The SaaS Income Statement

About SaaSOptics

570+ Customers in 17 Countries

$4.1B in Managed Customer Revenue

$12B+ in Customer-Raised Capital in 1,800+ Rounds

Tim McCormick
CEO

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About SaaS Capital

62	$630M	12
Companies Funded	of Equity Value Created	Years Lending

Todd Gardner
Founder and Managing Director

Agenda

1. Why does the Income Statement matter so much?
2. GAAP vs cash: Which one makes sense and when?
3. The “ideal” income statement layout for VCs, lenders, board members, and the management team
4. The SaaS Momentum Chart
5. Spending Benchmarks
6. ASC 606…ugh
7. Questions

Polling Question

What is your current ARR?

1. Under $1 million
2. $1 to $3 million
3. $3 to $10 million
4. Over $10 million

The Income Statement

A GAAP Income Statement is the best source for understanding <u>growth</u> and <u>burn:</u>

- When looking at *growth*, bookings are important, however:
  - Not always commonly defined and reported
  - Don’t always translate into revenue and cash (failed implementation)
  - Hard to see growth trends due to lumpiness/backlog

- When looking at *burn*, the cash flow statement is helpful, however:
  - Working capital swings in AR can swing monthly cash flows dramatically
  - Cash flow statement is best for near-term, seasonal, tactical planning
  - At “steady state,” in the long run, Net Income = Burn (Not EBIT or EBITDA)

Polling Question

What accounting method do you use to recognize revenue?

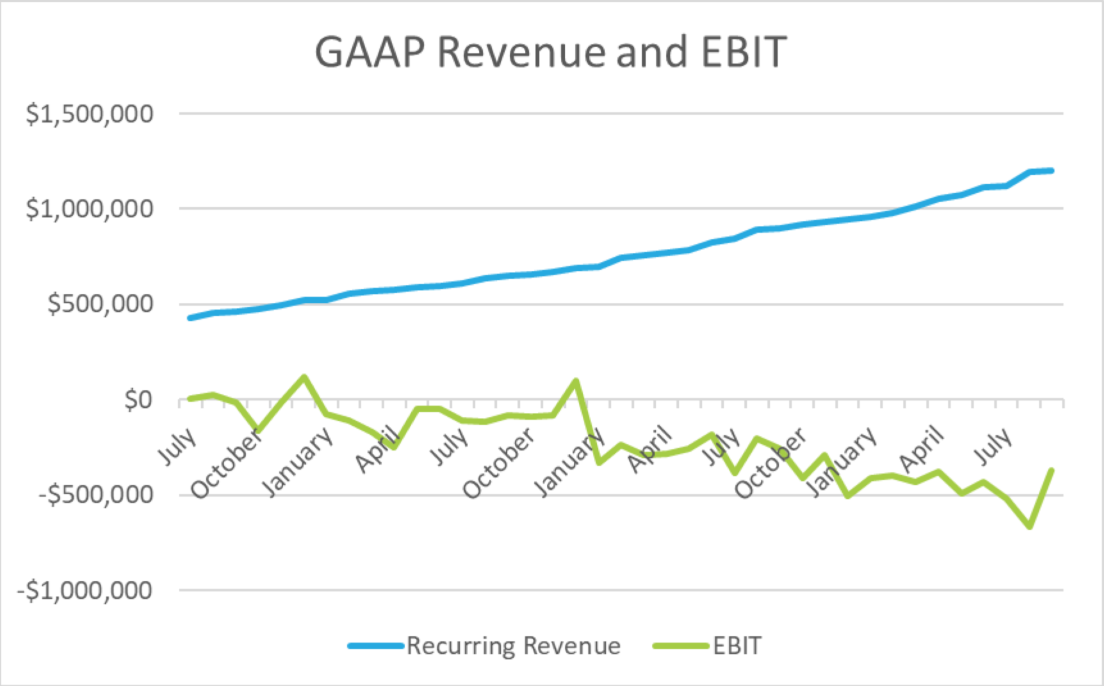
1. Cash
2. GAAP

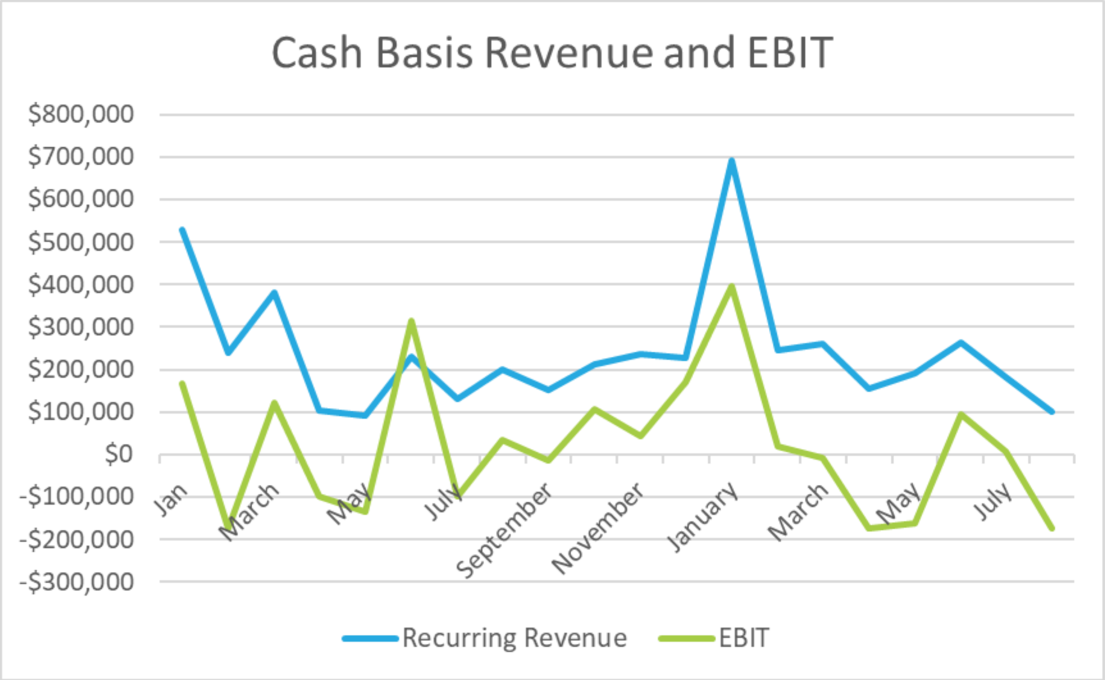
Cash-Based Accounting

- Benefits of *Cash*-Based Revenue Recognition
  - Is a fine way to get started, simple and easy
  - Provides direct visibility into monthly cash billings
  - Used by the majority of SaaS companies under $2 million in ARR
  - Can be used indefinitely for companies billing monthly and not raising institutional capital

- Disadvantages
  - Provides less visibility on underlying performance trends (see chart to follow)
  - Does not support many important SaaS financial metrics
  - Will not support a later-stage capital investment
  - Necessitates a separate "MRR sheet" (not tied to the financials)

GAAP Allows for Better Trend Visibility





The Ideal SaaS Income Statement

	Mar	April	May
Revenue			
Subscription Software Revenue	$ 385,000	$ 370,000	$ 375,000
Professional Services	$ 20,000	$ 55,000	$ 40,000
Other Revenue	$ 12,000	$ 1,000	$ 7,000
Total Revenue	$ 417,000	$ 426,000	$ 422,000
Cost of Goods			
Direct Third Party Costs	$ 3,850	$ 3,700	$ 3,750
Hosting Expenses	$ 9,625	$ 9,250	$ 9,375
Customer Success (Retention Focused)	$ 14,500	$ 13,000	$ 13,000
Internal Engineering (Salaries)	$ 4,000	$ 3,900	$ 4,300
Professional Services	$ 35,000	$ 33,000	$ 34,000
Total CoGS	$ 66,975	$ 62,850	$ 64,425
Gross Profit	$ 350,025	$ 363,150	$ 357,575
Gross Profit Margin	*84%*	*85%*	*85%*
Operating Expenses			
Sales and Customer Success (Sales Focused)	$ 122,000	$ 135,000	$ 140,000
Marketing	$ 89,000	$ 79,000	$ 90,000
Product Development	$ 128,000	$ 133,000	$ 135,000
General and Administrative	$ 73,000	$ 81,000	$ 83,000
Total Operating Expenses	$ 412,000	$ 428,000	$ 448,000
Operating Profit (EBIT)	$ (61,975)	$ (64,850)	$ (90,425)
Interest Expense	$ 7,000	$ 7,000	$ 7,000
Net Income	$ (68,975)	$ (71,850)	$ (97,425)

Tips

- Recognize revenue according to GAAP (spread it)
- Break out recurring vs non-recurring revenue and services from licensing revenue
- Provide detail on COGS expenses, and tie them back to revenue
- Include support and retention related Customer Success costs in COGS, and move cross/up selling costs into sales or by itself below gross margin
- Avoid one simple expense line called “salaries”
- Do not capitalize software development expenses (fight auditor on this one)
- Don’t allocate “Overhead”, not worth it

SaaSOptics' Income Statement

Income:
- Subscriptions
- Professional Services

Cost of Goods Sold:
- Professional Services Wages
- Hosting Fees
- Royalties
- Subscription Costs (Customer Success)
- Software Tools (Customer Success)
- Credit Card Fees
- Customer Support Wages
- Partner Commission Expenses

Gross Profit

Expenses:
- Subscription Costs
- Taxes
- Depreciation
- Customer Success
- General & Administrative
- Marketing
- Research & Development
- Sales

Net Operating Income

Explanation

- Recognize revenue daily over the legal contract term
- We break out recurring vs. non-recurring revenue
- COGS: Services wages, hosting fees, royalties, credit card fees, software tools to deliver support and customer success
- Exception: Do not have engineering expenses in the delivery of your services
- Expenses: Departmental expenses, and travel

The SaaS Perspective (the other key chart)

Key SaaS Metrics - Momentum

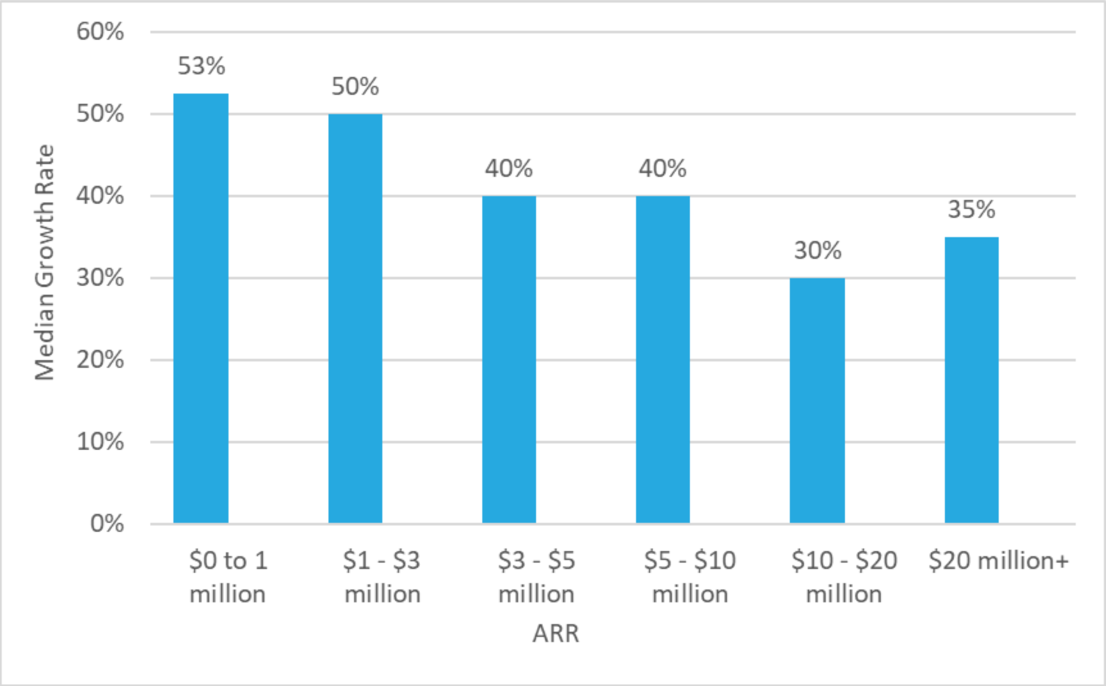
Customer: Name	Jul 18	Aug 18	Sep 18
⊞ Opening	14,725,510	15,117,258	16,854,568
⊞ New	601,986	1,759,291	1,489,243
⊞ Lost	-135,044	-118,603	-79,348
⊞ Expansion	6,451	230,203	117,334
⊞ Contraction	-81,645	-142,866	-35,389
⊞ End of Period	15,117,258	16,854,568	18,346,409

Key SaaS Metrics - Customer Count

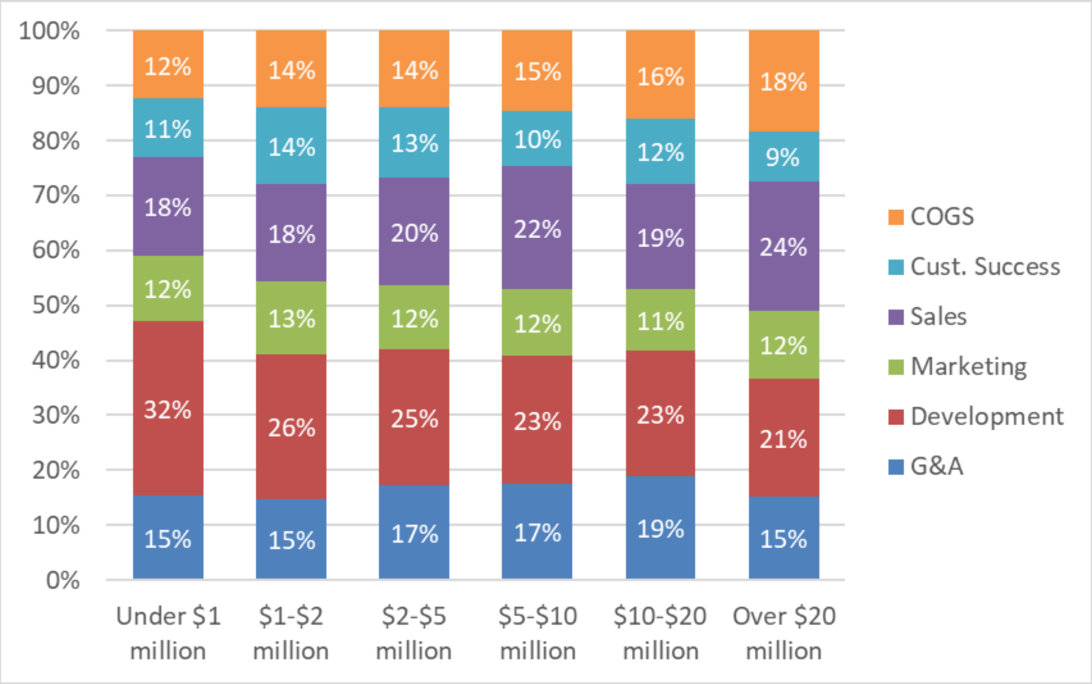
Customer: Name	Jul 18	Aug 18	Sep 18
⊞ Opening	882	907	993
⊞ New	36	92	96
⊞ Lost	8	7	1
Expansion	1	10	10
Contraction	5	7	5
⊞ End of Period	907	993	1,089

Benchmarking the Income Statement

Is your company growing faster than others its size?



How does your company spend its money compared to others?



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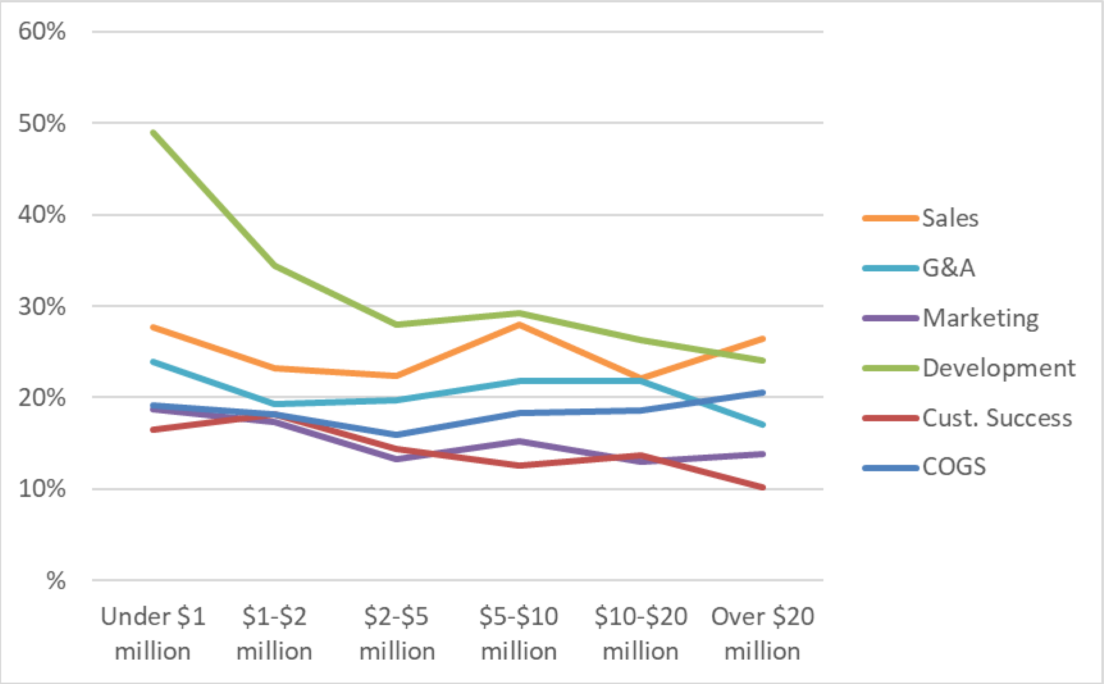
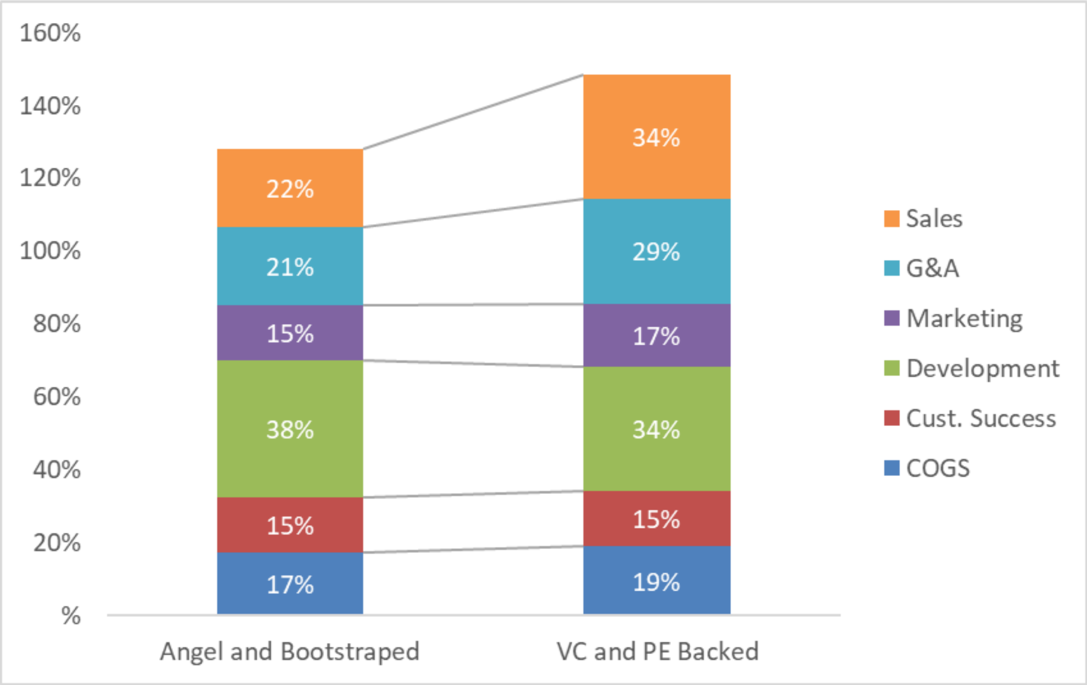
How Spending Changes: with Revenue, by Funding

How Spending Categories Scale with Revenue



Spending as a % of Revenue by Funding Source



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Polling Question

How has your company been Funded?

1. No Funding, bootstrapped
2. Angel Investment
3. VC Investment
4. Private Equity/Strategic

ASC 606 Adoption: SaaS Capital's Perspective

Despite 2019 being the first year private companies need to comply with ASC 606 for audit purposes, we have seen little adoption to date.

1. We have seen only 2 sets of ASC 606 compliant 2019 financials!
2. Everyone is waiting for their auditors to suggest year-end adjustments.
3. Year-end adjustments may work for 2019, but the 606 rules need to be baked into 2020 interim numbers and 2019 interim numbers recast for historical comparison.

ASC 606 Impact: SaaSOptics’ Perspective

570+ customers (99% private)

- <5% cash accounting
- 95%+ will have to comply with ASC606
- 20-25% will require advanced revenue recognition module:

  - Contract language that results in performance obligations (SLAs, cancellation for convenience, future commitment to discounts, etc.)

  - Revenue allocations due to discounting/bundling

  - Expense amortization (commissions)

  - Materiality matters (one-off contracts vs. majority of contracts)

Advice

- Ask your auditors or seek an independent review of your current rev rec practices against ASC606 changes – “Rev Rec Memo”
- Defend your interpretation of the new guidelines
- Consider automation to save time/headache

Summary

1. Switch to GAAP at $2 or $3 million in ARR.
2. Presenting the Income Statement in a format consistent with others will help you raise money, benchmark others, and run the business.
3. Understand your company's growth rate relative to its size.
4. Expect development expenses to scale down as revenue grows, but not expect other costs to do the same.
5. Proactively engage your auditors on ASC 606. Manual year-end adjustments become expensive and hard to maintain.

Questions?

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SaaS Capital is the Leading Provider of Long-Term Committed Credit Facilities to SaaS Companies

What Can SaaS Capital Do for You?

SaaS Capital funds the growth of VC and non-VC backed SaaS companies. Because of our higher availability and long-term structure, most companies use our Committed Credit Facilities in lieu of a Series A, B, or C of equity.

Benefits of our unique, SaaS-focused, approach:

- **Higher advance rates** — Capital availability is based on a multiple of your monthly recurring revenue (MRR) – typically 4x to 7x MRR
- **Capital availability that grows with your business** — The amount of capital that you can draw increases automatically as your revenue grows
- **Long-term source of capital** — The capital is drawn down over 2 years under the committed line of credit, and then either renewed, or repaid over the following 3 to 4 years
- **Efficient use of capital** — Capital is drawn down only as your business needs it, thereby reducing your interest expense
- **Cost is simple and transparent** — interest rate of 11% to 13%, a 0.75% to 1.50% commitment fee, and "at-the-money" warrants
- **No balance sheet covenants or cash reserve requirements**

SaaS Capital lends between $2M and $15M

SaaS Capital is best able to assist companies with the following attributes:

- Sell a SaaS-based solution
- $250,000, or above, in MRR
- History of renewals greater than 85%
- Headquarters in U.S., Canada, or the United Kingdom
- Revenue growth above 15% per year

Your business does **NOT** need to be:

- Venture Backed
- Profitable
- Billing your customers monthly

Visit www.saas-capital.com to learn more.

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