Presented by Marius Miškinis

Today's agenda

Motivation	*Why should you care about FS?*
Financial Statements	*Basic overview, how to read FS?*
Planning	*Key value drivers, what should you focus on?*
Investor Point of View	*Know your answers!*
Tips & Tricks	*Common mistakes*

Today's agenda

Motivation	*Why should you care about FS?*
Financial Statements	*Basic overview, how to read them?*
Planning	*Key value drivers, what should you focus on?*
Investor Point of View	*Know your answers!*
Tips & Tricks	*Common mistakes*

Reasons to use financial statements

INTERNAL

- Help to challenge your assumptions and increase objectivity
- Help to plan wisely
- Help to monitor actual performance VS plan and highlights troubling areas for improvement

EXTERNAL

- Help to communicate with partners and potential team members
- Help to apply for financing and explain business model to outsider

Today's agenda

Motivation	*Why should you care about FS?*
Financial Statements	*Basic overview, how to read them?*
Planning	*Key value drivers, what should you focus on?*
Investor Point of View	*Know your answers!*
Tips & Tricks	*Common mistakes*

Intro

- 3 types of financial statements:
  - Profit & Loss (P&L) / Income Statement
  - Balance Sheet
  - Cash Flow Statement

- All interrelated

- Specifics depend on:
  - Business model: product or service business?
  - What industry / sector you are operating in?
  - What is your aim and audience when presenting?
  - Particular accounting standards (should not care for now..)

It is important to understand use cases of each type of FS

Do not confuse with cash!!

Profit & Loss (P&L) / Income Statement	• Am I profitable? How much profit (loss) company made **over a period of time** (month, quarter, year)?
Balance Sheet	• Picture **in point of time** of what we OWN (assets) VS what we OWE (liabilities). Barometer of “health” – can I fulfill my financial obligations at any time?
Cash Flow Statement	• Sources (where has come from) and uses (where has gone to) of cash **during a period of time.** Barometer of liquidity.

Profit & Loss: typical items

<u>Revenues</u>

+ Product

+ Services

= Total Revenue

<u>Cost of Sales</u>

- Infrastructure

- Support

- Cost of services

= Gross Income

Other costs

- Research & Development

- Sales & Marketing

- General & Administrative

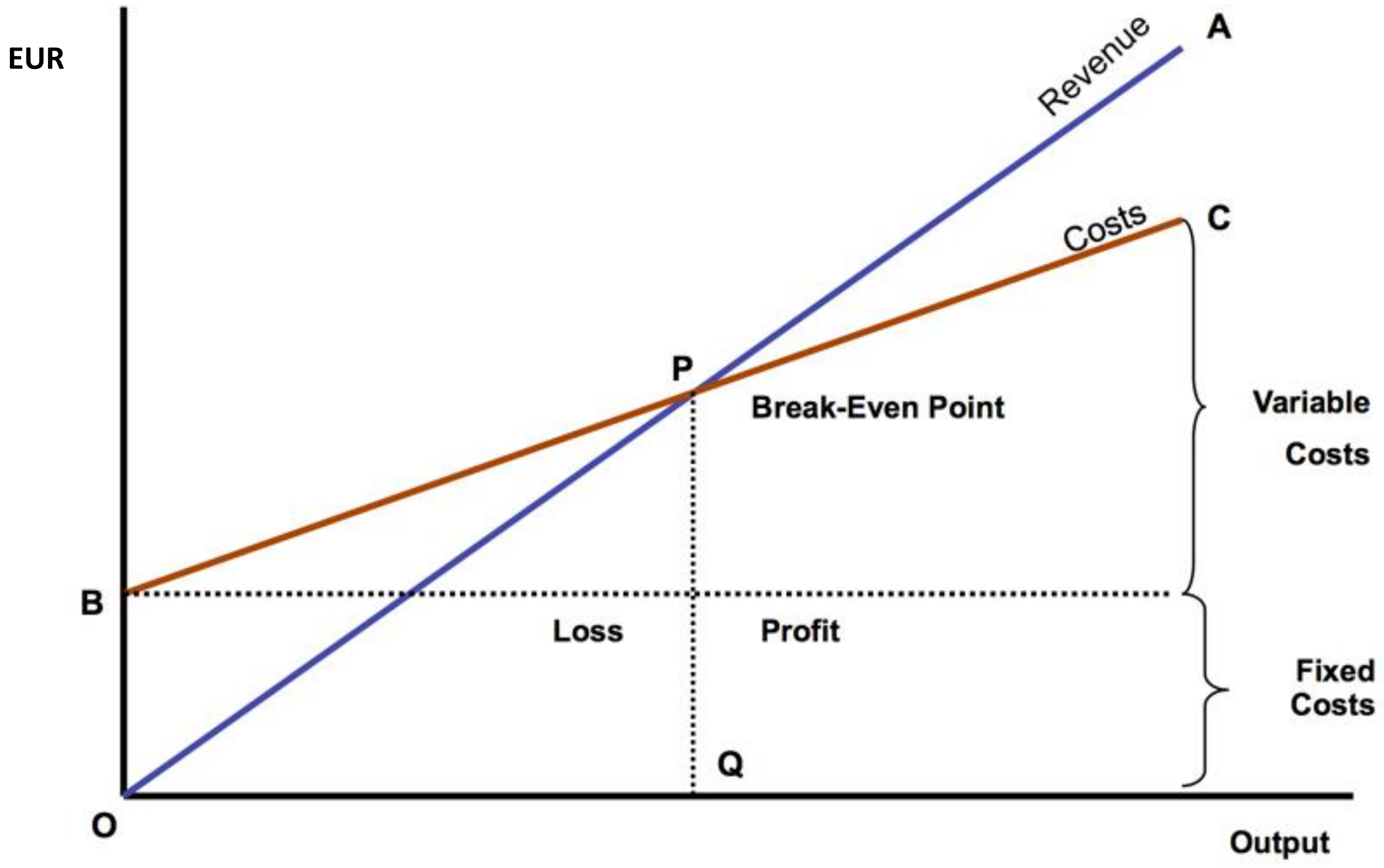
- Other

= EBITDA

- Taxes, Depreciation & Amortization

=Net Income

In the startup phase, it is extremely important to understand and manage the relationship between variable costs and revenue



LIGHTSABERS

Example: P&L of company selling light sabers

PROJECT Ltd., (figures in '000 EUR)	*2017, 12m*	*% of Rev*
Revenue	**1,000**	**100%**
Less: COGS (Cost of Goods Sold)	450	45%
Gross Margin	**550**	**55%**
OPEX (Operating Expenses)	**385**	**39%**
Salaries & Social benefits	200	20%
Rent & Utilities	60	6%
S&M (Sales & Marketing)	100	10%
G&A (General & Admin)	20	2%
Other Expenses	5	1%
EBITDA (Earnings Before Interest, Tax, Depreciation & Amortization)	**165**	**17%**
D&A (Depreciation & Amortization)	15	2%
EBIT (Earnings Before Interest & Tax)	**150**	**15%**
Net Interest Income (Expense)	-	0%
Tax Expense	23	2%
Net Profit (Loss)	**128**	**13%**

Balance Sheet: typical items

ASSETS (what you got):

Fixed assets:

- Real estate
- Plant, equipment, machinery
- Intangible assets (prestige, brand)

Current assets:

- Receivables / debtors
- Inventory
- Cash & equivalents (liquid)

=

LIABILITIES (what you owe):

- Payables / creditors
- Debt
- Accrued liabilities

Cause of bankruptcy: excessive debt (equity < 0)

EQUITY (what is left for owners)

- Nominal capital
- Additional paid-in capital
- Net profit (loss) brought forward
- Net income

Example: BS of company selling light sabers

PROJECT Ltd., (figures in '000 EUR)	2017 *12.31*	2016 *12.31*	*Change*
TOTAL ASSETS	**975**	**640**	**335**
Cash & Equivalents	75	100	-25
Receivables	200	120	80
Inventory	600	300	300
Fixed Assets	100	120	-20
TOTAL LIABILITIES	**800**	**440**	**360**
Payables	400	240	160
Debt	400	200	200
EQUITY	**175**	**200**	**-25**
TOTAL LIABILITIES & EQUITY	**975**	**640**	**335**

Cash flow: important theses

- Cash flow forecasting is important because if a business runs out of cash and is not able to obtain new finance, it will become insolvent
- Companies usually do not go bankrupt because they are not-profitable, usually they run out of cash to maintain growth & operations
- Cash flow is the life-blood of all businesses—particularly start-ups and small enterprises

Cash Flow

- Cash from operating activities **(your focus!)**
- Cash from investing activities
- Cash from financing activities

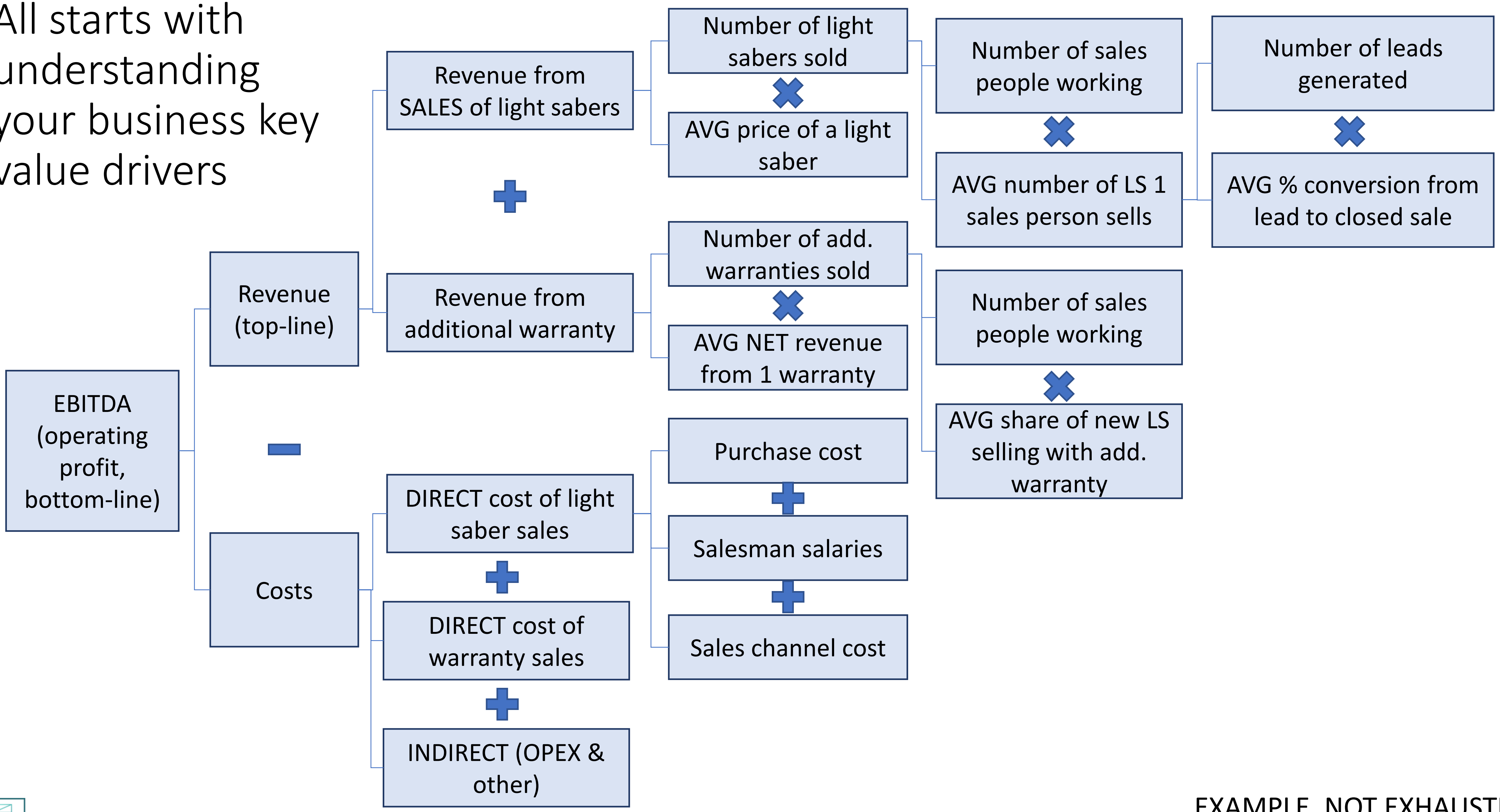
Focus on planning CF rather than accounting & reporting CF!

Today’s agenda

Motivation	*Why should you care about FS?*
Financial Statements	*Basic overview, how to read them?*
Planning	*Key value drivers, what should you focus on?*
Investor Point of View	*Know your answers!*
Tips & Tricks	*Common mistakes*


Your budget gets cut!
And your budget gets cut!
And your budget gets cut!
Everyone's budget gets cut!!!

All starts with understanding your business key value drivers



EXAMPLE, NOT EXHAUSTIVE

Revenue forecasting

- Sales force productivity:
  - Learning curve
  - Market acceptance
- Sales cycle for your target customer
- Impact on pricing
  - Competition
  - Market disruption

COGS (Cost of goods sold)

- Marginal cost of most goods are inversely proportional to quantity
- Marginal cost of most technology goods go down over time
- Includes total cost of getting a product ready for sale (packaging, shipping, etc.)
- Includes cost of direct effort to sell
- Clear relationship between quantity and level of costs
- Every industry is different – check industry peers

OPEX (Operating Expenses)

- Most of expense items are somewhat proportional to headcount:
  - Salaries & benefits
  - Social taxes
  - Office related
  - Communications
  - Travel
  - Trainings, etc.

- Some expense items are not correlated – forecast bottom-up or as % of revenue:
  - Marketing
  - Professional services
  - R&D & patents (industry specific)
  - Other

What are startup costs?

Everything you need to spend:

A. In the first year
B. Until you are profitable
C. Until you are cash flow positive
D. All of the above

What are startup costs?

Everything you need to spend:

A. In the first year
B. Until you are profitable
C. Until you are cash flow positive
D. All of the above

Answer: D

Sanity check & benchmarking

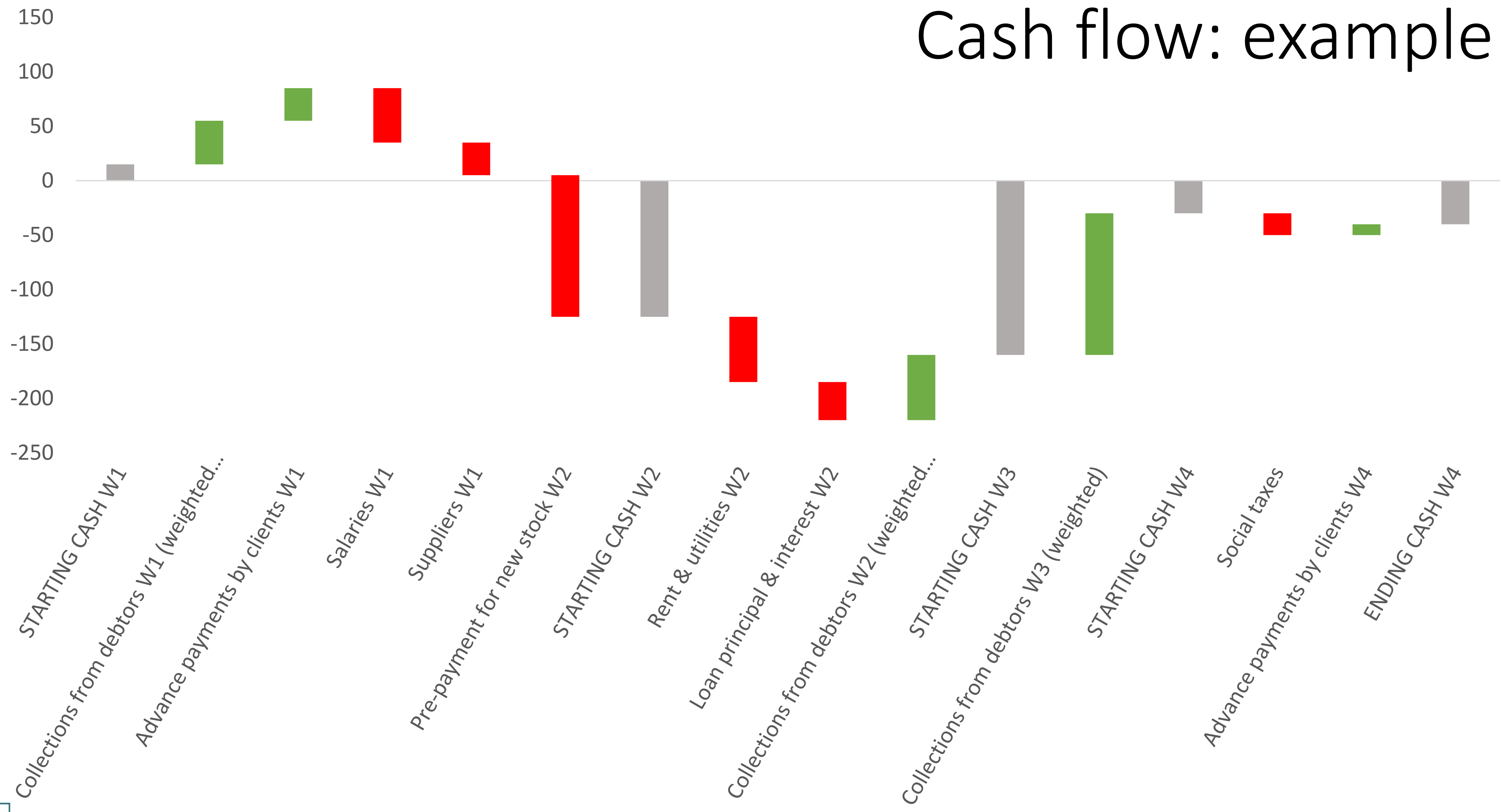
- Check dynamics of most important KPIs for your business (i) over time; (ii) benchmark with competitors & leading industry peers.
  - Gross margin (how does your business model compare with competition?)
  - Revenue per employee (productivity)
  - Sales / Profit per sales person
  - Organizational structure
  - AVG salary per function
  - Particular expense category as % of revenue
  - Financial ratios (liquidity, cash conversion)
  - Industry specific (Client acquisition cost, Average revenue per user, churn, etc.)

- Also, perform sensitivity analyses to identify opportunities / risks. Focus on biggest impact assumptions.

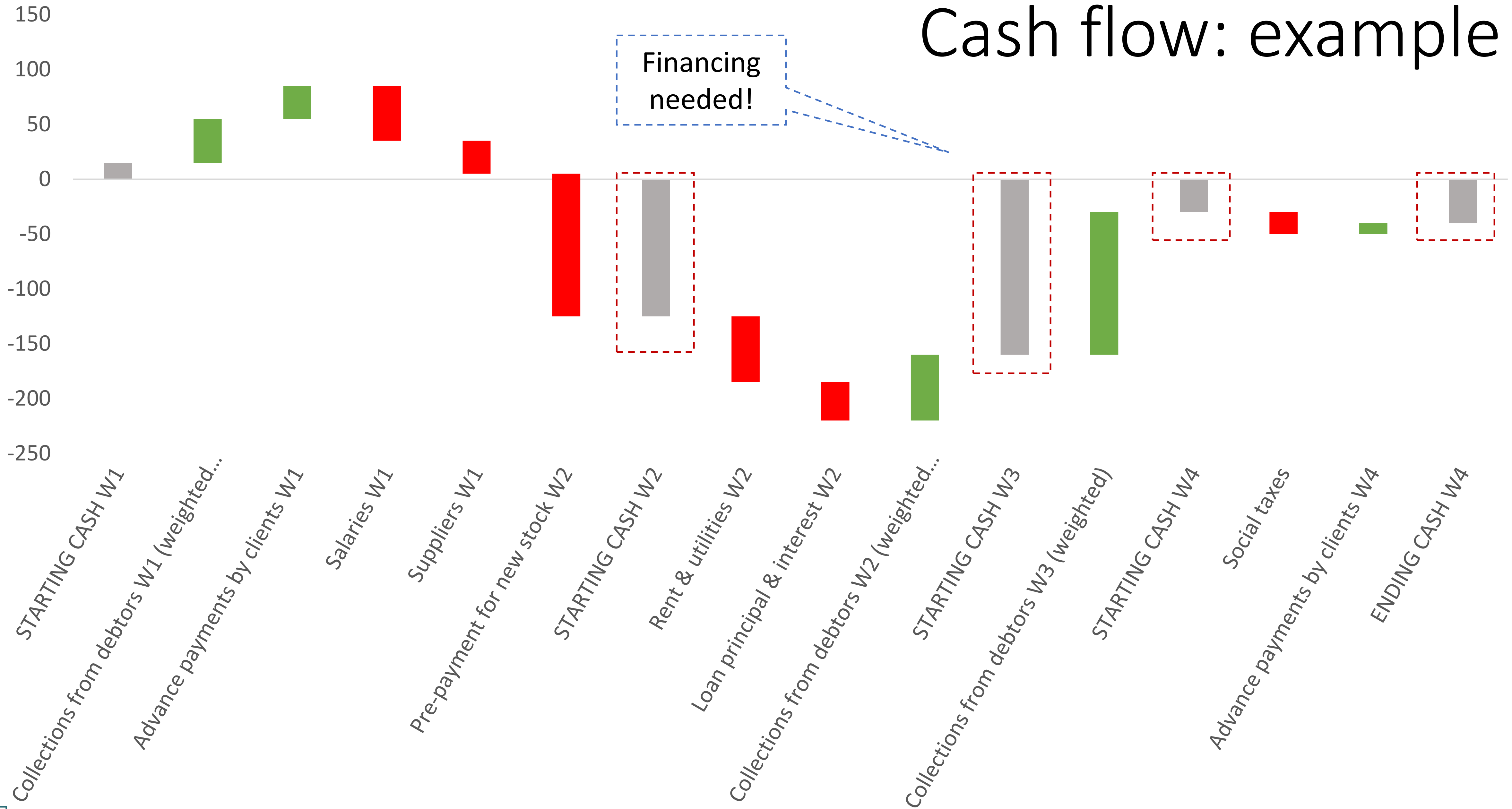
CFIMITYM

Cash Flow is More Important Than Your Mother

Cash flow: example



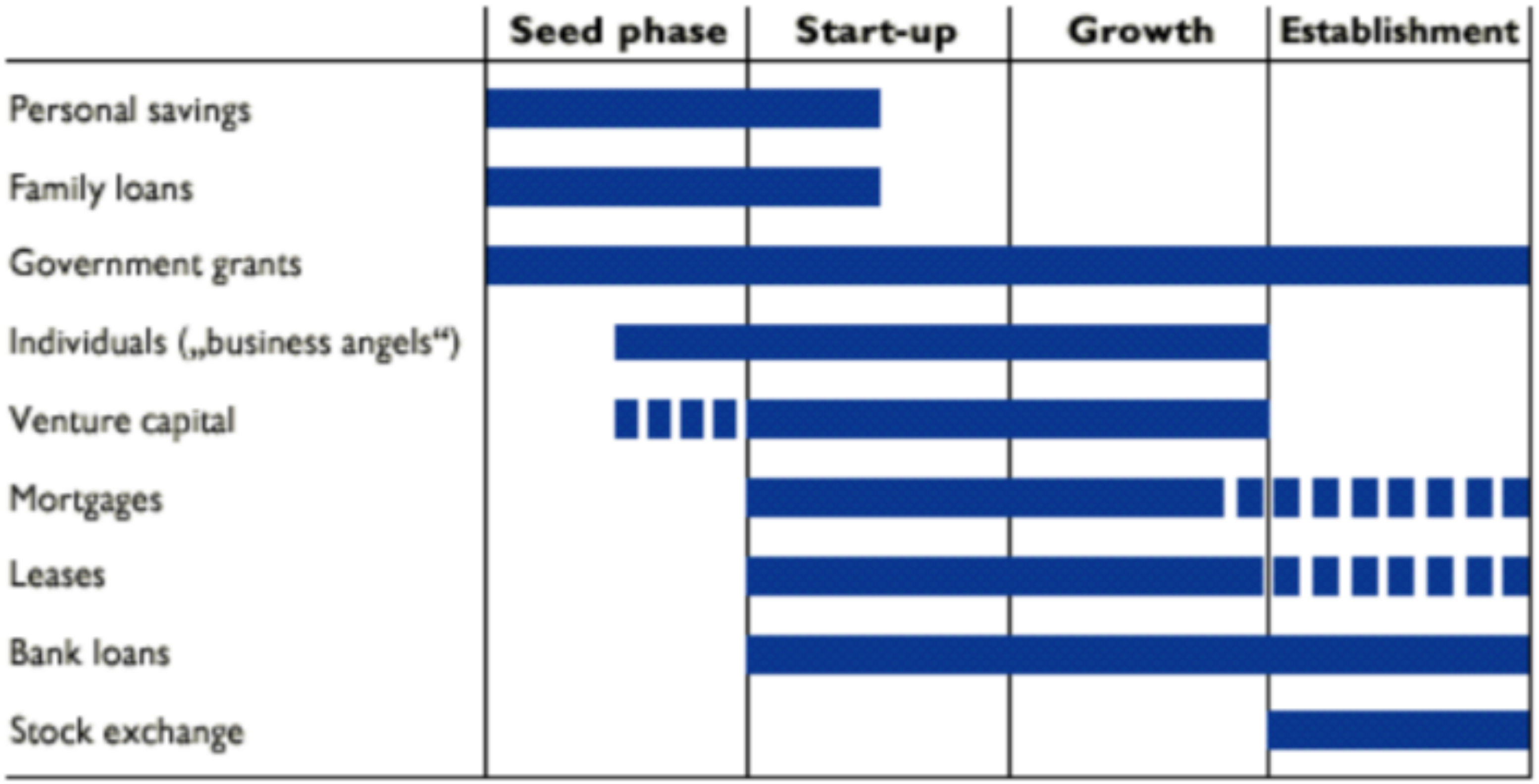
Cash flow: example



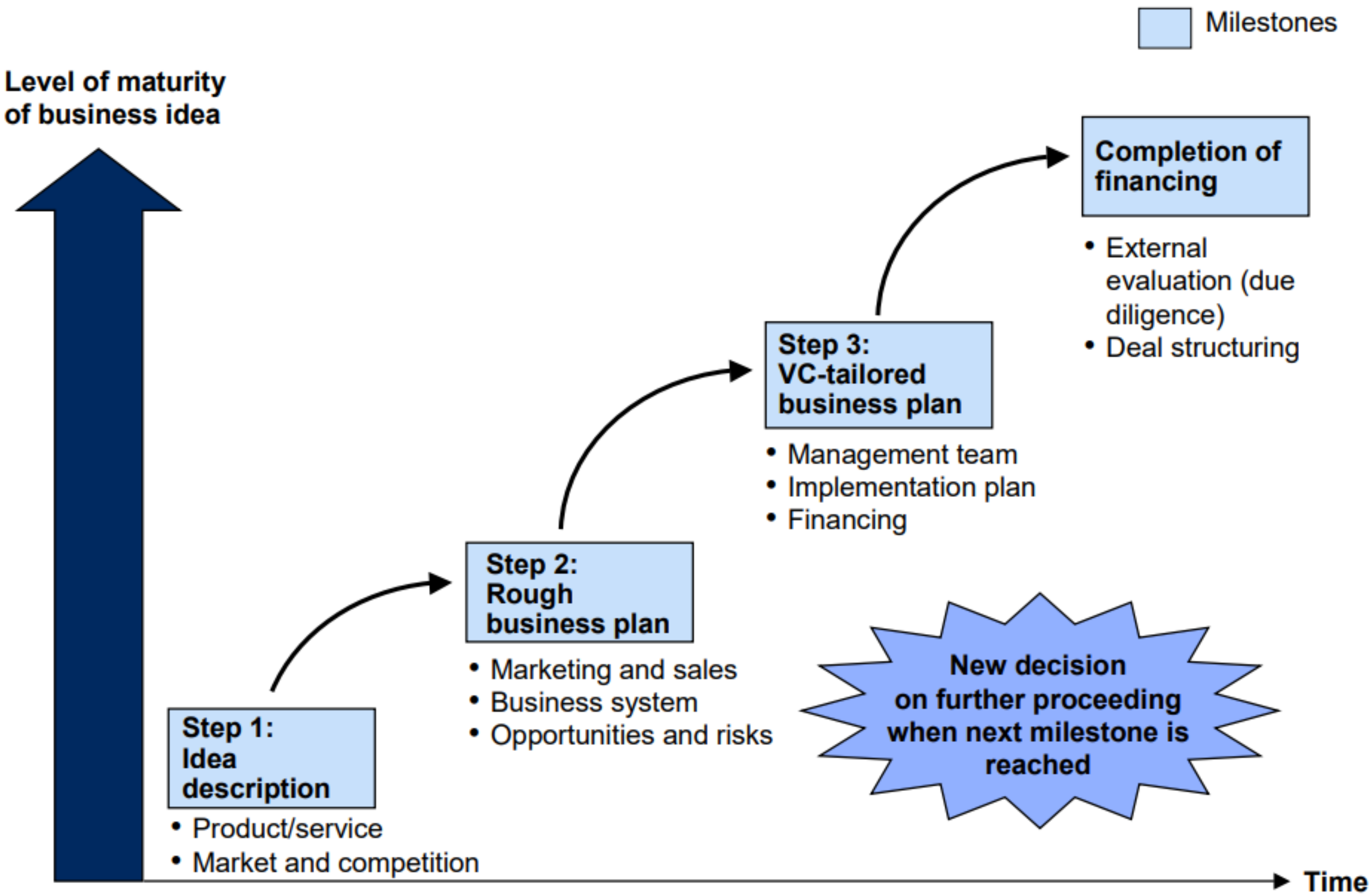
Today's agenda

Motivation	*Why should you care about FS?*
Financial Statements	*Basic overview, how to read them?*
Planning	*Key value drivers, what should you focus on?*
Investor Point of View	*Know your answers!*
Tips & Tricks	*Common mistakes*

Sources of capital at various stages of development



DEVELOPMENT STEPS FOR BUSINESS PLANS



Source: McKinsey & Company

The level of sophistication and detail of your financial statements, as well as what 3rd parties will expect from you depend on the stage your company is at.

But ALWAYS understand the dynamics of your business key value drivers and what are the levers to impact them!

Questions you will get asked

- How will your revenues, expenses and profit develop?
- How will optimistic, realistic and pessimistic scenarios look like?
- How will your cash flow develop? When will you expect to break even (=sum of all revenues > than sum of all expenses)?
- How high is your need for financing based on your liquidity planning?
- How much cash is needed in the worst case scenario?
- What assumptions underlie your financial planning?
- Why your future scenario will (not) be different from company's development until now?
- What are most sensitive areas (key risks) related with key value driver development?
- Which sources of capital are available to you to cover your financing needs?
- What deal are you offering potential investors?
- What return can investors expect?
- How will you realize a profit (exit options)?
- Your startup expenses will be scrutinized.

Minimum required financial planning in your business plan

- A cash flow calculation (liquidity planning), income statement, balance sheet.
- Forecasts over three to five years, at least one year beyond the point of breaking even, that is, beyond the generation of positive cash flow.
- Detailed financial planning for the first two years (monthly or quarterly), thereafter annually.
- All figures must be based on reasonable assumptions (only the main assumptions need to be described in the plan).

General requirements for business plan and financial planning part are the same!

FEATURES	EXPLANATION
Dynamic and adapting	Business planning is reflection of business – it is iterative process, requires constant updating and adjustments
Clarity of thought	Number of analyses does not impress. Focus, clarity and preciseness of your business and financial model figures and assumptions do!
Convincing, backed by facts	Do not confuse anyone by being over-hyped, but rather establish trust by providing facts
Understandable for non-experts	Decision makers are often not experts in specific technological features of your business
Consistent	Facts and assumptions must well fit together and provide a well rounded storyline
Visually clean and clear	Show your professionalism by providing structured and clear deliverable for people who will invest time in understanding your project

Today's agenda

Motivation	*Why should you care about FS?*
Financial Statements	*Basic overview, how to read them?*
Planning	*Key value drivers, what should you focus on?*
Investor Point of View	*Know your answers!*
Tips & Tricks	*Common mistakes*

Common mistakes

- Mixing up P&L items and cash flow items
- Timing confusion: record expenses over the period they generate revenue
- Over-optimism (assuming only optimistic scenario, but there will ALWAYS be surprises!)
- Forgetting growth in costs (related with increase in headcount, salary increase, office expansion, increase in back-office, etc.)
- Lack of detail or so detailed that “might miss an elephant in the room” (prevent: benchmarks, sanity checks)

First Law of Startups:

Everything takes longer to do than you think it will

Second Law of Startups:

Everything costs more than you think it will

Third Law of Startups:

No entrepreneur thinks of everything

Question time!