



## Growth Equity / Venture Capital Case Study on Financial Statement Projections: T. Rowe Price's \$150 Million Investment in Atlassian



You are working at a technology-focused growth equity firm that is considering a large investment in Atlassian, an Australian software company.

The company is based in Sydney, Australia, and offers software products for collaboration and software development. Its main product lines are JIRA (for project management), Confluence (for collaboration), and Dev Tools (for source code control, peer code review, and release management).

The company recorded \$200 million AUD (approximately \$210 million USD) in revenue in its most recent fiscal year, which represents a compounded annual growth rate (CAGR) of 25% over the past 3 years.

Atlassian has attracted attention from venture capital and growth equity firms due to its rapid growth, the quality of its products, and its innovative business model: unlike traditional enterprise software companies, it does **not** employ a commissioned sales force at all, and instead sells via indirect channels and “low-touch” methods.

As a result, the company can also afford to spend a significantly higher percentage of its revenue on research & development (R&D).

In April 2014, T. Rowe Price announced a \$150 million USD investment in the company. The sellers consisted primarily of **EMPLOYEES** selling their existing shares in the company; Atlassian did not issue new shares. Accel Partners also invested \$60 million USD at a \$400 million USD valuation 4 years ago, under similar terms.

In this case study, you will analyze the company from the perspective of a growth equity analyst, create projections for its 3 financial statements, and then make an investment recommendation and answer case study questions.

You will have **1 week** to complete your quantitative and qualitative analysis of the company, build your model, and answer the case study questions at the end of this document. You will then present your findings to the Partners at our firm.

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## Part 1: Reviewing the Data and the Process

In the first part of this case study, you'll review the information Atlassian has provided on its business, as well as research from 3<sup>rd</sup> party sources such as PrivCo.com and industry analysts.

Since Atlassian is a **private company**, there is far less information available than there would be for a public company in the same industry.

Its historical revenue figures are widely known, and the company has also disclosed its financial statements for the past 3 years, as well as its customer count and average customer value by segment (OnDemand vs. Download).

It has also given estimates for its revenue in the current fiscal year (\$200 million AUD), and its expected growth rates in users and pricing over the next several years.

Please review the following documents and data sources before completing your 3-statement model:

- Atlassian's historical financial statements over the past 3 years and the supplementary data on customer counts and average customer value.
- The press releases and online commentary on the company.
- [This TechCrunch video interview on Atlassian's business model.](#)

## Part 2: Projecting the Income Statement

The key items on Atlassian's Income Statement projections are its revenue and operating expenses; since it is a software company, Cost of Sales (or COGS) is minimal and can be a small percentage of revenue.

Rather than assuming a simple percentage growth rate for revenue, please use the following approach over the 5-year projection period:

- **Revenue:** Split this into revenue from one-time purchases ("Download" on Atlassian's website) vs. subscriptions ("OnDemand" on Atlassian's website). Use the historical figures as guidance, and remember that Atlassian first started offering on-demand products in 2011 and then greatly reduced its pricing in 2012.
- **Growth in Pricing and Customers:** You should assume flat to very modest price increases, given that Atlassian has actually *reduced* its pricing in recent years to win more customers. The company has grown its customer base at 20-30% per year historically, so you should assume something similar going forward, with the rate of growth decreasing over time. Also keep in mind that the "OnDemand" segment is growing more rapidly than the "Download" segment.

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Please use the following assumptions for the expenses:

- **Cost of Sales:** Use the company's historical gross margins to determine this, and assume a **0.25%** gross margin increase each year to account for greater economies of scale and more on-demand business.
- **Research & Development:** Link this to the historical average R&D spending as a percentage of revenue.
- **Sales & Marketing:** Although Atlassian has no commissioned sales reps, it still spends a fair amount on the *sales & marketing* process – including answering pre-sales questions from customers, setting up demos, using paid online advertising, and so on. However, it spends a different amount on selling/marketing to existing customers vs. brand new customers. You should split this into the “New” vs. “Existing” customer segments and project the categories separately.
  - **Growth Rate in Sales & Marketing Spend per Customer:** Assume that the spending per existing customer grows at 10% initially and declines to a 6% growth rate by the end of 5 years; the spending per new customer should start at a 15% growth rate and decline to 14% by the end of the period.
- **General & Administrative:** Split this into fixed vs. variable portions, tie the variable portion to the company's revenue, and tie the fixed portion to a growth rate in-line with the average historical growth rate.
- **Tax Rate:** Please use the Australian corporate tax rate in Australia of 30%.

Project the Income Statement down to the “Profit / (Loss) for the Period” (Net Income) line item, and also calculate EBITDA in the bottom section.

**Keep in mind that since this is an Australian company, some of the line items will have slightly different names** – but the concepts are universal.

### Part 3: Projecting the Balance Sheet and Cash Flow Statement

As a profitable, privately-held software company, Atlassian has relatively simple financial statements.

Please use the following assumptions for the key line items on its Balance Sheet:

- **Trade and Other Receivables:** % of Revenue.
- **Inventories:** % of COGS.
- **Property, Plant & Equipment, Net (PP&E):** Link this to annual CapEx and Depreciation.
- **Long-Term Investments:** Link this to the relevant Cash Flow Statement line item.
- **Other Non-Current Assets:** Keep this flat.
- **Trade and Other Payables:** % of Total Operating Expenses.

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- **Accrued Expenses:** % of Total Operating Expenses.
- **Deferred Revenue:** % of Revenue.
- **Deferred Tax Liabilities:** Link this to the relevant Cash Flow Statement line item.
- **Other Non-Current Liabilities:** Keep this flat.

Please use the following assumptions on the Cash Flow Statement:

- **Capital Expenditures:** Assume a growth rate in-line with historical CapEx spending growth; CapEx as a percentage of revenue should be between 7% and 10% each year in the projected period.
- **Depreciation:** Assume a 7-year average useful life for new assets; assume that the existing Net PP&E is depreciated at 45% in Year 1, 30% in Year 2, 10% in Year 3, 10% in Year 4, and 5% in Year 5.
- **Stock-Based Compensation:** Use a historical average % of Total Operating Expenses.
- **Deferred Income Taxes:** Use a historical average % of Income Taxes on the Income Statement.
- **Other Investing Activities:** Use a historical average as a percentage of revenue; as the company grows, it has more cash to invest in other assets.
- **Issuances of Equity:** This should be \$0 in each year – remember, Accel’s investment came from **before** the historical years shown in Excel, and T. Rowe Price **purchased shares from employees** but did not actually buy *new* shares in the company!
- **FX Rate Effects:** These are significant since over 50% of Atlassian’s customers are in the US, and the AUD-USD exchange rate has fluctuated substantially in the past 4 years. Make this a % of the company’s revenue, and use the historical average going forward.

For simplicity, please assume that the company **earns no interest income** on its cash and other investments (interest rates were close to 0% at this time).

Since the company has no debt or other borrowings, it incurs no interest expense.

#### **Part 4: Linking the Statements and Calculating the Potential IRR to Accel and T. Rowe Price**

In this section of the case study, you will link the Income Statement, Balance Sheet, and Cash Flow Statement, and ensure that your 3-statement model works properly.

Since Atlassian’s statements are relatively simple, this should be a straightforward process.

Make sure that each item on the Balance Sheet is reflected exactly *once* on the Cash Flow statement, and vice versa.



For example, if there's an item on the Cash Flow Statement that does not flow into the Balance Sheet anywhere, or if there's an item on the Balance Sheet that isn't reflected anywhere on the Cash Flow Statement, your model is incorrect and the Balance Sheet will not balance.

Once you've properly linked the model, please calculate the potential internal rate of return ("IRR") and money-on-money ("MoM") multiple to both Accel and T. Rowe Price.

For Accel, the calculations will be based on its initial \$60 million USD equity investment at a valuation of \$400 million USD in 2010.

For T. Rowe Price, the calculations will be based on its \$150 million USD equity investment at a valuation of \$3.3 billion USD in 2014.

**Remember that US-based firms made these investments in USD, but Atlassian's financials are all in AUD since it is based in Australia.**

Your model should allow for different exit values and exit years in the calculations.

The exit value should be based on an **EBITDA multiple** – make the baseline multiple similar to the multiple that T. Rowe Price paid recently, but build a wide range around that.

The exit year can be any year within the 5 years of the model's projection period.

Since T. Rowe Price is a late-stage investor, it is targeting a **20% IRR**: approximately twice the average annual return of the stock market over the past century.

Accel is targeting a multiple of **10x** on its initial investment since it was an earlier stage investor and targets money-on-money multiples rather than IRR.

You should build **sensitivity tables** showing the results at a wide range of different values for the exit multiples and exit years in this analysis.

### **Part 5: Case Study Discussion Questions**

Please use the output of your model to answer the following questions. You can submit your responses to these questions in a written Word document, or in a set of PowerPoint slides:

1. If you were T. Rowe Price, would you invest \$150 million USD in Atlassian at a valuation of \$3.3 billion USD? Why or why not?
2. If your answer is "no," what conditions would have to be true for you to change your decision and invest in the company anyway? For example, if the company's growth rates, margins, or valuation were different, would your decision change?



If your answer is “yes,” what investment terms might you stipulate to protect yourself in this deal?

3. At an Atlassian valuation of \$3.3 billion, Accel’s 15% stake is worth \$495 million, so it was not possible to sell their entire stake to T. Rowe Price. However, press releases and news reports confirm that Accel did sell at least some of its stake, “taking money off the table” in the process.

Do you agree with this decision? How much do you think Accel should have sold, and why? Or if you disagree with the decision, why would Accel be better off waiting to sell?

4. If you were to pursue this investment opportunity, what areas would you need to perform further due diligence on? For example, are there any assumptions that you had less conviction on? What are the top 2-3 most important figures and assumptions that you need to research in more detail?
5. In hindsight, was it a good idea for Atlassian to reduce its prices significantly in 2011 to win more customers, and to offer the on-demand model for its products? What are the financial implications of these decisions?
6. Do you think the growth numbers and margins you have projected are achievable? What is the relationship between average customer value, growth, and the total number of customers the company can potentially sell to?
7. How do Atlassian’s business and business model compare to other “hot” tech companies at this point in time, such as Box, Dropbox, and Square? What is more appealing and what is less appealing vis-à-vis peer companies? What about compared to companies in similar markets, such as 37 Signals (Basecamp), Wrike, and Github?
8. Even with conservative assumptions, Atlassian generates a huge amount of excess cash by the end of the 5-year projection period. How do you think it should use this cash? As an investor, how might you take advantage of this excess cash balance to mitigate risk?