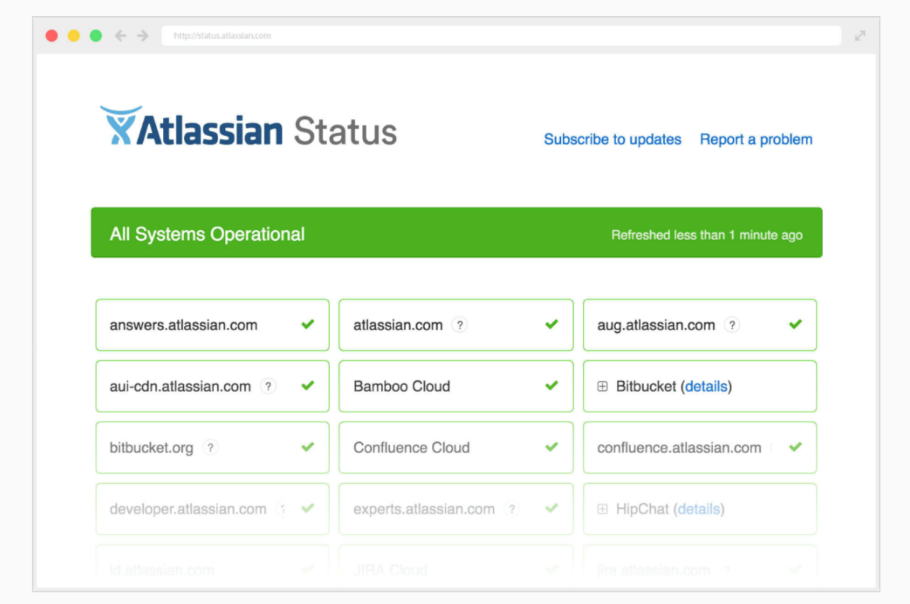
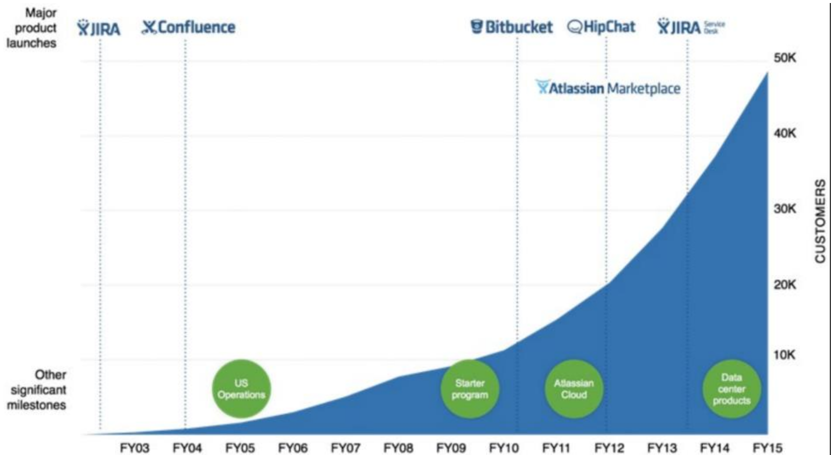


The Growth Equity Case Study 2.0: Atlassian Model

Add-On Acquisitions Are Always Better with Someone Else's Money

ATLASSIAN



What is Growth Equity?

This entire tutorial corresponds to an M&I article on the topic:

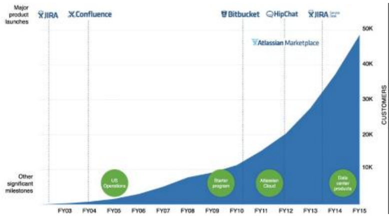
https://www.mergersandinquisitions.com/growth-equity/

We'll expand on that M&I article here and show you more of the Excel parts.

Plan for This Tutorial

- **Part 1:** What is Growth Equity?

- **Part 2:** Highlights of a Growth Equity Case Study and Model



- **Part 3:** How to Make an Investment Recommendation

Part 1: What is Growth Equity?

- **Basic Idea:** Mix of **private equity** (leveraged buyouts) and **venture capital** (investing in risky but high-growth-potential startups)

- **Difference 1:** Only tend to invest minority stakes in companies

- **Difference 2:** Companies must have proven markets and business models, i.e., have actual revenue, even if they're not profitable

- **Difference 3:** Companies use the investment for a *specific* growth purpose, such as market/geographic expansion, more sales reps, factories, acquisitions, etc.

Part 1: What is Growth Equity?

- **Other Differences:** A few related to the financial characteristics of deals…

- **Targeted Multiple or IRR:** Often 3-5x and 30-40%; lower than the 5-10x that VCs target and higher than the 2-3x PE target

- **Returns Sources:** Primarily **growth**, whether organic or other, no debt paydown, and *maybe* some from multiple expansion

- **Leverage:** Minimal debt used, but sometimes they use preferred stock or hybrid securities like convertible bonds to mitigate risk

Part 2: Growth Equity Case Study Highlights

- **This one** comes from our Excel & Fundamentals course and is based on **Atlassian**, a software company that creates tools for programmers

- **Financials:** < $1 billion in revenue, slightly negative operating income, 40% revenue growth, and transition to subscription model

- **Question:** Should we invest $2 billion for a small stake in Atlassian so they can use the funds to acquire other, high-growth software companies and get customers and cross-selling like that?

- **NOTE:** This is a bit weird since Atlassian is far too big for a traditional growth equity deal, $2 billion is huge, etc., but we'll go with it

Part 2: Growth Equity Case Study Highlights

- **Revenue:** Billings vs. Revenue → Billings represents cash collected from customers for orders, but isn't recognized right away

- **New Customers:** Billings increases by XX% per year (50% to 30%)

- **Existing Customers:** Certain percentage renew and accept price increases, so their Billings also increase

- **Subscription Billings:** New Billings + Existing Billings

- **Revenue:** % Recognized from This Year + % Recognized from Prev Year

Part 2: Growth Equity Case Study Highlights

- **License & Maintenance Revenue** is similar, but Licenses are simple one-time sales, and New Maintenance Revenue comes directly from License sales in that year

- **Expenses:** Some are simple percentages of Revenue or Billings; others, like R&D, are based on the Employee Count and Cost per Employee

- **Next:** We use these assumptions and fairly standard ones for Working Capital (e.g., Accounts Receivable as a % of Revenue) to build the financial statement projections

Part 2: Growth Equity Case Study Highlights

- **Add-On Acquisitions:** The company spends $700 – $775 million per year over 5 years to acquire other, high-growth companies

- **Problem:** Company pays an average **20x revenue multiple** for them! Yes, they're high growth(~100%), but are they worth that much?

- **Setup:** We created a mini-waterfall schedule to show the revenue and EBIT from each acquisition each year, and added them up

- **Punch Line:** Over $3 billion of spending generates only $600 million in extra revenue and $100 million in extra EBIT by Year 5

Part 2: Growth Equity Case Study Highlights

- **Tax Schedule and NOLs:** Standard setup – create NOLs when Taxable Income is negative, and use them when it's positive


- **Statements:** Ignore NOLs on the IS and account for the book vs. Cash tax differences on the CFS

- **Returns:** Based on Atlassian's historical revenue multiples, in the 10x to 25x range, and we create sensitivities at the bottom

- **Why Revenue Multiples?** EV / EBITDA ones don't work here given the company's low-to-negative EBITDA initially

Part 3: How to Make an Investment Recommendation

- **Goals:** 20-25% IRR in the base case, 30%+ in optimistic cases, and a minimum of 10% in downside cases

- **So:** This seems to be an easy "yes" since we meet all those targets, the company is growing quickly and moving to a better business model, and the market is fragmented but growing quickly

- **Biggest Risk:** Severe multiple contraction to the 7-10x level, but we could mitigate some of that with a convertible bond or other hybrid security for the investment

- **BUT:** You could take the other side of this as well!

Part 3: How to Make an Investment Recommendation

- **Why?** The issue is that the add-on acquisitions barely do anything… remove them, and the IRR only changes by ~2-3%

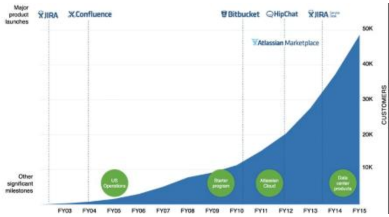
- They're **too expensive**, and their impact on the returns is questionable; company does well organically, not due to deals

- **So:** Maybe the answer is "No, because the company needs a better plan, such as hiring official sales reps or otherwise spending the money on sales & marketing rather than acquisitions"

- **OR:** Maybe we need to increase the holding period to see the full impact of the acquisitions?

Recap and Summary

- **Part 1:** What is Growth Equity?



- **Part 2:** Highlights of a Growth Equity Case Study and Model

- **Part 3:** How to Make an Investment Recommendation