Skift

Rooms, Hotels

Oyo's Post-Coronavirus Valuation Could Fall to Around $6 Billion

Seth Borko and Dennis Schaal, Skift - Mar 04, 2020 1:45 pm

Skift Take

Numerous travel companies, private and public, have seen their valuations taken down a peg by coronavirus. But Oyo's China business, where it fields about 60 percent of its rooms, and its ongoing operational problems in other regions exacerbate its likely valuation decline.

— Dennis Schaal

When an affiliated company writes off and walks away from a $77 million investment in your business for about $3 — that's not a typo — you know you're in trouble.

That's what happened to Oyo Life Japan, the hotel chain's co-living arm in that country, when fellow SoftBank portfolio company Z Holdings, formerly known as Yahoo Japan, shed its $77 million stake for $3, according to published reports. The transaction actually took place in December, but the terms are newly revealed.

The move involving Z Holdings and Oyo, one of SoftBank's most-high-profile investments after the demise of WeWork, takes place in a sensitive geography since it's SoftBank's home base.

Z Holdings' exit from Oyo Life isn't game-changing since its residential apartment rentals operation in Japan is a small portion of Oyo's overall business. Much more significant is the downturn in Oyo's China operation, and a report that Oyo is chopping its staff there by around 30 percent.

The downturn in Oyo's China business, where it potentially may be harder hit than other hospitality operations such as Marriott's, which has reopened a significant number of properties there, would likely hurt Oyo's valuation if it were a public company, falling perhaps to $6 billion. Its valuation was reported to be around $10 billion at its latest funding round last summer.

Oyo didn't immediately respond to a request for comment about its Japan and China operations.

THE LOWDOWN ON OYO'S VALUATION

Private company valuations are a funny thing, often more useful for bragging rights and a flashy headline than for an accurate depiction of the current worth of a company. Most private companies have their valuations updated when they raise new capital and issue new shares, called primary transactions.

Public companies have valuations set by secondary transactions, when investors sell to one another and no new shares get issued.

Secondary transactions in private companies are rare and can more easily be skewed out of line with intrinsic corporate value. One reason for that is because they happen in such low volume. It is easier for a handful of shares to sell at a $10 billion valuation, because of the low absolute dollar cost involved, then to sell 6 million shares — the amount of Marriott shares that changed hands yesterday — at the very same valuation.

Additionally, it is easier for investors to borrow shares and sell short in public markets, keeping runaway valuations in check. But in private secondary markets, most of the demand is from new buyers eager to get access to a limited supply of shares with no selling pressure to balance them out.

OYO'S VALUATION HISTORY

With that in mind, let's examine Oyo's valuation history. In August 2018, Oyo raised a Series E round that valued the company at about $5 billion post-money, according to Skift Research estimates and media reports. Then a year later, a new set of headlines blared that Oyo's valuation doubled to $10 billion.

That's true, but it wasn't the full story. Oyo actually had two transactions last summer that set its new valuation. First, it had a primary transaction raising around $1.5 billion in new equity capital from the Softbank Vision Fund and Oyo founder Ritesh Agarwal.

Next, Oyo did a secondary transaction with Agarwal buying back shares from existing investors. Based on Skift Research's review of company filings, the primary transaction took place at around an $8 billion valuation. Then the smaller, secondary transaction took place at a $10 billion valuation.

Now in one sense that $10 billion valuation is correct. Don't get us wrong, it absolutely is the latest market value of Oyo shares and accounting rules allow the company to be marked there. But that these two valuations took place back-to-back, practically part of the same transaction, and yet traded with a 20 percent differential, should tell you that perhaps $10 billion is not what Oyo would be fetching if it were publicly listed.

We would argue that that Oyo's latest fair market price — absent the coronavirus impact — is probably closer to the $8 billion figure, not $10 billion.

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POTENTIAL CORONAVIRUS IMPACT

And that's to say nothing of the coronavirus outbreak.The S&P 500 Hotels, Resorts, & Cruise Lines Sub-Industry Index, including Marriott, Hilton, Carnival Corp., Royal Caribbean, and Norwegian Cruise Line, has fallen 24 percent from February 19 through March 3. Marriott's market capitalization alone fell 22.1 percent to $37 billion in the same span, a loss of $11 billion in corporate value.

STILL WORTH $10 BILLION?

What about Oyo? Is it still worth $10 billion?

Well, technically speaking, yes. But the company is privately held and illiquid. It is probably safe to assume that were Oyo publicly traded it would be similarly penalized by the market, perhaps even more so given that China makes up approximately 60 percent of its rooms and 40 percent of its EBITDA (earnings before interest, depreciation, taxes, and amortization) losses.

As a thought exercise let's take that lower valuation of $8 billion, more realistic in our view, and trim it by 25 percent, similar to what Marriott has experienced. That would put Oyo at a $6 billion valuation today. That's just speculation, but it's a far cry from the $10 billion benchmark.

Perhaps that spread can serve as a reminder not be too taken in by the sky-high valuations we read about every day, and to focus on a company's core business model instead. And of course, the only way we'll ever really know what Oyo's valuation would be when — or if — it makes a public debut.

And we can only hope that coronavirus will disappear by then.

Tags: china, co living, japan, marriott, oyo, softbank, valuations

Photo Credit: Oyo Hotels and Homes markets itself to young couples in India who may need to get away from the family for a bit to find some private time. In China, Oyo is reportedly firing about one-third of its staff.