Annual Shareholder Letter #2

Dear Fellow Shareholders,

This is my second letter to you. Boy, what a year 2020 was! I’m going to start this letter by beginning at the end of the previous one, which came out four weeks after the COVID-19 Pandemic started to dominate our daily lives. I regularly describe 2020 as the longest and fastest year on record. We entered a generationally defining event abruptly, without any advance notice to prepare for the changes that would be forced upon our way of living.

We got to witness some pretty wild things in 2020:

Shelter in place and stay at home orders.

Non-essential businesses forced to close.

Massive unemployment, particularly in industries hit the hardest by the government orders given to flatten the curve (e.g., hospitality, travel, etc).

Unprecedented financial responses from governments and central banks around the world in an attempt to soften the blow from the drastic measures that were taken to fight the war against an enemy invisible to the human eye (I heard that at the last tally this pandemic had cost $28T globally).

Acceleration in trends that were already underway but pulled forward by a decade or more (e.g., work from anywhere, e-commerce, software eating the world, etc).

A housing boom driven by the lowest interest rates in history and a massive shift in the demand for housing outside the big cities.

A stock market boom led by easy money (the Fed put) and the technology sector.

Oil trading negative for the first time in history – you couldn’t give it away. At the worst, you had to pay someone $37.63/barrel to take it from you.

And so much more…

They are referring to this crazy year as The Great Lockdown of 2020 (and well into 2021, it’s yet to be fully behind us)!

A Quick Walk Down Memory Lane

There was so much uncertainty in the world when the first letter was published in April last year. In my closing words from that first letter (copied below), you can see that I was cautiously optimistic, but without enough visibility beyond the three months of contracted work in hand, I was checking that optimism:

> Final Words on the Current State of the World
>
> You know I couldn’t finish this letter without addressing COVID-19 and how it has or will impact our business for the remainder of 2020 and beyond. The world changed drastically halfway through the last month of our first full twelve months in business. We have yet to feel the impact directly in the financial results of our business but that is because we are still working through a backlog of pre-contracted work. And because our services are pre-paid, our clients are incentivized to continue forward with getting their software implementation over the finish line. It is more important than ever that they get the project complete so that they can have the visibility they need to make the hard decisions required to adjust to the new world we find ourselves in. As many companies downsize it becomes even more important to leverage technology to do more with less (in many cases, that “less” unfortunately means “people”).
>
> However, I would be delusional to think we are not impacted at all. Our sales pipeline has vanished overnight as companies hoard cash and freeze all discretionary spending. And who can blame them? There is so much uncertainty. We live in unprecedented times. The Federal Reserve and the Federal Government have been battling a war on two fronts. On one front they have taken monumental action to keep our people safe from the COVID-19 virus, while on the other front they have provided historic amounts of financial capital to support our people’s economy and livelihoods.
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> I have no idea how this all unfolds or where we go from here, but I do encourage each of you to remain optimistic and think of this as an opportunity

> to reflect, reset, and communally rejigger our path forward as one people. Let’s use this as an opportunity to connect with our families and our communities now in new ways, and then even more deeply once the restrictions on our daily lives are lifted. Truly, the only way we are getting out of this crisis is together!
>
> There is no doubt that life will be different. Business will be different. But what won’t be different is our ability to adapt and thrive! This is our “Greatest Generation” moment!
>
> Although I can’t predict how painfully or for how long our lives will be disrupted, I can say with full confidence that we (the world) have decades of prosperity and happiness ahead of us. We will emerge from this more resilient than ever. This crisis will ultimately lead to more innovation and unintended insights that will propel us toward a brighter tomorrow.

Shortly following the publication of the first letter I had cautioned my team to prepare for some potentially tough times ahead, at least beyond the three months of contracted work I was confident about. I encouraged each of them to save as much money as they could by cutting out all non-essential spending over the next three months. I shared with them that I was optimistic that the pipeline would come back and we would resume our growth and I promised I would do everything I could to win new work.

Once The Shock Wore Off

It wasn’t too long after the first shareholder letter was published that the shock of the Pandemic started to dissipate. It couldn’t have been more than a couple of days after publishing this letter that I receive a distressed call from the CEO of my prior employer. His paraphrased words to me were as follows:

> *Dom, the worst thing that ever happened to us (the business) was you leaving, the second-worst thing was you leaving and then getting hit with a Pandemic. I know this isn’t your core business but if you’re able and willing, I need you to pull together a proposal over the weekend for your company to take over the finance and business intelligence functions of our business. You can hire C-Money directly and charge us a margin but I also need to have 25% of your personal time written into the contract. I know you are running a business and*

can’t afford to give more than this and that 25% is a big ask. All I ask is that you don’t be greedy but make sure you make a fair margin on the deal. If you can do this for me it would mean the world and I assure you that it will lead to a long-term relationship between our companies.

This was certainly not something I had expected to happen but given that I had just hired another full-time resource on April 1 and under this new agreement I would have the same team (myself, C-Money, and T-Dog) to deliver this service, I decided to take the lemons provided by the Pandemic and make lemonade.

We inked a deal in April that went into effect May 1. This was the first domino in a long line of dominos to fall our way. Pre-pandemic we were on track to double our business in 2020, but by June, we were now tracking for more than a triple. What a turn of events to go from so much uncertainty to more business than we were staffed to handle. During the depths of the pandemic (March through May), we hired two additional full-time resources, both of whom are also now equity partners in the business. We needed more help but we were not ready to commit to any additional full-time team members due to my conservative nature. I take employing people very seriously: when they come to work for my company, their livelihoods are now my responsibility. I needed some flex resources, so I started to have some conversations in the partner community. Lucky for us, while we were getting tight on resources, we were flush with more than enough work to keep us busy, while other partners working with the same vendor were flush with resources and not enough work.

Opportunity strikes again!

We were able to solidify three new working relationships that gave us access to flex resources with no obligation should the work dry up. We started the year with three full-time team members and by the end of July, we had five and another six flex resources, which allowed us to more than double our capacity. We finished the year with 14 team members in various parts of the world as reflected in the map below.

We went global in midst of a global pandemic. This allowed us to dip our toes into a new offshore labor model that has proved to be highly accretive to our business and is turning into a strategic advantage against our North America-based partner and competitors.

Our Software/Application Stack

We run our business on a number of software applications. What is so amazing about software today vs. ten years ago is how cheap and integrated it all is. For anyone curious as to what it takes to run a completely remote workforce in multiple countries around the world...here you go!

- Sales & Marketing
    - Website
        - GoDaddy
        - WordPress
    - Salesflare
    - LinkedIn

- Project Delivery and Project Management
  - ClickUp
  - Microsoft Office Suite (particularly Excel) Word, PowerPoint, Excel, Outlook, Power Automate, Power BI
  - Slack
  - Zoom
  - ScreenToGif
- Accounting, Payroll, Employee Benefits, Time Tracking, Invoicing, and Bill Pay.
  - Quickbooks Online
  - QBO Full-Service Payroll
  - Guideline: company 401k plan
  - SimplyInsured
  - Vena Solutions
  - Divvy
- Productivity / Other
  - LastPass
  - Calendly
  - Boomerang
  - Dropbox
  - Chrome
  - Text Blaze

Our Financial Performance

2020 represents our second year in business and is the first calendar year that we were in operations for a full twelve months. We started the business in late Q1 of 2019.

I don’t have the statistics, but I’m willing to bet that we are in the top 1% in terms of performance for a second year business. According to Fortunly, 20% of businesses fail in their first year and another 33% that survive the first year fail in their second year – I’m happy to have defied the statistics once again this year. In another survey conducted by Business Know-How in 2020, the results showed that only 7% of small businesses earned $1M or more in revenue – we are among the elite!

With that stage set, here is a reminder of some of the unique characteristics of our business:

(1) We pre-collect revenue for our consulting services. This means that working capital is never an issue! Before starting this business, I had assumed that we would be cashflow negative for the first 12-18 months (so, I secured a $420,000 line of credit that has never been used). Instead, we were almost cash flow positive from day one if you exclude the initial investment of $267.42 (which rounds to **zero,** especially if you consider the business has generated ~$2M in revenue with robust profitability).

(2) The commissions we earn selling the software are 100% profit margin. We have an exclusive partnership with one software vendor and as a reseller earn commission on software sales. In some cases, the commission is a one-time payment, while in other cases there is a recurring residual for as long as the client remains a client.

(3) We are a 100% remote workforce. This allows us to keep our overhead very low as we don't need to pay for office space and all the associated ancillary costs. (In 2020 we did sign two leases in co-working offices for several employees that wanted separation between work and home.)

(4) We have enviable profit margins. I haven't seen very many businesses with profit margins as high as ours. As a consulting business, our major expense is people.

(5) Our cost structure is almost 100% variable. Although our team members are on payroll (W-2), they are effectively working on 100% commission. For some this is scary but for high performers, this is a dream come true. In return for this flexibility, I am generous with the pay structure, paying significantly above market rates. Each billable team member gets up to 50% of the billable revenue they help earn the company (an opportunity to earn well over $140,000 as a full-time billable resource).

And now the financial results…

ABBREVIATED P&L	Actual 2020	Actual 2019	Variance Analysis $	%
Reimbursable Revenue	29,332	26,696	2,636	9.9%
Software Reseller Commissions	201,043	63,229	137,814	218.0%
Fee Revenue	1,305,414	365,315	940,099	257.3%
Gross Revenue	**1,535,789**	**455,240**	**1,080,549**	**237.4%**
Reimbursable Expense	**29,332**	**27,177**	**(2,155)**	**-7.9%**
Net Revenue	**1,506,457**	**428,064**	**1,078,393**	**251.9%**
Direct Labor	**657,447**	**195,182**	**(462,265)**	**-236.8%**
Gross Profit	**849,010**	**232,882**	**616,128**	**264.6%**
GM %	**56.4%**	**54.4%**	**2.0%**	**3.6%**
Indirect Expenses	**283,225**	**81,130**	**(202,095)**	**-249.1%**
EBITDA $	**565,785**	**151,752**	**414,033**	**272.8%**
EBITDA %	**37.6%**	**35.5%**	**2.1%**	**5.9%**
Add Backs	**56,837**	**67,862**	**(11,025)**	**-16.2%**
Adjusted EBITDA $	**622,622**	**219,614**	**403,008**	**183.5%**
Adjusted EBITDA %	**41.3%**	**51.3%**	**-10.0%**	**-19.4%**
EV @ 5X Adj. EBITDA	**$3,113,111**	**$ 1,098,072**	**$ 2,015,039**	**183.5%**

What you see on the "EBITDA" line (green shading) in the above screenshot is synonymous with pre-tax net profit. As an S-Corp the taxes are passthrough to the shareholders, meaning that the corporation doesn't pay taxes on the profits; they are taxed on the individual owner's tax returns. For those not familiar with the term, EBITDA stands for **E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation, and **A**mortization (we currently have no ITDA in our cost structure). However, we have chosen to expense our CAPEX (capital expenditure) as we don't see a lot of value in creating a depreciation schedule for such a small dollar amount when we buy a laptop and a couple of monitors for a new team member. (The IRS allows the business to expense items if they are less than $5,000.)

Revenue growth was outstanding at 237.4% or 3.37X vs. the prior year. Our gross margins increased YoY, while our indirect expenses remained relatively flat as a percentage of revenue – running approximately 19% of Net Revenue. We expected to see an overall accretion in our unadjusted EBITDA margin (green highlight in above P&L) and we expect margins to continue to expand as we scale. The main drivers for the continued margin improvement are:

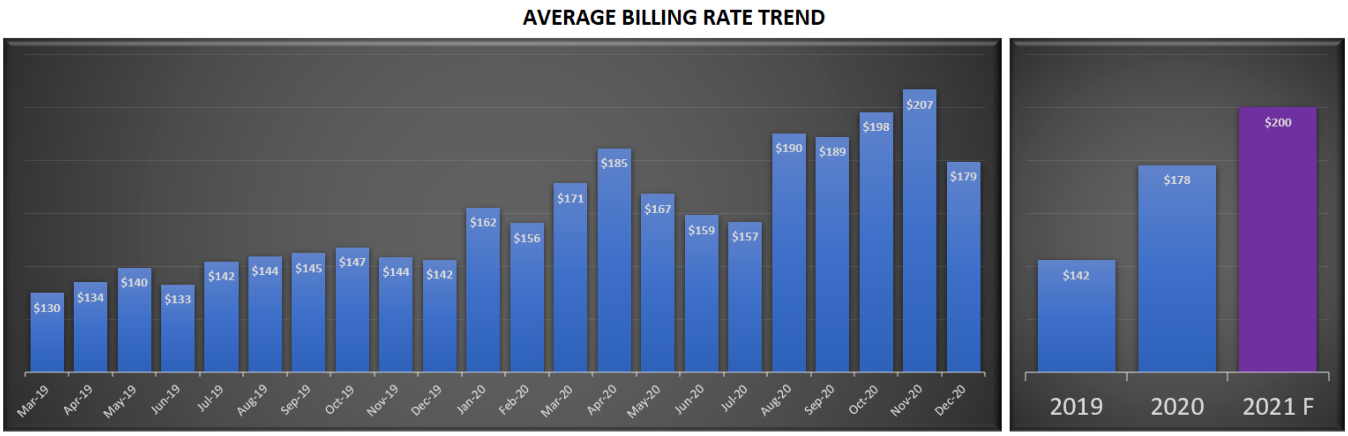
> **(1) An increased focus on availing of the reseller opportunity with our software partner.** We started this business handling overflow consulting work from our software partner – they scoped the implementation and then handed it off to us. We then transitioned to co-selling with our software partner, which allowed us to scope the deal on our paper and earn a one-time co-sell fee. This kept us (and me particularly) too busy to source many deals of our own. The focus for the first 18 months was to build a solid consulting practice and develop a playbook before I started to diversify the sales pipeline. That effort really just barely started in 2020 but is now well under way with my focus shifting to building the sales and marketing function for the business. The reseller opportunity comes with higher commissions and residuals!
>
> **(2) Continued effort in building out an onshore/offshore hybrid model.** This wasn't originally on our radar when we started the business but is something we are now very keen to continue developing after we opportunistically got to give this a trial run. I used to think that our profit margins would cap out at 50% but I now think we have upside to 60%+.

Note: The Adjusted EBITDA margin is really only applicable for an eventual liquidity event where we are adjusting for one-time expenses that we believe we could justify during such an event to sell the company.

Average Billing Rate

The majority of our business to date has been from our consulting practice and that is all time and billable rate driven. As we have built our resume of successful client engagements we have been able to continually drive our rate higher over time. It's amazing how fast we have been able to increase the billable rate from $130/hour to an ending average rate in 2020 of $178/hr.

We began aggressively raising our rates in early 2020 and then got set back (seen in the decline in May through July) due to the pandemic when I lowered rates to ensure we won work – we favored keeping the team busy and employed over maximizing our billing rate. We expect to get a lot more leverage in terms of margin improvements from these rate increase in 2021 and beyond as we work on the next level of the labor pyramid with offshore labor that we are able to pay less than 50% of the billable rate due to both a lower cost of living in their part of the world and the fact they are more junior to the core team members we have hired in the US.



We finished the last half of 2020 selling new jobs at an hourly billing rate of $175 to $200 per hour. Starting in 2021 we have moved the bar to target a billing rate between $200 to $225 per hour with a goal of achieving an average billing rate of $200 per hour in 2021. We have also recently dipped our toes into experimenting with fixed price jobs that if we get right could allow us another lever to increase our effective hourly rate.

A Peek Into the Future

In the public markets, they would call this section forward-looking guidance. During the month of November, I hosted a mini fall retreat and strategy session at the beach. I invited my partners and their spouses to share the beautiful beach rental that my wife and I had secured for the entire month of November. We discussed many items on the agenda related to the continued growth and success of our business. One of the items was to vet the business plan I had pulled together the month prior.

Unlike my experience in Corporate America, I like to set goals I believe are both achievable and beatable, and that everyone else agrees with as well. This was not my experience in Corporate America, where instead we would be forced to set goals that no one believed we could hit, and then hear how awful our performance was against budget. My team has become really comfortable with my “conservative yet aggressive” nature when it comes to forecasting the business. The below P&L is the budget that we agreed on during our strategy session. Some may be thinking that a

47% growth rate is not conservative, but let me explain.

ABBREVIATED P&L	Budget 2021	Actual 2020	Variance Analysis $	%
Reimbursable Revenue	36,000	29,332	6,668	22.7%
Software Reseller Commissions	365,010	201,043	163,967	81.6%
Fee Revenue	1,848,000	1,305,414	542,586	41.6%
Gross Revenue	**2,249,010**	**1,535,789**	**713,221**	**46.4%**
Reimbursable Expense	**36,000**	**29,332**	**(6,668)**	**-22.7%**
Net Revenue	**2,213,010**	**1,506,457**	**706,553**	**46.9%**
Direct Labor	**921,995**	**657,447**	**(264,548)**	**-40.2%**
Gross Profit	**1,291,015**	**849,010**	**442,005**	**52.1%**
GM %	**58.3%**	**56.4%**	**2.0%**	**3.5%**
Indirect Expenses	**361,153**	**283,225**	**(77,928)**	**-27.5%**
EBITDA $	**929,862**	**565,785**	**364,077**	**64.3%**
EBITDA %	**42.0%**	**37.6%**	**4.5%**	**11.9%**
Add Backs	**-**	**56,837**	**(56,837)**	**-100.0%**
Adjusted EBITDA $	**929,862**	**622,622**	**307,240**	**49.3%**
Adjusted EBITDA %	**42.0%**	**41.3%**	**0.7%**	**1.7%**
EV @ 5X Adj. EBITDA	**$4,649,310**	**$3,113,111**	**$ 1,536,199**	**49.3%**

We went through an exercise where we probability-weighted our pipeline and then added that to our contracted backlog and that is how we arrived at the $2.2M net revenue target for 2021. When we did this we had visibility of $1.5M of work that was already contracted in the backlog going into 2021 which when added to our total gross pipeline made the unchained opportunity $4.3M. So, the $700K added to our contracted work implied a win rate of only 25% needed to hit our overall target. Our actual win rate ran 57% in 2020.

I’m writing this letter in mid-February 2021. We currently have already earned $500K in revenue and still have a backlog of $1.5M (we’ve replaced contracted work as fast as we have churned it), implying that with 10.5 months to go we are only chasing $213K of new revenue needed to meet our 2021 goals. Everyone knows that our stretch number is $3M+.

The only other thing I would point out is that we have planned a 200 bps improvement in our gross margin (blue shading in the above P&L) and a 450 bps improvement in our EBITDA margin (green shading in above P&L). The other 250 bps is due to anticipated operating leverage from indirect expenses declining as a percentage of net revenue.

Other Important Metrics of Note

Total Contracted Revenue = ~$4,000,000 (since inception)

Revenue per FTE = $359,560 (based on 2020 avg. billable rate)

Average Client Lifetime Value (LTV) = $103,518 (and climbing)

Average Customer Satisfaction Score = 98.3%

Total Clients = 34

Closing Words

Like many, I look forward to life returning to a more familiar “normal,” as it was before all the pandemic restrictions. I’m in awe at the speed at which not one but multiple vaccines were developed and approved. I’m optimistic that we will achieve herd immunity in time for the summer of 2021 to be one of the best on record. In life, you will never truly appreciate the sweet without the bitter. I even hope to reflect back on this time period and see it as The Great Reset we all needed.

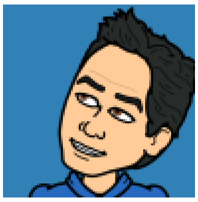
Although I am bullish on the continued success of this business and the resiliency of the human race I am still tempering my optimism with caution beyond 2021. Governments around the world have provided historic amounts of capital in the form of government stimulus to get us through this global pandemic and central banks around the world have also taken monumental action to help keep the world economy from collapse. There have been and there will be unintended consequences for so much stimulus and easy monetary policy – just look at the wild action in the stock market, crypto, real estate, etc. It has been several decades since inflation was a real threat here in the US and it's something my generation has never had to deal with, but if there was ever a perfect storm that would lead to inflation, I think we are in the middle of it.

I remember reading a book back around 2012 that predicted a future in which the US Federal Reserve would be faced with fighting depression or letting inflation run significantly higher than its historical target of 2%. With the trillions of dollars in stimulus money and the massive increase in the balance sheet of the federal reserve – also in the trillions – I have a hard time imagining a scenario where inflation doesn't rise in a significant way.

That said, I believe as a capital and asset-light business in the software consulting space, we are well-positioned to perform well in an inflationary environment.

Onward & Upward!

Your CEO



Gen Y Finance Guy

Hey, I'm Dom - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own financial stats. I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! Read More