

# The Impact of Riders on the Valuation of "Unicorn" Companies

-- Ants Group as an Example

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**Abstract:** With the development of the times, industry terms such as big data and artificial intelligence have become familiar, and with them the emergence of "unicorn" companies have also been given the opportunity to develop and the corresponding challenges, while the proliferation of "unicorn" companies has brought about a rigorous the proliferation of 'unicorn' companies brings with it the issue of rigorous valuation. In reports on unicorn companies published by major research institutions, Ant Group has led the way for the last five years, jumping from a valuation of US\$75 billion to US\$150 billion, making it a super unicorn. Whether its value actually matches its valuation, and which factors play a key role in this, and how, needs to be further explored: this paper takes Ant Group as the subject of this study, starting with a brief overview of 'unicorn' companies and Ant Group companies, and then introducing traditional valuation methods --The paper also examines the different types of riders in different financing rounds in the financing process of Unicorn companies, and finally analyses the impact mechanism and optimization of different riders on the valuation of Unicorn companies.

**Keywords:** Riders; Valuation; Impact Mechanism; Unicorn Companies; Ant Group.

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## 1. Introduction

(1) Definition of a "unicorn" company

"Unicorn" originally means a mythical creature that is noble and rare. "Few terms are as glamorous as "unicorn", a company whose valuation is extremely high to show its nobility and whose rarity is a sign that it is not yet listed. The term originated in Silicon Valley in the US and is considered to be an emerging company with a valuation of \$1 billion or more that has not been listed for a short period of time. The definition of a unicorn is usually characterized by high growth and innovation, both of which are difficult to replicate, and is representative of an emerging industry. "Unicorn" companies are those that have been established for a relatively short period of time but are growing rapidly, many times faster than those in traditional industries, or even far faster than traditional industries.

As China's economy continues to develop, more and more new companies are emerging in the capital market, including some "unicorns". As representatives of technological innovation, these companies are highly regarded in the capital market for their high growth and high valuation. However, unicorn companies often face additional terms and conditions during the listing process due to their unique characteristics and particularities. These additional terms and conditions may affect the valuation of these companies, which in turn may have an impact on their share price after listing.

(2) Introduction to Ant Group of Companies

Ant Financial Services, known as Zhejiang Ant Small and Micro Financial Services Group Company Limited, is an innovative technology company formally established in 2014, starting with Alipay and headquartered in the same city as Alipay, both in Hangzhou, China, with the aim of extending inclusive financial services to a global scale. -In July 2020, Ant Financial Services was officially renamed Ant Group. With a large number of sub-business segments, it helps users around the world to obtain better quality inclusive financial

services through technological innovation and independent research and development, realizing the company's own profits and creating more jobs to society, solving employment problems for the country and bringing economic benefits.

On 23 March 2018, Great Wall Strategy Consulting released the "2017 China Unicorn Enterprise Development Report" in Beijing, in which Ant Group stood out among 164 "unicorns" with a valuation of US\$75 billion; followed by the "2018 China Unicorn Enterprise Research Report" released in 2019, in which there were 202 "unicorn" companies, of which Ant Group still topped the list with its valuation of US\$150 billion; in the China Unicorn Report 2019 released by China Evergrande Research Institute on 8 March 2020, there were 161 "unicorn" companies, Ant Group has been the champion for three consecutive years, ranking first with a valuation of US\$150 billion; on the premise that the global technology bubble has burst and the value of most technology companies has declined, Ant Group still ranks third in China with RMB830 billion in the 2023 Global Unicorn List released by Hurun Research Institute. In recent years, Ant Group has become a super "unicorn" company.

## 2. Introduction to Traditional Valuation Methods

Valuing a business is different from valuing a stock in that it is a process of valuing the business as a whole as an object of study. It is a key component in exploring the impact on the current and future increase in shareholder wealth of a business, and the value of a business is of great interest to all stakeholders. An accurate and valid assessment of the intrinsic value of a business is the standard by which it is priced in day-to-day economic activity, thus establishing the basis for all stakeholders to decide whether to invest in the company, continue to invest or exit capital.

Valuing large listed companies is much simpler than valuing unlisted companies, such as 'unicorns', which can be

valued using a variety of methods, such as discounted cash flow, book value adjustment, comparable company law and relative value assessment, and listed companies are subject to macro-regulation and supervision. Under the joint supervision of the China Securities Regulatory Commission, the Shanghai Stock Exchange, the Shenzhen Stock Exchange and other institutions and the business administration, companies are more demanding of themselves and the accuracy and validity of their annual reports is higher, so forecasting and valuation of listed companies based on financial reports is simpler in comparison.

To illustrate the post-investment valuation of "unicorn" companies, take the Ant Group as an example: it announced the completion of its Series A financing in 2015, with a post-

investment valuation of over US\$45 billion, and has since completed its Series B and C financing rounds, reaching US\$4.5 billion and US\$14 billion respectively, with a post-investment valuation of US\$60 billion in Series B and US\$150 billion in Series C. valuation of US\$150 billion post-round. This valuation is an outsider's estimate of the post-investment value of the Unicorn companies by multiplying the total number of shares, including original common shares and potential common shares, by the preferred share price of the latest round of financing, where potential common shares represent the value embedded in the rider, i.e., the potential for future conversion into common shares. The number of shares in other forms of financing and option-based riders that have not yet been issued with effect.

**Table 1.** History of Ant Group's funding

Date	round	deal amount	investor	Valuation	ratio
15-Apr-14			CCB Investment		
15-May		RMB 219 million	Haier Capital		
6-Jul-15	Series A	RMB12 billion	Yunfeng Fund, China Pacific Life Insurance Company Limited, National Social Security Fund, China Post Capital, Xinhua Insurance, Spring Capital Primavera, PICC, Jinpu Investment, China Life, China Development Financial,	US\$45 billion	
5-Sep-15	Strategic financing		China Post Capital		
26-Apr-16	Series B	US\$4.5 billion	CIC, China Post Capital, Hanfu Capital, Tianzen Investment, CIMB A, Chunhua Capital, China Development Bank, E-Fangda Asset Management, Jianxin Trust, China Life, China Development Financial,	US\$75 billion	6%
1-Feb-18	Strategic financing	undisclosed	Alibaba		33%
8-Jun-18	Pre-IPO	US\$14 billion	Temasek Temasek, Canadian pension fund CPPIB, Treasury Holdings Malaysia, GIC Government of Singapore Investment Corporation, General Atlantic Pan Atlantic Investment, Silver Lake Capital, Discovery Capital Management, Carlyle Capital Warburg Pincus, Janchor Partners, Baillie Gifford, T. Rowe Price's funds, original shareholders,	US\$155,556 million	9%
23-Jun-18	Strategic financing	RMB 1.6 billion	Pacific Life		
5-Jul-18		undisclosed	CICC Kizhi Investment		

Data source: Sky Eye Search, public information

### 3. Mechanisms of the Impact of Riders on Valuation

(1) Additional terms attached to financing for "unicorn" companies

There are two ways in which a company can obtain funding: by borrowing money, i.e., debt financing, or by selling or diluting its equity, i.e., equity financing. Many companies use equity financing in the early stages because borrowing money from a bank or microfinance company requires collateral, but early-stage companies lack valuable collateral and there is a general stereotype that borrowing money is not a good thing, so it is less likely that companies will choose this method of financing in the early stages. Financing. In contrast, equity financing is a more acceptable option for entrepreneurs, as long as the equity assets are sold or diluted, there is no cost in the short term, and no repayment is required unless very

demanding conditions are triggered, such as a buy-back obligation.

In the case of Unicorn companies, the uncertainty of the future is such that most investors or institutions will stay on the sidelines and only a few venture capitalists will have room to negotiate, so Unicorn companies will use additional terms to retain their interest and it is not uncommon for Unicorn companies to offer additional terms to their new investors in order to raise capital. "There are two main types of riders used in the financing of Unicorn companies:

a. Option-based riders

"Unicorn companies may give investors an option-style rider when raising capital, more akin to the operation of a put option contract, a financial derivative product in which the investor's capital invested in the unicorn company is the price of the option, and the value of the unicorn company The time taken to change to the difference between the actual value at a future point in time and the amount invested by the investor

is used as the time premium of the option, and the greater the uncertainty of the future, the greater the time premium. In the valuation of unicorn companies, this option-style rider is an additional benefit that the "unicorn" company promises to investors if a certain scenario occurs, and there is no greater risk to investors if that scenario does not occur, so this rider may or may not increase the investor's income. The value of such a rider will be reflected in the likelihood.

#### b. Priority in riders

The second type of rider is in the form of a preference, which is a concession in the order of priority of the distribution of the property by the unicorn company in order to obtain stable financing, or a guarantee by the unicorn company to the investor of a certain rate of return on the exit capital at a certain point in time. The rate of return on the property that the "unicorn" company guarantees to the investor. This is usually based on "the exercise of the investors' right of first refusal at 80% of the agreed price. However, in exceptional circumstances, if the founding team has the ability and willingness not to relinquish control of the company, the period of exercise of the right of first refusal may be adjusted" is reflected in the additional terms of the financing.

As Ant Group is not listed and its shareholding structure is not explicitly disclosed, it is assumed that CDIB invested US\$100 million in Ant Group in its Series A financing, in order to reduce the risk of CDIB being able to exit and obtain the liquidation value before other investors in the event that the "unicorn" company is liquidated or acquired due to poor development. The earlier the funding round, the lower the priority given to the investor; or a commitment to receive an additional 200% yield on exit within five years. The rider has a preference similar to holding convertible preference shares, meaning that if the Unicorn business fails and goes into liquidation or is taken over, investors in this round will receive twice the return on their original investment as compensation for their venture investment before other investors receive any return. In fact, the rights received by different rounds of financing are different.

#### (2) Impact process

One of the most important uses of value assessment for unicorn companies that are not yet listed is to raise capital. It is difficult to raise capital for unicorn companies because, firstly, discerning investors in the community are on the fence about the future development of unicorn companies and do not contribute immediately. This requires the company to have a growth rate that sufficiently attracts their valuation, which requires investors in later rounds to give more money to maintain the high growth rate, and investors will be more hesitant to absorb funds for their own development.

The traditional valuation method used in the venture capital industry is the "post-transaction valuation", which means that after a company has received its latest round of funding, it is calculated as if all the shares within the start-up operate in the same way, as if they were ordinary shares. Take for example the Ant Group, which was valued at US\$75 billion after the last round of financing and received US\$10 billion in the latest round of financing, at which point the enterprise value was estimated at US\$150 billion, which includes the newly acquired financing of US\$10 billion, and the calculated financing of US\$10 billion is inclusive of the value of the preferential rights and other additional terms given by the enterprise to the investors. It does not simply look at how lucrative a sum of money the investor has put into the

business, but also at the possibility of this additional value becoming common stock in the future.

In a case study by Ilya A. Strebulaev, Professor at Stanford University Graduate School of Business, and Will Gornall, Professor at Columbia University's Sauder School of Business, a sample of 135 'unicorn' companies were overvalued. The traditional "post-investment valuation" approach to valuation is fundamentally flawed, firstly, because the range of targets for unicorn companies is small, much smaller than the range of financing available to the financial markets for listed companies as a whole, which creates a collective intellectual flaw in their valuation. Secondly, in order to maintain a rising valuation while still raising capital, additional value must be given to later rounds of investors, making the valuation of 'unicorns' more likely to be overvalued than undervalued. Option-based riders are effectively the same as riders with preemptive rights, in that they have more rights than ordinary shareholders, which means they generate more additional value, but this additional value is not reflected in the amount raised, but is reflected in the post-trade investment valuation, so the 'unicorn' company compensates for this. This is reflected in their valuation, and the valuation of such companies has become a black box, with complex financial structures and little knowledge of how different classes of stock operate internally, resulting in a situation where 'unicorns' are often overvalued by outsiders.

Suppose a common shareholder in the Ant Group receives \$9 per share for the sale of their holding, but investors in later funding rounds receive the same \$9 as the common shareholder, plus additional value. If the company is acquired, the investors will get their money back before the common shareholders and receive twice the return they were promised at the time of the financing, at which point there are few remaining rights to allocate to the common shareholders. Again, this means that the post-investment valuation method overestimates the value of the 'unicorn' company.

## 4. Optimized Valuation

In summary, it does not make sense to value an entire business on the basis of these lucrative shares. In order to more accurately calculate the value of a unicorn business, the value of these additional terms should be stripped away. First, by cutting through the lens of the dynamic development of unicorns such as Ant Group itself, the rider and the different stages of Ant Group's financing process are scanned for value drivers. For common shareholders, the riders in later financing rounds are not viewable and therefore not able to understand the value of them, but post-transaction valuations take into account both pre-existing and potential common shares, creating a misunderstanding among common shareholders about the actual benefits they will receive. However, it is not realistic to disclose the additional terms of each round of financing, so a "unicorn" company can use a second valuation after an investor exit as a reference for its ordinary shareholders, compare it several times to arrive at the approximate additional value offered by the company in later rounds of financing and estimate the return it will receive.

Ant Group, which was founded six years ago and has gone through nine rounds of financing, has the typical characteristics of a proposed listing stage and is best valued using the market financing valuation method, which takes into account the added value of the financing. Valuation of companies at the proposed IPO stage is relatively straightforward compared to start-up and growth stage and

companies, when companies gather a number of professional bodies such as securities firms (i.e., brokerage firms), law firms and accounting firms as a result of the IPO. Generally speaking, the SEC can, by default, value a company at the proposed listing stage by reference to the price of the most recent third-party financing. However, Ant Group, which had initially completed its IPO enquiry on 26 October 2020 at an issue price of RMB68.8 per share for A-shares and HK\$80 per share for Hong Kong shares, with a market capitalisation of RMB2.1 trillion (approximately US\$318.5 billion) for A-shares based on the issue price, was urgently halted by announcements from the Shanghai Stock Exchange and the Hong Kong Stock Exchange in November of that year, and Ant Group has remained in a holding period since then. The listing of Ant Group is still on hold. Therefore, when valuing the Ant Group, the market financing valuation method also requires consideration of the additional terms and time value of the financing.

In addition to this, Ant Group also has the characteristics of a typical internet business and using the DEVA derivative valuation method, which is the most widely used in the internet industry, is a reasonable way to value the Ant Group

taking into account the additional value of the financing. The DEVA model of discounted stock value analysis (Meeker, 1995) was the first to apply Metcalfe's law (that network value tends to increase exponentially with the growth of user size) to business valuation. And in recent years, on the basis of the original DEVA model, experts and scholars have practiced and optimised the growth of network size to obtain the quantitative formula as follows:

$$V = K \times N \times \ln(N)$$

Where V is the value of the network economy, K is the amount of contribution per user, N is the number of effective users. However, as the IPO of Ant Group was called off, the value of the network economy in the DEVA valuation model lacked a valid basis. The basis for the survival of unicorns in the Internet industry is user traffic. In addition, the Derivative DEVA model does not use underlying financial metrics because initial companies usually have negative cash flows and cannot use traditional discounted valuation methods, so the Derivative DEVA valuation model is the best choice for start-up unicorns.

**Table 2.** Tencent Users Data Sheet

Tencent Active Users Data Sheet								
Item (billion)	2021/3 /31	2021/6 /30	2021/9 /30	2021/12 /31	2022/3 /31	2022/6 /30	2022/9 /30	2022/12 /31
Combined monthly active accounts for WeChat and WeChat	12.42	12.51	12.63	12.68	12.88	12.99	13.09	13.13
Number of monthly active accounts on mobile devices for QQ	6.06	5.91	5.74	5.52	5.64	5.69	5.74	5.72
Number of registered paid members of fee-based value-added services	2.26	2.29	2.35	2.36	2.39	2.35	2.29	2.34
Total	20.74	20.71	20.72	20.56	20.91	21.03	21.12	21.19

**Table 3.** PayPal user data sheet

PayPal Active Users Data Sheet		
Item	2021/12/31	2022/12/31
Number of active users (billion)	4.26	4.51

**Table 4.** Calculation of the estimated market value of the Ant Group

Ants Group Estimated Market Capitalisation Calculation Table		
Item	2021Y	2022Y
Tencent's market capitalisation (USD billion)	7530	4590
Number of Tencent active users (billion)	20.56	21.19
Tencent's market cap per user (USD)	366.25	216.61
Market capitalisation of Paypal Inc.	3156	1143
Number of active PayPal users (billion)	4.26	4.51
PayPal Inc. market cap per user (USD)	740.85	253.44
Average market cap per user	553.55	235.02
Weighting of average market cap per user	70%	70%
Anthem market cap per user	387.48	164.52
Ant Group Number of users (billion)	8.2	8.9
Ant Group market capitalisation (US\$ billion)	3177.3	1464.2
	5	0

As of December 31, 2022, PayPal's market capitalization is US\$114.3 billion with 451 million total users and Tencent's market capitalization is US\$459 billion with 2.119 billion

total users. The calculation gives Tencent and PayPal a market capitalisation per user of approximately US\$216.61 and US\$253.44 respectively. Using 70% of the average of the market capitalisation per user of the two gives Ant Group a market capitalisation per user of approximately US\$164.52, multiplied by Ant Group's user base of 820 million, giving Ant a valuation of US\$317.735 billion. Comparatively, as of 31 December 2021, PayPal has a market capitalisation of US\$315.6 billion and a total user base of 426 million, while Tencent has a market capitalisation of US\$753 billion and a total user base of 2.056 billion.



**Figure 1.** Comparison of estimated market capitalization of Tencent, PayPal and Ant Group

The calculation gives Tencent and PayPal a market capitalisation per user of approximately US\$366.25 and US\$553.55 respectively. Using 70% of the average of the

market capitalisation per user of the two gives Ant Group a market capitalisation per user of approximately US\$387.48, multiplied by Ant Group's user base of 890 million, giving Ant a valuation of US\$146.42 billion.

Overall, Ant Financial Services (which was renamed Ant Group in 2020) held a large number of financial licences in its hands before suspending its listing. With great foresight, Ant Financial had already picked up a number of operating licences long before. The main ones are payment licenses, credit collection, online microfinance, banking, insurance, public funds and financial asset exchanges. In the list of five financial holding regulatory pilots circulated in May 2018, "Ant Financial Services" was listed. At the same time, the strategic investors in the multiple rounds of financing are of high status and hierarchy, and have a solid social base, which to a certain extent can indicate a high degree of market recognition of Ant Group as a company.

However, in the few years since Ant Group's listing was suspended, the market valuation has been severely diminished.

## 5. Conclusion

It is well known that technology companies are usually valued higher than companies in traditional industries, and Ant Group was previously valued at \$2.1 trillion as a technology company, but after the announcement of the Interim Measures for the Administration of Online Microfinance Business (Draft for Public Comments), issued by the CBRC and the Central Bank on 2 November 2020, the FinTech regulatory environment in which Ant Group reported has changed significantly. As a result, the valuation of Ant Group by major research institutions has returned to within the normal threshold range. Specifically, Ant Group's earnings revolve around its payment scenario, digital finance and technology services businesses, and therefore changes in policies related to financial regulation will have a significant impact on it, which is directly related to the continuity and depth of business development and will significantly increase the compliance costs of Ant Group's business operations, as well as impact Ant Group's financing and valuation.

As an innovative financial platform with great social influence and demonstration effect, Ant Group's inflated valuation caused by the various facilities brought about by the financing rider is not only harmful to the interests of investors, but also unhelpful to its own long-term development.

Therefore, both technology and financial companies should be valued in a more rational manner.

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