

CSE 190: Financial projections (Barr 10)

Although utterly boring, creating a financial projection model is an exercise in discipline. Having going through it in a serious attempt assures the investor (or partner or customer) that you are: (a) serious and disciplined, and (b) you may have worked out some obvious errors.

You also need this internally: to anticipate lack of funding, understand the impact pricing, cost of operation.

1. Types of financial documents (included in a Financial Projections)

- a. Source and Funds statement (startup capital): the money for starting the business
- b. Assumptions sheet:
- c. Pro Forma income statement: revenue and cost projections
- d. Balance sheet: Assets – Liabilities that need to match

For software companies and the investor pitch: you need a plausible revenue cost projection for 3-5 years. However, you need to be able to defend your numbers with a model!

2. Some terminology

- a. Revenue: incoming money from sales
- b. Cost of goods sold (COGS): total of all costs used to create a product or service including direct labor, materials, and overhead.
- c. Gross Profit: (Revenue – COGS) and Gross Margin: $(\text{Revenue} - \text{COGS}) / \text{Revenue}$
- e. Net Profit is the money left over after paying all the expenses of an endeavor.
Net Profit Margin = $\text{Net Profit} / \text{Revenue}$

3. Building a financial model:

- a. Consider all lines of revenue
- b. Consider all lines of expenses
- c. “Play out in time” the growth of the business, bottom up

4. Practical tips and tricks:

- Using an excel spreadsheet or equivalent can be useful as it allows to try out assumptions.
- You need to associate resource cost with growth:
 - e.g. salesperson salary with #deals they close per month
- Payments do not always take place immediately
 - Keep in mind: giving motives for upfront yearly instead of monthly is good.
- You need to have “reasonable assumptions”:
 - Avoid the “hockey-stick”
 - Your overhead, profit margins etc have to make sense for the sector and type of business
 - At the same time, projections need to reach big numbers:
 - The answer: back projections with a model that is based on reasonable assumptions and optimism

RESOURCES:

Financial Model Tutorial BYU Miller New Venture Challenge

NICE bottom up model: <https://www.youtube.com/watch?v=twMESR6SkIQ>

Spreadsheet model (\$15): <http://sharefuse.com/product/financial-model-tutorial-template-download/>

Tips for excel usage (conventions, group mods, etc): <https://www.youtube.com/watch?v=Xs3MCM0dXW0>