
Building an Operating Plan and Financial Model

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Why Bother Planning ?

It never turns out according to plan



- What's important is understanding the business ... and thoroughly thinking through the issues
 - Identify the most important assumptions
 - Identify the biggest obstacles / challengers
 - How can you “de-risk” the risks ?

- The journey is more important than the destination

What is a plan ?

- A living, breathing, dynamic roadmap for the company. It pulls everything together in one place.
 - Quantified, measurable goals:
 - **Customer-related (# of customers, revenues, etc)**
 - **Business, sales, engineering, product goals**
 - **Financial goals (profits, cash, expenses, staffing)**
 - Variance analysis and feedback loops
 - **What did (or didn't) work? Why or why not?**
 - **How does this impact the future?**
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How do I start?



- **Historical based budget**
 - Start with your history (what happened until now)
 - Build off the past then project into the future

and/or

- **Bottoms-up budget**
 - Starting from scratch, what do you need?

Either way:

- Update your budget frequently (preferably monthly), to constantly re-evaluate your assumptions
 - Include key milestones in your model
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- For \$x, you can achieve result 'y'

Building a Plan

- Start with revenues:
 - # of customers (acquired, churn, acquisition plan)
 - Customer value proposition
 - Average selling price, monthly recurring revenue

- Cost to generate revenue:
 - Salespeople & commission expense
 - Revenue split & affiliate fees
 - Sales channels and distributor discounts
 - Hosting fees
 - Timing of expense to generate the planned revenues
 - Marketing programs, trade shows

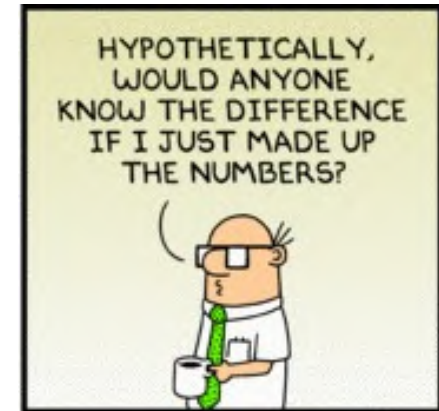
- Gross margins \$ and %

Building a Plan (continued)

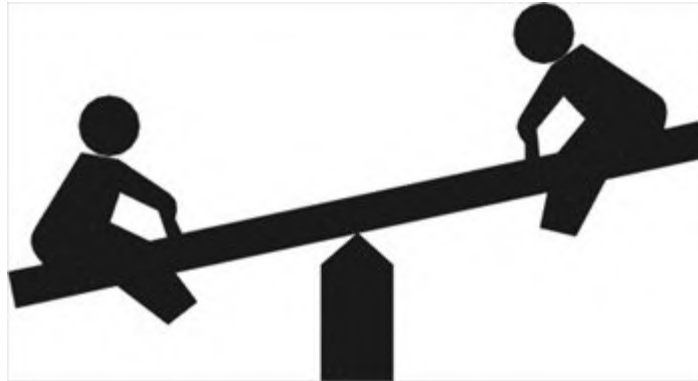
- Hiring plan:
 - Hiring ahead of (or behind) the curve
 - # of employees/consultants
 - Total cost of workforce (includes taxes/benefits)

- Other costs:
 - Customer support
 - Quality assurance
 - General & Admin (legal, accounting, rent, phones)

- Contingency (“slush fund” or “rainy day fund”)



Choosing your velocity.....



■ Preserve capital

- Must-have product
- Established revenue model
- Understanding of market uptake
- Customers' ability to pay
- Cash is king
- Need for profitability

■ Grab market share

- Great team
- Large market potential
- Sustainable advantage
- Sufficient capital
- Able to react when things go wrong

Reducing cash requirements

- Founders' salaries
- Paying cash vs. stock
- Commission-based sales compensation
- What features are absolutely essential?
- Effectiveness of marketing/sales spend
- Customer & vendor financing
- Spend every dollar as if it were your last
 - Zero-based budgeting
 - Get to cash-flow positive ASAP
- Find out what the customer wants before you build it.
- Learn quickly. Iterate, iterate, iterate.
- Don't fall into the trap of "if you build it, they will come"



Did you remember to include.....

- Enough headcount and marketing/sales money to hit your revenue and product development targets
 - Payroll taxes & employee benefits (including PTO and SF payroll tax)
 - Infrastructure: equipment/software for business and new hires (including laptops), rent, telecoms, hosting, etc
 - Recruiting (headhunter) fees
 - Legal costs (show patent costs separately)
 - Insurance (general, workers' comp, cyber/media, E&O, D&O, product liability, employment practices)
 - Interest expense on debt
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Building the Plan – the process



- The entire team should participate in the process
- Challenge every assumption. Iterate, iterate...
- In your XLS, identify which assumptions have the most leverage (the key assumptions)
- Push yourself hard. The competition will also !
- Get buy-in / consensus from the whole team
- “Sell” the plan to your Board of Directors / Investors

Paranoia is not only good, but necessary

“Only the paranoid survive.”

Andy Grove (former Chairman and CEO, Intel)

www.intel.com/pressroom/kits/bios/grove/paranoid.htm



- ❑ Identify the key risks, and how to “de-risk” them
- ❑ Will you run out of cash before milestones are achieved?
- ❑ Can you get to cash-flow-break-even with this plan?
- ❑ What are your competitors doing?

**Anyone who says “we don’t have any competitors”
doesn’t understand their own business.**

Financial Plan

- And now for some nuts and bolts.....



The Classic Financial Statements

- **Income Statement (the “P and L”)**
 - **Revenue and expenses, from date ‘x’ to date ‘y’**

 - **Balance Sheet**
 - **Snapshot of the company’s financial position, on date ‘x’**
 - **Assets, liabilities and equity**
 - **Includes: cash, accounts receivable, accounts payable, convertible debt, deferred revenue, accrued/unpaid PTO, etc**

 - **Cash Flow Statement**
 - **Cash inflows and outflows from date ‘x’ to date ‘y’**
 - **CASH IS KING – especially in today’s world**
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Financial Summary Chart - for the pitch deck

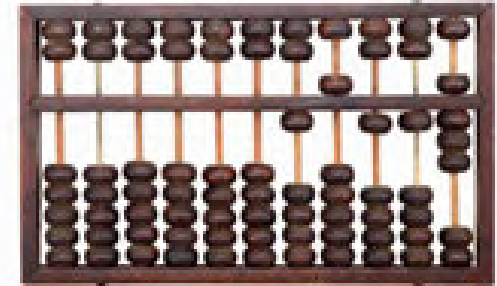
	2007	2008	2009	2010	2011
# of active customers		45	196	576	1,504
Bookings	-	600	3,023	7,601	18,558
Backlog	-	517	2,793	7,777	19,152
Revenue	-	83	747	2,617	7,182
Cost of sales	-	17	149	523	1,436
Gross margin \$	-	67	598	2,094	5,746
Gross margin %	0%	80%	80%	80%	80%
Operating expenses	115	410	1,000	1,800	2,600
Net income/(loss)	(119)	(351)	(410)	286	3,138
EBITDA	(115)	(343)	(402)	294	3,146
Headcount (FTEs)	2	3	8	13	18
Cash (w ithout new investment)	24	(356)	(819)	(570)	2,653

Financial Projections

(the “Eye chart”)

Company 'x'															
Projected summary financials															
as of 9/30/11															
in \$K															
	FY2007	1Q2008	2Q2008	3Q2008	4Q2008	FY2008	1Q2009	2Q2009	3Q2009	4Q2009	FY2009	1Q2010	2Q2010	3Q2010	4Q2010
# of active customers		15	20	30	45	45	68	101	143	196	196	262	344	447	576
Bookings	-	-	100	200	300	600	450	675	844	1,055	3,023	1,318	1,648	2,060	2,575
Backlog	-	-	92	267	517	517	879	1,410	2,040	2,793	2,793	3,699	4,798	6,137	7,777
Revenue	-	-	8	25	50	83	88	144	214	302	747	412	549	721	935
Cost of sales	-	-	2	5	10	17	18	29	43	60	149	82	110	144	187
Gross margin \$	-	-	7	20	40	67	70	115	171	242	598	329	439	577	748
Gross margin %	0%	0%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
Operating expenses	115	80	95	110	125	410	175	225	275	325	1,000	375	425	475	525
Operating profit/(loss)	(115)	(80)	(88)	(90)	(85)	(343)	(105)	(110)	(104)	(83)	(402)	(46)	14	102	223
Other income/(expense)	(4)	(2)	(2)	(2)	(2)	(8)	(2)	(2)	(2)	(2)	(8)	(2)	(2)	(2)	(2)
Net income/(loss)	(119)	(82)	(90)	(92)	(87)	(351)	(107)	(112)	(106)	(85)	(410)	(48)	12	100	221
EBITDA	(115)	(80)	(88)	(90)	(85)	(343)	(105)	(110)	(104)	(83)	(402)	(46)	14	102	223
Headcount (FTEs)	2	2	2	3	3	3	4	6	7	8	8	9	11	12	13
CASH FLOW															
From operating activities	(121)	(84)	(93)	(95)	(89)	(361)	(110)	(116)	(109)	(88)	(422)	(48)	15	107	234
From investing activities	(10)	(5)	(5)	(5)	(5)	(20)	(10)	(10)	(10)	(10)	(40)	(15)	(15)	(15)	(15)
Financing activities:															
Preferred stock	-	-	-	1,150	-	1,150	-	-	-	-	-	-	-	-	-
Convertible notes payable	150	250	-	(400)	-	(150)	-	-	-	-	-	-	-	-	-
Common stock	5	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Change in cash	24	161	(98)	651	(94)	620	(120)	(126)	(119)	(98)	(462)	(63)	0	92	219
Cash - beginning of period	-	24	185	88	738	24	644	524	398	279	644	181	119	119	210
Cash - end of period	24	185	88	738	644	644	524	398	279	181	181	119	119	210	430

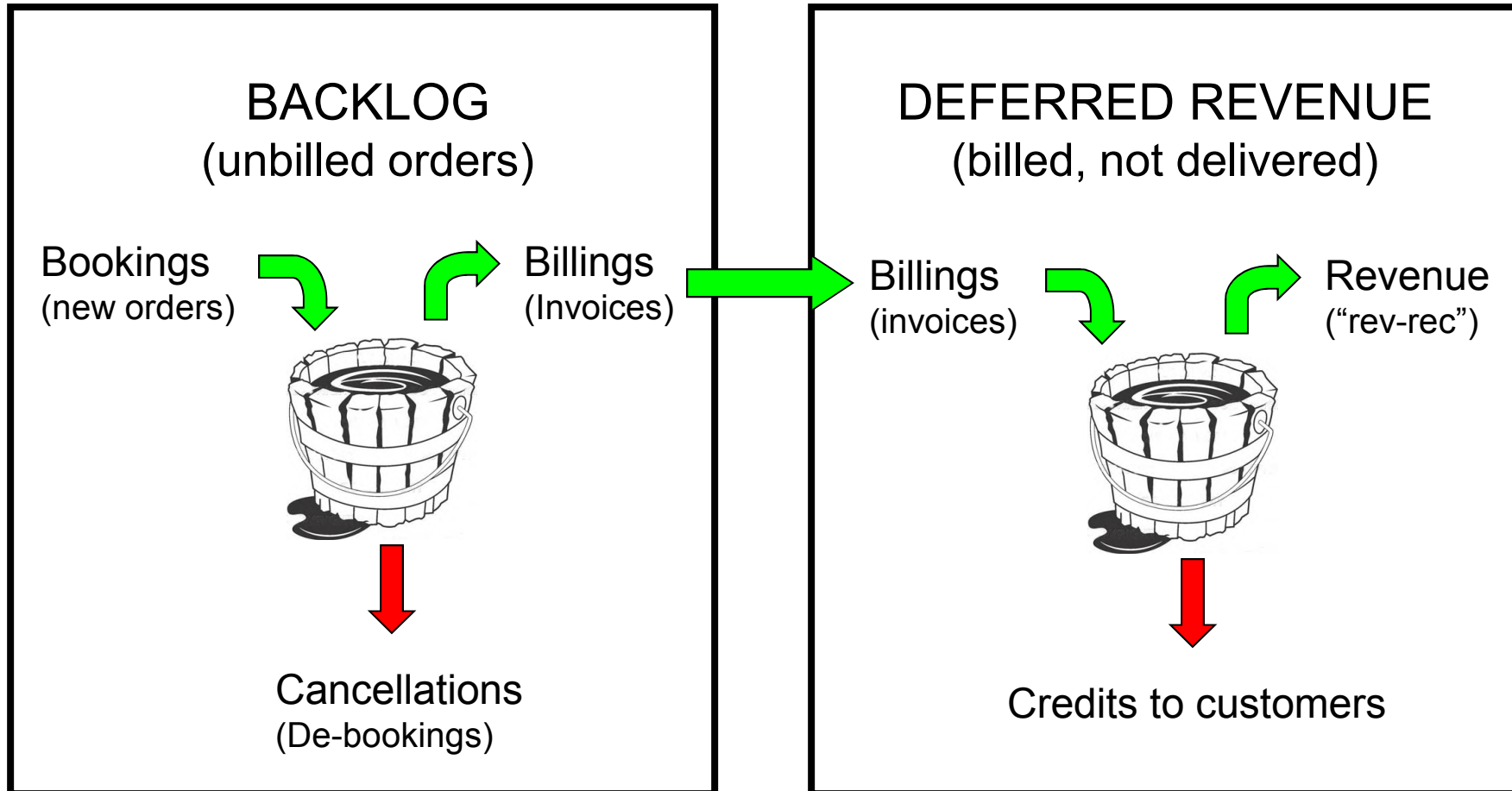
Accounting 101



- Cash-basis versus accrual-basis
- Big purchases: capitalize/depreciate or expense
- EBITDA (earnings before interest, taxes, depreciation and amortization)
- GAAP (generally accepted accounting principles)
 - Revenue recognition (“rev-rec”)
 - Accounting for stock options
 - Other requirements that aren’t intuitive
- FTEs (full time equivalents) = headcount, including contractors

Accounting 201

Bookings, Billings, Backlog, Deferred Revenue and Revenue



Accounting 301 - Dilution

Each time you raise money, you get diluted

Example: your company raises “\$500K on \$2M”

- ❑ Company was worth \$2M before you raised money
 - ❑ \$2M is the “pre money” value of your company
- ❑ Investors gave you \$500K of “new money”
- ❑ Company is worth \$2.5M after investment
 - ❑ \$2.5M is the “post money” value of your company
- ❑ Investors own 20% of the company ($\$500\text{K} / \2.5M)



Key Performance Indicators (“KPI”)

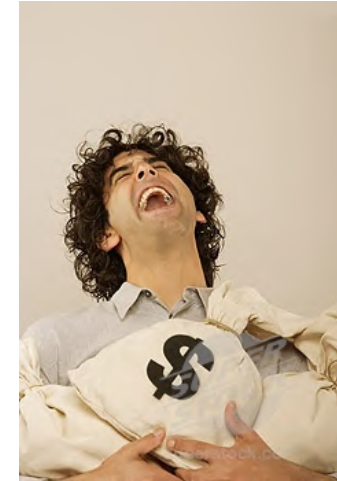
- The dashboard that says “how is the company doing?”
- KPI are based upon your type of business, but usually include:
 - Total customers, active customers
 - Bookings, backlog, billings, recognized revenue (“rev-rec”)
 - Annual recurring revenues (and churn rate)
 - Headcount (FTEs – usually, your largest expense category)
 - Cash burn (operating, gross, net)
 - Cash on hand
 - Cash-out date

CASH IS KING



What do investors want ?

HOCKEY STICK REVENUES AND PROFITS !!



Investor Pitches Need to Answer these Qs

- What milestones will you achieve with the money?
- How much money (and headcount) will it take to achieve these milestones?
- And, most importantly:

Do they believe that you can do it ?

How do you achieve this credibility?

- **Balance these two goals:**

- Get the investor excited about your multi-gazillion dollar potential
- Be conservative/credible
 - Under-promise so you can over-deliver and build credibility

- **Do your homework:**

- Know your space inside-and-out
- Anticipate questions, and have answers ready



- **If you DON'T know the answer to a question – don't fake it.**

- Tell the investor that you will get back to him/her in a day or two.
- Then follow up within this timeframe.

Your model: the Forest and the Trees

- So ... you built a detailed Excel model. It's a work of art.
 - Don't use Office 2007 – many investors only have Office 2003
 - Don't use fancy formulas and macros – they are hard to explain

- Now, stand back and look at the big picture:
 - How does it compare to your competitors?
 - Does it “smell” right?
 - This is a hard question for first time CEOs. Use your network to “sanity test” the numbers.
 - If you raise the amount of money you're asking for, how long does it last?
 - Try it out on some “friendlies” before showing it to important investors.

The lasting legacy of the meltdown:

Do you really need to raise money?

- If you can bootstrap you keep 100% ownership
- The longer you wait to raise money, the higher % of ownership you keep
- Spend every dollar as if it were:
 - Your own money
 - Your last dollar
- “Capital Efficiency” and cash are king

If you're raising money.....

Do the investors think that:

- Your team knows what it's doing ?
 - Investors "bet on the people"

- You and your model are believable ?
 - Balancing hockey stick with reality
 - Will the newly-raised cash accomplish the desired goal ?

- You know where the land mines are (and how to avoid them) ?
 - If things go wrong, will you react appropriately and quickly ?



MOSTLY: will you make money for them ?

Final words on your path to success



You learn from the process of planning.

The journey of discovery/planning is more important than the destination.

Most importantly: do something you enjoy and are passionate about.

GOOD LUCK IN YOUR NEW VENTURE !

Selected Resources

www.GuyKawasaki.com

www.feld.com

www.linkSV.com

www.CrunchBase.com and www.TechCrunch.com

www.vlab.org

www.SVforum.org

www.VentureHacks.com

www.angellist.com

www.theFunded.com

<http://WhoHasTimeForThis.blogspot.com/2005/11/how-to-not-write-business-plan.html>

Randi Komisar's <http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2415>

www.SteveBlank.com (lean startups)

<http://reaction.orrick.com/reaction/sites/TotalAccess/toolkit.asp>

Your bankers, attorneys, accountants, insurance agents and other professionals can help expand your network, introduce you to investors, and “sanity check” your business plan and financials.