Financial Projections

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What do we mean by “Projections”?

5 Year estimates of your:

- Balance sheet
- Income statement
- Cash flow statement

And a list of key assumptions

Aren't Projections 100% Fantasy?

- Done right, they are better than fantasy
- Build them bottom-up
- They need to be defensible

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Why do you need Projections?

- Because investors & bankers demand them
- You need them to plan cash needs

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Do you really have to do projections?

Yes, you do

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What if my projections are wrong?

Not to worry - they will be wrong

But they must be credible & defensible

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You'll need: A Detailed Version

- Excel spreadsheets
- Detailed Assumptions
    - Balance sheet
    - Income statement
    - Cash flow statement

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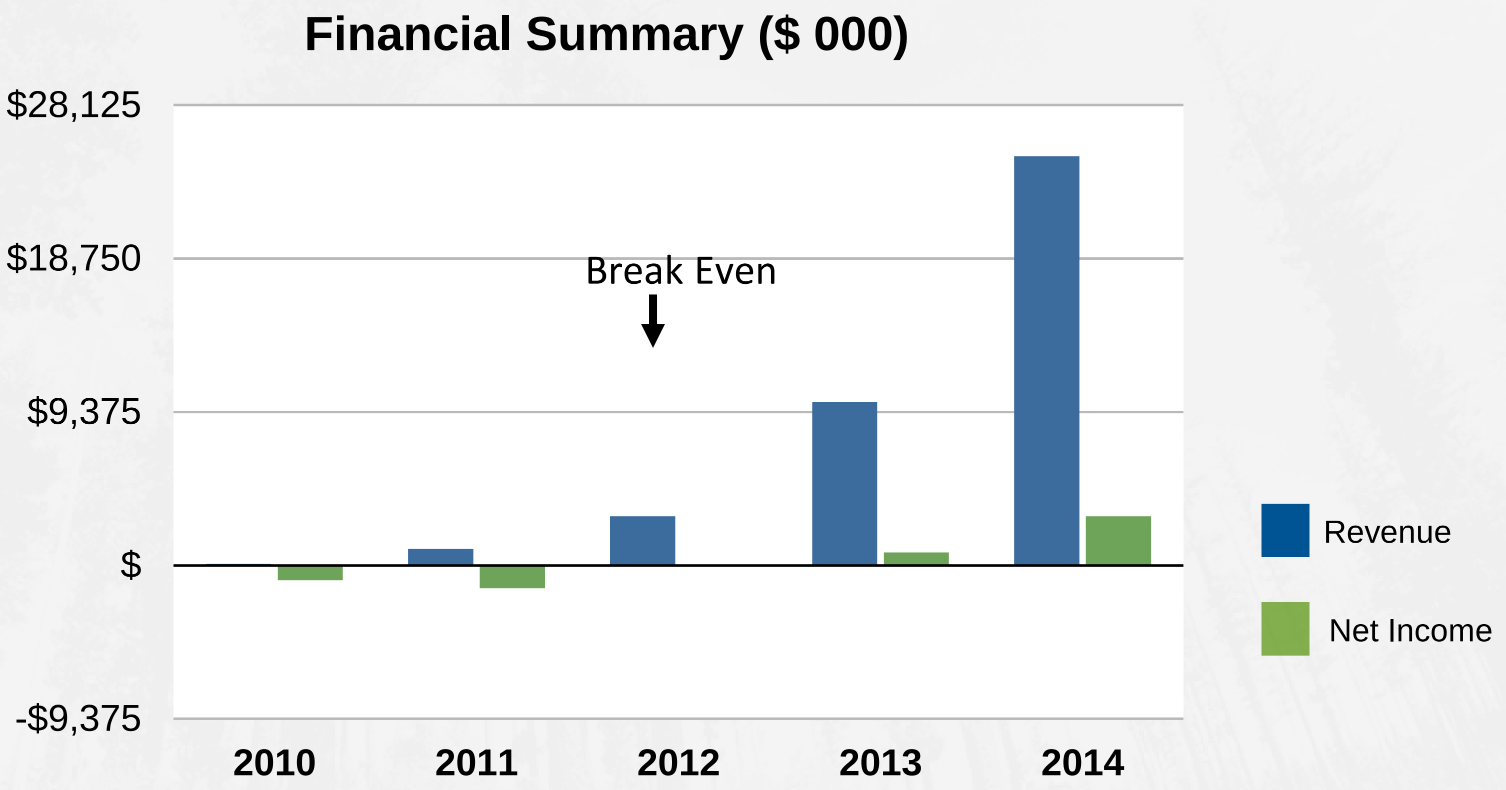
You'll need an Income Summary



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Balance Sheet

- Assets
  - Short-term
  - Long-term
- Liabilities & Shareholder Equity
  - Short-term liabilities
  - Long-term liabilities
  - Shareholder Equity
    - Stock
    -

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Balance Sheet

- Assets
  - Short Term
  - Long Term
- Liabilities & Shareholder Equity
  - Short Term liabilities
  - Long Term liabilities
  - Shareholder Equity
    - Stock
    - Retained Earnings

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Income Statement

- Revenue
- Cost of Goods Sold (COGS)
- Gross Profit
- Expenses
  - Admin/Sales & Marketing/R&D/Operations
  - Depreciation
- Net Income

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Accrual Accounting

- Revenue and cash-in are not the same thing
  - Typically, revenue is recognized upon shipment
  - For subscriptions, revenue is often recognized monthly
- Expense and cash-out are not the same thing
  - Typically accrued when expense is incurred

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Accrual Accounting

- You ship product in January & recognize revenue
- Assume your customer pays after 30 days; and you pay for raw materials after 30 days

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Accrual Accounting

- In January:
  - Buy raw material
  - Accounts payable goes up (liability)
  - Inventory increases (Asset)
  - You build & ship product
  - Income statement: revenue and expenses are accrued
  - Accounts receivable increases (Asset)
  - Inventory decreases (Asset)
  - Retained earnings increases (Equity)

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Accrual Accounting

- In February:
  - You pay your supplier
  - Accounts payable decreases (Liability)
  - Cash decreases (Asset)
  - Customer pays you
  - Accounts receivable decreases
  - Cash increases

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Cash Flow Statement

Beginning Cash

+ Net Income
+ Depreciation
- Change in assets
- Property/equipment purchases
+ Borrowings
+ Proceeds of stock sales

= **Ending cash**

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Predicting the Future

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The Big Challenge: Forecasting Sales

- The market is new - no historic market data
- Your company is new - no historic revenue
- No direct “comparable” example
- No sure way to estimate customer adoption of something new

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How do you get started?

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Bottom-Up

Behavior-Based

Document Assumptions

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Questions

- How will you do marketing?
- What sales channel will you use?
- If you do marketing in January - when will sales result from that effort?
  - i.e., how long is the sales cycle
- And how many sales will result from a given marketing investment
  - i.e., what’s the conversion rate?

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Think Bottoms Up

- Start with month 1
- What will you do that month to:
  - *Market (create leads)?*
  - *How many leads will that create?   When?*
  - *What will you do that month to sell?*
  - *How many leads will be closed? When?*
  - *What $ will you net through your channel?*
  - *What are the customer payment terms?*
- Now do month 2 - and keep repeating!
- Document your assumptions!

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Revenue: Things to Think About

- How quickly can you bring on sales people?
- How long will it take for new sales people will be productive?
- How long will the sales cycle be?
- How many times must you connect with a prospect before they buy?

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Assumptions: Example

- The average order will be $20,000
- Based on your experience:
    - Sales cycle = 6 months
    - Marketing generates 20 leads per mo.
    - 10% of those will close
    - A good sales person closes 1 order/mo.
- Hire 2 sales people in January
- Train for 3 months
- Orders: $40,000 per month, starting Sep.

Projecting Expenses

- What will you do in month 1 that has a cost?
    - Rent
    - Recruiting
    - Salaries, benefits
    - Equipment purchases
    - Travel. Conferences. Office supplies. etc.
- And then month 2?
- Expenses do scale with the business!

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Expenses

- People
- Rent
- Insurance – Liability, Property, D&O
- Telecom/Broadband
- Cloud Expenses
- Legal
- Accounting
- Office Supplies
- Training
- Capital equipment
- Outsourcing

- Sales
  - Travel & Entertainment
  - Commissions
  - Salesforce.com
- Marketing
  - Branding
  - White papers
  - Trade Shows & Conferences
  - Collateral
  - Google Adwords
  - Advertising

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Assessing your Forecast

Compare to similar companies

Get a startup CFO’s input

... or your numbers may not be credible...

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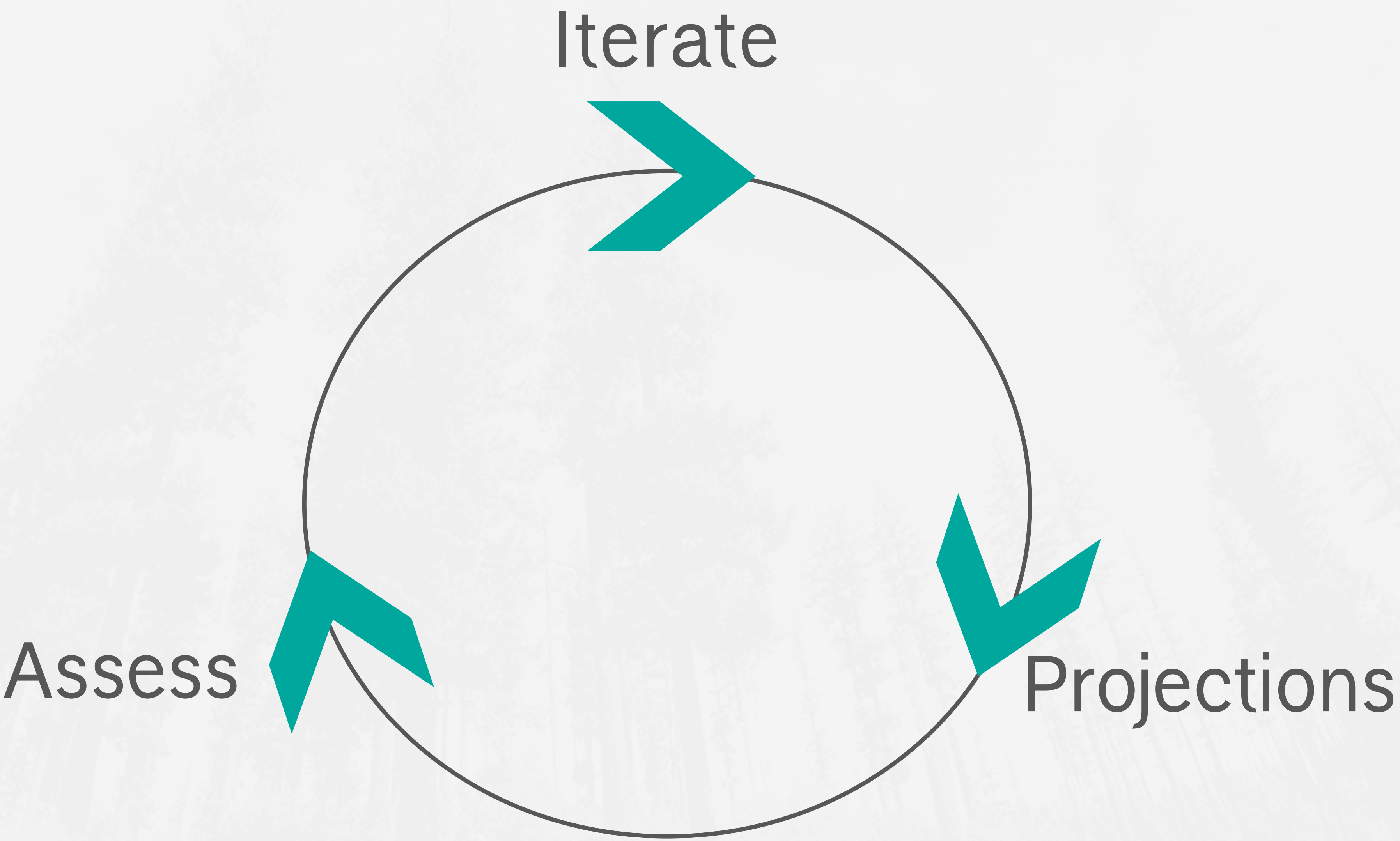

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Suggestion: Use a Planning Template

- Templates help
  - Remind you of categories
  - Avoid errors
- Examples:
  - Cascadia CleanTech Accelerator Excel forecast spreadsheet
  - SCORE budget/forecast tool
  - LivePlan (Palo Alto Software)

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Document your Assumptions

Examples:

- *Length of sales cycle*
- *Conversion rate*
- *Average sales price*
- *Sales channel discount*
- *COGS, salaries, rent, etc.*
- *How expenses will change over time*

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