



Financial Modeling Workshop



San Jose State University

SVCE Finance Workshop

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Presented by

Anthony Nassar

Founder & Principal

Venture Momentum, Inc.

1.415.897.0195

anthony@venturemomentum.com

www.venturemomentum.com

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Background

- Founded Venture Momentum in 1994
- 20+ years experience in finance
- Focus on early stage startups in 2 areas: financial modeling and financial operations
- Prior, 4 years in finance and wealth management with French group, 3 years in planning with a Silicon Valley semiconductor startup, and 6 years in finance, corporate planning and project management with Fair Isaac
- Lead workshops on financial modeling and financial management
- Publish articles for startup entrepreneurs
- MBA NYU, MS Columbia University, Engineering Diploma Ecole Centrale de Paris



Outline

- Purpose
- Approach
- Concepts
- VMI Financial Roadmap



Purpose of Financial Plan

1. Assess Feasibility of New Business Concept and Cash Requirements
2. Formulate Team's Vision; Quantify Business Model; Establish Financial Objectives and Milestones for Team, and Set Benchmarks to Measure Performance
3. Raise Capital
4. Provide Financial Data for Business Plan
5. Tell Story to Outside World: Investors, Lenders, Business Partners, Auditors, etc.
6. Provide Adaptive Tool to Adjust Business Model as Experience is Gained in the Field

Funded or Bootstrapped





Approach

1. Top-Down

2. Bottom-up

3. Create a Robust Framework

- ✓ Core Assumption models to exclusively drive revenues, staffing & expenses, and capital in the model
- ✓ Scope & Navigation
- ✓ Scaling & Data Integrity
- ✓ Granularity, Planning Horizon and Realistic Precision
- ✓ Version control – filenames, tracking changes and distribution
- ✓ Reporting, Analyses and Dashboards



Approach (Cont'd)

4. Understand and Define Your Revenue Model Drivers

(Market, Competition, Product/Service Offering, Customer, Pricing, Terms, Sales Cycle, Customer Acquisition, Selling Resources, Churn, Data Flow)

5. Gather Data Elements Before Starting

(Pricing, Salaries, Consultants, Cost of Space/sqft, Servers, Operating expenses, etc...)

6. Build a Realistic Product Plan

A well thought out Product Plan provides clarity about which products will be offered, development times, and release dates. It also drives the timing of revenues, expenses and staffing

Approach (Cont'd)

7. Build a Credible Revenue Model

8. Expenses, Headcount, Space & Equipment

- ✓ Develop expenses by department: Cost of Revenues, R&D, S&M, G&A
- ✓ Cost of revenues should track revenue model
- ✓ Model headcount when possible
- ✓ Expenses, space and equipment should track headcount when possible

9. Financial Statements

- ✓ Create Income Statement by Department
- ✓ Create Income Statement by Account Category
- ✓ Build Balance Sheet and Statement of Cash Flows
- ✓ Beware of Cash Plug



Approach (Cont'd)

10. Key Metrics

- ✓ Cash Requirements
- ✓ Cash Burn, Cash Flow and Breakeven Points
- ✓ Operating Results and Margins
- ✓ Revenue Breakdown
- ✓ Expense Highlights
- ✓ Balance Sheet Highlights
- ✓ FTE Metrics and Expense per Employee
- ✓ Customer Metrics: Number, Cost to Acquire, Cost to Service and Margin per Customer
- ✓ Traffic Metrics: Unique Visitors, Unique Visits, Pageviews, Referral Rates, Churn Rates
- ✓ Other Important Business Specific Metrics

Approach (Cont'd)



VALIDATE



Skills

- Finance & Accounting
- Modeling
- Excel
- Project Management
- Endurance & Perseverance



Concepts

- GAAP or Generally Accepted Accounting Principles
- Financial Statements
- Cash vs. Accrual



Concepts (Cont'd)

- GAAP - Generally Accepted Accounting Principles

Guidelines set by the Financial Accounting Standards Board for measuring, processing and reporting financial information.



Concepts (Cont'd)

- Financial Statements
 - **Income Statement**
 - Measures Operating Performance during a period
 - **Revenues – Expenses = Net Income**
 - **Balance Sheet**
 - Snapshot of resources (assets) and claims (liabilities and shareholders' equity) as of a specific date
 - **Assets = Liabilities + Equity**
 - **Statement of Cash Flows**
 - Reports sources and uses of funds during a period



Concepts (Cont'd)

ERP4US Income Statement

	Year 2
Net Revenues	\$4,401,520
Cost of Revenues	2,079,429
Gross Profit	2,322,091
Gross Margin	53%
Development	4,920,770
Sales & Marketing	3,010,338
General & Administrative	1,623,198
Total Operating Expenses	9,554,306
Operating Profit	(7,232,216)
Operating Margin	-164%
EBITDA	(7,094,188)
Interest Income	70,593
Income Before Taxes	(7,161,623)
Income Taxes	800
Net Income	(7,162,423)



Concepts (Cont'd)

ERP4US Balance Sheet

Period ended
month 24

Assets

Current assets:

Cash and cash equivalents	\$4,314,310
Accounts Receivable	519,480
Allowance for Doubtful Accounts	(25,974)
Prepaid expenses	63,851

Total current assets 4,871,666

Property & Equipment, net	345,167
Deposits	110,700

Total assets 5,327,533

Liabilities and Shareholders' Equity

Current liabilities:

Accounts payable & accrued expenses	889,957
Deferred Revenues-Current	-
Income taxes payable	-
Total current liabilities	889,957

Total liabilities 889,957

Shareholders' equity:

Common stock	5,000
Preferred Stock-Series A	4,950,000
Preferred Stock-Series B	9,920,000
Retained Earnings	(10,437,424)
Total shareholders' equity	4,437,576
Total liabilities and shareholders' equity	\$5,327,533



Concepts (Cont'd)

ERP4US Statement of Cash Flows

Year 2

Cash flow from operating activities:

Net income (loss)	(\$7,162,423)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation	138,028
Changes in assets and liabilities	
Accounts Receivable	(519,480)
Allowance for Doubtful Accounts	25,974
Prepaid expenses	(38,874)
Deposits	(83,500)
Accounts payable & accrued expenses	701,285
Deferred Revenues-Current	-
Income taxes payable	-
Net cash provided by operating activities	<u>(6,938,990)</u>

Cash flow from investing activities:

Purchase of Property & Equipment	<u>(261,500)</u>
Net cash used in investing activities	<u>(261,500)</u>

Cash flow from financing activities:

Proceeds from issuance of common stock	-
Proceeds from issuance of Series A Preferred Stock*	-
Proceeds from issuance of Series B Preferred Stock*	9,920,000
Net cash provided by (used in) financing activities	<u>9,920,000</u>

Net increase (decrease in cash)	<u>2,719,510</u>
Cash at the beginning of the period	<u>1,594,800</u>
Cash at the end of the period	<u>4,314,310</u>

* Net of qualifying transaction expenses



Concepts (Cont'd)

- Cash Accounting
 - Revenue recognized when cash is received from customers
 - Expenses are recognized when cash is paid to suppliers, employees and service providers
 - Provides poor matching of revenues and expenses
 - Not acceptable under GAAP



Concepts (Cont'd)

- Accrual Accounting
 - Revenue is recognized as goods are sold or services are rendered
 - Expenses are recognized after they are matched with corresponding revenues, or as period costs
 - Provides proper matching of revenues and expenses
 - Required under GAAP



Concepts (Cont'd)

Illustration

- You launch an Internet start-up on 12/1/08; Initial cash investment in start-up is \$5,000;
- A corporate subscriber pays \$24,000 for a 12 month subscription starting on 1/1/2009;
- You are the only employee as of 12/31/08; your monthly salary (incl. payroll taxes) is \$10,000; no employee benefits in place yet; no other expenses incurred or assets purchased in first month;
- The Company is on a calendar basis; no taxes or accrued liabilities assumed in first year.



Concepts (Cont'd)

Illustration I (cont'd)

Financial Results for period ending Dec 31, 2008

Cash Basis

<u>Income Statement</u>	
Revenues	\$24,000
Cost of Revenues	0
Gross Profit	24,000
Operating Expenses	10,000
Net Income (loss)	\$14,000
<u>Balance Sheet</u>	
Cash	\$19,000
Total Assets	19,000
Liabilities	0
Common Stock	5,000
Retained Earnings	14,000
Liabilities & Equity	\$19,000

Accrual Basis

<u>Income Statement</u>	
Revenues	\$0
Cost of Revenues	0
Gross Profit	0
Operating Expenses	10,000
Net Income (loss)	(\$10,000)
<u>Balance Sheet</u>	
Cash	\$19,000
Total Assets	19,000
Liabilities	24,000
Common Stock	5,000
Retained Earnings	(10,000)
Liabilities & Equity	\$19,000



VMI Financial Roadmap

- VMI Financial Roadmap
 - ERP4US, Inc.
 - On Demand ERP solution for SMB
 - Integration of all necessary modules to run a small/midsize business: Accounting & Finance, HR, CRM, SFA, Support, Stock Options, Contracts, Project Mgt, ...
 - Future offering to include vertical solutions: manufacturing, retail, hospitality, medical, ...



VMI Financial Roadmap (Cont'd)

- VMI Financial Roadmap Components

1. [VMI Navigator™](#)
2. [Product Plan](#)
3. [Assumptions-Market & Revenue](#)
4. [Assumptions-Employees Consultants and Space](#)
5. [Assumptions-Expenses](#)
6. [Assumptions-Capital](#)
7. [Forecast Summary](#)
8. [Graphs](#)
9. [Key Metrics](#)
10. [Proforma Inc. Stat. by Dept](#)
11. [Proforma Inc. Stat. Detailed](#)
12. [Balance Sheet](#)
13. [Statement of Cash Flows](#)
14. [Ratios 1](#)
15. [Ratios 2](#)



VMI Financial Roadmap (Cont'd)

- VMI Financial Roadmap Components (cont'd)

16.	<u>Direct Sales Model</u>
17.	<u>Customer</u>
18.	<u>Revenues</u>
19.	<u>Staff & Space</u>
20.	<u>Cost of Revenues</u>
21.	<u>Development</u>
22.	<u>Sales & Marketing</u>
23.	<u>G&A</u>
24.	<u>Equipment & Software</u>
25.	<u>AR</u>
26.	<u>AP</u>
27.	<u>Prepaid</u>
28.	<u>Graph Data</u>
29.	<u>Valuation</u>
30.	<u>Proforma Capitalization</u>
31.	<u>Cap Table</u>
32.	<u>Debug</u>