UW Business Plan Competition Resource Night

“Financials and Funding”

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Agenda

- Introduction
- Financial Projections
- Funding - Raising Capital
- Summary

Financial Projections

Quote from our major investor:

"Tell them just how important hockey sticks are to investors!!!

Lack of a hockey stick is what drives investors crazy!"

Financial Planning - Understanding Risk

- Finance - a way to think about <u>cash, risk & value</u>
  - Creating value is a key responsibility
- Financial risk - <u>uncertainty</u> about future cash flows
  - Create value by <u>managing & understanding risk</u>
    - Market, Management, Technology, Financial, Competition
- Finance does not answer questions
  - Helps to ask the right questions and narrow the options
- Some decisions will turn out to be illogical or unfeasible.

Projections - Overview

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

Projections - Overview

- **High level figures**
  - Underlying assumptions and detail should be available
  - Five-years – integrated
    - Monthly for the first two years; quarterly for the remaining 3 years

- **Projections should answer**
  - How will the company perform? **P & L**
  - What will the cash position be? **Cash Flow**
  - What will the financial position be? **Balance Sheet**

What's Wrong With Most Financial Plans?

- Waste too much ink on numbers
  - Too little focus on what really matters
    - Focus on strategy and execution
  - No need for detailed, monthly numbers forever
- Typically wildly optimistic
  - Entrepreneurs underestimate capital and time

Projections - Assumptions

- Organize in a separate worksheet
  - Used for sensitivity and “what-if” analysis
- Material assumptions
  - Support assertions with valid data
    - Estimate as best you can
  - Be clear about what you do & don’t know
  - Individualize
    - e.g., most advertising expenditures are made months before sales result
  - Include financial obligations of an evolving, growing company
    - New employees, additional physical space, increases in inventory and A/R
- 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

Assumptions – Some to Consider

- Revenue by distribution channel, geography, # sales people
- Manpower plan
- Cost of Goods Sold *(COGS)* - (labor, material, overhead)
- Expenses by department (engineering, sales, G&A, etc.)
- Fixed assets purchases and depreciation
- Debt and related collateral support (A/R, inventory, etc.)
- Interest income and expense
- # days in Accounts Receivable & Accounts Payable
- Inventory turnover
- Compare to industry norms

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
  - Demonstrates understanding of business
  - Reflects plan strategy

Bottoms Up Projections

- Revenues

Revenues	Units	Price	Amount
Product A - U.S. Direct	100	$100	$10,000
Product A - Europe Direct	75	$125	$9,375
Product B - U.S. Partners	40	$75	$3,000
Product B - Europe Partners	50	$90	$4,500
Service - U.S.	-	15%	$1,950
Service - Europe	-	17%	$2,359
Total Revenues			**$31,184**

  - Forecast sales at the lowest level of product or service detail (product, customer, channel, sales person, region)
  - Volume and pricing

- Expenses
  - Headcount dependent – wages, supplies, travel
  - Non-headcount – legal, acct’g, advertising, rent, insur.

Alternative Scenario Analysis

- **Revising multiple assumptions for changed strategy or business conditions**
  - vs. <u>Sensitivity</u> - changing an individual assumption *(e.g. pricing)* to determine impact
- **Examples**
  - Alternate distribution channels strategy
  - Timing issues (sales or development delayed)
  - Alternate financing options
- **Use this to run your business!!**

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 absorbs cash
    - Entrepreneurial firms have a very fast cash burn rate
      - ✓ Need for working capital and fixed investments
    - 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**:
  - **Cash Flow is More Important Than Your Mother!!**

DON'T RUN OUT of CASH!!

Funding – Raising Capital

Sources of Money

- Credit Cards
- Home Equity Loan
- Friends & Family
- Angel Investors (successful entrepreneurs)
- Venture Capitalists
- Government loan/grant programs
- Commercial Bank Loans
- IPO
- Mergers & Acquisitions (“M & A”)

Thoughts on Raising Capital

- Concisely link the strategy & financials
- A long & challenging process
  - 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 and have a "plan B"
- Friends, family & personal funds are usually the only source of capital available for new ventures

Current State of VCs

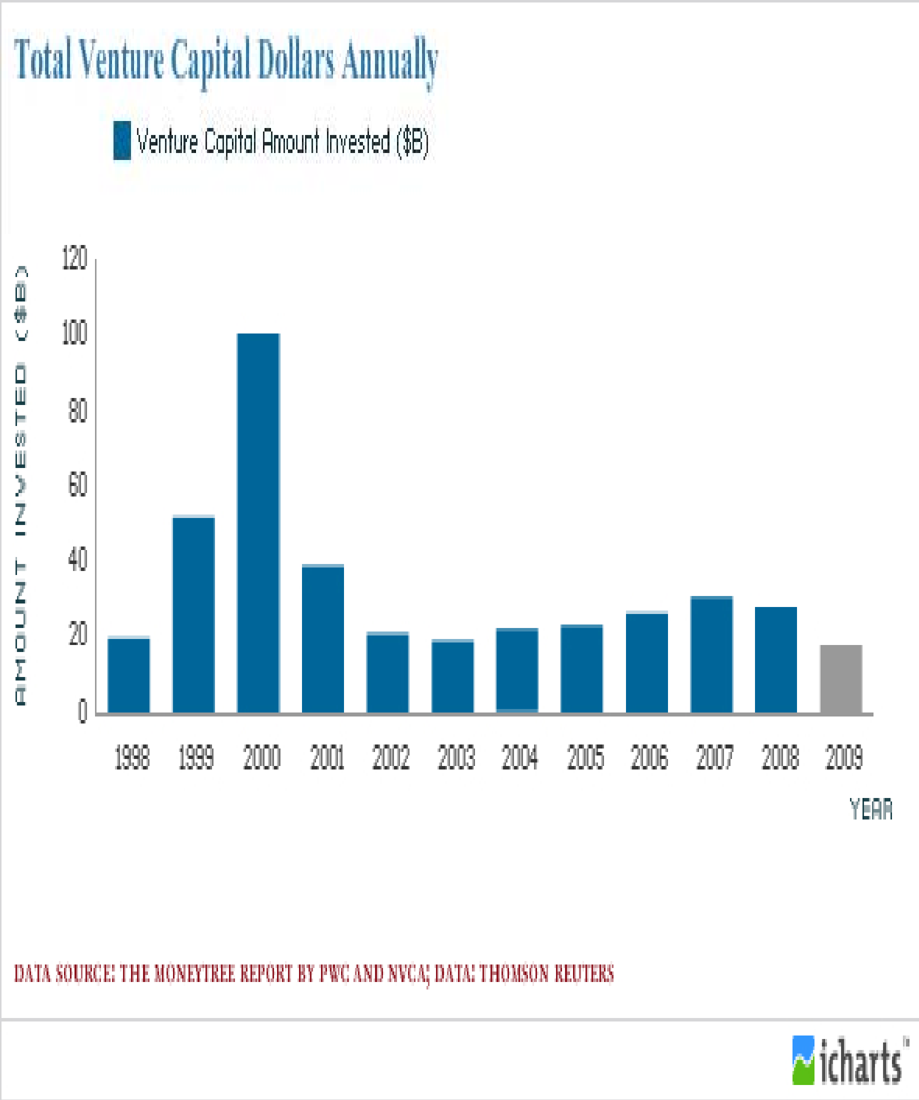
- Spending more time & capital w/ existing cos.
  - Due to poor economy & lack of funding and exits
- Bar raised
  - More due diligence
  - Value proposition is real
    - Credible homework and support
  - Lean and Mean
    - Spend money wisely (looking for “capital efficiency”)
- Raise minimum $$ to prove biz model
  - Raise larger $$ later at higher valuation

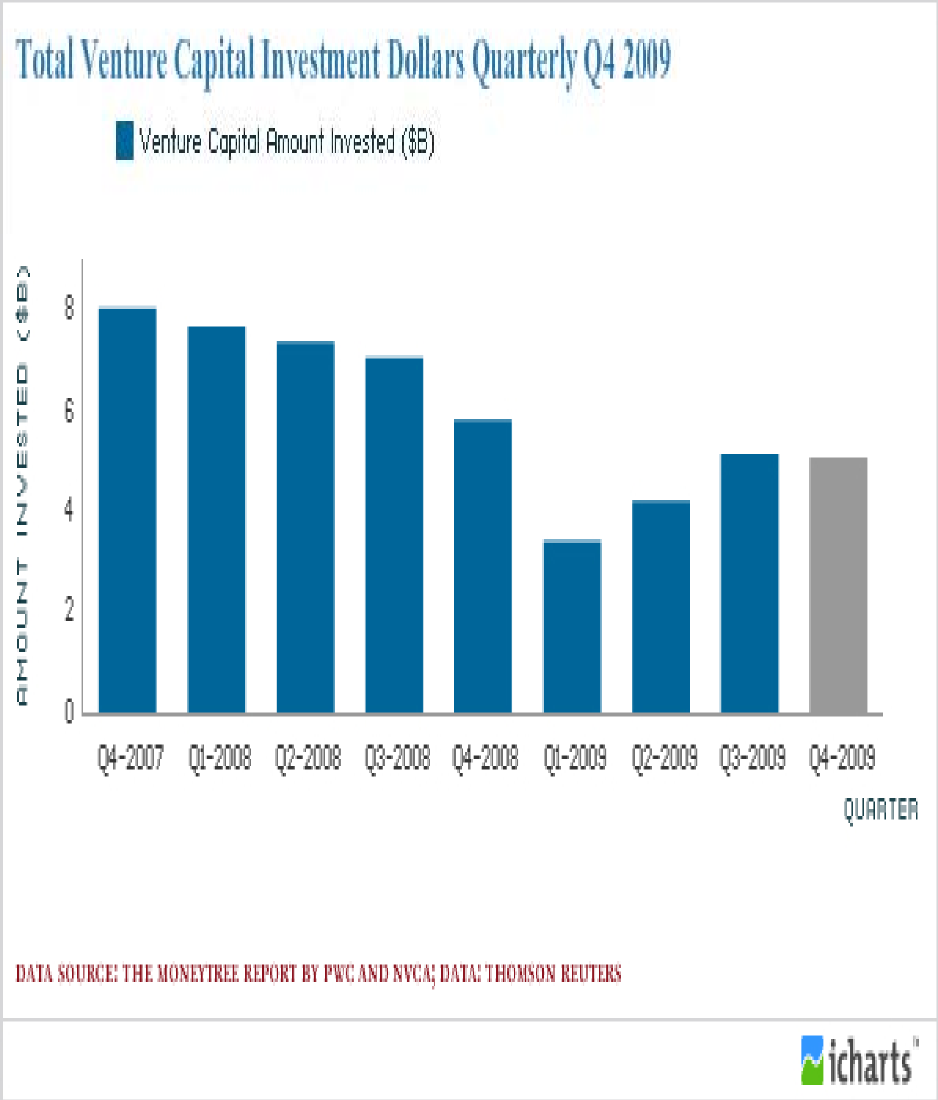
Current State of VCs

- Lower valuations
  - Reflection of economy and stock market

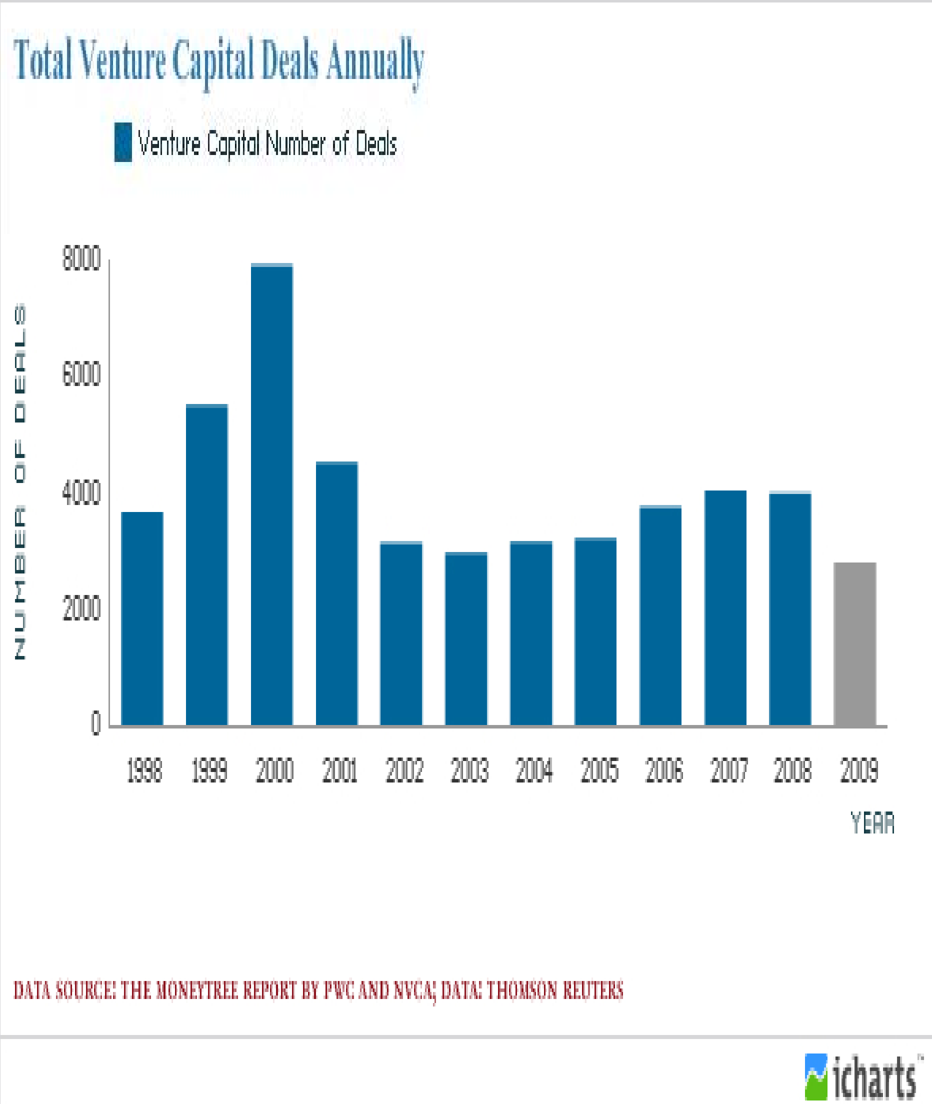
- Not a bad time to raise capital, esp. early stage!
  - Looking for aggressive entrepreneurs
  - An economic downturn is a time ripe with opportunity!!

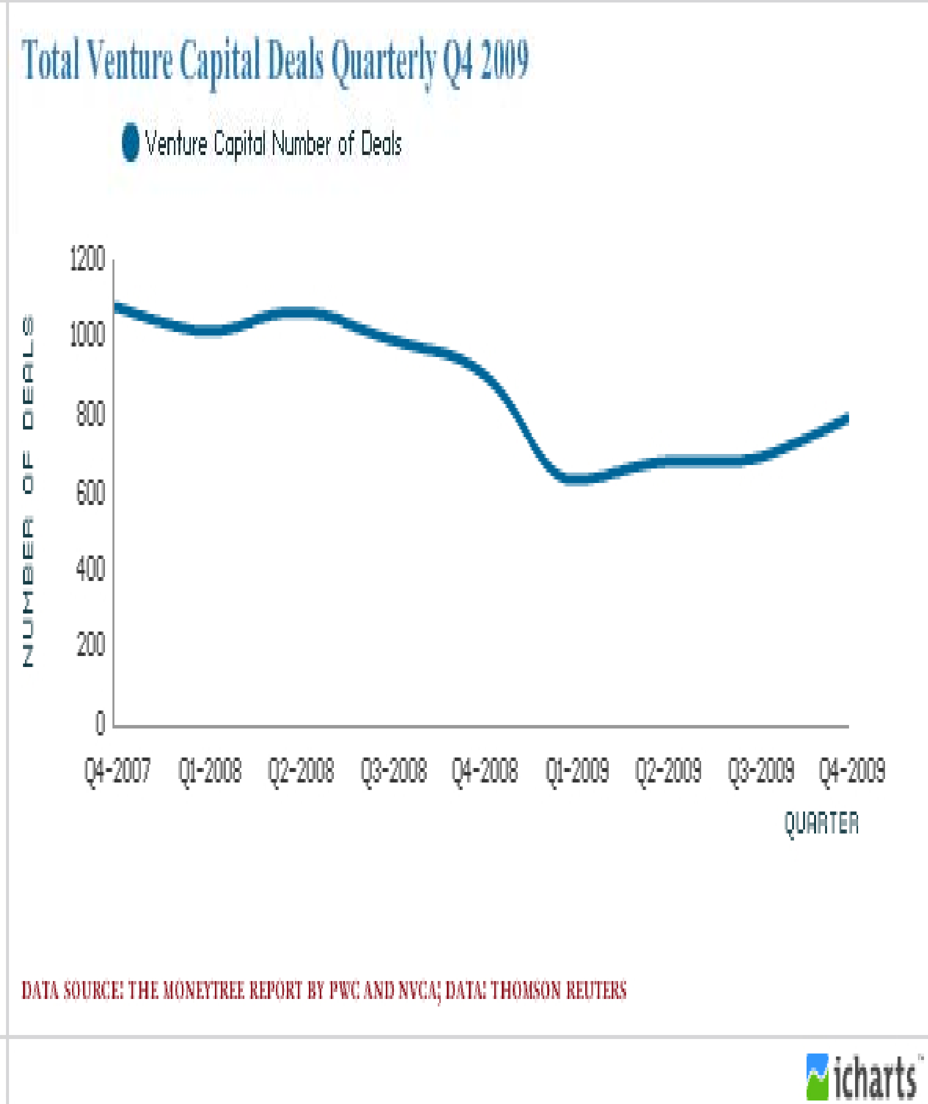
VC Investment History - $$





VC Investment History - # Deals





VC Investments

- **2009**: $17.7 billion invested in 2,795 deals
  - Lowest level of dollars since 1997
  - 37% decrease in $$ & a 30% decrease in ## deals vs. '08
  - Double digit $$ declines in almost every industry
  - $$ fell across every stage of development
  - Second consecutive year of annual deal and $$ declines
- **4Q09:** $5.0 billion invested in 794 deals
  - 2% decline in dollars but a <u>15% increase in # deals</u> vs.3Q09
  - Increases in the <u>number</u> of seed & early stage deals
    - Beginning of an uptick for 2010?
    - Early Stage deals had double digit increases with $1.6 billion going into 277 deals, up 32% in $$ and 26% in # of deals from 3Q09

What All Investors Look For

- Above average return on investment (20%+ per yr)
- 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 scalable?
- Exit strategies within 4 - 7 years
- Unique value proposition - not another “me too”
  - Build a company, not a product

Getting Angels to Invest

- Herding cats – invest together w/ friends
- Set a schedule/deadline
- Target & negotiate with a few lead investors
  - Close lead/key investors first
- Target Angel Networks (Alliance of Angels, Seraph, Portland Venture Group)
- Only take money from accredited investors

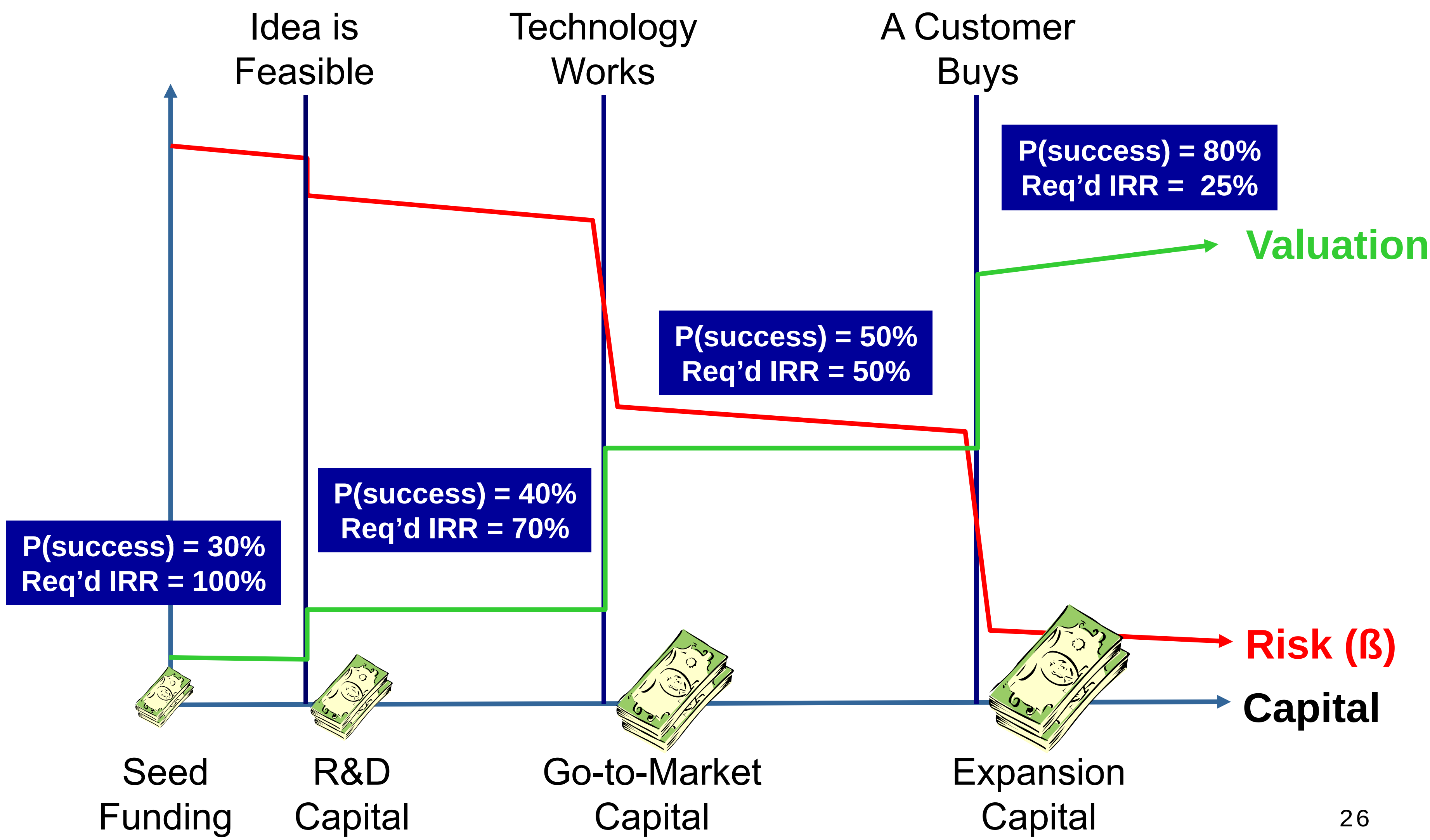
How to Get a VC's Attention

- **Great team**
  - Deep domain and execution expertise with realistic goals
    - Abundance of Sales and Marketing talent
- **Know Your Market & Customers**
  - Detailed understanding of market & competition is critical
- **Large market -** Ready for fundamental change
- **Difficult problem -** That few can solve
- **Real need -** That is visionary, but not missionary
- **Effective Business model**
  - Sustainable competitive advantage
- **Set of prospects who will validate plan**
- **Elevator pitch** – ability to tell a crisp story quickly

Funding To Milestones

- Milestones and expected cost
  - Shows business understanding and intention to track performance closely against the plan
- Milestone Examples
  - Completing prototype
  - Hiring of key managers
  - First customer shipment
  - First profits and positive cash flow
  - Achieving $”X” million in revenue

Funding to Milestones



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

- Have fuel in the tank
- Competitive bake-off
- Have alternatives
- Avoid investor collusion

After the Investment
Board Value Added

- Mentor & Advisor
- Introductions to
  - New investors
  - Strategic partners, customers
  - Advisory board candidates
  - Critical new hires
  - Merger partners
  - Financial institutions

Summary

- Create value by managing risk
- Projections need to be realistic and believable
  - Strategy & Financials - complementary and consistent
  - Focus on information that really matters
  - Integrate assumptions and statements
  - Bottoms Up approach
- Cash is king!
- Fundraising is a full time job
  - Relationships are most important
- Understand the investor
- Funding to milestones
- Realistic valuation expectations