Financial Modeling – Certification Quiz Questions

Module 14 – Private Company Analysis, Valuation, and Deals

1. You are advising a small, private company in the online education sector on a potential sale of the business to a larger, public company in the space. The small, private company is owned 100% by its Founder and has no outside shareholders or investors.

   As the first step in this sell-side M&A process, you are working with the client to create a more presentable version of its financial statements.

   The company's historical Income Statement and Cash Flow Statement are shown below:

Income Statement:	Units	Historical Year 1	Year 2	Year 3	Year 4	Year 5
Gross Sales by Category:						
Online Courses:	$	$ 108,419	$ 263,157	$ 433,718	$ 583,030	$ 734,675
Product Sales Referred by Affiliates:	$	40,392	52,631	61,087	37,859	47,706
Coaching & Resume Editing Services:	$	36,140	44,534	54,978	60,575	66,789
Sales to Institutions:	$	8,503	20,243	30,544	53,003	76,330
Commissions from Other Products:	$	19,133	24,291	30,544	22,715	28,624
Total Gross Sales:	$	**212,587**	**404,857**	**610,871**	**757,182**	**954,123**
Commissions by Category:						
Commissions Paid to Affiliates:	$	20,196	26,316	30,544	18,930	23,853
Commissions Paid to Coaches:	$	18,070	22,267	27,489	30,287	33,394
Commissions Paid to Sales Reps:	$	-	8,097	12,217	21,201	30,532
Total Commissions:	$	**38,266**	**56,680**	**70,250**	**70,418**	**87,779**
Gross Sales Less Commissions:	$	**174,321**	**348,177**	**540,621**	**686,764**	**866,344**
Fees & Refunds:						
Payment Fees:	$	6,165	11,336	17,104	21,201	26,715
Refunds:	$	6,378	12,551	21,380	30,287	39,119
Total Fees & Refunds:	$	**12,543**	**23,887**	**38,485**	**51,488**	**65,834**
Net Sales After Fees and Refunds:	$	**161,779**	**324,290**	**502,136**	**635,276**	**800,509**
Operating Expenses:						
Tax, Bookkeeping & Legal Fees:	$	1,250	1,500	1,500	2,000	2,250
Customer Support:	$	-	30,000	30,000	45,000	60,000
Online Advertising:	$	-	10,000	20,000	20,000	30,000
Web Design & Development:	$	10,000	30,000	60,000	60,000	60,000
Sales Reps - Base Salaries:	$	-	10,000	12,000	12,000	12,000
Marketing Staff:	$	-	-	40,000	60,000	80,000
IT Infrastructure:	$	2,000	5,000	10,000	15,000	20,000
Travel & Moving Expenses:	$	5,768	8,798	6,012	5,123	6,763
Depreciation & Amortization:	$	568	792	1,011	1,523	2,024
Product Creation:	$	-	-	40,000	40,000	80,000
Content Creation:	$	-	-	30,000	30,000	30,000
Total Operating Expenses:	$	**19,586**	**96,090**	**250,523**	**290,646**	**383,037**
Operating Income:	$	**142,193**	**228,200**	**251,613**	**344,630**	**417,472**
Income Taxes:	$	**35,548**	**61,614**	**70,452**	**99,943**	**125,242**
Net Income:	$	**$ 106,645**	**$ 166,586**	**$ 181,161**	**$ 244,687**	**$ 292,231**

BREAKING INTO WALLSTREET

Cash Flow Statement:	Units	Historical Year 1	Year 2	Year 3	Year 4	Year 5
CASH FLOWS FROM OPERATING ACTIVITIES:						
Net Income:	$	**$ 106,645**	**$ 166,586**	**$ 181,161**	**$ 244,687**	**$ 292,231**
(+) Depreciation & Amortization:	$	568	792	1,011	1,523	2,024
(+/-) Change in Accounts Receivable:	$	-	(2,024)	(4,084)	(1,463)	(3,878)
(+/-) Change in Accounts Payable:	$	98	767	2,392	1,975	2,812
(+/-) Change in Accrued Expenses:	$	196	765	2,797	602	1,386
(+/-) Change in Deferred Revenue:	$	-	810	2,245	2,625	3,862
Cash Flow from Operations:	$	**107,506**	**167,696**	**185,521**	**249,948**	**298,437**
CASH FLOWS FROM INVESTING ACTIVITIES:						
(-) Capital Expenditures (CapEx):	$	(850)	(2,024)	(3,054)	(3,786)	(5,725)
(+) Sales / (-) Purchasesof Other Assets:	$	(127)	(254)	(321)	(423)	(501)
Cash Flow from Investing:	$	**(977)**	**(2,278)**	**(3,375)**	**(4,209)**	**(6,226)**
CASH FLOW FROM FINANCING ACTIVITIES:						
(+/-) Change in Non-Current Liabilities:	$	53	102	1,211	2,310	3,123
(-) Dividends / Owner Draw:	$	(80,000)	(100,000)	(120,000)	(150,000)	(200,000)
Cash Flow from Financing:	$	**(79,947)**	**(99,898)**	**(118,789)**	**(147,690)**	**(196,877)**
Net Change in Cash:	$	**26,582**	**65,519**	**63,357**	**98,049**	**95,335**
Beginning Cash Balance:	$	**25,766**	**52,348**	**117,867**	**181,225**	**279,274**
Ending Cash Balance:	$	**$ 52,348**	**$ 117,867**	**$ 181,225**	**$ 279,274**	**$ 374,608**

Based on these screenshots and the company description, which of the following CHANGES would you make to the financial statements?

a. The top sections of the Income Statement should be Gross Sales, Allowances & Refunds, and Net Sales rather than Gross Sales, Commissions, and Fees & Refunds.

b. There should be an additional section for Cost of Goods Sold on the Income Statement, rather than just the one area for Operating Expenses.

c. Intermingled personal expenses, such as the “Travel & Moving Expenses” should be removed.

d. The “Dividends / Owner Draw” line item on the CFS should be re-allocated into standard expense line items on the Income Statement, such as R&D and SG&A, based on the Founder’s work responsibilities.

e. The Income Taxes in the projected period need to be adjusted because larger, public companies may have different effective tax rates.

f. All of the above.

g. Answer choices 3, 4, and 5.

h. Answer choices 2, 3, and 4.

i. Answer choices 1, 3, 4, and 5.

j. Answer choices 1, 4, and 5.

2. You are now completing a valuation of this same private company, including a DCF analysis and comparable public companies.

   Which of the following changes would you NOT expect to make in this valuation, compared with the valuation of a large, public company?

   a. The Terminal Value in the DCF should be adjusted down because this business seems to be dependent on one key person (the Founder).

   b. The Discount Rate should be significantly higher to reflect the lack of diversified shareholders and the company's size and concentration.

   c. If the comparable public companies are all much larger and more diversified than this private company, then a significant discount should be applied to the valuation multiples of these comparable companies.

   d. The company's Unlevered Free Cash Flow should grow at a much slower rate in the explicit forecast period of the DCF because the "key person" (the Founder) could leave the company.

   e. None of the above; i.e., these are all expected and standard changes in private company valuation.

3. This sell-side M&A process has now advanced, and your client is negotiating a purchase agreement with a potential buyer.

The buyer has proposed a Purchase Enterprise Value of $1.5 million and a separate Earn-Out worth $1.0 million, to be paid to the Founder in 3 years if the company achieves a certain EBITDA target by then.

The buyer believes this transaction structure with an Earn-Out is better because it aligns the interests of both parties, reduces the risk of overpayment, and eliminates the EPS impact of this $1.0 million of consideration, while also reducing the amount of Goodwill created in the transaction.

Are the buyer's arguments correct?

a. It's correct about aligning interests and reducing risk, but not about the EPS impact or the Goodwill reduction.

b. No – the buyer's arguments are all wrong.

c. It's correct about aligning interests, reducing risk, and eliminating the EPS impact from the Earn-Out, but not about the Goodwill reduction.

d. It's correct about eliminating the EPS impact and reducing the Goodwill created, but not about aligning interests or reducing risk.