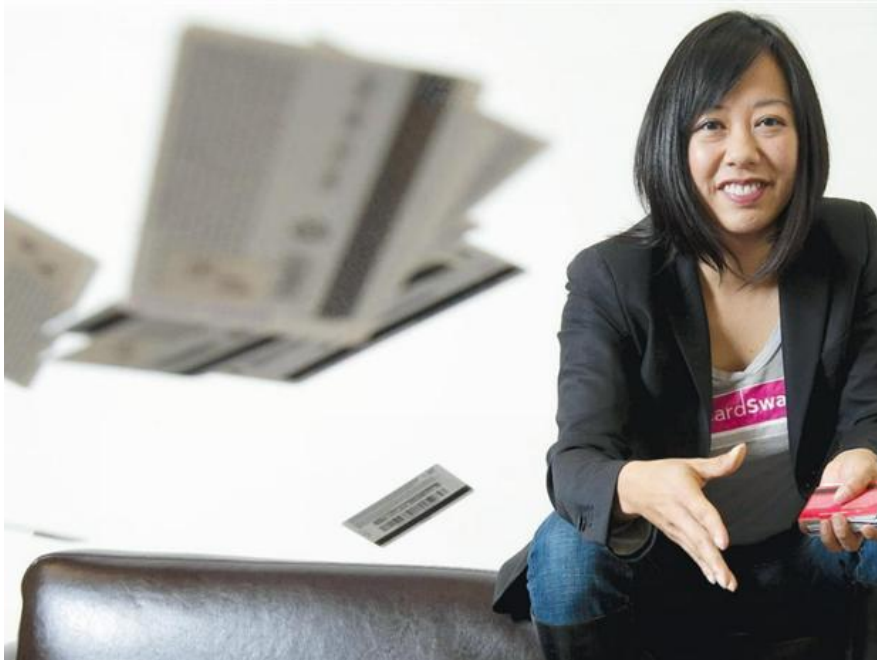


Financial Post

Gift cards that really do keep on giving



Frances Ho, founder of CardSwap, an online reselling service of consumer gift cards, says Canadians on average have \$300 each in unused gift cards.

Tim Fraser For National Post

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Each week, the Financial Post revisits CBC's previous week's episode of Dragons' Den. Mary Teresa Bitti captures what the cameras didn't and in the process provide a case study for readers, zeroing in on what pitchers and dragons were thinking and what the challenges for the deal are going forward.

The Pitch Toronto-based entrepreneur Frances Ho hit on the idea of CardSwap, an online site that resells unwanted gift cards, in January of 2009. "Christmas had come and so had more gift cards.

I had a separate wallet for all the gift cards I was collecting," says Ms. Ho. "I was at the point where I knew I would never use them all but I didn't want to throw money away and I didn't want to re-gift them. What I did want was to cash them out. In the U.S. there are services where you can convert gift cards to cash but not in Canada."

A problem-solver by nature, Ms. Ho did her research and came away with some staggering numbers: Canadians spend about \$6 billion each year on gift cards. Consumer Reports magazine estimates one out of every four gift cards goes unused more than a year after it was received, and many are ultimately lost or discarded. That's more than \$1 billion worth of gift cards that go unredeemed each year. On average, every Canadian household has more than \$300 in unused gift cards lying around gathering dust.

"This is a broad consumer problem," says Ms. Ho. "Everyone loves to give and receive gift cards and most are great, but it's that one card you don't know what to do with that gets left behind. And because there are no expiry dates, the problem gets bigger."

She did more research, put together a business plan outlining her business model and market entry, worked with a designer to create cardswap.ca and launched in July 2009. "I started on my own working out of my home and last year moved into an office space. There are now six full-time employees."

There are also competitors that have entered the space. "That tells me we're on to something," says Ms. Ho. "We are still the biggest, there are a couple hundreds cards available at any point in time on our site while our competitors only have a handful. And we were first to market and have a good brand. We are continuing to create awareness for our service and the industry."

That service looks like this: CardSwap pays up to 90% on the gift card value and then sells them to consumers who can buy on the site at a savings of up to 40%. CardSwap earns between 5% and 10% on the buy and sell spread. "It's an easy model," says Ms. Ho. And in fact, CardSwap had sales of \$1-million last year and 100,000 users when Ms. Ho appeared on Dragons' Den. "Most businesses need to create demand. We have the opposite problem. Our issue is supply and getting more cards in. That's where creating awareness comes in."

The deal Ms. Ho asked the dragons for \$500,000 for a 33% equity stake, valuing the company at \$1,515,000. The money would be used for customer acquisition. Newest dragon Bruce Croxon and Jim Treiving offered \$500,000 for a 50% stake bringing the valuation down to \$1-million. The three shook hands on air but during the due diligence process the valuation changed and they decided to walk away from the deal. Ms. Ho has since secured other financing but was more than happy to have had the experience in the den. "It was phenomenal. We had a lot of dialogue. They loved the business. Where we had a difference of opinion was how much money we needed to grow. We couldn't come to terms on it."

What a Dragon says "A lot of time you get interested in something because you can understand yourself doing it," says Mr. Croxon of his interest in the deal. "I have some fundamentally cheap habits. If you have a drawer of gift cards you can turn into cash conveniently, that appealed to me. It sounded unique. I liked the idea. I liked the presenter. She was clear and understood her business. Then you start the due diligence and you start looking at what this good idea can look like three years out, what the margins are, how to scale it. I still fundamentally think it's a nice business but there are challenges. Business comes down to how much you have to pay to acquire a customer vs. what they are worth to you in the long run. In this business, you have to acquire a lot of customers because the profit margins are so small. To do that economically she has to spend marketing dollars. That could be expensive unless it goes viral and word spreads free. In today's world viral isn't the easiest thing to achieve."

What the expert says Chris Van Staveren, partner, transaction service, KPMG Enterprise Services says that from a technology company perspective the valuation seemed reasonable, particularly when you look at the fact that it has a proven revenue stream and it has potential for high growth. "But if you look at the business from a cash flow perspective, then you struggle. Her profit, \$80,000 on \$1-million in sales, is small."

In terms of the concept, gift cards are incredibly popular, the challenge is scale, Mr. Van Staveren says. "If the average transaction size is \$60 and her cut is in the 8% range, each transaction is worth about \$5 and from that you have to ship it. Unlike digital companies such as Groupon, this is a physical transaction so she's lost the benefit of the e-business aspect. She should be testing at higher margins to make it viable going forward. At the same time, she still needs enough volume to make a margin on it. How do you get high volumes when so few people know about it? One possibility is to bring some retailers on side to offer specials where the retailer is the supplier. The show will be a boon for her. At the end of the day, I still think it's a great business but I don't know that it's maximizing its potential yet."

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