

Round2

CAPITAL PARTNERS

HOW REVENUE-BASED FINANCE CREATES EXCEPTIONAL VALUE FOR FOUNDERS AND SHAREHOLDERS

Dr. Christian Czernich



Revenue-based finance is a quantum leap forward in the way the growth of digital businesses with recurring revenues is funded. The Round2 revenue-based finance solution is not only a simple, flexible and transparent form of growth funding, it also creates exceptional value for Founders and shareholders without diluting ownership.

How can Founders and equity investors alike systematically think of the exceptional value a revenue-based finance solution creates for them? As an example, let us look at an imaginary B2B SaaS business under two different scenarios, an Exit scenario and as a going concern, and see how an investment from Round2 creates value.



EXAMPLE

Consider a B2B SaaS firm with EUR 2m of annual recurring revenue (“ARR”) operating at break-even. At Round2 we support revenue growth particularly through the expansion of sales and marketing by funding, e.g., hiring new personnel or additional sales and marketing campaigns.

Let us assume that every new customer generates on average EUR 5,000 of additional ARR and that the customer acquisition cost (“CAC”) is also EUR 5,000. Thus, it takes on average 12 months to earn the CAC back, which is a normal value for a well-managed B2B SaaS business with a functioning business model.

The SaaS company receives a Round2 revenue-based funding of EUR 500k in exchange for 5% of its yearly revenue. With a EUR 500k financing the company can acquire 100 new customers (EUR 500,000 / CAC of EUR 5,000) within a period of one year. These 100 new customers generate an additional ARR for the company of $100 \times \text{EUR } 5,000 = \text{EUR } 500,000$.

HOW EXCEPTIONAL VALUE IS CREATED

THE EXIT SCENARIO

Growing SaaS firms operating around break-even are typically valued at 5-10x of their ARR. In the example above the additional financing of EUR 500k led to an increase of EUR 500k of ARR. Applying the valuation multiple of 5 - 10x ARR, the company valuation at a possible exit has increased by $\text{EUR } 500\text{k} \times 5/10\text{x} = \text{EUR } 2.5\text{m} - 5\text{m}$ due to the newly acquired customers.

In the case of an exit within four years from funding the cost of a Round2 revenue-based financing is roughly EUR 375k, as Round2 receives in case of an exit its capital back plus 75% of the original capital on top in the form of royalties. Depending on the exit value an exit fee might be applied as well. Thus, roughly speaking with a capital cost of EUR 375k EUR 2.5m - 5m of value was created for the Founders and shareholders.

The calculation more in detail is as follows:

At an exit event or change of control Round2 receives the at the time of exit outstanding principal plus the open royalties. This equals to EUR 875k (EUR 500k of principal plus EUR 375k of royalties) minus the revenue shares that have been paid until the exit. Assuming a sales CAGR of 20% over a four year period the total revenue shares paid amount to approx. EUR 650k. Thus, at the event of exit there are still EUR 225k open to be paid to Round2 (EUR 875k - EUR 650k). This can be considered as net debt and needs to be subtracted from the enterprise value of the business. The value created for the Founders and shareholders is thus EUR 2.5m - EUR 5m minus EUR 225k debt outstanding. This outstanding debt is however considerably reduced by the tax advantage from the revenue-based funding, as all royalty payments are tax deductible

In summary, the net value created for Founders and shareholders of a EUR 500k Round2 revenue-based financing in the above outlined case is somewhere between EUR 2.5m to EUR 5m, which is between 6.5x - 13x of the Round2 cost of capital.



THE GOING- CONCERN SCENARIO

The beauty of Software firms and SaaS firms in particular is that these companies can scale at no or low cost other than expenses for sales, marketing and customer support. There is no need for working capital nor are there any cost for raw materials, machinery or equipment. Software can infinitely be replicated at virtually no cost other than the cost for the typically outsourced cloud infrastructure.

Thus, in the example from above the EUR 500k of new ARR that got created leads to a direct increase of profitability. Assuming a gross margin of 90% the ARR increase of EUR 500k leads to an increase of the gross profit by EUR 450k.

Based on these assumptions the Round2 financing solution has the following yearly cash and cost effects in the going concern:

CASH EFFECT

5% revenue share of EUR 2.5m ARR (2m old ARR plus EUR 500k new ARR) = EUR 125k cash effect.

COST EFFECT

50% of the revenue share is typically principal repayment and has no effect on the P&L. The P&L effect is only capital cost in the form of royalties. Thus, the cost of the Round2 financing solution is 50% of 125k = EUR 62,500. As these royalty payments are tax deductible the net capital cost at a 25% tax rate is EUR 46,875.

In summary, the Round2 funding increased yearly company profit as follows:

EUR 450,000 of additional margin - EUR 46,875 of net capital cost = EUR 403,125 per year. Accounting for the CAC of EUR 500k it takes 1.24 years to earn the CAC back. After that the Founders and shareholders have an increased profit of EUR 403k per year net of the Round2 capital cost.



CONCLUSIONS

Revenue-based financing is a quantum leap forward in the way the growth of digital businesses with high gross profit margins and low working capital requirements such as B2B SaaS firms is funded. Building on recurring revenues the funding solution is not only transparent, highly flexible and simple to implement, revenue-based finance also creates exceptional value for Founders and shareholders without diluting ownership. The calculations above are based on normal metrics for well managed B2B SaaS firms with a functioning business model. Building on these assumptions a growth funding of as little as EUR 500k can create between EUR 2.5m - 5m of shareholder value in an exit scenario as well as in a going concern scenario.

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