



# **Rocket Internet Case Study**

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## **List of Abbreviations**

|       |                                |
|-------|--------------------------------|
| CFROI | Cash Flow Return on Investment |
| DCF   | Discounted Cash Flow           |
| EVA   | Economic Value Added           |
| IT    | Information Technology         |
| MVA   | Market Value Added             |
| NPV   | Net Present Value              |
| RI    | Rocket Internet                |
| ROE   | Return on Equity               |
| ROI   | Return on Investment           |
| ROIC  | Return on Invested Capital     |
| TSR   | Total Shareholder Return       |

# 1 Introduction

Companies have been urged to reinvent and innovate their business model due to continuously increasing business complexity and technological advances (Chesbrough 2010), which leads to shortened lifecycles of products, companies and industries. In this context, business models were assigned a critical role. In fact, superior business models became the source of hard-to-imitate competitive advantages. By adopting superior business models, companies are not only able to explore, exploit and sustain potential competitive advantages (Barney, 1991), but also to create shareholder value (Rappaport, 1987). Thus, corporate strategy, business models and shareholder value intersect in the processes of identifying, selecting and evaluating superior business models. As a consequence, one of the most urgent questions companies raise is how to differentiate themselves in an intensely competitive landscape. Thus, the research question of this master thesis is: **‘How can companies identify, select and establish a viable and superior business model in nowadays dynamic and ever-changing business environment?’**

The first part will introduce the current literature on business models and shareholder value. The second part, the case study of the real world example Rocket Internet (RI), illustrates RI’s complex process of identifying, selecting, innovating and sustaining a superior business model in a particularly competitive environment, the Information Technology (IT) sphere. The case study presents RI at a turning point: RI can either continuously reinvent its business model and convince investors that it is able to generate shareholder value or RI will experience a further share price plunge.

This master thesis contributes to students’ theoretical and practical understanding of business models and their application in a real world example. In doing so, theoretical groundings of business models, strategy and shareholder value research are presented in a comprehensively and structured manner. Students are encouraged to apply these theoretical groundings in the interdisciplinary case study (strategic management and corporate finance) of the real world example of RI. As a result, students’ understanding of these terms in general, and of their differentiation and interplay, is improved. Furthermore, the combination of literature review and case study further sharpens students’ understanding of strategic decision making in respect to business models and their impact on a company’s financial performance. Thereby, this case study introduces a particularly interesting company example to students, as it examines a very fast paced industry and a controversially discussed company. Last but not least, this case study

might encourage to conduct further research of business models in the intersection between strategic management and corporate finance.

Both the literature review and case study apply strategic management and corporate finance related theories and tools to be able to identify, select and evaluate a superior business model. Business model concepts are reviewed from perspectives of IT based, structural, and strategic conceptualizations. These theories are complemented and linked to the shareholder value theory, in order to address the research question of this master thesis.

This master thesis is divided into three parts: Literature Review, Case Study, and Teaching Note. The literature review analyses the academic research bodies of corporate finance and strategy by applying a systematic literature review (see [Appendix 1](#)). The case study part includes industry and equity research reports regarding the internet industry and RI itself, company research, and databases (e.g. Reuters, Bloomberg, S&P Capital IQ). Furthermore, this case study is based on publicly accessible data and information, which is complemented with interviews of RI employees.

## **2 Literature Review: Business model**

This section includes the theoretical basis for business models as well as strategic concepts and the linkage to shareholder value, which is considered a financial measure to evaluate (superior) business models.

### **2.1 Origin and evolution**

In the time span from 1965 to 2013, 2,823 peer-reviewed journals using the business model term have been published, while most of these journals were published in the 2000s or later. However, there is only a very limited body of well-known and renowned academic research (Amit & Zott, 2001; Nelson, 1991; Teece, 2009; Zott & Amit, 2008; Zott, Amit, & Massa, 2011), as the vast majority of academic research stems from publications in minor ranked peer-reviewed academic journal as well as non-academic business related guides and books (Afuah & Tucci, 2001; Magretta, 2002; Wiley et al., 2011). As a consequence, the theoretical underpinnings remain thin, although the business model term has increasingly gained academic attention. The vast majority of business model research deals with conceptualizations, while the minor part follows an empirical research design (Lambert & Davidson, 2013). Regarding the peer-reviewed journals, the origin and evolution of the business model term was covered

by mainly three research strings: (i) IT based conceptualizations, (ii) structural conceptualizations, and (iii) strategic conceptualizations (Wirtz et al., 2016). In this respect, the historical developments of the business model term within the academic community can be summarized into three main phases (see [Appendix 2](#)).

First, the early stage phase, from 1957 – 1994, is a less intensively researched phase and describes the business model term's origin. In academic research, the business model term occurred for the first time around 1960 and was developed for so called business games (Bellman et al. 1957; Jones 1960). These business games were applied to practice managers' leading skills. Bellman et al. (1957) emphasized the complexity: '*We must first construct a mathematical model, then construct a simulation process based upon it. And many more problems arise to plague us in the construction of these business models [...]*'. The following time span from 1970 until the mid 1990s was characterized by a low number of published peer-reviewed academic journals on business models (Osterwalder, Pigneur, & Tucci 2005).

Second, the phase of IT based conceptualizations, from 1995 – 2002, outlines the increased momentum of research in the IT sphere. In the dot-com era, business models were predominantly used by investors to validate and explain both how business is done and how future cash flows of IT based companies are intended to be generated (Zott, Amit, & Massa 2011). This is due to the fact that internet companies emerged as entirely new companies so that they could not be compared to precedent or existing comparable companies (Thornton & Marche 2003). Zott et al. 2011 further claim, that IT based business models were a means to explain how companies did business based on the internet and how IT was used in this respect. Compared to the early stage phase, the business model term developed from a tool to improve managerial skills into an instrument for investors to examine business activity and cash flows.

Third, the differentiation phase, from 2003 – 2013, describes the shift of academic research towards strategy and structural conceptualizations based studies. After the bursting of the dot-com bubble in 2001, the academic research of business models shifted towards a more generic point of view (Wirtz et al., 2016). This transition from 2004 to 2007 was characterized by a stable number of academic publications (around 30 research papers each year). As the generic research stream picked up speed from 2008 to 2010, the number of publications did as well - 45 research papers were published in 2008, 68 in 2009 and 83 in 2010 (DaSilva & Trkman, 2014). Compared to the two preceding phases, the term business model developed from a managerial and investor instrument into a buzzword to analyze and explain a broad spectrum

of organizations' business models (e.g. UK Labour Party) and industries (e.g. airline, music etc.) account for this diversity and claim, that business models are connected to corporate business concepts and revenue model (DaSilva & Trkman, 2014; Ghaziani & Ventresca, 2005).

Concluding, research on business models developed due to consistently high interest by both practitioners and scholars, including various perspectives and definitions. This is in line with the tendency that the boundaries of the research angles of business models increasingly blur, resulting in broad definitions and characterizations (Wirtz et al. 2016).

## 2.2 Methodology

Using the business model term as a buzzword, it is no surprise there is no agreement on a commonly accepted definition (Scott et al., 2005; Zott, Amit, & Massa, 2011). Instead, a variety of not always consistent definitions and component breakdowns of business models exists, which often only partially capture the business model term. As a result, there are more than ten different approaches of strategic scholars to characterize business models, ranging from a simple description to associating the business model term to a concept, manner or dynamic process (Al-Debei & Avison, 2010; Bower, 1996; Osterwalder, Pigneur, & Tucci, 2005) (see Table 1). Not surprisingly, business model conceptualizations are still perceived as an ill-defined 'buzzword' within the academic community.

**Table 1:** Characterizations of business model definitions from 2000 since to date

| <b>Business model definition</b> | <b>Academic Literature</b>  |
|----------------------------------|---|
| <b>Architecture</b>              | Dubosson-Torbay et al. (2002); Timmers (1998)                         |
| <b>Concept / model</b>           | George and Bock (2009); Osterwalder (2004); Osterwalder et al. (2005) |
| <b>Construct</b>                 | Amit and Zott (2001)  |
| <b>Description</b>               | Applegate (2000); Weil and Vitale (2001)                              |
| <b>Dynamic Process</b>           | Casadesus-Masanell and Zhu (2013)                                     |
| <b>Framework</b>                 | Afuah (2004)  |
| <b>Manner</b>                    | Teece (2009)  |
| <b>Method</b>                    | Afuah and Tucci (2001); Chesbrough and Rosenbloom (2002)              |
| <b>Pattern</b>                   | Brousseau and Penard (2006)   |
| <b>Set</b>                       | Seelos and Mair (2007)  |
| <b>Statement</b>                 | Stewart and Zhao (2000)   |
| <b>System</b>                    | Zott, Amit, & Massa (2011)  |
| <b>Representation</b>            | Morris et al. (2005); Shafer et al. (2005)                            |

*Own illustration based on (Zott, Amit, & Massa, 2011)*

Despite various definitions, common ground in academic research could be established by agreeing on business models as a corporate instrument to both create and to capture value (Aspara et al., 2013; Teece 2010; Zott, Amit, & Massa, 2011). For instance, Amit & Zott (2001) emphasize the importance of a business model's construct by defining it as *'the design of transaction content, structure, and governance so as to create value through the exploitation of business opportunities'*. This view is complemented by the definition of Teece (2009), which emphasizes *'the architecture of revenues, costs, and profits associated with the business enterprise delivering that value'*. Furthermore, Teece (2009) points out that business models can also be understood as recipes (see *'Rocket Recipe'* in Case Study), which are practical models of technology not only open for copying, but also for variation and innovation (DaSilva & Trkman, 2014). Most recent definitions such as the one of Zott, Amit, & Massa (2011) focus on the aspect of reducing the complexity of business model definitions, by broadly defining the business model term. According to their view, a company's business model should be perceived as *'a system of interdependent activities that transcends the focal firm and spans its boundaries'*.

To conclude, the academic community is still widely dispersed. Thus, there is a variety of conceptual and content-wise definitions, which only partially capture the characteristics of business models. Even though a common ground has been established in terms of the strategic goals of business models (e.g. create and capture value), Zott et al. (2011) claim that academic research has to agree on a commonly accepted definition of business models in the first place to be able to agree on the theoretical underpinnings of business models.

### **2.3 IT based conceptualizations**

The perspective from the IT sphere has become a catalyst for general academic research of business models. During the 1990s, research on IT picked up speed (see [Appendix 2](#)) and the focus of the academic discussion soon was on the value creation potential of internet companies (Amit & Zott, 2001; Dyer & Singh, 1998).

Academic research began to examine the business model term from the 1990s onwards (Shafer et al., 2005: 200), while it was simultaneously used by internet companies by pitching the business ventures as attractive investment opportunities to attract more funding. In this respect, business models were used to explain and justify the enormous growth potential and enterprise valuations of the internet companies at that time. Since academic scholars struggled to find a

commonly accepted definition of the business model term, they outlined alternative business models. To explain their value creation potential, Rappa (2004) and Timmers (1998) proposed different types of IT based business models according to their level of innovation and functionality, which is one of the most prominent approaches. However, Amit & Zott (2001) claim that neither the research disciplines of strategic management nor entrepreneurship are able to fully capture the specific value creation potential of internet companies. Thus, Amit & Zott (2001) suggested four specific drivers of value creation in the respect of IT based business models of internet companies: (i) Novelty, (ii) Lock-In, (iii) Complementarities, and (iv) Transaction efficiency.

*(i) Novelty*

Novelty refers to business models that structure or bundle new or existing products, services, transactions and information. Virtual markets provide IT based companies with an ideal environment to innovate business models, which also supports the process of establishing first-mover advantages such as building reputation and brand awareness (Lieberman & Montgomery, 1988). For instance, eBay enabled and facilitated bilateral auctions for goods from low to high value-items.

*(ii) Lock in*

Lock-In or customer loyalty refers to the extent to which the business model is able to motivate customers to engage in transactions and also improve the customer retention by providing incentives, and enhance transaction frequency and value creation. Most common incentives compromise loyalty programs, trustful customer relationships or virtual communities (Hagel, 1999; Teece, 1987).

*(iii) Complementarities*

Complementarities exist whenever the combination of goods create more value than the sum of the parts (Brandenburger & Nalebuff, 1996). IT based companies frequently use complementarities to enhance their core product by offering additional directly related service to customers, to unleash hidden value and obtain a higher value creation, for example, after-sales services or one-stop-shopping solutions.

*(iv) Transaction efficiency*

Transaction efficiency increases when transaction costs decrease by reducing information asymmetries between buyers and sellers (Soto-Acosta & Meroño-Cerdan, 2008). Following Amit & Zott (2001), this process may lead to the creation of entirely new business models (Dyer

& Singh, 1998). Bottom line, the greater the degree of transaction efficiency of IT based companies, the more costs are decreased and the more value can be created.

Assuming interdependencies between these sources, their combination leads to even more powerful and diversified value creation potentials. This combination of value creation sources can be translated into nine basic categories of IT based business models (see Table 2) which are linked to existing companies' business models (Newbert, 2007; Rappa, 2004; Timmers, 1998).

**Table 2:** Overview of IT based business models

| IT based business models    | Description   | Example  |
|-----------------------------|---|--|
| <b>Brokerage models</b>     | Facilitation of Transaction   | Skyscanner   |
| <b>Advertising models</b>   | Generating advertisement fees   | Yahoo  |
| <b>Infomediary models</b>   | Collecting personal data  | Facebook   |
| <b>Merchant models</b>      | Enabling retailers to sell products online                              | eBay   |
| <b>Manufacturing models</b> | Enabling manufacturers to sell products online                          | Dell   |
| <b>Affiliate models</b>     | Affiliate is paid a commission fee by click-through purchases           | Social Media Links to brokerage or merchant models |
| <b>Community models</b>     | Users to invest in developing relationships with members of a community | LinkedIn Premium                                   |
| <b>Subscription models</b>  | Recurring subscription fees   | Netflix, Hello Fresh                               |
| <b>Utility models</b>       | Paying for services consumed  | Pay as You Go                                      |

*Own illustration based on (Newbert, 2007; Rappa, 2004; Timmers, 1998)*

To conclude, business models can be seen as the conceptual link between strategy, business organization and systems.

## 2.4 Structural conceptualizations

In comparison with the IT and strategy literatures, conceptualizations play a rather subordinate role. As companies tend to frequently and repeatedly combine value creation drivers (see 2.5.1

Value creation) for establishing business models, academic literature structured these business model patterns according to their level of conceptualizations (Osterwalder & Pigneur, 2010). In this respect, business model patterns can be understood as '*building blocks*', which share similar characteristics or behaviors, and are structured into three categories: (i) meta-models (Amit & Zott, 2001; Zott, Amit, & Massa, 2011), (ii) sub-meta-models, and (iii) particular real world companies (Morris, Schindehutte, & Allen 2005). The three categories

provide most value, when hierarchically linked to each other, from meta models, to sub-meta-models, to real world companies (Osterwalder, Pigneur, & Tucci, 2005).

(i) *Meta-models*

Meta models associate business models to an overarching concept. This concept can be transferred to any real world company and thus functions as the basis for the three levels of conceptualization. Definitions by Timmers (1998) and Zott et al. (2011) broadly outline the idea of what a business model deals with (Osterwalder, Pigneur, & Tucci, 2005). Osterwalder, et al. (2005) claim business models to be ‘*the translation of strategic issues, such as strategic positioning and strategic goals into a conceptual model that explicitly states how the business functions*’. This view is complemented by business models’ strengths, drawing attention to the fitting of a company’s pieces and creating value (Magretta; 2002). Scholars like Chesbrough & Rosenbloom (2002) and Johnson, Christensen, & Kagermann (2008) normatively define the single components (e.g. value propositions, key processes and key resources) of a business model and provide respective guidance and limitations of the selection of a business model’s components.

(ii) *Sub-meta-models*

In comparison with meta-models, sub-meta-models do not describe any real world company. Instead, they rather outline a specific set of businesses with common characteristics (Rappa, 2004; Timmers, 1998). Most academic and practical attempts to describe and classify business models have been taxonomies, which usually are established by abstracting from observations, typically by single industries (Baden-Fuller & Mangematin, 2013). Baden-Fuller & Mangematin (2013) suggest a typology that considers four elements, e.g. the characteristics that define the business model: Customer identification, value proposition, monetization (Teece 2010) and Value chain and linkages (Amit & Zott, 2001; Casadesus-Masanell & Ricart, 2010). This four-dimensional typology is offered as a valuable insight, because it provides a set of clear and alternative types of models.

(iii) *Real world companies*

Real world companies are the bottom-up approach to the business model conceptualization. In fact, they consist of company-specific business models and/or their very basic descriptions, representations and conceptualizations. Several authors used a business model perspective to analyze companies, such as IKEA (Morris, Schindehutte, & Allen, 2005), Xerox (Chesbrough & Rosenbloom, 2002) and Ryanair (Casadesus-Masanell & Ricart, 2010).

## 2.5 Strategic conceptualizations

The most advanced and important stream of academic literature regarding business models stems from strategic conceptualizations and consists of three research strings: (i) value creation, (ii) distinction between the business model and other strategy concepts and (iii) relationship between business models and company performance (Zott et al., 2011). The vast majority of research emphasizes the aspects of value creation by focusing on a company's activity centered on the customer needs.

### 2.5.1 Value creation

A business model can create value through the configuration of the value chain, the formation of strategic networks among companies (Dyer & Singh, 1998), or the exploitation of company-specific core competencies (Barney, 1991). From a company's perspective, value creation includes exceeding competitors' ability to provide solutions to customers' needs, as well as maintaining or improving own profit margins (Barney, 1991). A company establishes a competitive advantage (Barney, 1991), once it implements a value creating strategy based on its business model, which is not simultaneously implemented by any current or potential competitor.

### 2.5.2 Distinction with other strategy concepts

It has been proven difficult to clearly distinguish between the business model and the strategy it is based on (Baden-Fuller & Morgan, 2010; Onetti et al., 2012). Possible reasons may stem from the short period of academic research, the inclusion of various perspectives and its function as an interlayer between business strategy and business processes (Osterwalder, Pigneur, & Tucci, 2005; Scott et al., 2005). As a consequence, the buzzword business model developed a degree of uncertainty, and confusion regarding the distinction of strategy and business model notions emerged.

Since 2000, prominent scholars, e.g. Onetti et al. (2012), Osterwalder et al. (2005), suggest a distinction between the terms of business model and strategy in order to significantly improve the understanding of the term business model. There are two main characteristics that distinct business model from strategy. First, the *scope*. Business models are perceived as systems, that illustrate how the different parts of business concepts fit together (Osterwalder, Pigneur, and Tucci 2005). Strategy, however, additionally considers aspects of competition and implementation. Second, the *observability*. Porter & Millar (1985) point out that not every company, which operates a business model, also has a strategy in place. Furthermore they claim that business models are observable while strategies are not always fully observable so that a

company's business model is also considered as the reflection of its implemented strategy.

### 2.5.3 Relationship with company performance

Since its early days the strategic management research body addresses various attributes to companies' competitiveness. In this respect, three important drivers of companies' performance are (i) the overall corporate strategy (Peteraf, 1993), (ii) resources & capabilities (Eisenhardt, 2000; Wernerfelt, 1984), and (iii) core competencies (Prahalad, 1993). However, research considers sources of competitive advantages from various angles. On the one hand, Reed and DeFillippi (1990) consider corporate strategy a potential source of competitive advantage. On the other hand, Afuah & Tucci (2001) and Brandenburger & Stuart (2005) explain a business model as a unifying construct for explaining competitive advantage and company performance. Furthermore, some research considers business models to be the source of competitive advantages, referred to as superior business models (Christensen, Craig, & Hart, 2001; Markides & Charitou, 2004). Additionally, a superior business model is not only suggested to be a source for competitive advantage but to be an instrument to create shareholder value (Rappaport, 1987). Thus, shareholder value, which can be quantified by company performance measurements, can be used as tool to evaluate business models in general, and to identify superior business models in particular.

## 2.6 Shareholder value

### 2.6.1 Origin and evolution

Defining shareholder value, common ground has been established by agreeing on a commonly accepted conceptualization. In fact, the definition of shareholder value stems from a practical guide (Porter & Kramer, 2011) due to its practical relevance. Shareholder value is created '*from policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities, in which it operates*'. Shareholder value was associated with superior performance, expressed by the rate of return on corporate stocks (Fama & Jensen, 1983; Jensen, 1976). In this respect, the body of strategic management focused on conducting event studies to quantify the impact of strategic decision making on shareholder value, e.g. announcements of R&D expenses (Kelm, Narayanan & Pinches, 1995), M&A activities (Chatterjee, 1986; Chatterjee et al., 1992), and capital expenditures (McConnell & Muscarella, 1985). Building on these research papers, the most frequently cited papers on shareholder value (Hillman & Keim, 2001; Lazonick & O'Sullivan, 2000; Srivastava, Shervani, & Fahey, 1998) evolved around the 2000s. They served

as catalysts for practical guides regarding the implementation of shareholder value (Day & Fahey, 1990; Porter & Kramer, 2011; Rappaport, 2006) and were followed by research from the marketing perspective on drivers of shareholder value.

### 2.6.2 Measurement

Looking at the link between business models and shareholder value, only a limited number of peer-reviewed academic journals examines this interplay. Rappaport (1987) limits the main driver of shareholder value to seven factors, e.g. growth in sales, margins, working capital and fixed capital, which are complemented by the tax rate, the cost of capital, and the competitive advantage period. The following part introduces two main categories of performance measurements of shareholder value: (i) accounting based and (ii) market based metrics. It is worth mentioning that their application significantly varies for traditional and IT based companies.

#### *(i) Accounting based metrics*

Accounting based metrics include ratios such as return on equity (ROE), return on assets (ROA) and return on invested capital (ROIC). However, the academic community concludes that these metrics are not ideal for measuring shareholder value (Rappaport, 1987). The main flaws arise from reflecting historic company performance and being short term related (Hillman & Keim, 2001). Furthermore, accounting metrics are not able to capture intangible assets such as a company's reputation or a company's intellectual property (Barney, 1991; Dierickx & Cool, 1989; Hillman & Keim, 2001) and can be easily adjusted and manipulated by the companies' publishing reports (Fisher & McGowan, 1983).

#### *(ii) Market based metrics*

Compared to accounting based metrics, market based metrics benefit from their ability to take into account future developments of both the company's future cash flow generation and the company's future level of risk (Srivastava, Shervani, & Fahey, 1998). In the following the most relevant market based metrics are discussed, which include Discounted Cash Flow (DCF) and Net Present Value (NPV), Tobin's Q, Market Value Added (MVA), Cash Flow Return on Investment (CFROI), and Total Shareholder Return (TSR) approach (see [Appendix 3](#)).

Copeland & Galai (1983) claim the Net Present Value (NPV) to be beneficial in terms of investment decisions. Based on the Discounted Cash Flow (DCF) model, the value of the operations of a business (NPV) is determined by discounting expected future operating free cash flows at a risk adjusted cost of capital.

Another market-based metrics is Tobin's Q (Brainard & Tobin, 1968), which is obtained by dividing the company's market value by the company's replacement costs. However, both the DCF model approach and the Tobin's Q metrics have flaws inherent: subjectivity for estimating future cash flows and discount rates, and the difficulty to value intangible assets, respectively. The MVA approach eliminates these flaws (Hillman & Keim, 2001). The MVA approach uses the underlying concept of the internal rate of return by performing iterative calculations for determining the required discount rate, which offsets the sum of the present value of all cash flows with the present value of the investment (Hillman & Keim, 2001). In this model, a company's net income is taken as a proxy for the cash flow and is equally distributed over the respective time periods and therefore constant. This is essential, because it ensures the comparison of actual return and cost of capital. If the return exceeds the cost of capital, shareholder value is created. Thus, in academic research, the MVA approach is frequently used and cited for measuring the shareholder value, at least for traditional business models.

The CFROI expresses the mean return of companies' projects. If this rate of return exceeds the weighted accumulated costs of capital without inflation (WACC), the positive difference quantifies the level of shareholder value created (Fernández, 2002; Lewis & Lehmann, 1992). As a consequence, among practitioners the CFROI concept is perceived as an extension of the ROA, as it also considers the cost of capital. Following the concept of CFROI, the TSR extends ROE, which only considers the return of shareholders (Fernández, 2002). If this rate of return exceeds the cost of equity, the positive difference quantifies the level of shareholder value created.

Concluding, measurements of shareholder value are different for traditional and IT based businesses. Even though market based metrics gained more academic and practical interest due to their comprehensive consideration of companies' performance (e.g. forward looking character in form of cash flow calculation), these conclusions do not apply for IT based companies. Usually IT based companies tend to have high growth rates in sales and market penetration, while having negative earnings, few tangible assets, and sometimes low (even negative) book values (Zott & Amit, 2007). Thus, market based metrics for measuring shareholder value are not ideal, as market capitalization is associated with the uncertainty of the true companies' prospects (Stuart, Hoang, & Hybels, 1999). Furthermore, real options as alternative measurement for shareholder value of IT based companies are subject of discussion

within the academic research band of corporate finance, but tend to be prone to large model errors (Amram, 2000). To conclude, it is challenging to value IT based companies (Goldenberg & Goldenberg, 2009). However, best practice approaches, derived from investment banks and consultancy firms, suggest to start with comprehensively understanding the internet companies' value propositions, then projecting revenues, followed by projecting profitability measurements. These two steps are encouraged to be cross checked by comparing them to similar companies resulting in a weighted scenario analysis, which incorporates industry trends and economic drivers to make projections and valuations more realistic.

## **2.7 Conclusion**

Concluding, this literature review explores areas of corporate strategy, business models and shareholder value to provide a theoretical basis on how these three intersect in the process of identifying, selecting and evaluating superior business models. Reviewing business models conceptualizations from IT, structural and strategic perspectives, it can be affirmed that academic interest in the business model term has gained momentum. Even though the business model term experienced various definitions, research aligns on the idea of superior business models as a source of competitive advantage. However, research only considers the context of technological advancements and how the traditional business model view can be shifted towards an embedded view considering the intersection of strategy and shareholder value. Therefore, the aim of this master thesis is contributing to fill this research gap by applying a case study with a real world example to deliver insights and inspirations for bridging strategy, business models and corporate finance aspects in a dynamic business environment.

For future avenues of academic research, it would offer value to develop and establish a commonly accepted definition of business models first. This might foster conceptual and particularly empirical research because data sourcing would be simplified and facilitated. On this basis, further light should be shed on a more comprehensive approach of integrating corporate finance, strategy and business models aspects. By doing so, both practitioners and scholars would contribute practically and theoretically to finally close this research gap.

## Appendix

### Appendix 1: Process of systematic literature review

|               | Description  | Number of identified papers | Databases  |
|---------------|--|-----------------------------|--|
| <b>Step 1</b> | Three major databases were chosen for peer-reviewed academic journals (preferably, Strategic Management Journal, Journal of Management, Academy of Management Journal and Journal of Finance). The results were imported into literature management software Mendeley. | 76                          | <ul style="list-style-type: none"><li>▪ EBSCO</li><li>▪ Mendeley</li><li>▪ Scopus</li><li>▪ Web of Science</li></ul> |
| <b>Step 2</b> | Initial screening of existing academic papers according to commonalities regarding key words in abstracts, title or main body of these papers.   | 76                          | <ul style="list-style-type: none"><li>▪ Mendeley</li></ul>   |
| <b>Step 3</b> | Additional studies were found through new search strategies considering linkages between strategy, business models and shareholder value.  | 81                          | <ul style="list-style-type: none"><li>▪ EBSCO</li><li>▪ Google Scholar</li></ul>                                     |
| <b>Step 4</b> | Identification of most important academic papers according to the quantity of citations and the VHB-ranking of peer-reviewed academic journals.  | 29                          | <ul style="list-style-type: none"><li>▪ VHB database</li></ul>   |
| <b>Step 5</b> | Consolidation of results through retrospective and forward related search approach by following the citations.   | 31                          | <ul style="list-style-type: none"><li>▪ Google Scholar</li></ul>   |
| <b>Step 6</b> | Final selection of peer-reviewed academic papers and complementing academic literature.  | 31                          | <ul style="list-style-type: none"><li>▪ Mendeley</li></ul>   |

Source: Own representation based on (Burns & Grove, 1993)

## Appendix 2: Literature overview of business model term

| Conceptualizations | Early Stage<br>(1957 – 1994) |       |                  | Gained Momentum<br>(1995 – 2002) |         |         |                                 |   |  | Differentiation<br>(2003 – 2013)               |                  |  |                                     |             |   |   |  |  |                                  |
|--------------------|------------------------------|-------|------------------|----------------------------------|---------|---------|---------------------------------|---|--|--|------------------|--|-------------------------------------|-------------|---|---|--|--|----------------------------------|
|                    | 1957                         | 1960  | 1975             | 1997                             | 1998    | 1999    | 2000                            | 2001  | 2002   | 2003   | 2004             | 2005                                       | 2006                                | 2007        | 2008  | 2009  | 2010   | 2011   | 2013                             |
| <b>IT based</b>    |                              |       | Konczał; Dottore | Shaw                             | Timmers | Bambury | Amit & Zott; Eriksson & Penker  | Amit & Zott; Applegate; Gordjin & Ackermans; Papakiriako poulos et al; Petrovic et al.; Rappa; Rayport & Jaworski; Weill & Vitale | Bienstock et al., Dubosson-Torbay et al.; Eisenmann; Hawkins; McGann & Lyytinen; Osterwalder & Pigneur | Afuah & Tucci; Wang & Chang; Hedman & Kalling; | Pateli & Gigalis | Rajala & Westerhund                        | Haaker et al., Kallio et al.; Rappa |             | Eriksson et al.   | Andersson, Johansson & Zdravkovic; Björkdahl; Clemons; Tankhiwale | Zott & Amit  | Gambardella & McGahan; Sosna, Trevinyo-Rodriguez & Velamuri; | Huang                            |
| <b>Structural</b>  | Bellman et al.               | Jones |                  | Treacy & Wiersema                |         |         | Linder & Cantrell               |   |  |  |                  | Keen & Qureshi; Tikkanen et al.            |                                     | Zott & Amit | Al-Debei et al.; Hurt                                       | Osterwalder & Pigneur   |  |  |                                  |
| <b>Strategic</b>   |                              |       |                  |                                  |         |         | Afuah & Tucci; Hamel; Mahadevan | Hamel   | Betz, Chesbrough & Rosenbloom; Magretta  | Mansfield; Winter                              | Afuah            | Lehman & Ortega; Moris; Schafer; Schweizer | Chesbrough; Debelak; Lai & Weill    |             | Johnson et al.; McPhillips & Merlo; Richardson; Zott & Amit | Kind, Nissen & Sorgard  | Casadeus-Masanelli & Ricart; Smith, Binns & Tushman; Teece |  | Desyllas & Sako; Keen & Williams |

Source: Own illustration based on (Amit & Zott, 2001; Casadesus-Masanell & Zhu, 2013; Wirtz et al., 2016; Zott & Amit, 2008)

**Appendix 3:** Overview of shareholder value measurement metric

**Calculation**

| <b>Accounting based metrics</b> |   |
|---------------------------------|---|
| ROA                             | $\frac{\text{Net Operating Profit after Taxes (NOPAT)}}{\text{Total Assets}}$   |
| ROE                             | $\frac{\text{Net income after tax}}{(\text{Equity shareholder capital} + \text{reserves} - \text{preliminary expenses})}$ |
| ROI                             | $\frac{\text{Net operating income}}{\text{Average operating asects}}$   |
| <b>Market based metrics</b>     |   |
| Tobin's Q                       | $\frac{\text{Total Market Value of Company}}{\text{Total Asset Value of Company}}$  |
| MVA                             | $\text{Market value of company} - \text{Invested capital}$  |
| CFROI                           | $\frac{\text{Operating Cash Flow}}{\text{Capital Employed}}$  |
| TSR                             | $\frac{\text{Change in share's market price} + \text{dividends}}{\text{Initial stock price}}$                             |

Source: Own illustration based on (Fernández, 2002; Firer, 1995; Hillman & Keim, 2001; Reilly & Brown, 2003)

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# Rocket Internet Case Study (5,360 words)

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## Quo Vadis Rocket Internet?



Source: Sueddeutsche Zeitung 2017

### Abstract

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This case study addresses the increasing importance of unicorn, its IPO and its downturn will be analyzed and business models in nowadays business environment, connected to RI's management of its unique business model. characterized by technological advances and the dynamic Negative investor sentiment evolved due to profitability competitive landscape. Particularly interesting, this case study issues, lack of transparency, communication and shareholder considers the interplay of strategic management and corporate value. RI's future path is closely connected to its business finance aspects using the real world example of Rocket model. RI has to reinvent and innovate its business model, but Internet (RI), an IT based incubation and investment company for that investors' time and patience is required.

RI's turbulent company history of quickly becoming a

O presente estudo de caso aborda a crescente importância dos modelos de negócio na atual conjuntura empresarial, que é



caracterizada por avanços tecnológicos e por um cenário competitivo dinâmico. Sendo particularmente interessante, este estudo de caso considera a interação entre gestão estratégica e finanças corporativas, num contexto real de trabalho, como é o caso da Rocket Internet (RI), uma empresa incubadora e de investimento, cujo objeto são as TI. A história turbulenta vivida pela RI, ao tornar-se uma empresa unicórnio, a sua OPA e, mais recentemente, a sua desaceleração são analisadas e associadas à

singular gestão do seu modelo de negócio. Reações negativas por parte de investidores evoluíram devido a problemas de rentabilidade, falta de transparência, comunicação e valor para o acionista. O progresso da RI está intimamente ligado ao seu modelo de negócio. A RI precisa de reinventar e inovar o seu modelo de negócio, não obstante ser necessário tempo e paciência por parte dos investidores

When Oliver Samwer (CEO illustrated at the cover page) together with his board members Alexander Kudlich (CMO) and Peter Kimpel (CFO) rang the bell of the Frankfurt Stock Exchange on 2<sup>nd</sup> October 2014, at 09:30 AM, Rocket Internet (RI) had achieved its biggest success: The IPO of RI. RI's controversial business model was finally accepted and even appreciated by investors after seven remarkable years. From 2007 to 2014, RI transformed from a technology start up to one of Europe's largest technology companies, being the parent of every fourth European unicorn<sup>1</sup>.

Founded as an operating platform for investments and company developments in the technology space, RI focused on copying business models from already successful E-commerce companies (e.g. Amazon and Alibaba), transferring them to Emerging Markets, adapting them to local characteristics (e.g. infrastructure, culture and customer behavior), and scaling operations to achieve a market leading position. *Who is Rocket comparable to?*<sup>2</sup> In the venture capital sphere, RI would be among the largest players in Europe. However, unlike most venture capital firms, RI uses solely its own resources to build companies and provides access to its web interface. Moreover, unlike E-commerce platforms such as Alibaba or Amazon, RI represents a portfolio of investments. Thus, RI prefers not to be categorized within common definitions but instead describes itself as '*We are builders of companies, we are not innovators*'. Thus, this case study will refer to RI's activities of developing companies as company-building (see [Exhibit 4](#)).

RI's superior business model, the *Rocket Recipe*, is for RI what the Coke Recipe is for Coca Cola - the formula of success. RI has developed a unique skill in identifying already proven business models, replicating them, and applying them in untapped markets, most commonly emerging markets. From 2014 on, RI quickly established a market leading position due to its aggressive and relentless company-building process based on the *Rocket Recipe*. However, not everyone is fond of RI's business model. Increasing resistance from Silicon Valley claims that '*the Samwer brothers are despicable thieves*'<sup>3</sup>. However, RI founder Oliver Samwer points out,



that *'all companies, whether bricks-and-mortar shops or online businesses, are based on existing ideas and RI only builds on these ideas to develop even better companies'*.

From 2014 to 2017, RI shifted its business model from a company builder to a listed venture capital fund - that is, RI invested more frequently and larger amounts in selected companies throughout their lifecycle, while the number of company-buildings significantly decreased over time. Thus, RI's share price plunged (see [Graphic 4](#)) and investors' doubts and complaints steadily increased, as they still wait to be rewarded, and neither dividends nor share buybacks by RI limited their negative earnings per share. Hence, one thing is clear: RI's shifted business model is not appreciated by shareholders. However, is it right to conclude that RI needs to better align its business model with shareholders' interest to be successful in future?

### The Road to Rocket Internet

*'Everything big starts small'* – Looking at the early days of RI's future founders, from 1999 on the Samwer brothers interned at various tech start ups in the Silicon Valley, marking the first step for their successful career. The three brothers founded companies, became serial technology entrepreneurs and then turned into technology investors. Emphasizing the Samwer brothers' sense for business, it is estimated that they raised more than \$2.0 billions of funds for approximately 260 investments<sup>4</sup>. Two out of three of these investments were either sold or cashed out by an IPO tripling their invested capital on average - Industry experts call this a 3.0x Money-on-Money Multiple (MM).

The Samwer brothers started their time as technology entrepreneurs when they stumbled across eBay, at that time a new business model aiming to disrupt traditional auction houses by providing online auction services. Attributing eBay's unrealized potential to the narrow focus on the US market, the Samwer brothers wanted to transfer and implement eBay's promising business model to Germany and pitched the idea to eBay's senior management– eBay turned down their offer. Returning to Germany, the Samwer brothers set up their very own eBay. In 1999, they built Alando, the German answer to eBay, selling their childhood toys as first auction on the online platform. Quickly and relentlessly implementing its business model, Alando outpaced fourteen competitors and rapidly increased its customer base. Only three months after its building, Alando was one of the largest online auction houses in Germany. Both surprised and convinced by Alando's rapid success in Germany, eBay revised its decision one year later

and acquired Alando for \$53 million<sup>5</sup> - making the Samwer brothers the first Internet millionaires in Germany and providing them with capital to get started with further investments, i.e. Jamba.

Founded in 2000, Jamba evolved to become Europe's largest provider of ring tones and mobile applications, and was eventually sold for \$273 million to Verisign in 2004<sup>6</sup>. Remember the Crazy Frog song that was stuck in everyone's head? Jamba was behind it! The Samwer brothers understood to rapidly grow their customer basis heavily investing into advertisement, e.g. TV. An approach they should apply more often in future endeavors, resulting in further successful company sales. Earning money from sold companies, the Samwer brothers re-invested their sale proceeds into new business ideas and companies such as Facebook, LinkedIn and Trivago at their early stage. In 2006, the Samwer brothers set up a fund vehicle, the European Founders Fund (EFF), to structure their increased number of investments as well as to improve their fundraising process.

### **Rocket Internet's Development, 2007 - 2013**

In 2007, RI was founded as the parent company of Samwer brothers' existing investments and company-buildings. That is, the brothers established a hub of IT know-how, infrastructure, and capabilities, being the platform for future investments and company-buildings. The Samwer brothers' strategy should work ... at least for a while.

From 2008 to 2014, RI massively invested its funds in diverse company-building processes, to mention the most prominent examples, e.g. Zalando (2008), Home24 (2009), HelloFresh (2011) or Lazada (2012) (see **Error! Reference source not found.**). The funds stem from both third party financings and sale proceeds of smaller company-building projects such as Bigpoint (online game community) and MyCityDeal (discount deals), which were sold for €70 million in 2008 and \$126 million in 2010, respectively.

*Graphic 1: Timeline of RI's most important milestones*



offering with clothing and fashion items. Within the next five years, Zalando quickly accomplished a market leading position in the European E-commerce market. Key drivers for this rapid success have been the heavy funding of TV advertising and consistent efficiency improvements of Zalando's supply chain. Both initiatives ensured a fast brand building and a more compelling shopping experience for its customers. After following years of ever-improving Zalando's customer lifetime value (CLV)<sup>9</sup> by consistently fine-tuning the usability of the online platform, logistics and return processes - the efforts paid off: Zalando was one of the largest European technology IPOs ever, valuing the company with €5.3 billion<sup>10</sup>. To date it remains RI's biggest success.

### ***RI's IPO: Further large investments and company-buildings***

Zalando's successful IPO demonstrated that the capital markets were optimistic about on technology IPOs, in case the private company's business model was well understood and underpinned by a strong management team. Considering this positive investor sentiment, the Samwer brothers wanted to take the next level – the IPO of RI. Similar to Zalando, RI also showed a history of consistent sales growth with a large potential to continue this trend. The Samwer brothers considered RI's IPO as a big chance to increase RI's liquidity and to get greater access for funding investments and company-buildings in the future. Although RI achieved significant growth in sales within its first seven years, RI was not able to consistently generate profits. However, the market didn't mind yet and RI's IPO was a success story. Stock market investors not only believed in the Samwer brothers' excellent track record of successful company-buildings and investments in the internet industry, but also saw in RI the opportunity to gain access to fast-growing emerging countries. As a result, RI received heavy demand for its shares and roughly doubled the raised proceeds expected when announced its IPO of €1.6bn. The offering was over-subscribed well in excess of ten times at the top end of the price range. With a market capitalization of €7.9 billion<sup>11</sup>, RI's IPO marked Europe's largest technology IPO so far. According to RI's IPO prospectus as of 2014, the IPO proceeds should be primarily used to *'finance its future growth through the launch of new businesses and providing further equity capital to its network of companies'*. Bearing that in mind, in seven years RI has turned into a European key player in the technology space, which was vigorous and ready to expand its existing and upcoming businesses.

*Graphic 2: Rocket Internet Financial Snapshot (fully consolidated)*



| Key Income Statement      | 2014A  | 2015A  | 2016A |
|---------------------------|--------|--------|-------|
| (EUR millions)            |        |        |       |
| Sales                     | 128    | 128    | 50    |
| Adjusted EBITDA           | -155   | -176   | -75   |
| Net Income (Adjusted)     | 463    | -203   | -697  |
| Key Cash Flow Statement   |        |        |       |
| Cash Flow from Operations | -95    | -106   | -86   |
| Cash Flow from Investing  | -62    | -1,300 | -120  |
| Cash Flow from Financing  | 1,760  | 1,120  | -166  |
| Change in Cash            | 1,600  | -285   | -367  |
| Free Cash Flow            | -1,644 | -118   | -92   |
| Key Balance Sheet         |        |        |       |
| Cash & Equivalents        | 2,060  | 1,760  | 1,400 |
| Total Assets              | 3,920  | 5,000  | 4,200 |
| Short-term Debt           | 10     | 12     | 37    |
| Long-term Debt            | 5      | 527    | 333   |
| Total Equity              | 3,770  | 4,350  | 3,750 |




















Source: Rocket Internet Company Reporting

## Business Model: The ‘Rocket Recipe’

### The Ingredients

RI’s successful IPO raises the question of what makes this company outstanding and what drives its success in such a short period of time. The answer is given by RI’s superior business model: The *Rocket Recipe*, which can be seen as a tool for achieving what Oliver Samwer describes: ‘Every new company is like a speedboat, and we want them to become aircraft carriers’<sup>12</sup> The critical component is speed – in terms of the company-building process, setting up and scaling of operations, and establishing strong and consistent revenue growth. When the companies have achieved a so-called critical size (e.g. revenues of at least €100m), the companies’ focus can shift towards profitability improvements by controlling costs, while pursuing a more modest growth path. This path of profitable growth makes the companies more stable and resilient to external shocks, like an aircraft carrier. Besides, RI not only builds companies from scratch, but also invests into early stage companies. RI’s CEO Oliver Samwer summarizes the superiority of RI’s *Rocket Recipe*: ‘we just build faster and better in more instances than anyone else’. The seven steps of the Rocket Recipe break down these instances, in which RI excels competitors (see [Graphic 3](#)).

Graphic 3: The ‘Rocket Recipe’

| Ingredient                              | Preparation Style   | Preparation Time |   | RI's Best Practice  | Company Building  | Investment  |
|---|---|------------------|---|---|---|---|
| #1 Selecting Business Models            | Already proven business models with potential of <ul style="list-style-type: none"> <li>▪ \$1.0bn market size; and</li> <li>▪ \$100m revenue.</li> </ul>  | Within 100 days  |  | Business Model of Swedish company Linas Matkassa with a potential of <ul style="list-style-type: none"> <li>▪ \$6.0bn market size, and</li> <li>▪ \$6.0bn revenue.</li> </ul> |  |   |
| #2 Selecting Untapped Markets           | Emerging Markets countries, with a <ul style="list-style-type: none"> <li>▪ Low competition level; and</li> <li>▪ Limited usage of e-commerce applications.</li> </ul>  | Within 100 days  |  | 23 African Countries, such as Egypt, Ghana, Nigeria etc.  |  |   |
| #3 Operating Platform                   | RI's data warehouses centrally review and optimize <ul style="list-style-type: none"> <li>▪ Client Relationship Management (CRM), and</li> <li>▪ Marketing activities of the ventures.</li> </ul>   | Within 100 days  |  | Home24 has used <ul style="list-style-type: none"> <li>▪ SEM, SEO; and</li> <li>▪ Skyrocket platform.</li> </ul>  |  |  |
| #4 Deep Localization                    | Business models need to be adjusted to local characteristics by establishing local know-how, operations and in-house facilities.  | Ongoing          |  | GFG has established <ul style="list-style-type: none"> <li>▪ Own delivery fleets;</li> <li>▪ Last mile delivery; and</li> <li>▪ Cash-on-delivery.</li> </ul>                  |  |  |
| #5 Mobile First Strategy                | In Emerging Markets, smartphones are <ul style="list-style-type: none"> <li>▪ Largely distributed; and</li> <li>▪ Represent best point of sale (POS).</li> </ul>  | Ongoing          |  | Lazada launched Android and iOS app, resulting in 87% mobile traction (2013).   |  |  |
| #6 Scaling and Realization Of Synergies | After large up-front costs to scale operations, break-even is envisaged to be achieved by <ul style="list-style-type: none"> <li>▪ Pricing and Margin Improvement,</li> <li>▪ Shared knowledge within ventures, and</li> <li>▪ Economies of Scale.</li> </ul> | Ongoing          |  | Zalando managed to break-even on group level after six years.   |  |  |
| #7 Value Crystallization                | Company building and investments are realized by <ul style="list-style-type: none"> <li>▪ Selling companies (Trade Sale) or</li> <li>▪ Going public with companies built (IPO).</li> </ul>  | Ongoing          |  | <ul style="list-style-type: none"> <li>▪ Lazada was sold to Alibaba in 2016</li> <li>▪ Zalando managed to IPO in 2014</li> </ul>  |  |  |

Source: Own illustration based on Rocket Internet Company Reporting

### #1: Selecting Business Models

The *Rocket Recipe* follows a Top-Down approach: Global key trends such as the disruptive power of software, increasing mobile device diversity, and the accelerated rate of smartphone penetration in Emerging Markets are perceived as particularly interesting. According to RI, already proven business models around E-commerce, Marketplaces and Fin Tech offer the greatest potential for building a new company and developing it into a unicorn. Most commonly, these already proven business models stem from the USA (e.g. Amazon, eBay, Airbnb) or China (e.g. Alibaba), and target a significant market of at least \$1.0 billion in market size and \$100m in revenue with a low competition level. RI backs companies most commonly from areas of (see [Exhibit 1](#)):

- **E-s:** Conducting commercial transactions electronically on the Internet;
- **Marketplaces:** Ensuring that sellers and buyers are matched for millions of order processing in the travel, real estate, transport and food delivery markets; and
- **Fin Tech:** Enabling small and mid-capped businesses to fund their operations bilaterally, apart from the established processes with usual financial institutions.

### #2: Selecting Untapped Markets



The feasibility of a roll-out to Emerging Markets is evaluated in a 60 - 90 day window. In case of a positive evaluation in terms of the business models' financial and commercial viability, the business models are envisaged to be simultaneously rolled-out to three to six Emerging Markets including:

- **Africa:** E.g. Egypt, Morocco, Nigeria and Tunisia;
- **Latin America:** E.g. Brazil and Mexico;
- **Europe and Middle East:** E.g. India, Kazakhstan, Russia and UAE;
- **South East Asia:** E.g. Indonesia, Malaysia, Philippines, Thailand and Vietnam.

### ***#3: RI as Operating Platform***

From day one of the company-building, the companies can rely on RI's well-diversified spectrum of investors, consisting of sector specialists (e.g. Digital Sky Technologies, and New Enterprise Associates), Strategic Partners (e.g. Kinnevik, and Tesco), and Institutional Investors (e.g. J.P. Morgan, and Goldman Sachs). Furthermore, the companies also have access to RI's centralized technology platform, which provides them with IT know-how, data warehouses and best practice approaches, enabling an ongoing data-driven optimization of the operational business (see **Error! Reference source not found.**). One of RI's best practice approaches is to focus on the optimization of CLV and Customer Acquisition Cost (CAC)<sup>13</sup>. Key features for improving CAC and CLV are Customer Relationship Management (CRM) tools, Search Engineering Marketing (SEM) and the access to payment solutions.

### ***#4: Deep Localization***

However, *'It's very hard to take a business model and adapt it successfully to a divergent market. Think about cultural, legal, geographic, economic, institutional and other ways in which countries differ'*<sup>14</sup>. Local operations and sourcing teams are important to identify and understand the opportunities, threats and dynamics of local markets. For instance, setting up own logistics or offering alternative payment methods makes the customers' shopping experience more comfortable, and increases CAC and CLV – essential for rapidly scaling businesses.

### ***#5: Mobile First Strategy***

Entering untapped markets abroad, RI provides users with the opportunity to access their business on mobile devices first. As smartphones are widely distributed in the Emerging

Markets, they offer the best and most comfortable point of sale (POS) with the customer, before transferring them to the desktop experience.

### **#6: *Scaling and Realization of Synergies***

With the centralized construction kit for the companies, economies of scale are realized and a significant knowledge share allows the entrepreneurs avoid mistakes that potential competitors would make. RI expects the businesses in general to break-even within on average six to eight years according to the theme '*Scale. Scale. Scale. And the rest will come*'. In case the new companies are profitably growing into a long-term market leading position, they receive on average total funding of \$2 million<sup>15</sup>.

### **#7: *Value crystallization***

RI's last step includes to crystallize value by exiting its companies. Most commonly, RI realizes the company exits by either selling the companies (to larger competitors: e.g. Lazada was sold to Alibaba), or by transforming the companies built from private to public companies (e.g. IPO of Zalando). While an IPO offers a company a lot of advantages such as generating liquidity for shareholders, owners, and investors, it also increased costs (e.g. for paying audit companies, investment banks and lawyers), and meeting new reporting standards with the potential loss of privacy need to be considered as well. Nevertheless, high growth companies usually prefer IPOs, as they are a means of further securing funds in the future to continue their growth path. Following the valuation, RI has not only cashed out its investment but also de-risked its portfolio.

After having reviewed the best practices for each ingredients #1 - #7, Delivery Hero and Hello Fresh demonstrate that the *Rocket Recipe* can be a one-stop solution for building unicorns. As a result, it is no coincidence that Delivery Hero (#57) and Hello Fresh (#1) find themselves in Financial Times' '*Europe's 1000 fastest growing companies*' from 2012 to 2015<sup>16</sup>.

### **The '*Rocket Recipe*': Hello Fresh**

Hello Fresh, in which RI currently holds ca. 53%<sup>17</sup>, represents a best practice example for Rocket Recipe's company-building approach. Germany-based Hello Fresh provides online food services on a global scale, offering a subscription service in which customers receive a weekly box of recipes and meal ideas<sup>18</sup>. The global food market is estimated to have a size of €6.5 trillion and offers substantial growth prospects. This is due to the global reach of the online

business model and the low market penetration of only 1% currently. Besides, Hello Fresh competes with offline food providers such as Aldi, Mark & Spencer or Waitrose, and similarly to Netflix they try to disrupt the offline competitive landscape by exploiting customers' convenience with regular delivery service.

### **Development, 2011 – 2017**

From 2011 onwards, Hello Fresh experienced '*in five years (..) what a normal company undergoes in 20*'. The main challenge for Hello Fresh and its CEO Dominik Richter has been to attract new customers for their meal package delivery concept and to transfer them into loyal long-term customers. The only way for explaining meal packages to customers was either by granting discounts on first orders or by significantly increasing marketing expenses to increase brand awareness. Using plain slogans such as '*No Planning, No Shopping, No Waste*', the much desired growth has been primarily realized by geographical expansions into markets such as Belgium, Switzerland and Canada in 2015 and 2016. Since Q1 2014, the company almost consistently increased every quarter's revenues €2.3 million in 2012 to €305 million (Compound Annual Growth Rate > 400%). Despite these impressive developments, plans in October 2015 to go public failed because the IPO market was not, what bankers call, '*hot*' anymore, valuing Hello Fresh considerably below the management board estimates. After this blowback, Hello Fresh decided to further strengthen its market positions through product diversification. As a result, new features on the website platform (e.g. individualization of recipes, Hello Fresh FamilyBox, Breakfast recipes or the 20 minute meals) were launched. By doing so, Hello Fresh established strong Adjusted EBITDA (AEBITDA) improvements by nearly halving the absolute AEBITDA losses, translated into an AEBITDA margin improvement from -32% in Q4 2015 to -7.4% in Q2 2017<sup>19</sup>.

### **Global Leader, Online Consumer Food Market**

Looking at the financial perspective, Hello Fresh's business implies recurring subscription based revenues and just-in-time fulfilment centers that generate a low asset base with minimal inventory and negative working capital. These factors drove the rapid scaling of the business into nine countries simultaneously: Australia, Austria, Belgium, Canada, Germany, Netherlands, Switzerland, UK and USA. Except for the USA, Hello Fresh inherits the market leading position in the other eight markets. To date, Hello Fresh has raised ca. €364 million of total funds.

## **Competitive Landscape in the USA**

Looking at the future, Hello Fresh's main goal is to become the market leader in the USA in 2018, and to breakeven on a group level until 2019 (see [Exhibit 5](#)). Currently, the competitive landscape in the US market is dominated by Blue Apron. In early 2017, there was speculation that Blue Apron would seek an IPO valuation of \$3.0 billion, which implied a positive effect on Hello Fresh, as it was close to the size of its US peer. However, Blue Apron's actual IPO was priced at \$10/share, the bottom end of a range that was reduced from \$15-17/share to \$10-11/share, with an implied market capitalization of only \$1.9 billion. However, what came after was even worse: Amazon has started to sell meal kits and also acquired Whole Foods for a total consideration of \$13.7 billion<sup>20</sup>. Considering Blue Apron's downturn and Amazon's step into the food market (saving on marketing costs and being comfortable undercutting on price), there is a clear question mark on the competitive outlook of the online consumer food industry in the USA, and thus on Hello Fresh's short-term goal. Not such good news for Hello Fresh and its IPO prospects, although its business model proved to be more resilient than competitors' ones in the light of the US market's development.

## **The 'Rocket Recipe': Delivery Hero**

Delivery Hero, in which RI currently holds ca. 26%<sup>21</sup>, represents a best practice example for RI's investment approach. Germany-based Delivery Hero, founded in May 2011, provides online food delivery services to restaurants and cafes in more than 40 countries<sup>22</sup>, while being market leader in 35 countries. The company is the largest food network in the world with more than 150,000 restaurant partners and more than 171 million orders processed in 2016. Offering customer services through websites, mobile and tablet apps, Delivery Hero emphasizes customers' convenience, reliability and quality of the ordering and delivery process.

### ***Global Leader, Online takeaway market***

In February 2015, RI deviated from building companies only. That is, RI did not build Delivery Hero from scratch but instead acquired a 30% stake for €496 million, increasing to €657 million over time. RI built a similar company to Delivery Hero, Foodpanda, which quickly rose to RI's proven winners. Foodpanda continued to grow fast through acquiring competitors such as Talabat, La Nevera Roja, and Pizzabo.it. As a result, two large online takeaway providers with complementary geographical scope have been created. However, there can only be one. After investing further €37m in Foodpanda, RI transferred these assets to Delivery Hero for stock and

acquired further shares (€52m) in the group, such that RI had a 39% stake of Delivery Hero by March 2015. In December 2016, Delivery Hero acquired Foodpanda, increasing RI's stake to 37.7% stake in Delivery Hero forming a global leader in the online takeaway market. As a result, Delivery Hero's sales, number of orders, and revenue considerably increased by more than 60% from 2015 to 2016<sup>23</sup>. Not only strong financial figures backed Delivery Hero's business model, but also external proof was received by the investment of well reputable online investor Naspers (€387m for a 13% stake in Delivery Hero), leading to an increased LPV of Delivery Hero of €3.0bn. To date more than \$1.0 billion have been invested into Delivery Hero in various funding rounds (Series A – G) and private equity deals.

### **Competitive Landscape**

Rumors have occurred that Delivery Hero could tap into the equity markets quite soon, following its peers Grubhub, JustEat and Takeaway, that are already listed on stock exchanges (see [Exhibit 6](#)). Positive momentum arises from the highly fragmented and large market size (estimated at €6.5 trillion) of the online food takeaway segment and existing investor appetite for this kind of business model. However, Delivery Hero differs from its peers due to its company history and financials, so that the critical question remains whether Delivery Hero is already a suitable candidate for an IPO.

## **Rocket Internet's Transformation to a Listed Venture Capital Fund**

After its IPO in September 2014, RI's story of success continued. RI's Last Portfolio Value (LPV)<sup>24</sup> increased from €2.7 billion at the end of fiscal year 2014 to €6.1 billion in 2015. Key drivers have been the strong development of proven winners with growth rates of more than 100% in revenues and EBITDA margin improvement by 10pp on a yoy level. However, due to complicated and time consuming negotiations with 3<sup>rd</sup> parties regarding the strategic and financial development of its proven winners, RI decided to shift its investment strategy from a major shareholder (on average 33% ownership of proven winners) towards a majority shareholder approach (> 50% ownership of proven winners)<sup>25</sup>. Selective M&A activities should complement RI's adjusted investment strategy in cases where scale and synergies justify the purchase price (e.g. Delivery Hero in 2015)<sup>26</sup>.

In 2016, RI's investment strategy was characterized by a disciplined capital allocation, with overall limited funding amounts of €250 - €350 million. Furthermore, RI set up the RICP, which

focuses on both early and later stage investments, and marked a turning point for RI<sup>27</sup> (see [Exhibit 3](#)). RI's CFO, Peter Kimpel pointed out that *'the Fund provides access to capital [...]* Furthermore, Rocket Internet and its shareholders participate in the returns generated by the investments made by the Fund'<sup>28</sup>. RICP's investment focus is on technology based companies, particularly in the sub-segments of Consumer Tech, Fin Tech, Food Tech, Property Tech, B2B SaaS, and Travel Tech. All in all, the set up of the RICP, a new funding vehicle, marked a milestone and will provide RI with more than \$1.0bn of additional investment power. On the other side, the RICP will make RI walk away from its operating platform business model, the *Rocket Recipe*, because the number of company-buildings decreases and the investment frequency and amount increases.

### **Negative Investor Sentiment**

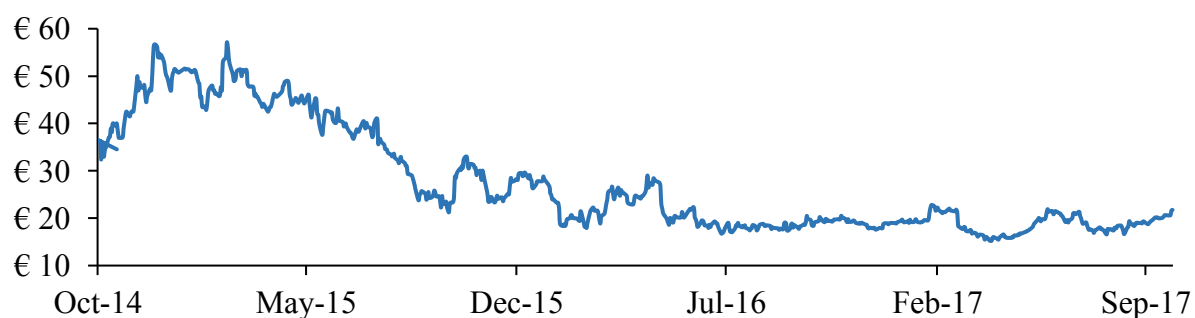
From March 2016 on, the sentiment regarding RI's shares drastically became negative, as first indications of a conflict with long-term investor and large shareholder Kinnevik (see [Exhibit 2](#)) became public. Kinnevik was not completely convinced about RI's Africa business as the Swedish investor hedged its bets on Jumia by investing in its main rival Konga. Besides, Kinnevik considered RI's proven winners less prosperous than RI does, based on LPV<sup>29</sup>. Additional negative media coverage was based on RI's complicated network construction of more than 100 direct and indirect holdings and its non disclosure of non-controlling stakes. One question, which was frequently discussed in the investor community, was: *'Is RI able to realize the value of its individual companies?'* Given RI's newly established majority shareholding driven investment approach, Kinnevik and RI frequently competed against each other in terms of growth investment ideas, resulting in a conflict of interests. Doubts regarding RI's ability to turn its proven winners into profitable companies started to spread across the markets. May 2016 marked the beginning of RI's share price sell off: Kinnevik left RI's supervisory board and shortly after it sold its 13% stake in RI for €426<sup>30</sup>. Kinnevik's interim head Joakim Andersson pointed out, that *'Our business models have become too similar. Rocket isn't just building up young companies any more, it's also investing in larger companies. We're doing the same thing'*. During 2009 and 2013, the Swedish investment company invested €155 million and received €510 million in cash and dividends (pre-IPO), and divested its entire stake in RI for an accumulated €426 million<sup>31</sup>. This amounts to an IRR of >90% and 6.0x MM – which can be seen as a very profitable investment, even for the successful Swedish investment company. As good as it was for Kinnevik, it was as bad for RI: The sale of Kinnevik's shareholdings on

7<sup>th</sup> June 2017 led to another significant plunge in RI's share price to €20.98 (-51% since IPO)<sup>32</sup>.

## Quo Vadis Rocket Internet?

Since RI's IPO in 2014, RI invested ca. €1.7 billion, which seems rather low in the light of RI's many portfolio companies and leads to RI's increasing cash pile (€2.4 billion as of 30 June 2017). However, taken RI's large cash pile together with its plunged share price since IPO (see [Graphic 4](#)), criticism from RI's shareholders has been increasing steadily. The shareholders started to disagree with RI's constrained payout policy, which neither pays out regular or special dividends nor share buybacks. The media picked up this sentiment and questioned the prospects and profitability of RI's business model. At the end of September 2016, RI reported the H1 2016 figures, stating a loss of €617 million (H1 2015: €45.9 million), which primarily was triggered by Global Fashion Group's (one of RI's proven winners) valuation slash from €3.1 billion to €1.0 billion due to a down-round<sup>33</sup>. RI's management board played down these figures by emphasizing that the increased loss would reflect one-time write offs and deconsolidation activities, while the companies would be on track operationally. However, most analysts from investment banks linked the write downs to RI's non-transparent valuation methodology of its network companies, concluding that the profitability path of these companies was far off, resulting in further plunges of RI's share price (see [Graphic 4](#)).

*Graphic 4: RI's share price development since IPO*



At this moment, about one-third of Rocket's free float is out on loan to investors betting against the company and short interest remained high throughout the year<sup>34</sup>. Undoubtedly, RI's proven winners show significant potential for value crystallization, however only two of them were realistic IPO candidates in 2017, both of which are highly dependent on how favorable the IPO market window might be. Additional concerns come from the significantly decreased company-building activity in 2017 and the rather thin pipeline for 2018. Investors frequently raise one question: *'Where are the new ideas coming from?'*

### **Is the Current Business Model outdated?**

The increasingly negative perception of RI pointed out that RI did a poor job in explaining its business model to investors. A former RI executive takes the same line: *‘It’s just incredibly hard for investors to judge a group with such a diverse portfolio of early-stage companies’*. Most commonly this results in a so called ‘illegitimacy discount’<sup>35</sup>. This phenomenon describes that companies, which span multiple business and industry segments are traded at a discount due to reduced audience attention. If the Samwer brothers want to achieve a clearance, they would have to better communicate with the investor community. Pitched as an *‘operating platform’* at the IPO in October 2014, RI is developing into a listed venture capital fund. However, the consequence of this development is that RI is only able to generate profits when investments in proven winners are exited by selling them to strategic sellers or by publicly floating them. In this respect, the sale of companies to strategic sellers tends to be the alternative to maximizing the companies’ values, as strategic sellers are usually able to afford higher premia. By holding the assets longer as financial investors, strategic investors are able to bundle new assets with existing ones and can realize respective synergies from combining them. That being said, RI’s investments need several years for their path on value crystallization (e.g. selling companies to strategic sellers or publicly floating them), which is not easy to communicate at the stock exchange’s short-term profitability pressure and myopic view on companies’ development. Only a minority of public shareholders have the patience to wait several years for gaining value. Therefore, it is no surprise that there is a discrepancy between RI’s share price (market capitalization) and its net asset value. Like many publicly traded investment or private equity funds, RI also trades at a discount of 39% (Q2 2017), compared to its net asset value of €4.3 billion.

### ***Commitment to The Public Markets or Back to Earth***

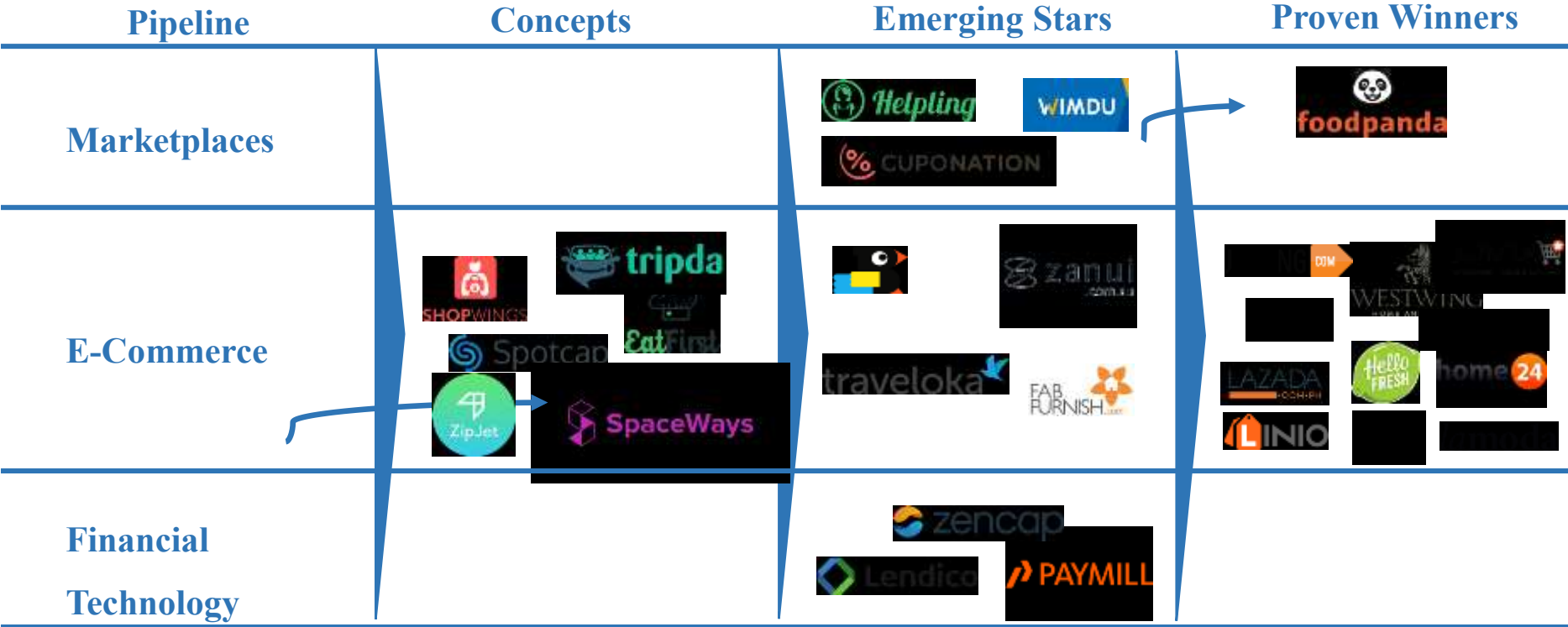
Since its foundation in 2007 until 2015, RI achieved great success based on its *Rocket Recipe*. RI in form of its proven winners achieved astonishing growth, while becoming formidable E-commerce competitors in their respective markets. However, particularly the years from 2015 onwards have illustrated that it cannot be expected to consistently maintain this rapid growth rate for a long period of time, considering macroeconomic developments, increasing competition in Emerging Markets and the experience of E-commerce development in China, US and Europe. It’s still too early to predict whether RI can gain a dominant position in their respective markets over the long term.



However, one thing is sure – RI’s situation cannot continue for much longer. Oliver Samwer has a decision to make and several options are on the table. On the one hand, Oliver Samwer could delist RI. On the other hand, RI could use its large cash pile to pay dividends and/or buy back shares to reward impatient investors, especially bearing in mind that an IPO of Delivery Hero and Hello Fresh might be far off after the failed IPOs of their peers. The question remains whether RI needs to better align its business model with shareholders’ interest to be successful in future?













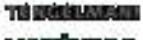




















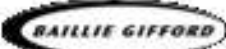


# Exhibits

Exhibit 1 RI's investment stages



Source: Rocket Internet Company Information

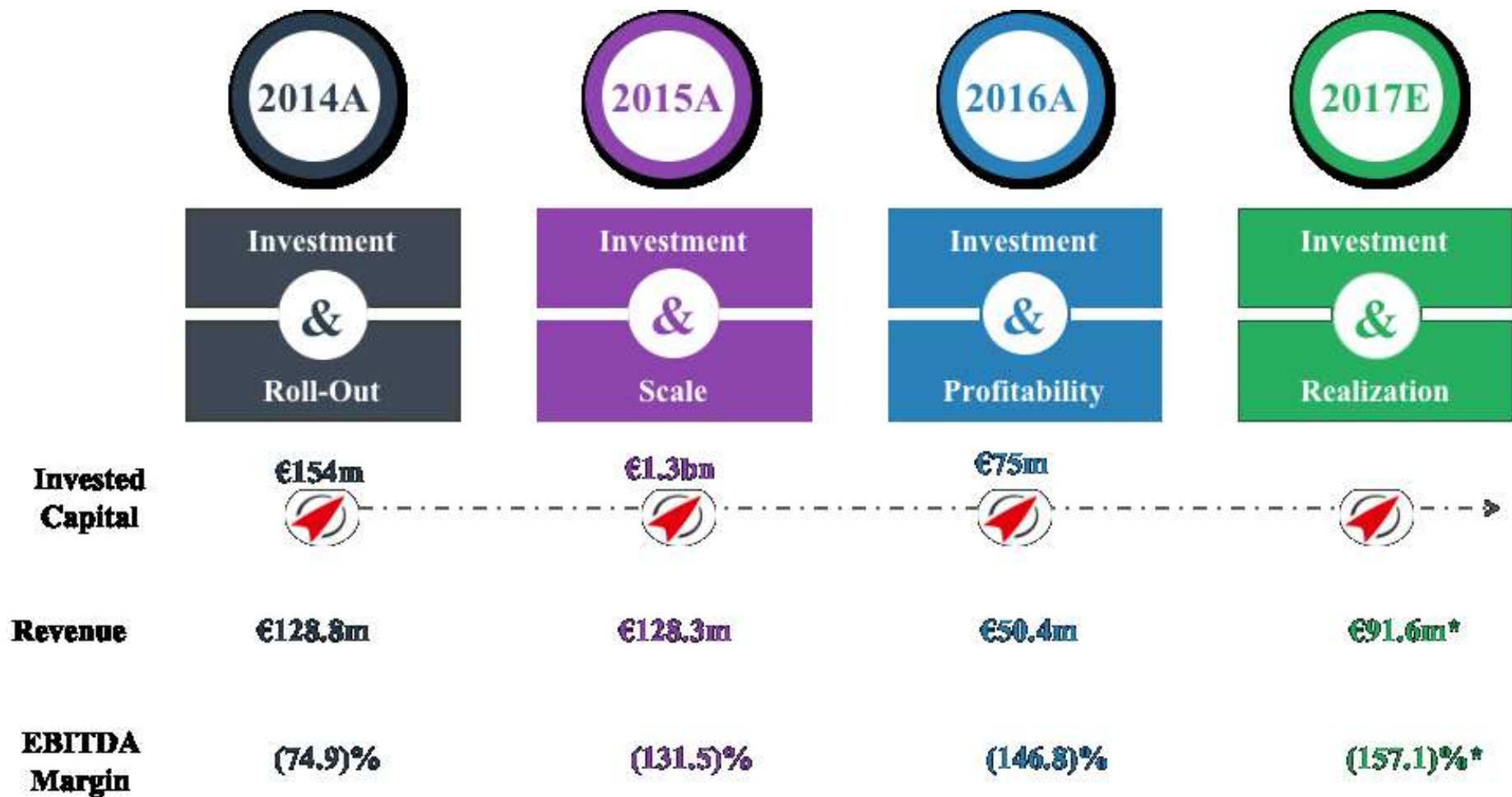
Exhibit 2 RI's proven winners in 2014

| Company   | Sector              | Business Model            | Region            | Investors  |
|---|---------------------|---------------------------|-------------------|--|
|    | Fashion             | E-Commerce                | Latin America     | J.P.Morgan  KINNEVIK  |
|    | Fashion             | E-Commerce                | Central East Asia | J.P.Morgan    |
|    | Fashion             | E-Commerce                | India             |  HVC  KINNEVIK   |
|    | Fashion             | E-Commerce                | Middle East       | J.P.Morgan  KINNEVIK  |
|    | Fashion             | E-Commerce                | South East Asia   |  SUMMIT PARTNERS  TVC  ventures       |
|    | Fashion             | E-Commerce                | Latin America     | J.P.Morgan  TVC  ventures  |
|    | General Merchandise | E-Commerce / Marketplaces | Africa            |  AWA  Goldman Sachs  |
|    | General Merchandise | E-Commerce / Marketplaces | South East Asia   |  Alibaba.com  KINNEVIK   |
|  | Home & Living       | E-Commerce                | Europe            |  BAILLIE GIFFORD  HVC  KINNEVIK |
|  | Home & Living       | E-Commerce                | Europe            |  Fidelity  KINNEVIK  |
|  | Food & Groceries    | Marketplaces              | Global            |  Goldman Sachs  NASPERS  |
|  | Food & Groceries    | E-Commerce                | Global            |  BAILLIE GIFFORD  HVC  KINNEVIK |

Source: Reuters Eikon Terminal, Rocket Internet Company Information and TechCrunch



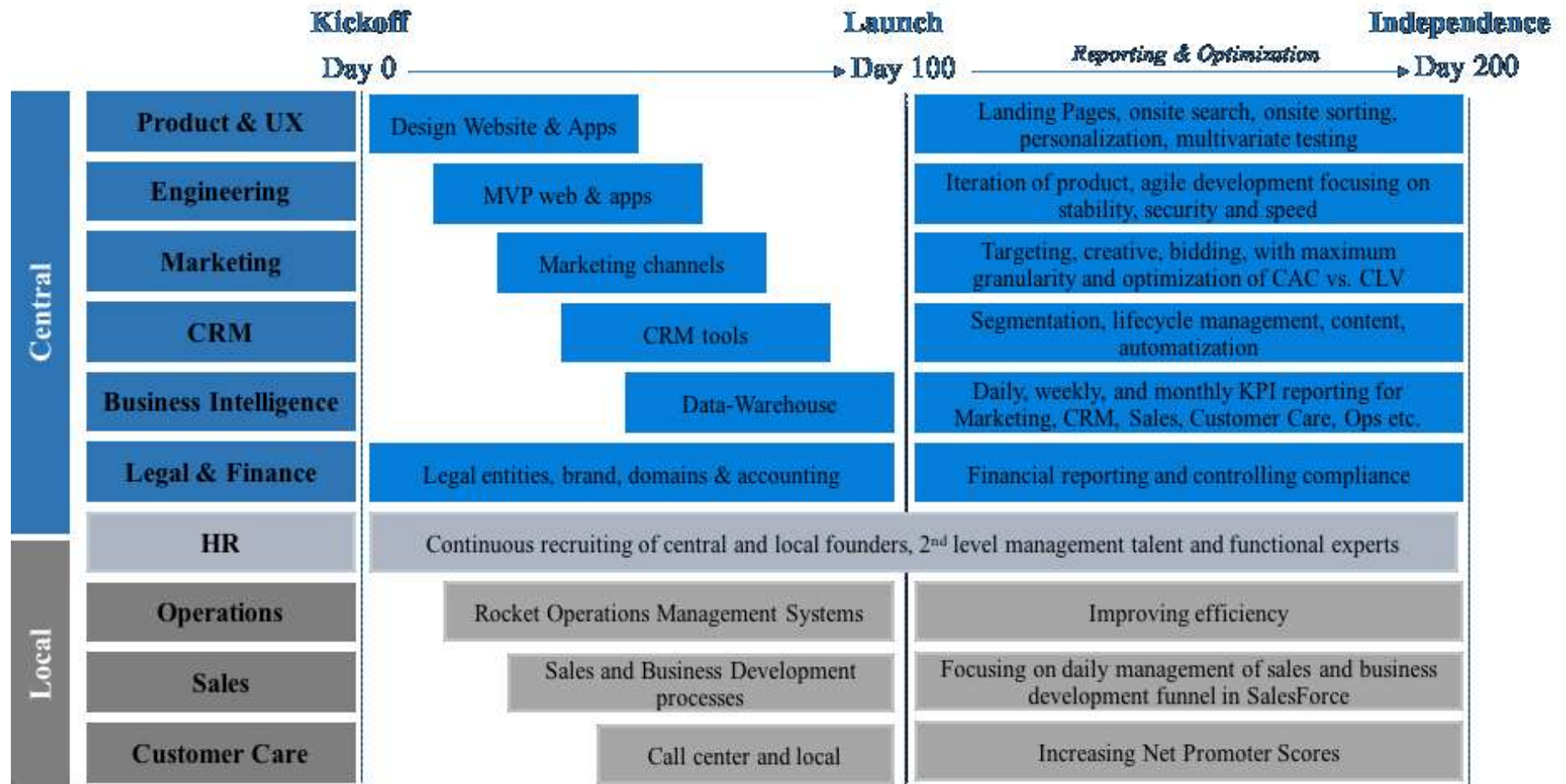
Exhibit 3 RI's strategy evolution over time



\* Thomson Reuters Consensus Estimate





Source: Rocket Internet Company Information

Exhibit 4 First 200 days within RI's company-building process







Source: Rocket Internet Company Information

Exhibit 5 Hello Fresh vs. Blue Apron

| (EUR millions)                  | Q2 2017   |   |   | Q1 2017   |   |   | 2016  |   |   |
|---------------------------------|---|---|---|---|---|---|---|---|---|
|                                 |  |  |  |  |  |  |  |  |  |
| <b>Revenue</b>                  | 216.2   | 230.1   | 106%  | 229.8   | 205.3   | 89%   | 718.6   | 596.7   | 83%   |
| <b>COGS</b>                     | -148.5  | -179.3  |   | -158.2  | -164  |   | -481.2  | -495.8  |   |
| <b>Gross Profit</b>             | 67.7  | 50.8  |   | 71.6  | 41.3  |   | 237.2   | 100.9   |   |
| <b>Margin</b>                   | 31.30%  | 22.10%  |   | 31.20%  | 20.10%  |   | 33%   | 16.90%  |   |
| <b>Marketing</b>                | -31.1   | -58.5   | 188%  | -56.9   | -64.6   | 114%  | -130.2  | -157.4  | 121%  |
| <b>Marketing (% of revenue)</b> | 14.50%  | 25.40%  |   | 24.80%  | 31.5%   |   | 18.10%  | 26.40%  |   |
| <b>EBITDA</b>                   | -21.7   | -16.9   | 78%   | -44.6   | -30.8   | 69%   | -42.1   | -86.2   | 205%  |
| <b>Margin</b>                   | -10%  | -7.30%  |   | (-19.4%)  | -15.00%   |   | -5.90%  | -14.40%   |   |
| <b>Active Subscribers</b>       | 943   | 1253  | 133%  | 1036  | 1160.2  | 112%  | 879   | 857.1   | 98%   |
| <b>Revenue/active users</b>     | 874   | 762.8   | 87%   | 960.1   | 814.2   | 85%   | 1098.8  | 807.4   | 73%   |

Source: Barclays Equity Research Report (July 24, 2017), Blue Apron Company Information and Hello Fresh Company Information





Exhibit 6 Delivery Hero vs. Peers (Grubhub, JustEat, Takeaway.com)

| KPIs                              | Industry Median |  |         |        |  |       |       |  |        |        |  |        |        |
|-----------------------------------|-----------------|---|---------|--------|---|-------|-------|---|--------|--------|---|--------|--------|
|                                   |                 | 2014  | 2015    | 2016   | 2014  | 2015  | 2016  | 2014  | 2015   | 2016   | 2014  | 2015   | 2016   |
| <i>(EUR millions)*</i>            |                 |   |         |        |   |       |       |   |        |        |   |        |        |
| Sales                             | -               | 88.0  | 166.2   | 297.0  | 209.8   | 333.2 | 470.5 | 157.0   | 247.6  | 375.7  | 46.7  | 76.7   | 111.6  |
| Growth                            | -               | -   | 88.9%   | 78.7%  | -   | 58.8% | 41.2% | -   | 57.7%  | 51.7%  | -   | 64.2%  | 45.5%  |
| Marketing Expense<br>(% of Sales) | -               | -   | 120.6%  | 74.9%  | 26.1%   | 25.2% | 22.4% | n.a.  | 35.0%  | 28.4%  | 53.3%   | 76.9%  | 74.0%  |
| EBITDA Margin                     | 34.1%           | -81.3%  | -92.9%  | -35.8% | 29.9%   | 25.8% | 24.5% | 18.0%   | 23.8%  | 29.8%  | -6.4%   | -18.5% | -19.8% |
| Operating Margin                  | 24.7%           | -92.4%  | -123.0% | -56.2% | 0.18  | 17.1% | 17.0% | 12.1%   | 15.5%  | 24.3%  | -13.6%  | -24.4% | -24.4% |
| <b>Earnings Power</b>             |                 |   |         |        |   |       |       |   |        |        |   |        |        |
| ROIC                              | -               | -33.9%  | -29.3%  | -14.6% | 3.2%  | 4.1%  | 4.8%  | 41.0%   | 5.4%   | 9.2%   | -18.0%  | -30.6% | -24.8% |
| ROE                               | 8.8%            | -55.7%  | -45.4%  | -22.0% | 3.6%  | 4.6%  | 5.4%  | 44.0%   | 5.7%   | 9.9%   | -19.2%  | -33.1% | -26.0% |
| <b>Liquidity</b>                  |                 |   |         |        |   |       |       |   |        |        |   |        |        |
| Current Ratio                     | 1.08            | 0.75  | 1.07    | 1.25   | 3.17  | 3.98  | 3.59  | 2.70  | 1.87   | 1.05   | 1.23  | 0.44   | 3.40   |
| Cash Cycle (Days)                 | 40.0            | -723.9  | -844.0  | -418.8 | 47.2  | 39.5  | 38.1  | -578.7  | -634.2 | -527.1 | -586.3  | -542.7 | -391.0 |
| <b>Leverage</b>                   |                 |   |         |        |   |       |       |   |        |        |   |        |        |
| Assets/Equity                     | 1.62            | 1.92  | 1.80    | 1.81   | 1.27  | 1.21  | 1.23  | 1.44  | 1.22   | 1.28   | 1.28  | 1.59   | 1.26   |

\* For Grubhub USD/EUR conversion was calculated with FX-rates as of 31-December: (2014: 1.2101, 2015: 1.0858, 2016: 1.04844), for Just Eat GBP/EUR conversion was calculated with FX-rates as of 31-December: (2014: 0.7763, 2015: 0.7377; 2016: 0.8553)

*Source: Company Investor Relations, Reuters Eikon Terminal*



Exhibit 7 Delivery Hero vs. Peers (Grubhub, JustEat, Takeaway.com) cont'd

| Peers<br>(as of 2017-06-30)   | Market Capitalization<br>(\$m) | Sales LTM<br>(\$m) | Price /<br>Sales LTM |
|---|--------------------------------|--------------------|----------------------|
|  | ?                              | 383.5              | --                   |
|  | 5,689.2                        | 480.1              | 11.85x               |
|  | 1,736.2                        | 120.4              | 14.42x               |
|  | 3,760.4                        | 537.2              | 7.00x                |
| <b>Peer Mean</b>  | <b>3,758.5</b>                 | <b>480.1</b>       | <b>11.85x</b>        |

**Example:** Calculating Just Eat’s Market Capitalization = Sales LTM \* Price/Sales LTM = 480.1\* 11.85 = 5,689.2

Source: Company Investor Relations, Reuters Eikon Terminal

Exhibit 8 Delivery Hero and Hello Fresh – good IPO candidates?

|              | Characteristics   |  |  |
|--------------|---|---|---|
| Quantitative | <b>Upside potential / Revenue:</b> <ul style="list-style-type: none"> <li>▪ Rule of Thumb: Revenue &gt; €100m; and</li> <li>▪ Strong prospects for future revenue growth.</li> </ul>                            | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> </ul>                  | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> </ul>                  |
|              | <b>Outperforming peers:</b> <ul style="list-style-type: none"> <li>▪ Debt/Equity, ROE, Marketing expenses</li> <li>▪ EBITDA margin.</li> </ul>  | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> </ul>                  | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> </ul>                  |
| Qualitative  | <b>Compelling equity story:</b> <ul style="list-style-type: none"> <li>▪ Management credibility and experience;</li> <li>▪ Quality of strategy &amp; execution; and</li> <li>▪ Brand strength.</li> </ul>       | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> <li>▪ ?</li> </ul>     | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> <li>▪ ?</li> </ul>     |
|              | <b>Understandable business model:</b> <ul style="list-style-type: none"> <li>▪ Recurring revenue business;</li> <li>▪ Operational effectiveness; and</li> <li>▪ Low and declining customer churning.</li> </ul> | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> <li>▪ ?</li> </ul>     | <ul style="list-style-type: none"> <li>▪ ?</li> <li>▪ ?</li> <li>▪ ?</li> </ul>     |

Source: Own illustration based on Delivery Hero Company Information and Hello Fresh Company Information

## **#1 Interview with Fabian Zilker, Corporate Finance Manager, Rocket Internet**

### **Q1: How does Rocket Internet create customer value? Please give an example of a Rocket Internet company.**

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**FZ:** Rocket Internet creates customer value by optimizing operations and technology of a portfolio company. I have to admit that sounds quite abstract – lets take an example, that most people are probably familiar with: Zalando. If you would have ordered, lets say a t-shirt, at the very first month on the online store – it took quite some time as you received your parcel at home with the t-shirt in it. Rocket Internet has tremendously helped here by both providing funds, but also the know-how and experience how to implement quick wins, the customer recognizes and appreciates. So when you would have done the same exercise again few months later – you would have received the parcel with the t-shirt some hours earlier with a discount for further purchases on top.

### **Q2: Please describe Rocket Internet's strategy and its business model?**

---

**FZ:** I personally would outline it as the following: Rocket Internet's strategy is to back companies in the early and growth stage to achieve the next stage in the lifecycle as efficient and as fast as possible. By providing sector expertise, funding, knowledge and IT-infrastructure, it is the perfect Strategic Partner a young company needs to outperform its peers. So its about both: Building the companies from scratch, what is referred to as Incubation, and Investing in already existing companies. In both approaches there is a replicable process in place, which ensures a standardized flow of actions in a minimum amount of time. – as time is essential in today's fast paced business environment. In short, we give our companies a head start, which increases the companies' likelihood to succeed in the long-term.

### **Q3: Please describe the development of Rocket Internet's business model and the consequence of Rocket Internet's IPO in October 2014.**

---

**FZ:** I think Rocket Internet's business model evolved over time and gets quickly adapted to meet new challenges. First, it basically was all about Incubation. Later, the frequency and amount of investments increased steadily over time, culminated in the 30% stake acquisition of Delivery Hero.

So right now, we are at a point, at which the company has a less stringent business model: It frequently invests its cash in early stage and growth companies, but also incubates companies – but more selectively as at the beginning. To put it differently, after becoming a public company we can say Rocket Internet has become an adult.

**Q4: From a financial perspective, which key performance indicators would you take and why in order to measure a superior business model in the internet industry? Please elaborate on the evaluation process and the dependencies of the KPIs.**

---

**FZ:** I think in this industry three components are key: Growth, growth and growth. In the internet industry its all about growth: Your last active customer figure, your processed orders, your customer lifetime value and your sales, all together have to consistently grow. Of course, you have to control costs as well, but this comes later. Once you have achieved a threshold of size, which is usually measured in sales, then its time to talk about profitability and your progress of improving. EBITDA margins and cash-burn ratios that you are able to transform these growth companies in profitable as well. So, of course, you only should compare companies in the same lifecycle.

**Q5: When financially assessing Rocket Internet, which KPIs does Rocket Internet use and what would you conclude for Rocket Internet?**

---

**FZ:** Well, when we talk about Rocket Internet, we actually talk about its portfolio companies. As most of the companies stem from the Tech Space – it makes sense to use industry specific KPIs such as Last Active Customer, Customer Acquisition Cost, Customer Lifetime Value, Total orders next to traditional KPIs such as sales growth, EBITDA Margin, Marketing expenses and cash-burn rate.

**Q6: What do you understand under Shareholder Value? How do you think does Rocket Internet create Shareholder Value?**

---

**FZ:** For me personally Shareholder Value means that shareholders participate in a company's success via the share price, share buybacks, etc. In case of Rocket Internet, I can definitely see that – however we don't have to forget that Rocket Internet is listed since 2014 and therefore needs still time to reach the ideal state of maximizing shareholder value.

**Q7: ‘Rocket Internet has been increasing its cash surplus steadily - resulting from ongoing successful exits which exceed new investment funding. Based on Rocket Internet’s strategic and financial positioning, does Rocket Internet have a superior business model?’**

---

**FZ:** You mentioned the successful exits – for me that is proof that Rocket Internet obviously has a superior business model. I have to honestly admit that from my point of view Rocket Internet does not have one major competitor, much more Rocket Internet with different players: Large technology companies, Venture Capital Funds and Private Equity firms. But I think, this is exactly the strength of the business model: It’s flexible and easily adaptable, so from my understanding also very resilient, as the business model can quite fast adapt to changing environments.

**Q8: Where do you see Rocket Internet in five years? What are the key challenges? What are areas of improvement?’**

---

**FZ:** Obviously a lot depends on future large projects if they pay off and are able to generate regular earnings and will be reflected in a higher share price. So, as I said before, Rocket Internet accumulates experience and knowledge continuously. Therefore, I expect the company to even better adapt to new challenges in the future. However, given the complexity of today’s world – in particular the dynamic environment of technology – it is almost impossible to answer this question.

## **#2 Interview with Kaan Oglou, Business Development Manager, Rocket Internet**

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***Q1: How does Rocket Internet create customer value? Please give an example of a Rocket Internet company.***

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**KO:** When Rocket Internet backs a company by giving advice or providing cash, you can be sure that the companies will significantly improve in areas, which matter to the customers. For instance, when we talk about the huge segment of E-commerce. Its all about customer friendliness – how can I get from selecting the item I want to buy as fast and as easy as possible to the final payment action. An example out of many would be Jumia.

***Q2: Please describe Rocket Internet's strategy and its business model?***

---

**KO:** Its basically the answer of the previous question in a high level perspective. So what do I mean with that? As the example of Jumia, Rocket Internet provides young technology based companies with everything they need – IT, Experience, Network and Financing – to make incredibly fast progress. Just look at Zalando, Delivery Hero or Hello Fresh. By exactly knowing what to do, this happens very efficient. In case everything goes well, Rocket Internet usually sells the companies to larger competitors or takes the company public. Both to realize returns and to de-risk its balance sheet.

***Q3: Please describe the development of Rocket Internet's business model and the consequence of Rocket Internet's IPO in October 2014.***

---

**KO:** I think at the beginning in 2014, Rocket Internet's business model was much more focused on the actual company-building aspect. Over time, I think it is fair to say, that this focus shifted more to investments. Nowadays, Rocket Internet also has the fire power to do large investments. So, I would definitely say that the company has become more flexible from a business model point of view.

***Q4: From a financial perspective, which key performance indicators would you take and why in order to measure a superior business model in the internet industry? Please elaborate on the evaluation process and the dependencies of the KPIs.***

---

**KO:** When we look at the largest Tech companies worldwide: Amazon, Facebook etc.. One thing has become quite clear – it is a long and rocky road to glory. Usually it takes you at least six to nine years to become profitable. But to reach this point, you have to consistently show large growth rates year by year for achieving a critical mass making sure that you have established a solid customer base, superior business model and also great growth potential. In detail, I would look at the very beginning on revenue growth (5-year CAGR: > 30%), increase in orders, active customer, Gross Merchandise Value, which is basically what the customer puts in his virtual basket, and cash-burn ratio. After achieving the critical mass, profitability has to be improved fast e.g. EBITDA Margin, Reduction in Customer Acquisition Cost etc.

**Q5: When financially assessing Rocket Internet, which KPIs does Rocket Internet use and what would you conclude for Rocket Internet?**

---

**KO:** Basically I think every KPI mentioned before should occur. Obviously the proven winners have a large impact on assessing Rocket Internet. Rocket Internet, but these companies are also in different stages in their lifetime cycle so its hard to generalize it. There are portfolio companies that are well on track, while others need more time than expected to grow into market leading positions etc. But all together, I think Rocket Internet is well on track.

**Q6: What do you understand under Shareholder Value? How do you think does Rocket Internet create Shareholder Value?**

---

**KO:** Do I participate in the company's success? Related to Rocket Internet, considering the share price, I would say that there is room for improvement. However, I think the differences to other businesses lie that earnings are not easy to plan and thus not easy to realize. Investors usually do not like any surprises, so a lot depends on your investment horizon, if you want to invest in the mid-term and short-term, from my point of view, it will surely pay off.

**Q7: 'Rocket Internet has been increasing its cash surplus steadily - resulting from ongoing successful exits which exceed new investment funding. Based on Rocket Internet's strategic and financial positioning, does Rocket Internet have a superior business model?'**

---

**KO:** From my understanding, I can answer this question with a yes. Considering the fast and rapid success of Rocket Internet, the company is only ten years old, from transforming of a technology start-up to a multi billion company, this has to be based on a superior business model. I think,

from a strategic point of view, the flexibility of the business model to either invest in companies or to build them from scratch with Rocket Internet's unique experience and know how, is certainly the largest reason for the superior model. This gets complemented by also being able to monetize this superior business model into superior returns – just look at Lazada, Zalando and much more.

**Q8: Where do you see Rocket Internet in five years? What are the key challenges? What are areas of improvement?**

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**KO:** In the following five years Rocket Internet, again has to find the next disruptive powers that will change our environment e.g. blockchain or something completely different. If Rocket Internet manages to do so, particularly with its unique expertise and capabilities, the company can be one of the winner in five years. The area of improvement lies in the share price, but this will improve by itself, when the company is able to show consistent profitability improvement over time.

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24 LPVs are calculated based on the amount invested and price paid by a third party, divided by the stake acquired by such third party, and represent post-money, post-capital commitment valuations. However, LPV valuations do not reflect liquidation preferences

25 E.g. Hello Fresh: RI's shareholding increased from 37.1% to 57.2% in September 2015

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28 RI has 28% economic exposure through its direct investment (20% in the company with RI and 10% of the remaining 80% in the company) in a funding round. Furthermore, RI will also receive a carried interest of >20%, which is RICP's hurdle rate, on top of the economic upside of its investments

29 As of 31 December 2015, RI vs. Kinnevik valued GFG (€3.1bn vs. €1.7bn), Lazada (€1.0 bn vs. €0.63bn), Home24 (€0.94bn vs. €0.51bn), Westwing (€0.48bn vs. €0.25bn) and Linio (€0.42bn vs. €0.18bn) (please see footnote 41)

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# Rocket Internet Case Study

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Quo Vadis Rocket Internet?



Source: Sueddeutsche Zeitung 2017

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**Teaching Note** (2,828 words, excluding Appendix)

Strategic Management & Corporate Finance

## Rocket Internet Case Study I **Teaching Not**

*‘We are builders of companies, we are not innovators’* (Oliver Samwer). Referring to RI’s activity of developing companies, Oliver Samwer’s expression of ‘company-building’ is used. Pitched as an operating platform for investments and company-building projects at its IPO in 2014, Rocket Internet (RI) grew to one of Europe’s largest technology companies. After a time of continued positive momentum, headwinds arose. Large shareholder Kinnevik sold its stakes in RI in 2016, fueling investors’ uncertainty of RI’s business model. After RI’s significant share price plunge, investors question whether RI is able to generate profits and to establish a viable business model.

### **Position in Course**

This case is intended for use on evaluating business models’ implications on company performance and the business models’ perception by its shareholders. It highlights that operating a business model is an ongoing process of redefining and reshaping. The case also provides insights into a public company’s need to establish a clear business model, which results in regularly generated earnings, and the need to properly communicate this business model to shareholders. Students are envisaged to connect and apply both strategic management and corporate finance disciplines, and to further sharpen their understanding of strategic decision making in respect to business models, and its impact on a company’s financial performance.

### **Teaching Approach**

The length of the class should be 1 hour and 30 minutes. The first hour is devoted to case conversation, whereas the last 30 minutes are to Q&A. Students will give considerable attention to the financial information provided in the exhibits in addition to the strategic issues raised.

### **Structure of Teaching Note**

- I. Introduction of RI’s business model
  - **Question 1:** Key characteristics;
  - **Question 2:** Development over time; and
  - **Question 3:** Company Building and Investments.
- II. Financial assessment of the Value crystallization of RI’s business model
  - **Question 4:** Value crystallization;
  - **Question 5a:** Value crystallization of best practice examples; and
  - **Question 5b:** Impact of value crystallization.
  - **Question 5c:** Evaluation from investors’ point of view
- III. Strategic and financial evaluation of RI’s business model (Question 6)
- IV. Outlook and potential adaptations of RI’s business model (Question 7)

**Question 1: Key characteristics of RI's business model**

In which competitive environment does RI operate? What is the foundation of RI's superior business model?



**Working Time: 15 minutes**

Students recap the strengths of RI's business model and consider Case Study: p. 8ff. and Figure 3.

In general, students may find it hard to determine a single competitive environment because of RI's unique business model, which comprises a **large amount** of Technology related **investments and company-building projects**. *'However, unlike e-commerce platforms such as Alibaba or Amazon, RI represents a portfolio of investments.'* (Case Study, p. 1). Thus, RI's competitive environment is determined by each portfolio company's environment, which can be identified based on two options: compare the portfolio company **to the original company** (e.g. Zalando vs. Zappos) **or to its competitors** (Hello Fresh vs. Blue Apron). Referring to RI's superior business model, the Rocket Recipe breaks down the single steps (Case Study, p. 8 following pages (ff.)).

**RI's superior business model is based on the following key success factors (Table 2):**

- **Selecting attractive investment opportunities:** Marketplaces, E-Commerce and FinTech;
- **Minimizing investment risk** by copying already proven business models;
- **Business model adaptation by deep localization:** Companies' core functions such as logistics, HR, Finance are sourced locally for optimizing Customer Lifetime Value (CLV) and Customer Acquisition Cost (CAC);
- **Centralized hub** of company-building and technology knowledge;
- **Execution speed** for implementing business models leads to **first mover advantages**, establishing entry barriers, brand building, and economies of scale and scope.
- Samwer brothers' **entrepreneurial experience**, established Tech network and **successful track record** of more than 250 investments;
- **High cash balance:** Complementary M&A activities feasible; and
- **Flexibility of business model:** RI is able to invest in attractive investment opportunities ranging from small (< €100m) to big-tickets (> €1,000m).

**Conclusion:**

RI established a unique business model as an operating platform company, comprising company-building and investment activities. As a consequence, RI's competitive environment is determined by each portfolio company's environment in terms of the original company and competitors. Using RI's IT-infrastructure, centralized entrepreneurial knowledge and experience, RI's portfolio companies are able to grow much faster and efficiently than traditional businesses do.



**Question 3: Company building and investments as part of RI's business model**

The case study introduces the unicorns: Delivery Hero, Hello Fresh and Zalando. Which parallels and differences exist between their development in terms of rocket recipe, milestones, target market, positioning, and value crystallization?

?

**Working Time: 15 minutes**

This question highlights the two different approaches of RI's business model: Company building and investing. Students should understand that both approaches are applied to all portfolio companies with a common goal, that is, to rapidly scale companies into market leading positions. Students should pay special attention to Case Study: p. 6, 11ff.

Delivery Hero, Hello Fresh and Zalando are unicorns and ranked in RI's proven winners segment, which relies on **copying and adapting the already proven business model**. All three companies experienced a history of high growth and **rapid scaling of their operations**. Although, the three unicorns went through RI's Rocket Recipe, they either did so through the **company-building or the investment process**. Further differences occur from the business models, geographical scope, scope of expansion, and duration of break-even, as detailed below.

**Parallels:**

- **Rocket Recipe:** Focus on strong revenue growth;
- **Milestones:** From market leaders to technology unicorns; and
- **Value crystallization:** Most likely by IPO.

**Differences:**

- **Rocket Recipe:** Company Building (Rocket Recipe Ingredient #1 to #7: e.g. Hello Fresh and Zalando) vs. Investment (Rocket Recipe Ingredient #3 to #7: e.g. Delivery Hero);
- **Segment:** Marketplaces (Delivery Hero and Hello Fresh) vs. E-Commerce (Zalando);
- **Timing of break-even:** Marketplaces (5 - 7 years) vs. E-Commerce (6 - 9 years);
- **Positioning:**
  - Delivery Hero being market leader in 35 out of 40 markets;
  - Hello Fresh being market leader in seven out of nine markets; and
  - Zalando being Europe's largest online fashion retailer.

**Conclusion:**

Comparing the three unicorns, the Rocket Recipe generates parallels and differences at the same time, emphasizing the flexibility and uniqueness of the business model. The reason lies in the Rocket Recipe's two-way approach of company-building and investments.

**Question 4: Value crystallization of RI's business model**

Discuss 3 general (dis)advantages of an IPO and RI's strategic rationale for a unicorn's IPO.



**Working Time: 15 minutes**

Students should start to develop an understanding of IPOs in general and connect these ideas to RI. For RI, IPOs are of utmost importance for continuing its business model, as they are the means to both crystallize value and re-invest the IPO proceeds in existing or future projects. Students should pay special attention to Case Study: p. 6 following page (f.), 11ff.

In general, an IPO **transforms a private company into a public company**. In the following, the most common advantages and disadvantages of an IPO are presented.

**IPO advantages:**

1. **Greater access to funds;**
2. **Higher valuation** and liquidity: Illiquidity discount for private companies is eliminated;
3. **Liquid currency** for acquisitions: Facilitation of future acquisitions;
4. **Exit strategy:** Liquidity for investors, owners and shareholders; and
5. Enhances company's **prestige, brand image**, public profile and credibility.

**IPO disadvantages:**

1. **High costs:** Investment banks, lawyers and accountants have to be paid;
2. **Potential loss of control and privacy:** Need to reveal highly sensitive information in public reports;
3. **'IPO Underpricing':** At closing of first trading day, public companies tend to have positive returns, leading to the assumption that *'money was left on the table'*;
4. **Limited window of opportunity** to access IPO markets; and
5. **Shareholders' earnings expectations can create pressure** on management.

RI's **strategic rationale** of the IPO, is to *'finance its future growth through the launch of new businesses and provide further equity capital to its network of companies'* (Case Study, p. 7).

**Conclusion:**

With an IPO, private companies get greater access to funds and liquidity, which translates into more operational and financial flexibility, but also more regulation, reporting and pressure for generating shareholder value. For RI, IPOs of unicorns are a means of value crystallization, in order to use the generated cash flows to fund new company-buildings, new investments or dividends and share buybacks.

**Question 5a: Value crystallization of best practice examples of RI’s business model**



Currently, Delivery Hero and Hello Fresh are unprofitable, but deliver strong sales growth. Do you think these companies are reasonable IPO candidates? Please evaluate them from a qualitative and quantitative point of view.



**Working Time 25 minutes**

Students should understand, what shareholders appreciate most when assessing public companies, and are supposed to build their answers on the successful IPOs of RI and Zalando, and the failed IPO of Hello Fresh. Potential pitfalls may arise from considering profitability ratios only. Students should pay special attention to Case Study: p. 8f., 15 and Exhibit 6, 7, 9.

There is no simple formula to follow when deciding which company makes a good IPO candidate. However, investors want to invest their money into businesses that can really scale up and deliver outsized returns. Analyzing quantitative and qualitative characteristics (Case Study, p. 6), Delivery Hero and Hello Fresh are evaluated whether they are reasonable IPO candidates:

| Characteristics |   |   |    |
|-----------------|---|---|--|
| Quantitative    | <b>Upside potential / Revenue:</b> <ul style="list-style-type: none"> <li>▪ Rule of Thumb: Revenue &gt; €100m; and</li> <li>▪ Strong prospects for future revenue growth.</li> </ul>                            | <b>Good</b> <ul style="list-style-type: none"> <li>▪ €297m (2016) ✓</li> <li>▪ CAGR<sup>2015</sup><sub>2012</sub> : 146%</li> </ul>   | <b>Excellent</b> <ul style="list-style-type: none"> <li>▪ €597m (2016) ✓</li> <li>▪ CAGR<sup>2015</sup><sub>2012</sub> : 410%</li> </ul> |
|                 | <b>Outperforming peers:</b> <ul style="list-style-type: none"> <li>▪ Debt/Equity, ROE, Marketing expenses</li> <li>▪ EBITDA margin.</li> </ul>  | <b>Good</b> <ul style="list-style-type: none"> <li>▪ Highest growth rates in EBITDA margin and revenue ✓</li> </ul>                   | <b>Good</b> <ul style="list-style-type: none"> <li>▪ EBITDA margin Q2 2017: -7.3% vs 10.1% (BA) ✓</li> </ul>                             |
| Qualitative     | <b>Compelling equity story:</b> <ul style="list-style-type: none"> <li>▪ Management credibility and experience;</li> <li>▪ Quality of strategy &amp; execution; and</li> <li>▪ Brand strength.</li> </ul>       | <b>Excellent</b> <ul style="list-style-type: none"> <li>▪ Very good ✓</li> <li>▪ Very good ✓</li> <li>▪ #35 Market leaders</li> </ul> | <b>Good</b> <ul style="list-style-type: none"> <li>▪ Good ✓</li> <li>▪ Good ✓</li> <li>▪ #7 Market leaders</li> </ul>                    |
|                 | <b>Understandable business model:</b> <ul style="list-style-type: none"> <li>▪ Recurring revenue business;</li> <li>▪ Operational effectiveness; and</li> <li>▪ Low and declining customer churning.</li> </ul> | <b>Excellent</b> <ul style="list-style-type: none"> <li>▪ Yes ✓</li> <li>▪ Improved CLV, CAC ✓</li> <li>▪ Decreasing churn</li> </ul> | <b>Excellent</b> <ul style="list-style-type: none"> <li>▪ Yes ✓</li> <li>▪ Improved CLV, CAC ✓</li> <li>▪ Decreasing churn</li> </ul>    |

**Conclusion:**

Reasonable IPO candidates are companies with historic revenue growth, outperformance of peers and an understandable business model with a compelling equity story. Considering the qualitative/quantitative characteristics, Delivery Hero and Hello Fresh seem reasonable IPO candidates.

**Question 5b: Value crystallization's impact on RI's business model**

Do the potential IPOs of Delivery Hero and Hello Fresh contribute to RI's value crystallization? Please explain your reasoning by calculating RI's share in potential IPO proceeds.

2

**Working Time: 15 minutes**

Students should be able to qualitatively and quantitatively evaluate the implications of potential Delivery Hero and Hello Fresh IPOs for RI. Furthermore, an understanding of using multiples of comparable companies should make students feel more comfortable in quantitatively assessing companies. Student should pay special attention to Case Study: Exhibit 5, Exhibit 6.

In general, **RI crystallizes value**, when its proven winners are **either sold to larger competitors or transformed from private to public companies by an IPO**. Considering the potential IPOs of Delivery Hero and Hello Fresh, RI would be able to sell its stake in these companies (usually after a lock-up period of 180 days after IPO). RI's respective IPO proceeds are calculated pro rata, meaning that the market capitalization of both companies will be multiplied with RI's share holdings in these companies.

**RI's IPO proceeds for Delivery Hero: €1.2bn** ( $= 11.85 * €384m * 0.26$ )

- RI's Economic Ownership: 26%
  - P/S (LTM) = 11.85x
  - Delivery Hero Sales (LTM): €384m
- ⇒ Market capitalization: approx. €4.5bn

**RI's IPO proceeds for Hello Fresh: €0.8bn** ( $= 3.35 * €435m * 0.53$ )

- RI's Economic Ownership: 53%
  - P/S = 3.35x
  - Hello Fresh Sales: €435m
- ⇒ Market capitalization: approx. €1.5bn

**Conclusion:**

Going public with Delivery Hero and Hello Fresh, RI could generate PO proceeds of roughly €2.0bn. By doing so, RI successfully complies with the approach of value crystallization.

**Question 5c: Evaluation of RI's business model from investors' point of view**

Imagine that the recommended IPOs were successfully executed and fairly stable in market price. Evaluating RI's business model, please compare the sum of RI's cash (equivalents) and RI's potential IPO proceeds (of Delivery Hero and Hello Fresh) with RI's current market capitalization. Is there a discrepancy from an investor's point of view? If so, please explain.

☒

**Working Time: 15 minutes**

After qualitatively analyzing the negative sentiment of RI's shareholders, students are supposed to complement this analysis with a quantitative perspective. By doing so, they should understand how RI's non-transparent business model may have hampered RI's perception and financial evaluation. Students should pay special attention to Case Study: p.16.

On 30<sup>th</sup> June 2017, RI has roughly accumulated €1.6bn in net cash (equivalents) and its proven winners additional €0.8bn, leading to RI's overall **gross cash balance of €2.4bn** (Case Study: p. 16). This number combined with the theoretical IPO proceeds of RI in **Delivery Hero (€1.2bn)** and **Hello Fresh (€0.8bn)** by far exceed RI's current **market capitalization of €3.6bn**, without even considering further proven winners' value. As a result, RI trades at a massive discount ( $€3.6bn < €4.4bn$ ).

There are several reasons for explaining this imbalance between market capitalization and RI's gross cash balance and IPO proceeds:

- **Non-transparent valuation methodology:** RI applies Last Portfolio Values (LPV) instead of commonly used valuation metrics;
- **Restrictive payout policy:** No dividends and no share buybacks;
- **Negative investor sentiment:** Doubts about RI's business model and RI's ability to achieve break-even on a group level; and
- **Negative momentum:** High short interest on RI and exit of long-term investor Kinnevik.

**Conclusion:**

RI is trading at a massive discount because investors developed a negative sentiment towards RI's business model due to its little earnings as well as questionable future prospects.

**Question 6: Strategic and financial evaluation of RI's business model**

Considering investors' negative sentiment, could the two potential IPOs lead to a positive long-term investor perception regarding RI's business model? Please explain your answer and present solutions on how to improve investors' sentiment in the future.

☒

**Working Time: 20 minutes**

Students should view the big picture building on the answers of Question 1-5 and should be able to identify both the positive short-term effects of the potential IPO's on RI's performance, and the issue of consistently satisfying its shareholders. Students should pay special attention to Case Study Page 17ff. and Exhibit 9.

*'It's just incredibly hard for investors to judge a group with such a diverse portfolio of early-stage companies'* (Case Study, p. 18). Keeping this in mind, the negative investor sentiment regarding RI's business model is multifaceted and can be best described by:

- **Decreasing share price** since 2014 by more than -50%;
- **Thin pipeline** of new company-building projects;
- **Increasing net loss** since 2015; and
- **Restrictive payout policy** (no dividends or share buybacks).

The two potential IPOs of Delivery Hero and Hello Fresh would certainly improve investors' sentiment in the short-term. However, to restore investors' confidence also in the long-term, investors' patience has to be rewarded until further proven winners' value can be crystallized. In doing so, RI should focus on implementing the following actions:

- **Less restrictive payout policy:**
  - Regularly paying dividends; and/or
  - Introducing share buyback program (typically increasing share price);
- **Filling pipeline with more prosperous** company-building and investment projects to ensure more regular value crystallization; and
- Using RI's large **cash pile** for **further investments** in attractive companies.

**Conclusion:**

Considering RI's negative shareholder value, the two potential IPOs are a means to turn investor perceptions positively in the short-term. For the mid-term, however, a less restrictive payout policy is necessary to reward investors' patience, e.g. paying dividends. A filled pipeline with prosperous company-building and investment projects, which can be backed by RI's large cash pile, is a prerequisite to generate more recurring cash flows in the long-term.

**Question 7: Outlook and potential adaptations of RI's business model**

Imagine you are in Oliver Samwer's shoes and an angry investor approaches you with the following question during the annual meeting: *'Why should I hold or even increase my investment in RI?'* What would you tell him? Please state specific reasons and focus on the future strategic development to persuade the shareholder.



**Working Time: 25 minutes**

Students should summarize their key findings of the Case Study and should present precise actions to adapt and align RI's business model with shareholders' interests.

*'I take your complaint very seriously. Since the IPO in 2014, RI has done very well from an operational point of view. We made tremendous progress in terms of bringing our proven winners on the path of profitable growth. We are on track regarding our strategic goals, to go public with at least one of our unicorns in 2017. Unfortunately, in RI's share price, this progress is not yet reflected. I can ensure you that we work very hard to improve this as soon as possible.*

*However, it takes time to communicate to the markets that we learned from mistakes and that we will adapt our current business model. We are currently shifting our company-building focus more towards an investment focus. Thus, we will be able to pay out more to our shareholders, as we will be able to generate more regularly occurring earnings not only in early stage, but also in grown companies. Also, we currently think about introducing a share buyback program to reward RI's loyal shareholders, like you, for their patience. We estimate to receive significant IPO proceeds from Delivery Hero, Hello Fresh and further companies this year. With these proceeds and the RICP fund, we will make sure that we re-invest our cash holdings in large and attractive investment opportunities to be able to realize large returns, that can be given back to you and other shareholders.*

*Our operations do work – so at RI, we are currently in a transition phase to become a more diversified investment company. We, as the management board, need a little bit more time to get this process done and need to better communicate the shift of our business model. I start with it today with you and I hope, that I can count on you in this important stage of our company history'*

**Conclusion:**

Considering negative market sentiment reflected in RI's low share price, RI acknowledges investors' increasing demand for rewards by participating in prosperous future investments.

## Appendix: What happened afterwards?



Source: Zeit

Oliver Samwer, Rocket Internet CEO: *‘We are proud of Delivery Hero’s and Hello Fresh’s achievements and would like to congratulate the teams on their success. Rocket Internet’s investments in the Food & Grocery sector in 2014 and 2015 have proven to be a successful investment focus. We will continue to incubate and invest in promising Internet business models and strive to continue to identify attractive investment opportunities.’*

### IPO key facts:



#### **IPO of Delivery Hero in June 2017 (Pre exercise of Greenshoe option)**

- IPO valuation: €4.9bn
- RI IPO proceeds: €425m, RI shareholding: 13%
- Share price development since IPO: +39.3% (as of 4 December 2017)



#### **IPO of Hello Fresh in November 2017 (Pre exercise of Greenshoe option)**

- IPO valuation: €1.6bn
- RI IPO proceeds: €277m, RI shareholding: 44%
- Share price development since IPO: -6.7% (as of 4 December 2017)

### Further developments since June 2017:



- **Sale of 13% stake in Delivery Hero for €660m**
- **Continued implementation of adjusted business model:**
  - **Less investment restrictions** in terms of company’s size, stage and regional scope;
- **Improved Payout policy:** Share buyback program with a volume of up to €100m launched in August 2017, according to RI no dividends will be paid;

- **Share price volatile, but stabilized in €19 to €22/share range**
  
- **Financial improvement within portfolio companies: 9M 2017 vs. 9M 2016**
  - Aggregate revenue grew by 28% to €1.85bn
  - Aggregate adj. EBITDA margin improved from -19% to -12%
  
- **Increased gross cash balance (incl. portfolio companies): €2.9bn (Excl. proceeds of €660m from sale of 13% stake in Delivery Hero)**
  
- **Market capitalization: €3.6bn (as of 30 September 2017)**

**Conclusion:**

Although RI managed to achieve significant value crystallization (e.g. IPOs of Delivery Hero, Hello Fresh and sale of Delivery Hero stake), launched a share buyback program, and established financial improvements of its portfolio companies, RI's share price has only stabilized. Considering that RI's gross cash balance of €3.6bn (incl. Delivery Hero proceeds of €660m) roughly equals RI's market capitalization as of 30 September 2017, this basically means that RI's privately held portfolio companies are valued as worthless.

**Bottom line, RI's key issue remains to align strategic and financial aspects. To be successful in the long-term, RI continuously re-invents its business model. However, RI has painfully experienced, that this business model shift needs to be aligned with shareholders' interest, that is shareholder value. The prerequisite for generating shareholder value is that RI regularly crystallizes value, which can be used to reward investors patience in form of share buybacks and/or dividends.**