. Revenue Growth

Afterpay had impressive revenue increase over the period of 2017-2021. The company's revenues increased from AUD 22.9 million in the 2017 to AUD 924.67 million in the 2021 financial year which represents the indications of a compound annual growth rate (Afterpay, 2017: Afterpay, 2021). This growth is due to more merchants and consumers adopting the platform and its expansion into new and international markets.

2. Profit/Loss Analysis

The revenue of Afterpay was not large enough to generate profits during the formative years of the company. For the year ended 2017, the company recorded a net loss of AUD 9.62 million. However, they were again incurred in other years where loss was marginally higher and was equal to AUD 43.79 million in the year 2019 (Afterpay, 2019). But it returned a small profit in 2020, a net income of AUD 22.86 million, and a loss of AUD 159.4 million in 2021 (Afterpay, 2020: Afterpay, 2020).

3. Cash Flows

The cash flow of this company is very much influenced by its strategic policy relating to faster growth and development. To continuously grow, Afterpay has always aimed to increase the available capital it has for its constant expansion in equity, as well as in debt. The total debt in the network augmented up to AUD 1.29 billion up to 2021 from AUD 469 million in the year 2020 indicating the utilization of debt financing for working capital of the company.

4. Total Assets and Liabilities

Total assets grew from USD 240.3 million in 2017 to USD 3.12 billion in 2021 for the Afterpay consolidated statement of financial position (Afterpay, 2017: Afterpay, 2021). Such growth can be looked at in connection with its aggressive acquisition strategy particularly on the international markets and its consumers.

5. Debt and Equity

The current debt leverage is also presented from the rise in the company's debt equity which measures the ratio of debt to equity. By the year 2021, the total recorded debt was at AUD 1.29 billion, from a recorded AUD 46.7 million in 2017 (Afterpay, 2017: Afterpay, 2021). shareholder's equity has not changed greatly in the years up to 2021 when it was slightly above AUD 946.4 million.

During 2017-2021, Afterpay had fair revenue growth and expanding the number of markets it operates in. But its average profitability remained a variable up and down, and going global and expansion of operations meant huge loss making. While huge amount of debts observed in 2021 are also considered as unsustainable, this Nature of calculation requires the firm to continue with the long-term investment at the times when short term earnings is being ignored.

Key Ratios

Current Ratio

Current Ratio = Current Assets / Current Liabilities

2017 = 148,817,409 / 31,622,727 = 4.70.

2018 = 305,586,000 / 46,593,000 = 6.56

2019 = 696,288,000 / 109,981,000 = 6.33

2020 = 1,405,291,000 / 193,552,000 = 7.26

2021 = 2,657,757,000 / 325,397,000 = 8.17

Source: (Afterpay, 2018: Afterpay, 2019)

Based on the current ratio of Afterpay, it is evident that it has been presenting an increasing trend from the financial year 2017/2018 at 4.70 to the financial year 2021/2022 at 8.17 demonstrating an improvement in liquidity (Afterpay, 2017: Afterpay, 2021). This seems to mean that the company has improved in its ability to collect every current assets from the total current liabilities, which exist. However, it could also have very high value as was realized in 2021 and this might mean that the company is not effectively utilizing the current assets or even has excess liquidity than required.

Debt-to-equity ratio

Debt-to-equity ratio: Total liabilities / Shareholder's equity

2017 = 80,244,481 / 160,083,417 = 0.50

2018 = 208,670,000 / 183,555,000 = 1.14

2019 = 174,312,000 / 183,555,000 = 0.95

2020 = 662,175,000 / 946,351,000 = 0.70

2021 = 2,042,840,000 / 946,424,000 = 2.16

As for the debt-to-equity ratio, it has also been increasing in Afterpay, and it was 0.50 in 2017 and 2.16 in 2021. This means that the company's financing has been majorly from the borrowings, especially in 2021 where the total liabilities were more than double the total equity (Afterpay, 2017: Afterpay, 2021). A ratio that is higher than that represents more risk in the financial aspect because the firm might have problems in terms of its ability to pay the debts when operating with cyclically generated cash flows or when profits are likely to fluctuate.

Net Profit Margin

Net Profit Margin = Net Profit / Total Revenue x 100

2017 = -9,619,630 / 22,905,727 * 100 = -42.00 %

2018 = -8,976,000 / 113,899,000 * 100 = -7.88%

2019 = -43,799,000 / 264,112,000 * 100 = -16.85%

2020 = 22,857,000 / 519,151,000 * 100 = 4.40%

2021 = 159,395,000 / 924,670,000 * 100 = 17.24%

Source: (Afterpay, 2019: Afterpay, 2020)

Looking at the Net Profit Margin of Afterpay, from the year 2017 to 2021, there is a constant positive improvement from -42.00 % to a 17.24%. In the beginning, costs such as scaling and overhead costs that are inherent in the systems operated as majors that caused the firm to make losses (Afterpay, 2017: Afterpay, 2021). However, the relocation to the profitable realm in 2020 in addition to the high steep up in the subsequent year is an indication that it has achieved an objective of revenue mobilization and control of costs. These figures suggest that Afterpay has been on an uptrend and it is going in the right direction of attaining sustainable profitability although the task of getting and maintaining such a margin as the firm expands is challenging.

Debt-to-Assets Ratio

Debt-to-Assets Ratio = Total Debt / Total Assets.

2017 = 46,747,800 / 240,327,898 = 0.19

2018 = 161,555,000 / 392,225,000 = 0.41

2019 = 50,223,000 / 820,468,000 = 0.06

2020 = 469,045,000 / 1,608,526,000 = 0.29

2021 = 1,286,383,000 / 3,116,227,000 = 0.41

Debt to assets ratio ranges between 0.06 to 0.41 in the period between 2017 and 2021, this is an indication that Afterpay has been using debt financing in its operations with different intensities in the years. This value reached its highest level of 0.41 in both 2018 and 2021, which indicates that during such two years, the share of the company's assets financed by means of loans was high. Like many other ratios, an increased debt to assets ratio suggests that the financial leverage has also gone up this means that returns will be higher and the risk has also risen especially where the company is unable to generate adequate revenue to meet its debt obligation.

Opportunities and Challenges

Opportunities:

1. **Continued Revenue Growth:** Based on Afterpay revenue, which generated from AUD 22.9 million in 2017 to AUD 924.67 million in 2021 and solid customer base, the company can continue to grow its customer base and add more merchants in newly emerging and existing markets (Afterpay, 2021). The increasing adoption of e-commerce and the BNPL solutions make for its favourable conditions.
2. **Increased Market Demand for BNPL:** The world BNPL market is anticipated to grow to 3.98 trillion USD by 2030 indicating a vast potential (AMR, 2021). Afterpay benefits from the growth in BNPL services, especially among younger consumers and can expand user interactions further. Since consumers seem to incline towards deferred payment options, Afterpay may ensure that it creates niche additions and collaborations to make its product better.

Challenges:

1. **Profitability Concerns:** Afterpay has not been immune to loss, and it posted substantial losses in the fiscal year, which peaked at 159.4 million Australian dollars in 2021 (Afterpay, 2021). The management of operation costs and maintaining growth while ensuring profitability is still an issue, especially since the competition for space in the BNPL market is expected to grow more significant.
2. **Rising Debt Levels:** As the company has shifted to relying heavily on debt to fund its activities, the total debt has increased to AUD 1.29 billion in the year ended 2021 (Afterpay, 2021). A debt-to-equity ratio of 2.16 means higher financial risk, and thus, difficult to service debt if revenues growth is slowing down or there are problems with profitability.

Valuation of Afterpay's Buyout

Overview of the Buyout

In August 2021, Square, Inc., the fintech company co-founded by Jack Dorsey, revealed that it has agreed to acquire Afterpay, an Australian "buy now, pay later" firms for \$39 billion by in stock. This deal was one of the biggest in Australian corporate history and revealed Square's plan to incorporate Afterpay's BNPL offering within Seller and Cash App (Shevlin, 2021). Due to Afterpay's weak and unpredictable profitability and growing competition in the BNPL sector, investors expressed concerns over the \$39 billion asking price. The three methods include the Scorecard Method, Risk Factor Summation Method and Venture Capital Method.

Valuation Methods

Scorecard Method (Bill Payne)

1. **Strength of Management (30%)**: Afterpay's founders include Nick Molnar and Anthony Eisen, who turned the firm into an international player from an Australian domestic company. They were instrumental in Afterpay's exponential growth especially in its expansion in markets such as United States and Europe (Tuchman, 2022). However, it was challenging for the leadership team to achieve the targeted profitability and debt emerged to be a concern in the firm(Arnaud, 2018).

Score: Afterpay's management has extensive experience, and it also offers innovative solutions, but the company has not been profitable, so this criterion has **+20% added**.

2. **Market Size (25%)**: The BNPL market has grown exponentially over the last few years due to the increased uptake of such flexible payment solutions. The world BNPL market is anticipated to grow to 3.98 trillion USD by 2030 indicating a vast potential (AMR, 2021). This market is therefore suited for Afterpay especially concerning its targeting of the younger demographic and its seamless merges into e-commerce(Arnaud, 2018).

Score: Due to the size of the market as well as Afterpay's growth opportunities, there is a positive adjustment made to this criterion of +25%.

3. **Product and Technology (15%)**: Afterpay's primary offering is the BNPL service, which is innovative but can be easily imitated as seen by competition from Klarna and PayPal. While Afterpay is already creating a healthy user base, the technology is not highly differentiated or protected from competition (Daniels, 2023). Moreover, Afterpay is also experiencing some issues in some territories, where credit regulation is tightening over time(Arnaud, 2018).

Score: The technological advancement of Afterpay is not new that leads to no change of 0%.

4. **Competition (10%)**: The BNPL market is again more saturated, with major competitors such as Klarna, Affirm, and PayPal (Fuchs, 2024). Also, a variety of Afterpay partners with large merchants has been beneficial as a market differentiation strategy; still, intense competition threatens the prospects and profitability.

Score: Because of competition pressures indicating the significance of this factor in dowry systems, it incurs a negative adjustment of -10%.

5. **Marketing and Distribution Channels (10%)**: Afterpay has relations with some of the e-commerce giant market players such as Shopify, and other respective relevant fashion firms.

Score: Marketing and strong partnerships give a positive adjustment of + 10%.

6. **Need for Additional Investment (5%)**: Afterpay has used debt to drive its growth, which is a weakness. It had long-term borrowings of AUD 1.29 billion in 2021 and to support this growth it might take more investments which could further reduce future returns.

Score: This risk results in a negative adjustment of -5%.

7. **Other Factors (5%)**: Every Afterpay consumer spending habit operates with millennial and Gen Z as its target market making the company well positioned for future trends in the market.

Score: For these reasons there is a positive adjustment of + 5%.

Based on the Scorecard Method analysis, it remained that Afterpay's valuation is rather justified when all the above factors have been considered. The market size, good management and effective alliances mitigate threats such as competition and profitability in the firm. Thus, nearly all the adjustments are positive, and this in conjunction with high growth rates and possible synergies imply that Square is may be valued, although at a significant premium.

Risk Assessment - Risk Factor Summation Method

Risk Category	Score	Explanation
----------------------	--------------	--------------------

Management	+1	Strong leadership and international expansion, but challenges remain with profitability and scaling (Sarath, 2021).
Stage of Business	+2	Established player in the BNPL market, showing strong growth and scalability.
Legislation/Political Risk	-1	Increasing regulatory scrutiny in major markets like Australia, the US, and the UK could impact operations and growth.
Manufacturing Risk	N/A	Not applicable as Afterpay operates in the financial technology space.
Sales and Marketing Risk	+1	Effective sales and marketing strategy, with rapid adoption of services, though increasing competition may challenge growth (Esteban, 2022).
Funding/Capital Raising Risk	+1	Successful capital raising, but high reliance on debt financing (AUD 1.29 billion in 2021) introduces financial risk if profitability issues persist (Afterpay, 2021).
Competition Risk	-1	Growing competition from other BNPL providers like Klarna and PayPal could reduce market share and profitability.
Technology Risk	0	Strong platform, but the need for continuous innovation in the evolving fintech sector poses a potential risk.
Litigation Risk	0	No major ongoing litigation, but future legal challenges may arise due to increasing regulatory scrutiny (Schmidt, 2024).
International Risk	+1	Successful expansion into international markets like the US and Europe, but these regions bring regulatory and operational challenges.
Reputation Risk	+1	Well-regarded in the fintech industry, though regulatory backlash and potential consumer debt issues could harm its reputation in the future.
Potential Profitable Exit	0	Profitability remains volatile, with significant losses in 2021 (-AUD 159.4 million), though there is potential for profitability with better cost management.

Total Risk Score: +5

Considering the aspects such as emerging regulation issues and reliance on debt, Afterpay has very strong points such as high and continued growth along with market dominance. The company's success will therefore depend on factors such as the level of competition forces, regulatory issues as well as sound debt management (Arnaud, 2018). A risk score of +5 is still rather high, while in the medium term, there is still a considerable amount of financial risk/public risk, especially as concerns profits and managing the change in regulations.

Venture Capital Method Analysis of Afterpay Acquisition

1. Terminal Value

- The estimated of terminal value for Afterpay in the next five years is \$60 billion.
- This terminal value is calculated using Afterpay's current market position, its projected growth rate and the fact that is to remain a part of Square (Andrusiv et al., 2020).

2. Return on Investment (ROI)

- Square is perhaps aiming at a return on investment level of between two and three times what it spends.
- This is a rational expectation for a fintech acquisition, like Afterpay. For getting 2X return, after evaluating the Afterpay's future growth and synergy with Square the Afterpay would require value of \$78 billion.

3. Post-Money Valuation

Using the **VC Method Formula**:

Post-Money Valuation = Terminal Value / Expected ROI

- **Terminal Value** = \$60 billion
- **Expected ROI** = 2x (for conservative estimation)

Post-Money Valuation = 60 billion / 2 = 30 billion

4. Pre-Money Valuation

Pre-Money Valuation = Post-Money Valuation – Investment

- **Post-Money Valuation** = \$30 billion
- **Investment (Price paid by Square)** = \$39 billion

Pre-Money Valuation = 30 billion – 39 billion = -9 billion

Pre-Money Valuation:

- This gives a pre-money negative valuation of -9 billion which makes it clear that Square had a huge overpayment for Afterpay in the scale of its standalone worth. The market price that Square is willing to offer for Afterpay is not just for the value of Afterpay but also the value of the synergies that will come with the acquisition of Afterpay by Square (Arnaud, 2018).

High Valuation Concerns:

- The acquisition price of \$39 billion shows that it costs more than the post money valuation of \$30 billion and this indicates that Square believe Afterpay will add a lot of extra value in the future. This premium might likely be driven by the expectation of improving the quality of products through upgrading, expansion into new markets, as well as improvement in the company's competitiveness within the fintech segment due to inclusion of Afterpay services.

Synergy and Growth Expectations:

- The high price indicates Square believes that the integration of the payment platform and the BNPL services of Afterpay will reap big benefits. If integrated Afterpay can attract more customers than before, increase the number of transactions, and engage more people with Square's ecosystem, then such premium will be justified.

Conclusion

The acquisition of Afterpay by Square for \$39 billion seems a tad high but makes a great deal of sense tactically given projected synergetic gains. In the light of Venture capital Method, the post money value of Afterpay was calculated to be \$ 30 billion which, gave a pre money value of -\$ 9, hence the firm was acquired at a premium over Afterpay 'real' worth. This means that Square did not only pay for the worth of Afterpay today, but it also paid for what Afterpay could be worth with Square and its synergies. Similarly, the financial performance highlighted a rapid increase of revenues from AUD 22.9 million in 2017 to AUD 924.67 million in 2021 along with fluctuating profitability where Afterpay reported a loss of AUD 159.4 million in 2021. The current debt/equity ratio of 2.16 and increasing competition risk indicates that the acquisition price was on the higher side. However, the market in BNPL is projected to expand, and Square may therefore consider using Afterpay for the growth in the long-term, especially through consolidation with other platforms and the ability to tackle new segments of the market.

References

- Afterpay. (2017). Preliminary Final Report. <https://announcements.asx.com.au/asxpdf/20170824/pdf/43lp8kv10bt5ht.pdf>
- Afterpay. (2018). Afterpay Touch Group Limited Annual Report for the year ended 30 June 2018. https://www.annualreports.com/HostedData/AnnualReportArchive/a/ASX_APT_2018.pdf
- Afterpay. (2019). Preliminary Final Report. https://www.annualreports.com/HostedData/AnnualReportArchive/a/ASX_APT_2019.pdf
- Afterpay. (2020). Afterpay Limited FY20 Annual Report. https://www.annualreports.com/HostedData/AnnualReportArchive/a/ASX_APT_2020.pdf
- Afterpay. (2021). Afterpay Limited FY21 Annual Report. https://www.annualreports.com/HostedData/AnnualReports/PDF/ASX_APT_2021.pdf
- AMR. (2021). Buy Now Pay Later Market to Reach \$3.98 Trillion By 2030: Allied Market Research. <https://www.globenewswire.com/news-release/2021/08/25/2285991/0/en/Buy-Now-Pay-Later-Market-to-Reach-3-98-Trillion-By-2030-Allied-Market-Research.html>
- Andrusiv, U., Kinash, I., Cherchata, A., Polyanska, A., Dzoba, O., Tarasova, T., & Lysak, H. (2020). Experience and prospects of innovation development venture capital financing. *Management Science Letters*, 10(4), 781-788. http://m.growingscience.com/msl/Vol10/msl_2019_302.pdf
- Arnaud, B. (2018, October 2). The most common ways on how to value early-stage companies. *EU-Startups*. <https://www.eu-startups.com/2018/10/the-most-common-ways-on-how-to-value-early-stage-companies/>
- Crunchbase. (2024). Afterpay. <https://www.crunchbase.com/organization/afterpay-bb1f>
- Daniels, M. (2023). Fintech platforms are leaning more heavily on BNPL. <https://www.modernretail.co/technology/fintech-platforms-are-leaning-more-heavily-on-bnpl/>
- Esteban. (2022). What is the Risk Factor Summation Startup Valuation Method?. https://medium.com/@fro_g/what-is-the-risk-factor-summation-startup-valuation-method-fe12b5d21f98
- Fuchs, J. (2024). Buy Now Pay Later and Its Implications for Community Banks. <https://medium.com/@jakefuchs1/buy-now-pay-later-and-its-implications-for-community-banks-4d4c53c30052>
- Sarath. (2021). Risk Factor Summation Method: Everything you need to know. <https://eqvista.com/risk-factor-summation-method/>
- Schmidt, J. (2024). Startup Valuation Methods. <https://corporatefinanceinstitute.com/resources/valuation/startup-valuation-methods/>
- Shevlin, R. (2021). Why Square Acquired Afterpay For \$29 Billion: Merchant And CashApp User Acquisition. <https://www.forbes.com/sites/ronshevlin/2021/08/02/why-square-acquired-afterpay-for-29-billion-merchant-and-cashapp-user-acquisition/>
- Tuchman, R. (2022). How Success Happened for Nick Molnar, Co-Founder of Afterpay. <https://www.entrepreneur.com/leadership/how-success-happened-for-nick-molnar-co-founder-of-afterpay/416121>

Appendix

Appendix 1: Revenue Growth

Year	Revenue (AUD)
2017	22.9 million
2018	113.9 million
2019	264.1 million
2020	519.2 million
2021	924.67 million

Appendix 2: Profit/Loss Analysis

Year	Net Profit/Loss (AUD)
2017	-9.62 million
2018	-8.97 million
2019	-43.79 million
2020	22.86 million
2021	-159.4 million

Appendix 3: Total Assets and Liabilities

Year	Total Assets (AUD)	Total Liabilities (AUD)
2017	240.3 million (Afterpay, 2017)	80.24 million
2018	392.2 million (Afterpay, 2018)	208.67 million
2019	820.5 million (Afterpay, 2018)	174.31 million
2020	1.61 billion (Afterpay, 2020)	662.2 million
2021	3.12 billion (Afterpay, 2021)	2.04 billion

Appendix 4: Debt and Equity

Year	Total Debt (AUD)	Shareholder's Equity (AUD)
2017	46.7 million (Afterpay, 2017)	160.1 million
2018	161.6 million (Afterpay, 2018)	183.6 million
2019	50.2 million (Afterpay, 2018)	183.6 million
2020	469 million (Afterpay, 2020)	946.4 million
2021	1.29 billion (Afterpay, 2021)	946.4 million

Appendix 5: Key Ratios

	2017	2018	2019	2020	2021
Current Asset	148,817,409	305,586,000	696,288,000	1,405,291,000	2,657,757,000
Current Liabilities	31,622,727	46,593,000	109,981,000	193,552,000	325,397,000
Total Liabilities	80,244,481	208,670,000	174,312,000	662,175,000	2,042,840,000

Shareholder's equity	160,083,417	183,555,000	183,555,000	946,351,000	946,424,000
Net Profit	-9,619,630	-8,976,000	-43,799,000	22,857, 000	159,395,000
Total Revenue	22,905,727	113,899,000	264,112,000	519,151, 000	924,670,000
Total Debt	46,747,800	161,555,000	50,223,000	469,045, 000	1,286,383,000
Total Asset	240,327,898	392,225,000	820,468,000	1,608,526, 000	3,116,227,000