



**UW Business Plan
Competition Resource Night
“Financials and Funding”**

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February 14, 2008**



Agenda

- **Introduction**
- **Financial Projections**
- **Raising Capital**
- **Summary**

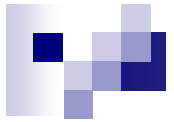


Financial Projections



Financial Planning - Understanding Risk

- Finance - a way to think about cash, risk & value
 - Creating value is a key responsibility
- Financial risk - uncertainty about future cash flows
 - Significant value can be created by managing & understanding risk
 - ▶ Market, Management, Technology, Financial, Competition
- Finance does not answer questions
 - It does not make decisions
 - Finance can help identify the right questions to ask and narrow down the options
- When viewed from the finance perspective, some decisions will turn out to be illogical or unfeasible.



“Ob, it’s great here, all right, but I sort of feel uncomfortable in a place with no budget at all.”

Don’t let this be you!



Financial Projections - Investor Comments

- “Financial projections consistently are the weakest part of business plans.”
- “I rarely see a financial plan I can’t take apart quickly.”
- “No consistent formats”
- “Lack of detail – not bottoms up”
- “Unrealistic and overly optimistic assumptions – especially timing related (revenues, development schedule, cash flow break even)”
- “Model cannot be easily manipulated (too much hard wiring and not enough assumptions-driven)”
- “Omission of costs and balance sheet items”
 - Understates capital requirements



Projections - Overview

- **A reflection of your business plan quantified**
 - Consistent with the plan strategy
 - Is your strategy financially feasible?
 - Key indicator of the amount of outside financing necessary to support the execution of your strategy
- **Understand the quantitative and financial elements of your business plan**
 - Not doing so is the fastest way to lose credibility



Projections - Overview

■ High level figures

- Underlying assumptions and detail should be available

■ Projections should answer

- How will the company perform financially?
- What will the company's cash position be?
- What will the company's financial position be?

P & L

Cash Flow

Balance Sheet

■ Five-years - integrated

- Monthly for the first two years; quarterly for the remaining 3 years
- Well-thought out assumptions
- Include key financial ratios and compare to competitors & industry
- Include historical financial information, if any



What's Wrong With Most Financial Plans?

- Waste too much ink on numbers
 - Too little focus on information that really matters
 - Support strategy and key drivers of success
 - ▶ Manufacturing - yield on a production process
 - ▶ Magazine publishing - the anticipated renewal rate
 - ▶ Software - impact of using various distribution models
 - No need for detailed, monthly numbers forever
- Financials are typically wildly optimistic
 - Entrepreneurs underestimate capital and time

Projections - Assumptions

- Organize in an easily accessible separate worksheet
 - Identifies key items in one place
 - Used for sensitivity and “what-if” analysis
- Don't be afraid to make material assumptions
 - Especially uncertain ones (re-purchase rate, returns, cash collection cycle)
 - Individualize
 - ▶ e.g., don't just show advertising costs as a % of sales
 - ✓ Most advertising expenditures are made months before sales result
 - Include financial obligations of bringing your product/service to market
 - ▶ New employees
 - ▶ Deviations from historical trends
 - ▶ Additional physical space
 - ▶ Increases in inventory and A/R
- Support your assertions with valid data
 - Identify what data you have & also be clear about what you don't know



Assumptions – Some to Consider

- Revenue by distribution channel and/or geography
 - Volume
 - Pricing
 - Sales per sales person
- Manpower plan
- COGS detail (labor, material, overhead, royalties)
- Expenses by department
 - Dependent on manpower (payroll, space, benefits, supplies)
 - Independent of manpower (insurance, prof. fees, advertising, depreciation)
- Fixed assets purchases and depreciation
- Debt and related collateral support (A/R, inventory, etc.)
- Interest income and expense
- Days sales outstanding
- A/P – no. of days outstanding
- Inventory – days sales in inventory; turnover
- Sales per employee

Projections – Assumptions Linking

<u>Assumption</u>	<u>Linked to</u>
■ Cost of Sales	■ Sales
■ Benefits & payroll taxes	■ Headcount & Salaries
■ Depreciation Exp	■ Fixed Assets & Accum Dep
■ Headcount Driven Expenses	■ Manpower Plan
■ Interest Expense	■ Specific Debt Instruments
■ Interest Income	■ Cash and Investments
■ Income Taxes	■ Profit before Tax
■ Accounts Receivable	■ Sales
■ Bad Debt Reserve	■ A/R & Bad Debt Expense
■ Inventories and Reserves	■ COGS
■ Balance Sheet Accruals	■ Underlying Expenses



Bottoms Up Projections

- Build from low levels of detail
 - vs. Tops Down
 - ▶ Revenues extrapolated from market size & share
 - ▶ Expenses are forecast as percentages of revenue

- Start with line items that are relevant to describing the business model

Bottoms Up Projections

■ Revenues

Revenues	
Product A - U.S.	\$2,500
Product A - Europe	1,250
Product B - Direct	750
Product B - Partners	250
Service - U.S.	325
Service - Europe	160
	<u>\$5,235</u>

- Forecast sales at the lowest level of product or service detail (channel, sales person, region)
- Volume and pricing data behind the summary
 - ▶ By geographic market, customer or distribution channel

■ Expenses

Professional and Outside Services		Facilities	
Legal Fees - General Corporate	\$250	Rent	\$1,000
Legal Fees - Intellectual Property	100	Utilities	100
Audit & Tax	125	Maintenanc	50
Consulting - IT	300	Insurance	75
	<u>\$775</u>		<u>\$1,225</u>

Bottoms Up Projections

- Create Line Items that are Activity Driven
 - Don't plan the dollars – plan the underlying activities that drive profits and cash flow

Sales Target	Productivity	No. Sales People	Related Costs
\$12,000,000	\$1,000,000 per Sales Person	12	Salaries, Commissions, Taxes, Benefits, T&E, Conferences

- Assumptions come from table above
 - Don't forget that productivity improves over time
 - Sales ramp over time
 - Understand the cost impacts
 - ▶ Selling activities generate productivity assumptions and cost rates for the variable expenses



Projections - Alternative Scenario Analysis

■ Changing many assumptions for different strategy or business environment

- vs. Sensitivity where change an individual assumption to reveal financial impact

■ Examples

- Alternate distribution channels strategy
- Timing issues (sales or development delayed)
- Alternate volumes and pricing

■ Use this to run your business!!



Projections - Plug Cash

- On the balance sheet
 - A residual amount
 - ▶ Cash = [Total Liabilities + Equity] minus
[Total Assets other than Cash]
- If cash is negative, the company is undercapitalized
 - Need to raise equity capital or borrow or both
- If cash is positive and growing, the company is generating positive cash flow
- Identifies seasonality needs



Understanding Cash

- **First rule** : Cash is the most important resource
 - More cash is better than less cash
 - Cash now is better than cash later
- Focus on cash flow versus accounting income
- Growth often absorbs cash flow because of a higher need for working capital and fixed investments
 - Entrepreneurial firms with negative income and high growth can have a very fast cash burn rate
 - Today's investments are tomorrow's growth opportunities
- Focus on the dynamic picture of cash flow
 - Cash cycles (A/R collections, A/P payments), seasonality
- **Last rule: CFIMITYM !!!**
 - **Cash Flow is More Important Than Your Mother!!**

DON'T RUN OUT of CASH!!



Projections Should be Integrated

- Enter assumptions and data and set up links
 - The statements build themselves
- P&L
 - Segregate revenues, COGS, Op Ex, Income Taxes
 - ▶ Subtotals for gross margin, operating profit, net income
- Balance Sheet
 - Segregate short- and long-term assets and liabilities
- Cash Flow
 - Segregate operating, investing and financing activities

Income Statement

XYZ Company
Projected Income Statements
Years 1 to 5

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
REVENUES	\$1,000,000	\$5,250,000	\$9,750,000	\$16,250,000	\$26,000,000
COST OF REVENUE	1,116,464	3,526,164	5,683,429	9,313,286	13,997,143
GROSS PROFIT	(116,464)	1,723,836	4,066,571	6,936,714	12,002,857
% of Revenues	-11.6%	32.8%	41.7%	42.7%	46.2%
OPERATING EXPENSES					
Sales & Marketing	229,000	997,750	1,805,400	2,911,500	4,676,000
Research & Development	149,000	413,000	702,550	1,241,500	1,752,000
General and Administration	171,667	465,150	783,440	1,191,933	1,771,467
Total Operating Expenses	549,667	1,875,900	3,291,390	5,344,933	8,199,467
% of Revenues	55%	36%	34%	33%	32%
EARNINGS FROM OPERATIONS	(666,131)	(152,064)	775,181	1,591,781	3,803,390
INTEREST INCOME / (EXPENSE)	0	(60,000)	(48,000)	(45,000)	(14,000)
NET EARNINGS BEFORE TAXES	(666,131)	(212,064)	727,181	1,546,781	3,789,390
TAXES	0	0	0	(558,307)	(1,515,756)
NET EARNINGS	(\$666,131)	(\$212,064)	\$727,181	\$988,474	\$2,273,634
% of Revenues	-66.6%	-4.0%	7.5%	6.1%	8.7%

XYZ Company
Projected Balance Sheets
Years 1 to 5

Balance Sheet

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
ASSETS					
CURRENT ASSETS					
Cash	\$361,970	\$99,620	\$180,177	\$54,936	\$477,714
Accounts Receivable	215,000	945,000	1,375,000	2,375,000	4,000,000
Inventories	176,000	630,000	733,333	1,266,667	2,133,333
Other Current Assets	18,000	75,600	110,000	190,000	320,000
Total Current Assets	770,970	1,750,220	2,398,510	3,886,603	6,931,047
PROPERTY & EQUIPMENT (net)	236,619	604,905	917,476	1,193,857	1,434,048
TOTAL ASSETS	1,007,589	2,355,125	3,315,986	5,080,460	8,365,094
LIABILITIES & SHAREHOLDERS' EQUITY					
CURRENT LIABILITIES					
Accounts Payable & Accrued Expen	155,720	657,720	957,000	1,653,000	2,784,000
Other Current Liab	18,000	75,600	110,000	190,000	320,000
Current portion of long term debt	0	100,000	100,000	100,000	100,000
Total Current Liabilities	173,720	833,320	1,167,000	1,943,000	3,204,000
LONG TERM DEBT	0	400,000	300,000	200,000	100,000
STOCKHOLDERS' EQUITY					
Common Stock	500,000	500,000	500,000	500,000	500,000
Preferred Stock	1,000,000	1,500,000	1,500,000	1,500,000	1,500,000
Retained Earnings	(666,131)	(878,195)	(151,014)	837,460	3,061,094
Total Equity	833,869	1,121,805	1,848,986	2,837,460	5,061,094
TOTAL LIABILITIES & EQUITY	\$1,007,589	\$2,355,125	\$3,315,986	\$4,980,460	\$8,365,094

XYZ Company
Projected Statements of Cash Flow
Years 1 to 5

Cash Flow

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
OPERATING ACTIVITIES					
Net Earnings	(\$666,131)	(\$212,064)	\$727,181	\$988,474	\$2,273,634
Depreciation	43,381	131,714	237,429	373,619	509,810
Working Capital Changes					
(Increase)/Decrease Accounts Rec	(215,000)	(730,000)	(430,000)	(1,000,000)	(1,625,000)
(Increase)/Decrease Inventories	(176,000)	(454,000)	(103,333)	(533,333)	(866,667)
(Increase)/Decrease Other Current Assets	(18,000)	(57,600)	(34,400)	(80,000)	(130,000)
Increase/(Decrease) Accts Pay & Accrd Expenses	155,720	502,000	299,280	696,000	1,131,000
Increase/(Decrease) Other Current Liab	18,000	57,600	34,400	80,000	130,000
Net Cash Provided/(Used) by Operating Activities	(858,030)	(762,350)	730,557	524,760	1,422,777
INVESTING ACTIVITIES					
Property & Equipment	(280,000)	(500,000)	(550,000)	(650,000)	(750,000)
Other					
Net Cash Used in Investing Activities	(280,000)	(500,000)	(550,000)	(650,000)	(750,000)
FINANCING ACTIVITIES					
Increase/(Decrease) Short Term Debt	0	0	0	100,000	(100,000)
Increase/(Decrease) Curr. Portion LTD	0	100,000	0	0	0
Increase/(Decrease) Long Term Debt	0	400,000	(100,000)	(100,000)	(100,000)
Increase/(Decrease) Common Stock	0	0	0	0	0
Increase/(Decrease) Preferred Stock	0	500,000	0	0	0
Dividends Declared	0	0	0	0	(50,000)
Net Cash Provided / (Used) by Financing	0	1,000,000	(100,000)	0	(250,000)
INCREASE/(DECREASE) IN CASH	(1,138,030)	(262,350)	80,557	(125,240)	422,777
CASH AT BEGINNING OF YEAR	1,500,000	361,970	99,620	180,177	54,936
CASH AT END OF YEAR	\$361,970	\$99,620	\$180,177	\$54,936	\$477,714

XYZ Company
Financial Summary & Other Information
Years 1 - 5

Other Information

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Summary Financials (\$)					
Revenue	\$1,000,000	\$5,250,000	\$9,750,000	\$16,250,000	\$26,000,000
Gross Profit	(116,464)	1,723,836	4,066,571	6,936,714	12,002,857
Net Earnings	(666,131)	(212,064)	729,181	988,474	2,273,634
EBITDA	(622,750)	(20,350)	1,012,610	1,965,400	4,313,200
Net Cash from Operating Activities	(858,030)	(762,350)	730,557	524,760	1,422,777
Capital Expenditures	280,000	500,000	550,000	650,000	750,000
Interest Income (Expense)	-	(60,000)	(48,000)	(45,000)	(14,000)
Cash	361,970	99,620	180,177	54,936	477,714
Total Equity	(166,131)	(378,195)	348,986	1,337,460	3,561,094
Total Debt	-	500,000	400,000	300,000	200,000
Growth					
Revenue Growth Rate - CAGR		425%	86%	67%	60%
Net Earnings Growth Rate - CAGR		N/A	N/A	35.9%	130.0%
Ratios					
Current Ratio	4.4	2.1	2.1	2.0	2.2
Quick Ratio	3.4	1.3	1.4	1.4	1.5
Debt to Capital (LT Debt + Equity)	0.0	0.3	0.2	0.1	0.0
Days Sales in A/R	75.0	72.0	68.0	68.0	65.0
Days Sales in Inventory	95.0	92.0	90.0	85.0	81.0
Debt to Capital (LT Debt + Equity)	0.0	0.3	0.2	0.1	0.0
Profitability					
Gross Profit %	-11.6%	32.8%	41.7%	42.7%	46.2%
Operating Expenses %	55.0%	35.7%	33.8%	32.9%	31.5%
Net Earnings %	-66.6%	-4.0%	7.5%	6.1%	8.7%
Returns					
Return on Assets	-66.1%	-9.0%	21.9%	19.5%	27.2%
Return on Equity	-79.9%	-18.9%	39.3%	34.8%	44.9%
Return on Capital (LT Debt + Equity)	-79.9%	-13.1%	32.3%	31.5%	43.2%
Metrics					
Employees	8	35	60	75	100
Sales per employee	\$125,000	\$150,000	\$162,500	\$216,667	\$260,000
Sales per sales person	\$500,000	\$656,250	\$975,000	\$1,083,333	\$1,300,000
Customer acquisition cost	\$150	\$100	\$75	\$60	\$40



Funding Considerations



BUILDING A FUNDABLE COMPANY

- Great Team
- Dominate a Market Niche in a Rapidly Growing Market
- Know Your Competition
- Know Your Distribution Channels
- Create a Sustainable Competitive Advantage
- Build a Company Not a Product



Thoughts on Raising Capital

- Be prepared to concisely link the strategy & financials
- A long, hard & challenging process
 - Requires substantial time & effort – Start EARLY
- “Inside” introductions
 - Surround yourself with a few key advisors
- **Who** is much more important than **how much**
- Listen, learn & improve your plan along the way
- Have realistic expectations about how much money you can raise and have a “plan B”
- Friends, family & personal funds are usually the only source of capital available for new ventures



What Investors Look For

- Good return on investment
- Realistic assessment of risks
 - Is the plan and the management team credible?
- Is there a fit between the investor and the firm
 - CEO and team with passion and vision
- Detailed and realistic financial plans
 - Are financials “really” conservative?
 - Is the company growing or is it scaleable?
- Exit strategies within 4 - 7 years
- Unique value proposition - not another “me too”



Sources of Money

- Commercial Bank Loans
- Angel Investors
- Venture Capitalists
- Credit Cards
- Accounts Receivable
- Equipment Sales and release
- Advances on credit card receipts
- IPO
- Home Equity Loan
- SBA Loan Guarantee Programs



Getting Angels to Invest

- Herding cats
- It's more important to you than to them
- Set a schedule/deadline
- Target and negotiate with a few lead Investors
 - Close lead/key investors first
- What counts is checks deposited!
- Target Angel Networks (Alliance of Angels, Seraph, PVG, PAN, WIN)
- Only take money from accredited investors



How to Get a VC's Attention

■ Great team

- Deep domain and execution expertise
- Abundance of Sales and Marketing DNA

■ Huge market

- Ready for fundamental change

■ Difficult problem

- That few can solve

■ Real need

- That is visionary but not missionary

■ Effective Business model

- That recognizes how your industry works

■ Realistic goals – a commitment to achievement

■ Set of prospects

- Who will validate your mission

■ Elevator pitch – the ability to tell a crisp story



What is the planned "Use of Proceeds"?

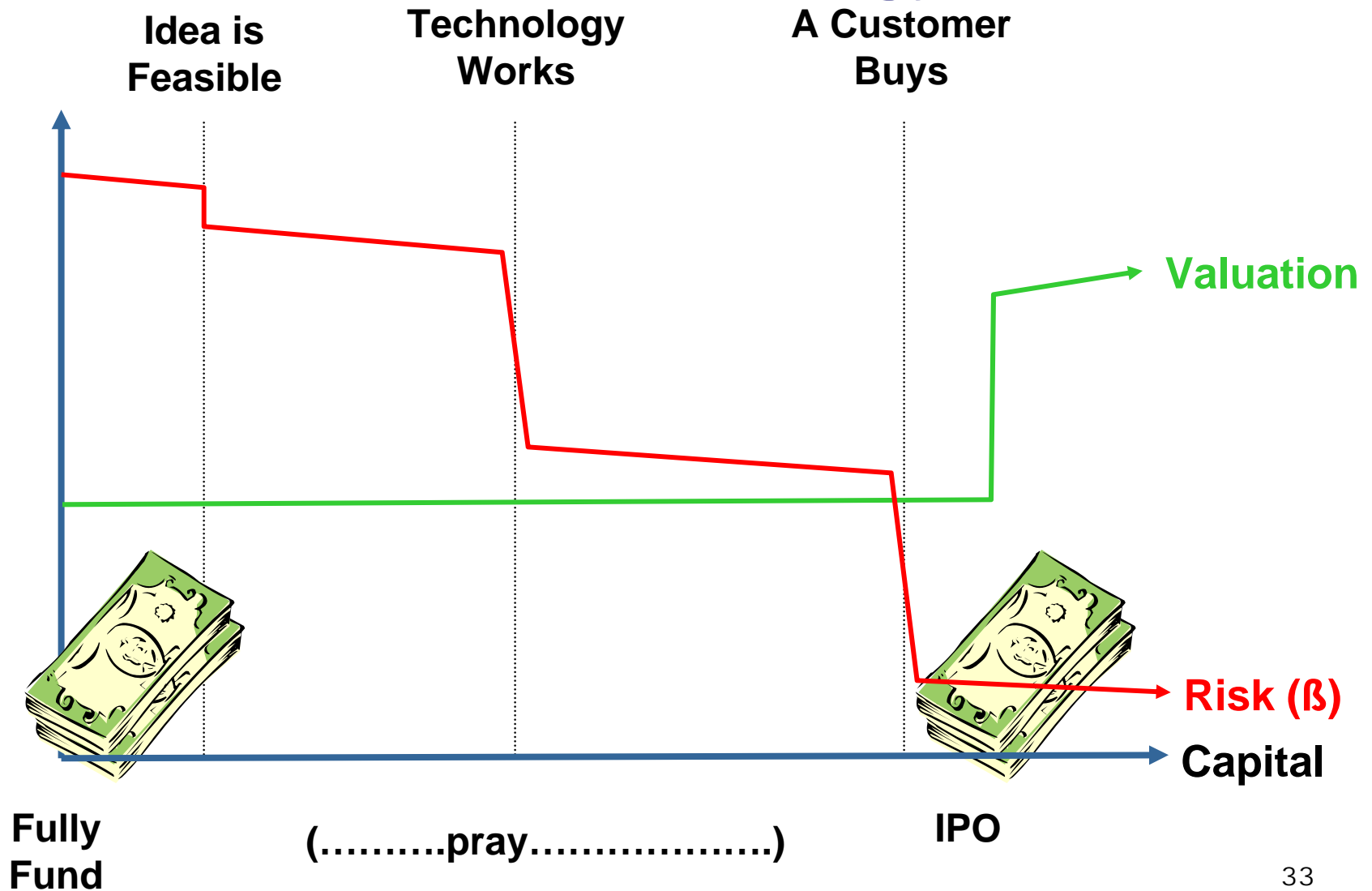
- **Investors want to know how their money is being deployed**
 - Sales/market growth
 - R&D
 - Headcount
 - Milestones achieved
- **When will your company break even in terms of profitability and cash flow?**
 - The ultimate goal is to reach an exit scenario
 - Profitable businesses are more attractive to potential buyers or public markets



Milestones

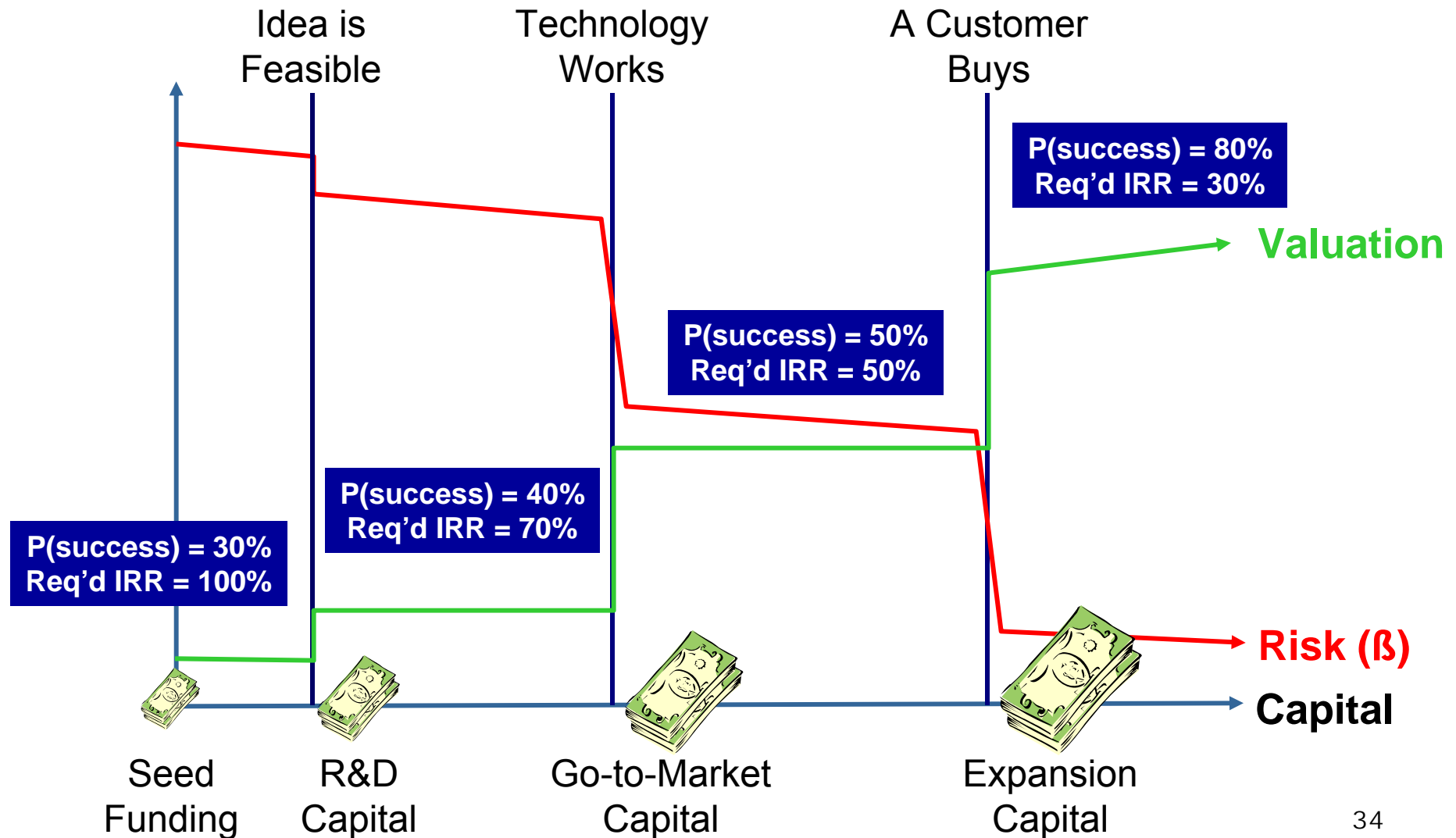
- Milestones and expected cost
 - Shows business understanding and intention to track performance closely against the business plan
- Milestone Examples
 - Hiring of a full management team
 - Completing product specifications
 - Completing prototype
 - Product testing
 - First customer shipment
 - First full quarter of profitability
 - Achieving \$X million in revenue

The “Fully Funded” Folly aka “Bubble Strategy”



Funding to Milestones

aka “Old-Fashioned Venture Capital”





Understand The Valuation Process

- Art - NOT a science
- Identify the major risks in your business
- Reduce the perceived risks to increase value
 - Management, sales/customers, patents
- Understand investors' ROI criteria
 - Discount rates for earlier stage cos. are significantly higher vs. later stage
- Identify a clearly definable exit strategy
- Bottom Line – Must be fair to both sides
 - A healthy negotiation



Achieving Higher Valuations

- Bargain from a position of **STRENGTH**
- Have fuel in the tank
- Competitive bake-off
- Have alternatives
- Avoid investor collusion



Ownership & Equity Considerations

- How will equity in the venture be distributed?
- Will the founders retain control?
- Will employees be able to earn equity for their performance?
- How much equity will investors have, and how will that change over time?
- How do the investors get their money out, and when?



Summary

- Create value by managing risk
- Communicate the business strategy in easily understandable and believable financial terms
 - ▶ Strategy & Financials - complementary and consistent
- Projections need to be realistic and believable
 - Focus on information that really matters
 - ▶ Numbers should support strategy and key drivers of success
 - Integrate assumptions and statements
 - Bottoms Up approach
- Reduce risks of the business
- Funding milestones
- Understand the investor
- Realistic valuation expectations