Finances and Revenue

1st May 2018
Finances and Revenue

- Only 1:30 proposals pitched to investors are “investor worthy”.

- Only 14% of Australian Start-ups have successfully raised capital.

- 66% of Australian Start-ups have never raised capital.

http://pitchn.com.au/ April 2018
Show Me The Money!!
Potential sources of funding
- Owner’s money
- 3F’s - Family, Friends and Fools
- Angel Investors
- Crowdfunding.
- Private Equity and/or Debt funding
- Trading or Commercial Banks
- Venture Capitalists
- Investment Bankers and IPO’s
- Business Grants – Government funding

Show Me The Money!!
Who Is Funding Entrepreneurial Start-Up Companies?

Financing Continuum

The following diagram depicts the typical financing for start-up companies.

- **Owner’s Money**: $10–100K
- **Family & Friends**: $100K–2M
- **Angels**: $500K–3M
- **Seed Capital**: $2–50M
- **Venture Capital**: $5K & up
- **Banks & Gov’t Programs**: $500K & up
- **Private Placements**: $5M & up
- **IPOs**
Owner’s Money
Family, Friends and Fools

- Easy to locate and access.
- Can be awkward to approach.
- Emotions can cloud judgement.
- Failure can cause lasting issues.
- Can be better to deal with strangers.
Angel Investors

- Also known as –
  Business Angel
  Angel Funder
- Usually smaller start-up type funding.
- Also provide –
  Experience
  Managerial Expertise
  Contacts
Crowd Funding

- Raises funds from a large number of people.
- Usually an internet platform.
- Brings together the project initiator or entrepreneur and individual or groups of supporters.
Private Equity or Debt Funding

- Equity securities or shares that are not traded on a stock exchange.
- Equity or Debt.
- Debt may be convertible.
- LBO’s and distressed businesses.
Equity vs Debt

- **Equity Financing**
  - Involves the sale (exchange) of some of the ownership interest in the venture in return for an unsecured investment in the firm.
  - Money invested in the venture with no legal obligation for entrepreneurs to repay the principal amount or pay interest on it.

- **Debt Financing**
  - Secured financing of a new venture that involves a payback of the funds plus a fee (interest for the use of the money).
Trading or Commercial Banks

- Accept deposits and make loans.
- Retail banking.
- Corporate banking.
- Provide leasing capital.
Early stage funding.

High potential opportunities.

Structured as funds.

Prepared to take risks.

Seek higher returns.
Stage 1: Initial Screening
– This is a quick review of the basic venture to see if it meets the venture capitalist’s particular interests.

Stage 2: Evaluation of the Business Plan
– This is where a detailed reading of the plan is done in order to evaluate the factors mentioned earlier.

Stage 3: Oral Presentation
– The entrepreneur verbally presents the plan to the venture capitalist.

Stage 4: Final Evaluation
– After analyzing the plan and visiting with suppliers, customers, consultants, and others, the venture capitalist makes a final decision.
Criteria for Evaluating New-Venture Proposals

- Major Categories of Venture Capitalist Screening Criteria
  - Product or service characteristics
  - Market characteristics
  - Financial considerations
  - Nature of the venture team
  - Entrepreneur’s personality
  - Entrepreneur’s experience.
Investment Bankers

- Focus is more on larger businesses or corporates.
- Underwrite the issuance of securities and equities.
- Corporate bonds and IPO’s.
- Mergers and Acquisitions.
Public Offerings

- Public Offering
  - “Going Public” refers to a corporation’s raising capital through the sale of its securities on the stock market.
  - Initial Public Offerings (IPO’s) – new issues of common stock.
Public Offerings

- **Advantages**
  - Size of capital amount
  - Liquidity
  - Value
  - Image.

- **Disadvantages**
  - Costs
  - Disclosure
  - Requirements
  - Shareholder pressure.
Business Grants – Government Funding

- Business Grants
- Innovation Grants
- Austrade
Financial Plan

- Forecasts the financial performance for the business.

- Establishes the financial viability for the business.

- Informs investors of the required investment and the potential for returns.

- The hockey-stick growth forecast.

- Realistic assumptions and forecasts are the key.
Key elements of the Financial Plan

- Assumptions
- Establishment costs
- Sales Forecast
- Forecast Profit & Loss
- Forecast Cash Flows
- Forecast Balance Sheet
- Forecast Break Even Point
- Valuation
Assumptions

- Economic
- Marketing
- Revenue
- Costs
Establishment Costs

- Start up capital
- Setting up the business
- Setting up the premises
- Plant and equipment
- Payroll
- Mobilising the operation.
Sales Forecast

- Sales forecasting
  - Product categories
  - Time lines
  - Intuition and educated guesses
  - The hockey-stick forecast.
Profit & Loss Forecast

- Profit & Loss forecast
  - Sales
  - COGS – Cost of Goods Sold
  - Gross Profit
  - General and Administrative Expenses
  - Operating Profit
  - EBITDA
  - Net Profit.
An analysis of the cash availability and cash needs of the firm that shows the effects of a firm’s Operating, Investing, and Financing activities on its cash balance.

How much cash will the firm generate from operations?
How will the firm finance fixed capital expenditures?
How much new debt will the firm add?
Will cash from operations be sufficient to finance fixed asset purchases?
The use of a cash budget may be the best approach for an entrepreneur starting up a new venture.
Balance Sheet Forecast

- **Balance Sheet**
  Represents the firm’s financial condition at a certain date.
  It details the items the firm owns (assets) and the amount the firm owes (liabilities).
  It also shows the net worth of the firm and its liquidity.

- **Assets = Liabilities + Owners’ Equity**

  **Asset** is something of value the firm owns – Current and fixed, tangible and intangible assets.
  **Liabilities** are the claims creditors have against the firm – Current or short-term and fixed or long-term liabilities.
  **Owners’ Equity** is the firm owners’ residual interest in the firm.
Financial Budgets

- **Operating Budget**
  A statement of estimated income and expenses over a specified period of time.

- **Cash Budget**
  A statement of estimated cash receipts and expenditures over a specified period of time.

- **Capital Budget**
  The plan for expenditures on assets with returns expected to last beyond one year.
Contribution Margin Approach

Uses the difference between the selling price and the variable cost per unit.

The amount per unit that is contributed to covering all other costs.

Graphic Approach

Graphing total revenue and total costs.

The intersection of these two lines – where total revenues are equal to the total costs – is the firm’s break-even point.

Two additional costs, variable and fixed costs also may be plotted.
Break Even Analysis

- Break Even analysis
  - Average selling price per unit
  - Average cost per unit
  - Gross margin per unit
  - Fixed costs
  - Unit sales to break even
  - Dollar sales to break even
Valuation

- **Net Earnings Multiple Method**
  Projected net earnings for the current period are multiplied by a risk adjusted price earnings factor to derive a current valuation.

- **Net Present Value (NPV) or Discounted Cash Flow (DCF) Method**
  The premise that a dollar today is worth more than a dollar in the future.
  The cost of capital (adjusted for risk), is the rate used to adjust future cash flows to determine their value in present period terms.
  This procedure is referred to as discounting the future cash flow – cash value is determined by the net present value of the cash flow.

- **Internal Rate of Return (IRR method)**
  Similar to the net present value method, but future cash flows are discounted at a rate that makes the net present value of the project equal to zero.
Ratios are useful for showing relationships between financial statement accounts.

- EBITDA
- ROI
- ROA
- ROE