Creating Financial Projections

Modified from the following source:
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What Must Be Included

- Two years of projections (in Excel)
  - Project ***cash flow***, not income statements or balance sheets
  - By month, with subtotals for each year
  - Of revenues (and components of revenues)
  - Of expenses (all that are likely)
  - All subtotaled
- Assumptions as to how the numbers were derived (in Word)
  - In detail, accounting for every number in the projections (do line by line)

Three Types of Projections

1. Most likely case

   - Contains your very best estimates

   - Forms the basis of your operating plan

2. Worst-case scenario

   - Proves you can survive a disastrous start

   - Useful for calculating capital required and B/E

3. Best-case scenario

   - Useful for anticipating problems of higher-than-expected demand and too-rapid expansion

   - Will ***not*** be required this quarter ☺

Most Critical Requirement—*Realism*

- Anyone can string together "numbers"
  - Unrealistic numbers can be spotted easily
  - All credibility is lost
- Using *realistic* numbers
  - Requires research
  - Requires experience
  - Requires resisting making them look better than they are
- The numbers used also reflect how you will manage the company
  - How you will drive revenues (targets to achieve)
  - How you will control costs and expenses (budgets to be adhered to)

The Revenue Model

- Include a separate line for each component of revenue, and one for "Total Revenues," e.g.,
  - Sales of main product
  - Sales of accessories
  - Sales from consulting and service calls
- This comes from what you have already done in your marketing plan ☺
- Remember to write down how all the numbers were derived (include only *cash receipts,* not accounts receivable)

The Revenue Model (cont.)

- If you have reason to believe that you will get paid according to a pattern, e.g., 50% within 30 days, 30% 60 days, 10% 90 days, 5% 120 days, and 5% never, then cash receipts ***must*** take into account this pattern (see next slide)
  - This is how accounts receivable are factored into a cash projection

Factoring in A/R

Month>>>	1	2	3	4	5	6
Revenues	150	250	350	500	700	950

Factoring in the pattern 50-30-10-5-5 introduced earlier:

150 Revenues	75	45	15	8			
250 Revenues		125	75	25	13		
350 Revenues			175	105	35	18	
500 Revenues				250	150	50	25
700 Revenues					350	210	70
950 Revenues						475	285
Total Revenues	75	170	265	388	548	753	etc.

Expenses

- Include <u>every</u> kind of *<u>cash</u>* expense your company will possibly incur, e.g.,

Salaries
Wages
Benefits
Equipment
Supplies
Telephone
Hardware/software
Leases (autos, equipment)
Rent (or mortgage payments)
Commissions

Travel and entertainment
Brochures
Advertising & promotion
Coupons and discounts
Consulting/accounting services
Legal services
Insurance (pay only when due)
Website development/maintenance
Training
Conferences/trade shows, etc.

Expenses (cont.)

- You may need supplemental schedules
  - These contain details that would clutter the main projections
  - Only the totals from these schedules are transferred to the main projection
  - For example, numbers of people hired at different times and at different salaries (only the total salary line is transferred to the projections)
- Remember to build in benefits (typically 15% for partial and 25% for full, as a percent of someone's salary; hourly-wage earners don't get benefits)
- Remember to allow for raises or other increases (e.g., bonuses) in costs from year 1 to year 2

For Each Set of Projections

- Include a row called "Monthly Surplus (Loss)" which is monthly total revenues less monthly total expenses
    - Note that these numbers are *not* profit numbers (yet)
- Under that, include a row called "Cumulative Surplus (Loss)" which is the sum, in any one month, of all previous "surplus (loss)" figures
- This cumulative surplus line will initially be negative for several months
    - The month in which it becomes permanently positive, in the most likely case, is called the ***BREAKEVEN MONTH***

Startup Capital Required

- This is derived from the *worst-case* scenario
- The most negative number in the “cumulative surplus (loss)” row is the startup capital required
  - *“If $1.5M is the startup capital required as determined above, then were you to start off with that amount of capital, you could survive the worst times you could imagine for this business”*

Financial Projections—Results

- You should be able to give the following results or objectives to an investor from your financial projections
  - Est. total revenues, Yrs 1 and 2 (from ML case)
  - Est. profit (EBIT), Yrs 1 and 2 (from ML case)
  - Startup capital required (from worst case)
  - Breakeven month (from ML case)
  - Return on investment, Year 2, assuming the investment is the startup capital and the profit earned is the sum of Years 1 and 2 (ML case)