# Financial Modeling Mastery – Certification Quiz Questions

## Module 14 – Private Company, Venture Capital, and SaaS Modeling and Valuation

1. You are advising a private Software-as-a-Service (SaaS) company in the cybersecurity space that is currently structured as an S-corporation (a "pass-through" entity). The company is highly dependent on the Founder and CEO, who wins approximately 25% of new customer accounts. The company's contracts last for 2 years, with ~5% price increases upon renewal.

   This company is so small that it does not have real financial statements, and it uses cash accounting rather than accrual accounting. Its historical Profit & Loss Statement and a list of cash flow-related line items are shown below:

| | | Historical: | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Historical and Projected P&L:** | *Units:* | 1Q 20 | 2Q 20 | 3Q 20 | 4Q 20 | 1Q 21 | 2Q 21 | 3Q 21 | 4Q 21 |
| **Revenue:** | $ | **$ 793,750** | **$ 823,750** | **$ 866,875** | **$ 910,625** | **$ 955,000** | **$ 985,625** | **$ 1,030,625** | **$ 1,076,250** |
| (-) Commissions: | $ | (47,250) | (36,750) | (49,875) | (47,250) | (55,125) | (39,375) | (57,750) | (60,375) |
| (-) Payment Processing Fees: | $ | (15,875) | (16,475) | (17,338) | (18,213) | (19,100) | (19,713) | (20,613) | (21,525) |
| **Net Sales After Fees & Commissions:** | $ | **730,625** | **770,525** | **799,663** | **845,163** | **880,775** | **926,538** | **952,263** | **994,350** |
| **Operating Expenses:** | | | | | | | | | |
| (-) General & Administrative: | $ | (120,250) | (120,250) | (120,250) | (120,250) | (123,858) | (123,858) | (123,858) | (123,858) |
| (-) Research & Development: | $ | (136,500) | (136,500) | (136,500) | (136,500) | (174,070) | (174,070) | (174,070) | (202,524) |
| (-) Sales & Marketing: | $ | (91,000) | (91,000) | (110,500) | (130,000) | (160,680) | (180,765) | (200,850) | (220,935) |
| (-) Customer Support: | $ | (58,500) | (58,500) | (58,500) | (58,500) | (80,340) | (80,340) | (80,340) | (80,340) |
| (-) Travel: | $ | (12,000) | (12,000) | (15,000) | (15,000) | (15,450) | (18,540) | (18,540) | (21,630) |
| (-) Overhead: | $ | (13,500) | (13,500) | (14,400) | (15,300) | (18,540) | (19,467) | (20,394) | (22,248) |
| (-) Onboarding: | $ | - | - | (5,000) | (5,000) | (15,450) | (5,150) | (5,150) | (10,300) |
| (-) Server Infrastructure & Bandwidth: | $ | (47,625) | (49,425) | (52,013) | (54,638) | (57,300) | (59,138) | (61,838) | (64,575) |
| (-) Marketing: | $ | (39,390) | (47,250) | (54,285) | (53,535) | (59,160) | (56,865) | (56,540) | (67,620) |
| (-) Office Rent: | $ | (25,500) | (25,500) | (25,500) | (25,500) | (25,500) | (25,500) | (25,500) | (25,500) |
| (-) Lease Early Termination Fees: | $ | - | - | - | - | - | - | - | - |
| (-) Other Miscellaneous Expenses: | $ | (30,000) | (30,000) | (30,000) | (30,000) | (30,900) | (30,900) | (30,900) | (30,900) |
| **Total Operating Expenses:** | $ | **(574,265)** | **(583,925)** | **(621,948)** | **(644,223)** | **(761,248)** | **(774,592)** | **(797,979)** | **(870,429)** |
| **Operating Income:** | $ | **$ 156,360** | **$ 186,600** | **$ 177,715** | **$ 200,940** | **$ 119,528** | **$ 151,946** | **$ 154,284** | **$ 123,921** |
| *Operating Margin:* | % | *19.7%* | *22.7%* | *20.5%* | *22.1%* | *12.5%* | *15.4%* | *15.0%* | *11.5%* |
| *Revenue Growth:* | % | | | | | *20.3%* | *19.7%* | *18.9%* | *18.2%* |

| | | Historical: | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Cash Flow Line Items:** | *Units:* | 1Q 20 | 2Q 20 | 3Q 20 | 4Q 20 | 1Q 21 | 2Q 21 | 3Q 21 | 4Q 21 |
| CEO / Founder Distributions % LTM OpInc: | $ | | | | 20.8% | | | | 18.2% |
| CapEx % Revenue: | $ | 0.3% | 0.2% | 0.5% | 1.0% | 1.2% | 0.7% | 0.5% | 0.2% |
| CEO / Founder Distributions: | $ | - | - | - | (150,000) | - | - | - | (100,000) |
| Capital Expenditures: | $ | (2,303) | (1,534) | (4,237) | (9,174) | (11,753) | (7,180) | (5,333) | (2,194) |

Based on the screenshot and the company description, which of the following CHANGES would you make to the financial statements if you're preparing the company for an outside fundraising or sell-side M&A process?

a. If the Revenue is based on cash received rather than product/service delivery, you will have to change the numbers so that Revenue is based on delivery, likely resulting in lower numbers in the earlier periods.

b. If the Commissions are based on cash payouts, you must amortize them over the 2-year average contract life and track the Commission Recognized vs. Cash Commissions Paid difference on the Balance Sheet.

c. Some expenses, such as Payment Processing Fees and Server Infrastructure & Bandwidth, should be reclassified into "Cost of Sales," and the smaller expenses should be shown within the G&A, R&D, and S&M categories.

d. The "CEO / Founder Distributions" line item should be reallocated into standard expense categories on the Income Statement, such as R&D and S&M, based on how the CEO spends their time in different areas.

e. There should be line items for Income Taxes and Net Income at the bottom so potential acquirers and investors can evaluate the company as if it were a traditional C-corporation.

f. All of the above.

g. Answer choices A and B.

h. Answer choices A, B, and C.

i. Answer choices A, B, C, and D.

2. You are now completing a valuation of this same private SaaS company, including a DCF analysis, comparable public companies, and precedent transactions. The company has approximately $4 million in revenue and is still heavily dependent on its Founder and CEO.

The median revenue for the comparable companies and the acquired companies in the precedent transactions is approximately $500 million.

At the same time, you are also building a valuation for a much larger SaaS company in the same vertical with an executive management team and revenue closer to $200 million. The companies in the sets of public comps and precedent transactions for this larger company also have median revenue in the $500 million range.

Which of the following statement(s) BEST describe(s) the differences you might expect in these two private company valuations?

a. Terminal Value would be heavily discounted (reduced by some percentage BEFORE discounting it to Present Value) for the $4 million company because of its high dependence on a key person; this discount would be minimal or nonexistent for the larger company.

b. The Discount Rate will be significantly higher for the $4 million revenue company to reflect much higher risk (and higher potential returns).

c. A 10-30% "illiquidity discount" should apply to the multiples from comparable public companies and precedent transactions in both valuations because these companies are both private and, therefore, much less liquid than publicly traded companies.

d. It's more important to build in multiple scenarios, such as Base, Upside, and Downside cases, for the $4 million revenue company because the range of potential outcomes is much wider; the $200 million company is more likely to continue growing at a steady rate.

e. All of the above.

f. Answer choices A and B.

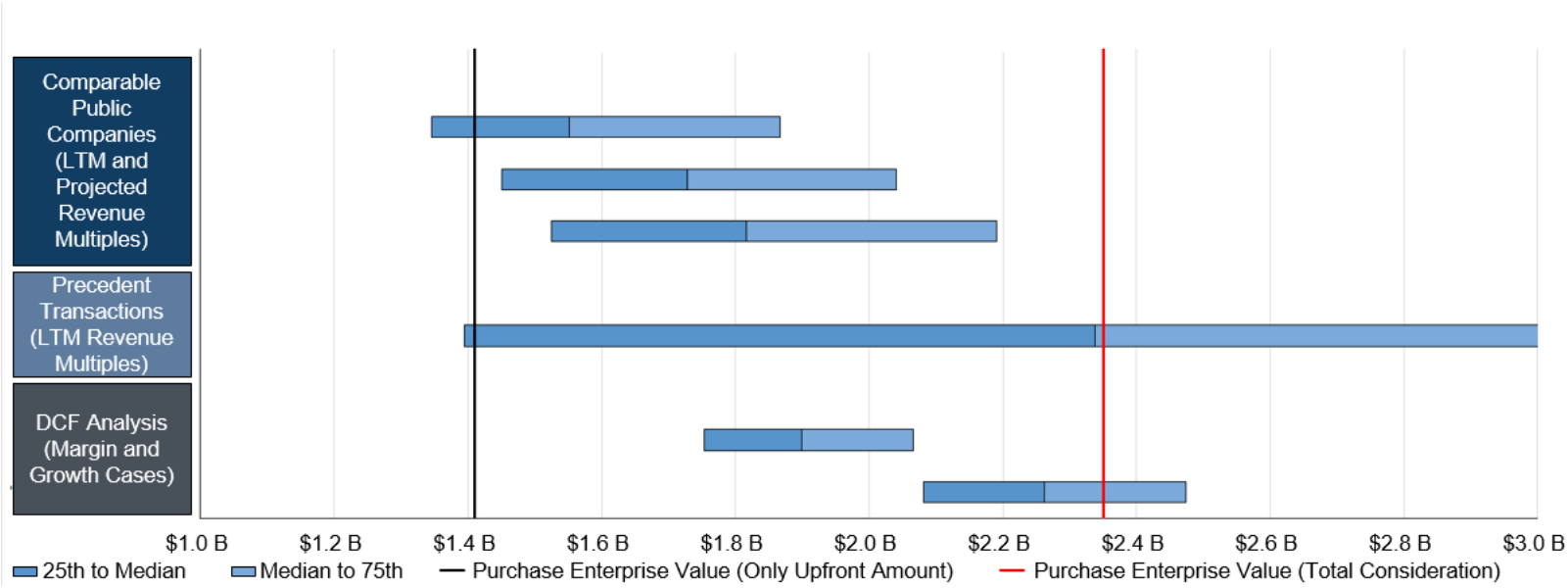
g. Answer choices A, B, and D.

h. Answer choices C and D.

3. You continue advising the $200 million revenue SaaS company on a potential transaction, and it has received an acquisition offer from a larger public company.

   However, the offer includes a significant Earnout component (worth 40% of the purchase price) and other items common in acquisitions of private companies, such as a Working Capital target and a Minimum Cash requirement. The deal will also be done on a cash-free, debt-free basis.

   With the Earnout, the Purchase Enterprise Value is $2.35 billion; without the Earnout, it's closer to $1.4 billion, as shown in the valuation summary below:




   The buyer has indicated that it could potentially increase the offer price, but if it does, it will also have to make the Earnout a higher percentage of the price.

   However, it is very concerned about the EPS impact of this Earnout, especially if it is paid in full rather than written down.

   Are the buyer's concerns rational in the context of *completing this transaction*?

   a. No, because the Earnout payment does not appear on the Income Statement; only changes in the value of the associated Liability do, and write-downs are positives on the Income Statement.

b. Yes. Although the Earnout payment does not appear directly on the Income Statement, the additional interest expense on Debt and the foregone interest on Cash used to fund the earnout payment will reduce the company's EPS.

c. It depends on whether the Earnout is structured as a single payment or multiple payments and if there are tiers in the payout structure.

d. No, because both Earnout write-downs and cash payouts will reduce the company's EPS in future years, so the main issue is the total price – not the Earnout percentage.