

Financial Projections That Guarantee A Winning Proposal

Aldis Jakubovskis
Lynette Watson
Missouri SBTDC

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Agenda

- The purpose and benefits of budgeting and financial projections;
- Financial projections spreadsheet tool;
- Developing and validating financial assumptions;
- How the clients can get the most benefit from the cash flow projection process

Purpose and Benefits of Budgeting and Financial Projections

- Setting goals for the owner;
- Benchmarking – how a company can be expected to perform relative to industry norms;
- Educational value – understanding the value of cash flow dynamics;
- Gives the financial interpretation to your overall business plan;
- Bankers want them – know what bankers expect

What is Typically Included in the Projections

- Usually projections should include a minimum of 3 years, at least 1 year on a monthly basis;
- Should include the full set of financial statements:
 - Income or P&L;
 - Balance sheet;
 - Cash flow statements
- All financial statements must RECONCILE among each other;
- Supplementary sheets that explain details;
- Document your financial assumptions and sources

St. Louis SBTDC Cash Flow Projections Tool

- Location:
www.missouribusiness.net/sbtcd/docs/fin_proj.xlsx
- Utilizing the functionality and flexibility of Excel;
- Advantages of the template:
 - Convenience of minimal data entry, focus on entering the assumptions vs. the dollar figures;
 - Maximum adaptability to different business cases;
 - **Integrated** worksheet that serves as a “hub” for user-created sheets
 - [fin_proj.xlsx](#) – Appendix 1

Focus on Entering Assumptions

- Whenever possible, the data is entered as assumptions rather than dollar figures;
- Examples:
 - Loan amortization: interest rate, term, start date, original balance;
 - Depreciation: useful life, current age, original cost;
 - Operating capital: days A/R, days A/P, days inventory;
 - Percentages: COGS, payroll tax
- Easier ‘what-if’ analysis

Focus on Entering Assumptions: Examples

64	Long-term Loan 1	70,000	60	7.5%	-57	4,156	2,779	1,394	0	0
65	Long-term Loan 2	80,000	60	7.0%	3	0	0	0	80,000	78,883
66	Long-term Loan 3	0	0	0.0%	0	0	0	0	0	0
67	Other LT Liab					0	0	0	0	0
68	Total Long-term Liab					4,156	2,779	1,394	80,000	78,883

40	Accounts Receivable	0	19,000	24,000	29,500
41	Days A/R		15	15	15
42	Inventory	0	68,400	86,400	106,200
43	Days Inv		90	90	90

Maximum Adaptability

- Every business case is different (start-up vs. existing businesses, product based businesses vs. service based businesses, etc.);
- A good cash flow projections spreadsheet must have both the following features (possibly contradictory requirements):
 - Automate as much work as possible;
 - Accommodate as much business-specific details as possible
- The proposed approach allows to custom-create sheets and link into one integrated and standardized sheet;
- The spreadsheet can be expanded to more than 3 years relatively easily

Setting Up the Opening Balance

- One of the most difficult tasks when developing projections – setting up the opening balance;
- Start-up vs. existing businesses:
 - **Categorize** start-up costs:
 - Investment in tangible (equipment, improvements, etc.) or intangible long-term assets that can be depreciated or amortized;
 - Other assets: non-depreciable or non-amortizable (deposits);
 - Working capital and/or inventory;
 - One time start-up expenses (incorporation costs, grand-opening advertising, etc.) – go into Retained Earnings as a negative number
 - Opening balances for existing businesses – reconcile the time gap and critically assess the most recent balance sheet

Show the Financial Need When Applying For a Loan

- Show how the cash position is affected by the additional financing – for example, occasionally when the working capital loan being sought is taken out of the projections, the cash balance is still positive and sufficiently large;
- Look at the month with the lowest cash balance – that will help to determine the working capital needs;
- What is sufficient lowest projected cash balance? – 1 week, 10 days, 1 month, 3 months of operating expenses

How to Choose the Start Time For the Projections

- Current time?
- Beginning of calendar year (Jan 1)?
- Beginning of operations (sales) or trade season?
- Expected date of obtaining financing (30-60 days in the future)?
- Other considerations?
- The proposed spreadsheet allows to set the first month (includes both the month of projections and the calendar month)

Developing Financial Assumptions

- Project cost and uses of funds:
 - Start-up;
 - Expansion;
 - Business acquisition
- Revenue model;
- Monthly operating expenses

Project Cost and Uses of Funds – Start-up

- For start-ups clearly indicate owner's investment – usually 20% of the total project cost (not of the loan amount);
- Categorize the start-up costs (as discussed before);
- One time start-up expenses vs. recurring – why it is important;
- Make necessary adjustments – for example, clients will include 3 months, or even a year's worth of salaries;
- Estimated project costs – client example (Appendix 2)

Project Cost and Uses of Funds – Ongoing Business

- Funds typically needed for additional working capital (NOT TO COVER LOSSES), or additional equipment or improvements;
- Ideally, show balance before and after the new funding is implemented; or in the case of re-financing – the old and the new loans;
- Potential problem – frequently client's bookkeeping does not represent the balance sheet accurately

Project Cost and Uses of Funds – Business Purchase

- Try to “put weight” on tangible assets vs. “goodwill”;
- Working capital needs to be estimated – cost above the purchase price;
- Seller's financing desirable;
- Factor in all the changes – revenue flow, expenses, new debt service

Developing Revenue Model

- Traditional approach (Appendix 3 & 4):
 - Units per month times sales price minus COGS for each product category
- Industry specific models (Appendix 5);
- Businesses with multiple product/service lines:
- Mathematical revenue modeling (Appendix 6 & 7):
 - When appropriate?
 - Potential benefits
- Sometimes need to build a model with very specific features

Revenue Model Must be Consistent With the Marketing Plan

- Demographic target and purchase frequency;
- Product/service positioning and pricing;
- Luxury or necessity;
- Competitive factors

Developing Revenue Model

In-class Exercise: Real World Example

(Appendix 8)

Projecting Expenses

- Cost of goods sold: applicable in certain industries by convention;
- Fixed vs. variable; semi-variable and stepwise expenses;
- Focus on key expense categories; don't struggle over expenses that constitute only a fraction of a percentage point of sales;
- May include 5-10% contingency

Projecting Expenses (cont.)

- Some expenses are more certain than the others;
- Allocate expenses evenly between months when there is no basis to do otherwise (for example, hard to assign repairs and maintenance to specific months);
- Provide detailed explanations for the major expense categories

Some Numbers Are More Important Than the Others

- Look at your monthly sales, for example, if monthly sales are \$20,000, don't worry about a \$100 expense – it is only 0.5%;
- Pay attention to major expense categories first – look at the BIG PICTURE, don't get bogged down with minutia

Break-even Analysis and Debt Coverage Ratio

- Emphasize the benefits of understanding the break-even concept;
- Aim for slightly above break-even – can't go wrong...
 - Vast majority of industries have the profit before taxes in the 0-10% range
- Make sure the projections "cash flow" – safe DCR 1.3-1.5

Projections Have to be "Elegant"

- Have to be easy to understand;
- Use level estimates, if there is no reasonable basis for differences between months (when appropriate);
- Round estimated numbers to 1,000s, 100s, etc. – zeros indicate that they are estimates, and the number of zeros indicate the assumed accuracy of these estimates;
- Example of projected income statement, balance sheet, and cash flow statement (Appendix 9)

Sources of Information

- Previous performance results;
- Comparable businesses;
- Field research;
- Trade associations;
- Publications:
 - RMA,
 - Etc...

Validation of Assumptions

- Look for multiple sources to re-enforce and validate from different perspectives;
- Indicate the sources of information;
- Each industry has its own specific rules of thumb

Client Counseling Process

- Start-up/existing business with limited financial acumen
 - Lots of hand holding
 - Need to keep it as simple as possible
 - Help them understand what numbers they are looking for and why
 - Assist in the creation of the financial projections and narrative with the numbers provided.
 - Explain to them in detail what the numbers mean and how to present it to the bank.

Client Counseling Process

- Business Owner with intermediate or advanced financial acumen
 - Work with them to identify strengths and weaknesses in their financial structure and to develop strategies to address their specific needs.
 - Assist them with further understanding of ratio and industry analysis.
 - Help them utilize their financials to operate their business proactively versus reactively.
 - Utilize their historical financials to assist in the creation of financial projections.

Bank Presentation

- Make sure the number/projections make sense.
- Financial projections should include an explanatory narrative.
- The financial projections should include:
 - Income Statement
 - Balance Sheet
 - Cash Flow Statement
 - Sources and Uses of Funds
 - Personal Financial Statement

Bank Presentation

- Have a solid understanding of what is being presented to the bank.
- Have a Plan B in mind.
- Be detailed in what you need and explain why. Ask for the money.

Thank you!

Aldis Jakubovskis
100 N Tucker Blvd, Ste 530
St. Louis, MO 63101
314-241-1591
jakubovskisa@missouri.edu

Lynette Watson
260 Brown Rd
St. Peters, MO 63376
636-970-3000
watsononly@missouri.edu