CS 175: 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: (Revenue – COGS)/ Revenue
   e. Net Profit is the money left over after paying all the expenses of an endeavor.
      Net Profit Margin = Net Profit/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