



Financial Models for Startups

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Welcome

- Introductions
- Goals:
 - Familiarize you with financial models for startup companies
 - Provide overview of StartupModels financial model
 - Available for download at <https://www.startupmodels.com>
 - Answer your questions

What financial documents do you need?

- Profit and loss statement (P&L)
- Cash flow statement
- Balance sheet (sometimes)

Why do I need these statements?

- Does your company or will your company make money?
- Does your company have enough cash to survive and thrive?
 - Long product development cycles
 - Long sell cycles
 - Large inventory requirements
- What is the company worth today and in the future?

Investors want a return on investment

- Banks: bankable loan with low risk of loss
- Equity investors: seek high growth company with 10x or better returns with acceptable higher risk
 - A \$500K investment for 10% of company with a 10x return (\$5M) equates to a \$50M sale
 - SaaS company with annual reoccurring revenue of \$7.2M at 7x valuation = \$50M value
 - Exit must take place in 5 to 7 years

What is a P&L?

Profit and loss statement (P&L)

Revenue	\$10,000
Cost of revenue	<u>(\$4,000)</u>
Gross margin	\$6,000
Operating expenses	<u>(\$4,500)</u>
Profit	\$1,500

P&L forecast

- Invest the time and effort to develop a realistic and detailed forecast
- Grounded in realistic assumptions
- First 12 -18 months critical and must be supported
- 3-year forecast is normally sufficient
- 5-year projections are often unrealistic
 - Some investors want this to see your aspirations

Example SaaS P&L statement

Report Year 2019

ClinicNote P&L Forecast for the year 2019

Revenue Recognition Based

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Revenue													
Subscription Software Revenue	\$ 1,092	\$ 2,561	\$ 4,644	\$ 8,069	\$ 12,431	\$ 19,396	\$ 24,576	\$ 29,248	\$ 36,679	\$ 44,121	\$ 49,662	\$ 52,784	\$ 285,262
Product Revenue	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Professional Services Revenue	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Revenue	\$ 1,092	\$ 2,561	\$ 4,644	\$ 8,069	\$ 12,431	\$ 19,396	\$ 24,576	\$ 29,248	\$ 36,679	\$ 44,121	\$ 49,662	\$ 52,784	\$ 285,262
Cost of Goods													
Third Party / Transaction Fees	\$ 63	\$ 136	\$ 271	\$ 449	\$ 696	\$ 1,241	\$ 1,269	\$ 1,285	\$ 1,832	\$ 1,931	\$ 1,923	\$ 1,709	\$ 12,803
Hosting Expenses	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 75	\$ 900
Customer Support	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,603	\$ 2,603	\$ 2,603	\$ 2,603	\$ 2,603	\$ 2,603	\$ 2,603	\$ 18,223
Internal Engineering Support	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Professional Services	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Cost of Product Sales	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Cost of Goods	\$ 138	\$ 211	\$ 346	\$ 524	\$ 771	\$ 3,919	\$ 3,947	\$ 3,963	\$ 4,510	\$ 4,609	\$ 4,601	\$ 4,388	\$ 31,925
Gross Profit	\$ 954	\$ 2,350	\$ 4,298	\$ 7,546	\$ 11,660	\$ 15,478	\$ 20,629	\$ 25,285	\$ 32,169	\$ 39,512	\$ 45,061	\$ 48,396	\$ 253,337
Gross Margin	87.4%	91.8%	92.6%	93.5%	93.8%	79.8%	83.9%	86.4%	87.7%	89.6%	90.7%	91.7%	88.8%
Operating expenses													
Total Sales expense	\$ 4,965	\$ 4,965	\$ 4,965	\$ 4,965	\$ 4,965	\$ 6,701	\$ 6,701	\$ 6,701	\$ 6,701	\$ 6,701	\$ 6,701	\$ 6,701	\$ 71,734
Marketing expense	\$ 200	\$ 200	\$ 200	\$ 200	\$ 200	\$ 2,450	\$ 2,450	\$ 2,450	\$ 2,450	\$ 2,450	\$ 2,450	\$ 2,450	\$ 18,150
Product Development	\$ -	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000	\$ -	\$ 100,000
General and Administrative	\$ 5,210	\$ 7,110	\$ 1,310	\$ 810	\$ 810	\$ 8,100	\$ 900	\$ 1,900	\$ 900	\$ 900	\$ 900	\$ 900	\$ 29,750
Total Operating expenses	\$ 10,375	\$ 22,275	\$ 16,475	\$ 15,975	\$ 15,975	\$ 27,251	\$ 20,051	\$ 21,051	\$ 20,051	\$ 20,051	\$ 20,051	\$ 10,051	\$ 219,634
Operating Income	\$ (9,421)	\$ (19,926)	\$ (12,177)	\$ (8,430)	\$ (4,316)	\$ (11,773)	\$ 578	\$ 4,234	\$ 12,118	\$ 19,461	\$ 25,010	\$ 38,345	\$ 33,703
Interest Expense	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other Income	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Net Income before Taxes	\$ (9,421)	\$ (19,926)	\$ (12,177)	\$ (8,430)	\$ (4,316)	\$ (11,773)	\$ 578	\$ 4,234	\$ 12,118	\$ 19,461	\$ 25,010	\$ 38,345	\$ 33,703
Full Time Headcount	2	2	2	2	2	3	3	3	3	3	3	3	
Contract Headcount	0	0	0	0	0	0	0	0	0	0	0	0	



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What is a cash flow statement?

Cash flow statement

Starting cash	\$31,000
+ New investment	\$0
+ Revenue	\$10,000
- Expenses	<u>(\$6,000)</u>
Ending cash	\$35,000

Example SaaS cash flow statement

Report Year 2019

Revenue Recognition Based

ClinicNote Cash Flow Forecast for the year 2019

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Starting Cash	10,000	201,412	182,914	180,257	182,784	191,831	206,177	228,460	250,174	287,277	326,980	366,483
Revenue Received	1,650	3,578	13,619	18,303	24,823	39,146	39,884	40,315	54,704	57,304	57,104	51,484
Cost of Goods	63	-	-	-	-	-	-	-	-	-	-	-
Operating Expenses	10,175	22,075	16,275	15,775	15,775	24,801	17,601	18,601	17,601	17,601	17,601	7,601
Other Income	-	-	-	-	-	-	-	-	-	-	-	-
New Investment	200,000	-	-	-	-	-	-	-	-	-	-	-
Ending Cash Balance	201,412	182,914	180,257	182,784	191,831	206,177	228,460	250,174	287,277	326,980	366,483	410,366
Change in Cash	191,412	(18,498)	(2,657)	2,527	9,047	14,345	22,283	21,714	37,103	39,703	39,503	43,883



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Cash flow management

- Good business operators manage to cash flow
- Know your cash requirements
- Spend wisely, be thrifty
- Delay hiring, be creative
- Reduce salaries or take no salary
- Know your burn rate

Always have a detailed cash flow forecast at least 180 days in length. Manage your cash carefully.

What is a balance sheet?

- Balance sheet: *financial statement that reports a company's assets, liabilities and shareholders' equity at a specific point in time*

$$\text{assets} = \text{liabilities} + \text{shareholder equity}$$

- Assets = cash, inventory, property, equipment
- Liabilities = rent, wages, utilities, loans, taxes
- Shareholder equity = net of assets and liabilities
 - Not the same as valuation

See blog post in appendix: How to read a balance sheet



Financial models vs. accounting statements

- Accounting statements are factual
 - Deal with past and present
- Financial models are forecasts
 - They are always incorrect
 - They are critical to planning your business
 - They are an ongoing requirement

See blogpost from Fred Wilson of Union Square Ventures: The Financial Function



Summary: financial documents

- These documents matter
- Investors and bankers read these in detail
- An experienced banker or investor can tell an amazing amount about your company by only looking at these documents
- Have an experienced mentor or advisor review these with you before presenting to others
- Get comfortable with your financials - know your numbers
- Don't pretend to know something you don't know



Building the financial model

There are several steps in building a financial model

- Step 1: the revenue model (most of the work is here!)
- Step 2: product development
- Step 3: sales and marketing expenses
- Step 4: general and operating expenses
- Step 5: people