

# How Nykaa went from investor darling to tech laggard

The lifestyle e-tailer had a stellar IPO in late 2021 and remained the top pick among tech stocks. But with the end of the lock-in period and questions over its fashion business, Nykaa is trading near its all-time low



[Seetharaman G](#), 23 Jan 2023

Once a top pick, Nykaa is down 35% since October, faring worse than Zomato or Paytm

The end of the lock-in period for pre-IPO investors in November triggered a sell-off, with the stock now worth less than one-third of its market cap after the listing

And Nykaa's fashion vertical has underperformed its much bigger mainstay—beauty and personal care—on growth in orders and monthly average unique visitors

Adding to investors' concerns was the company's controversial 5:1 bonus issue, timed with the end of the lock-in period



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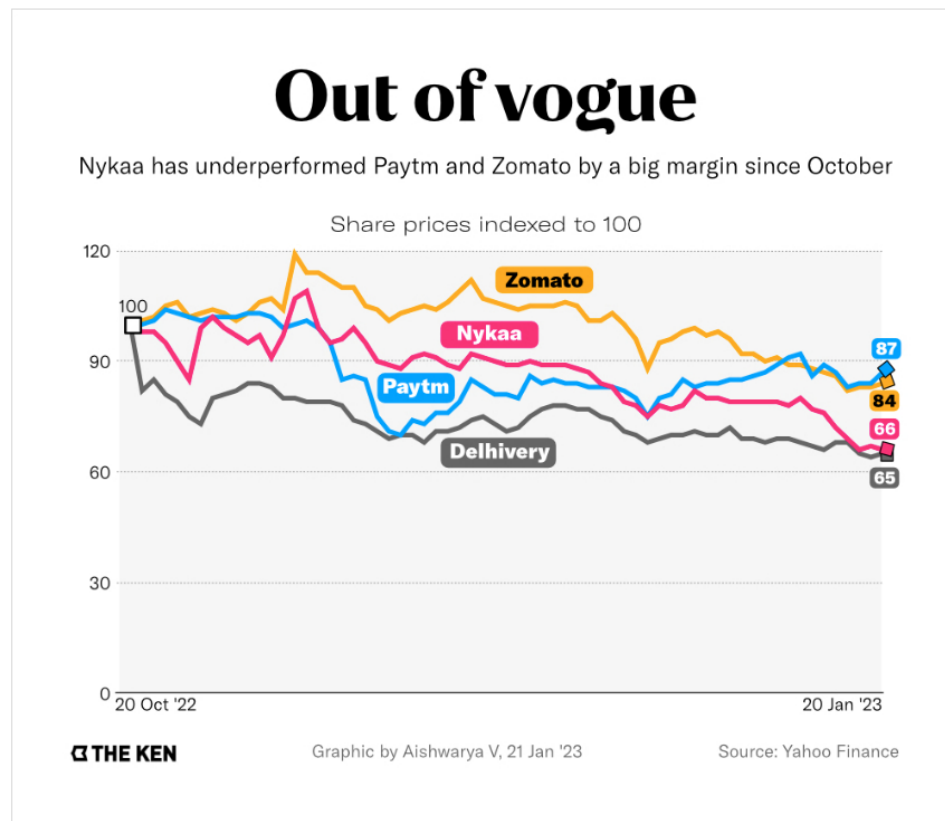
There was a time, not long ago, when Nykaa could do no wrong.

The lifestyle e-tailer's Rs 5,350 crore (~US\$660 million) initial public offer (IPO) was a standout in 2021. Subscribed 82X in November that year—compared to food-delivery platform Zomato's 38X in July—Nykaa listed at ~80% premium to its issue price, versus the foodtech's 53%. And even as the stock market entered choppy waters in early 2022, Nykaa navigated them better than Zomato or fintech Paytm\*.

But lately, nothing is as it was.

In the past three months, shares of FSN E-Commerce Ventures—which

In the past three months, shares of E-commerce ventures—which owns Nykaa—have plunged ~35%, faring much worse than those of Paytm or Zomato. Logistics company Delhivery is the only tech company that makes Nykaa look good, but only slightly.



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Last week alone, Nykaa's share price slid 13%, even as the benchmark Nifty 50 index remained flat. The company is now worth ~Rs 36,180 crore (US\$4.4 billion)—less than one-third of its market capitalisation days after its listing. Since the lock-in period for Nykaa's pre-IPO investors ended in November 2022, private-equity firms Lighthouse Advisors India and TPG Growth—which together owned 4.3%—have sold shares in multiple tranches, according to research firm Prime Database and Bombay Stock Exchange data.

Nykaa has everything going for it: a charismatic founder in Falguni Nayar, a former investment banker; one business (beauty and personal care, or BPC) that created a category online, and another (fashion) with a huge addressable market; and, most importantly, profitability, which the other listed tech companies are nowhere near.

So, why is Nykaa plumbing new lows on the bourses?

“The stock was very expensive, it had to correct. It was valued like a platform but it's just like any other retailer, except it does its business online,” said Jay Gandhi, an analyst with domestic brokerage HDFC Securities. “Because platforms are the ultimate business model, everyone wants to be that. Nykaa was sold like that.”

Even if two-thirds of the gross merchandise value in Nykaa's fashion

business comes from its marketplace hosting third-party sellers, fashion itself accounted for under one-tenth of Nykaa's revenue of Rs 3,775 crore (~US\$466 million) in the year ended March 2022. In BPC—the company's mainstay—Nykaa owns the inventory as any brick-and-mortar retailer does.

Despite the plunge in its share price, Nykaa is trading at nearly 424X its profits in the past 12 months. That's significantly higher than the 116X Trent Ltd—the Tata Group retailer that runs the apparel chain Westside—is priced at.

Nykaa's five-year-old fashion business is also contributing to investor wariness for other reasons. "Someone buying lipstick from you will not necessarily buy clothes from you as well," said Salil Desai, head of research at Marcellus Investment Managers, which offers funds for high-net-worth individuals. "It's a fragmented space with strong incumbents [Flipkart-owned Myntra, e-commerce giant Amazon, and Reliance-owned Ajio]. Nykaa doesn't have an edge." Marcellus has not invested in Nykaa or any other recently listed tech companies.


There are investors who are bullish on Nykaa's fashion ambitions. After all, the vertical has positive contribution margins thus far. But the fashion category's order-growth rate was only one-third of BPC's in the six months ended September 2022, despite a smaller base compared to the latter.

In recent months, the discussion around Nykaa has not just been about its operations, but also beyond it. The company's 5:1 bonus issue in November 2022 was purportedly an attempt to delay the inevitable fall in the share price after the lock-in period ended, and it didn't go down well with investors.

"They tried to be cute," said a senior executive with a large mutual-fund house that's also an investor in Nykaa, adding that the move angered shareholders. They and several others *The Ken* spoke with did not want to be named because they're not authorised to speak to the media or they didn't want to be seen commenting on the company.

Nykaa's investors will hope that the stock's current woes are only courtesy of the lingering effects of the lock-in expiry and the slowdown in discretionary spending. But the company is likely to face more scrutiny over its business in the coming quarters than when it went public.

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## Looking for the right fit

It's evident why Nykaa chose to take a shot at fashion in 2018, after six years of building a strong BPC brand. India's online fashion market was worth Rs 45,000 crore (~US\$5.6 billion) in 2020—5X of the BPC e-commerce industry—according to Nykaa's IPO filing.

And fashion is a close cousin of BPC in the 'lifestyle' family tree. But, Nykaa had to embrace the marketplace model for this vertical, a departure from its BPC strategy of scaling up with its inventory alone. Given the larger breadth of products in fashion than in BPC, it would have been highly unlikely for Nykaa to sell them all on its own.

As of March 2022, Nykaa offered 4.3 million stock-keeping units in fashion, which is nearly 15X its offerings in BPC.

Nykaa chose to focus on the premium end of the fashion market and has managed to increase its average order value (AOV) by 20% to Rs 3,835 (~US\$47) in the six months ended September 2022. On the other hand, the AOV in BPC declined marginally to ~Rs 1,830 (US\$23).

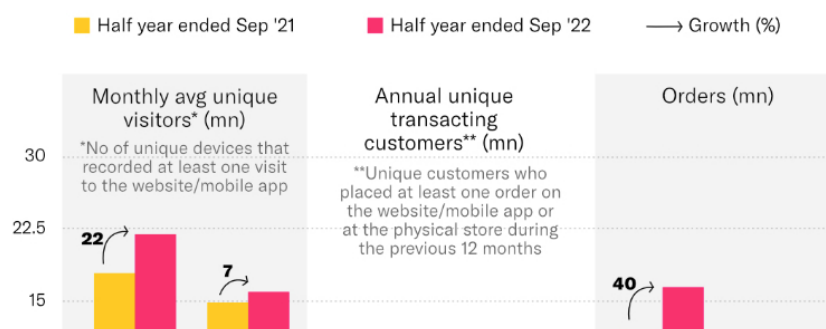
While this has helped improve the economics of the fashion business, e-commerce is still a tough nut to crack for apparel priced above Rs 2,000 (~US\$25), according to Subrata Siddhanta, a former senior executive at apparel retailers such as Trent and Shoppers Stop. "It works on touch and feel. That's why 65-70% of apparel sold online is priced less than Rs 1,000 (US\$12.4)."

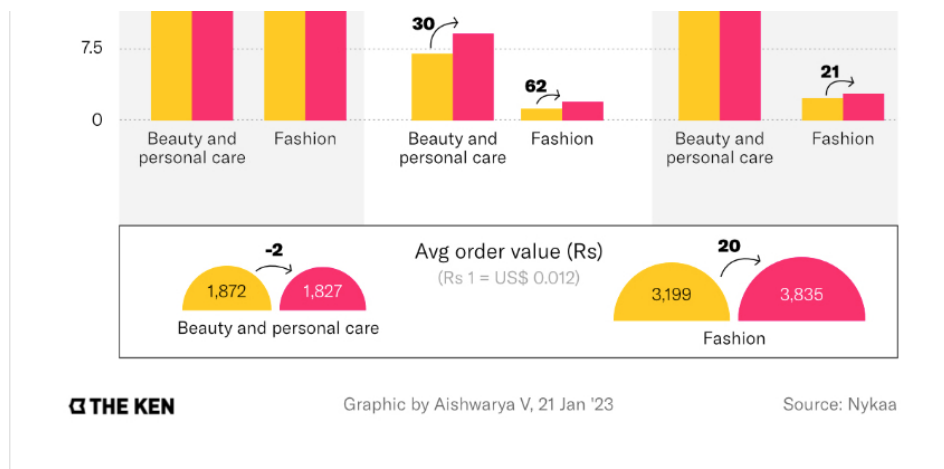
So, even if fashion offers an expansive total addressable market—more than BPC—Nykaa has chosen to focus only on a part of it.

The number of unique customers who placed at least one order in the previous year may have risen sharply in the six months ended September, albeit on a low base. But the annual rise in fashion revenue was similar to the growth of the much larger BPC business. And, the unique monthly average visitors for fashion grew at a slower pace than for BPC in the same period.

## A patchwork performance

Despite strong growth in transacting customers, Nykaa's fashion orders have been relatively muted





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When asked about this during the company's earnings call in August 2022, Adwaita Nayar, chief executive of Nykaa Fashion, said the company wanted to focus on improving conversions from the visits. "And from here, again, we can think about focusing on scaling the visits number."

Nykaa declined to respond to *The Ken's* questions citing the silent period before announcing its quarterly results.

Fashion, by its very nature, is a thorny proposition for Nykaa—something that it may not have experienced in the BPC business. "I do believe that fashion is the ultimate discovery problem. Fashion has so many products, far more than beauty. So, how do you really show the right thing to the right person at the right time? And that remains a focus for us," Adwaita said during the same call.

Then there's the seasonality of fashion, supercharged by the rising popularity of fast-fashion retailers like Trent's Zudio, which we wrote about in August. "In cosmetics, there's just the expiry of the product. Once you get used to a certain product or brand, you're going to stick to it," said the senior executive of a mutual-fund house quoted earlier.

Above all else, Nykaa wants its investors to bet on an upstart in this cut-throat category, which is poles apart from pitching them on its desire to fortify its incumbent status in BPC.

## Tapering spends

The S&P BSE Consumer Discretionary Goods & Services index has slid almost 6% in the past three months, while the Sensex has risen 2.4%.



## Will investors play the long game?

In the year ended March 2021, the company's marketing and advertising expenses had dipped to sub-7% of its revenue from 11.4% in the previous year—likely because of the pandemic.

But in the year ended March 2022, that number jumped to 12.7%, the highest in three years.

“In the initial period, you spend a lot to build a brand, and then you reap its rewards,” said Desai. “We don’t know how long Nykaa will have to keep spending to acquire customers.”

As a relatively new fashion-e-commerce entrant—looking to take on Myntra, Amazon, and Ajo—Nykaa has to spend a considerable amount to attract new customers. The chunk Nykaa spent on promoting its fashion vertical in the year ended March 2022 was over 50% of what it spent on BPC, even though its fashion-business revenue was one-tenth of the latter.

The head of an alternative investment fund drew parallels between investors’ assessment of Nykaa’s two key verticals and Zomato’s food-delivery and grocery-delivery vertical—the latter being the result of its acquisition of quick-commerce company Blinkit last year. “Investors don’t value Blinkit much now, but at some point, they will have to.”

And as Nykaa attempts to disrupt the fashion e-commerce space, it has to safeguard its lead in BPC. That has a bearing on a key revenue stream—roughly 10-12% of its BPC net sales value comes from advertising income, according to a November 2022 report by HDFC Securities. “Ads are a great way of adding to your profitability. But Nykaa’s ad income is going to be split with rising competition,” said HDFC’s Gandhi.

Last year, the Tata Group entered the online BPC business with Tata Cliq Palette. Besides the likes of Myntra, Nykaa’s competition in the space also includes direct-to-consumer brands such as SUGAR Cosmetics and Mamaearth, which has filed to go public.

### **For what it’s worth**

Even if investors perceived Nykaa’s future as bright—*despite* the challenges—its valuation may have forced several of them to keep their distance. But with the recent fall in the share price, mutual funds upped their stake in the company to 4.1% in December from 2.2% in November. Although it’s still less than the 5.7% they own in Zomato and the 11.1% they hold in Delhivery.

Their interest notwithstanding, the stock continued to slide in January. On 12 January, nearly Rs 210 crore (US\$26 million) worth of Nykaa shares were reportedly sold in a block deal at a 4% discount to the market price. Details of the buyer and seller are not available yet.

Regardless of what investors make of its business, Nykaa would want to avoid an encore of the blowback it faced after its bonus issue.

Timing the bonus issue with the end of the lock-in period meant investors would get the additional shares only after a few days; this would, in turn, delay the sell-off. Investors wanting to sell would also have to pay a higher tax on the gains from the sale of the new shares.

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“They were thinking short-term. But even the short-term benefits were questionable,” said Shriram Subramanian, founder and managing director of InGovern Research Services, a proxy-advisory firm. “It was a question of delaying the inevitable.”

Nykaa’s chief financial officer, Arvind Agarwal, resigned two weeks after the lock-in period ended. While Nykaa said he left to “pursue other opportunities in the digital economy and start-up space”, his resignation following close on the heels of the bonus issue was hard to miss.

As the dust settles on that front, the focus will be on what Nykaa is worth. “Nykaa is early in its journey, so price discovery is going to be slow,” said Gandhi. And, according to a second analyst with a domestic brokerage, investors are wary of valuing the company on the basis of future sales and instead are cautiously valuing it on estimated profits, as listed companies are. “EV/sales is a ballpark kind of metric to value startups. It’s nonsensical,” they said.

As its tech peers talk up their ‘path to profitability’, Nykaa may be sitting pretty. But its post-listing dream run is definitely a thing of the past now.

*\*Paytm founder and CEO Vijay Shekhar Sharma is an investor in The Ken*

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