UW Business Plan Competition Resource Night
“Financials and Funding”

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Agenda

- Introduction
- Financial Projections
- Funding - Raising Capital
- Summary
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 cash, risk & value
  - Creating value is a key responsibility

- Financial risk - uncertainty about future cash flows
  - Create value by managing & understanding risk
    - 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

<table>
<thead>
<tr>
<th>Revenues</th>
<th>Units</th>
<th>Price</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A - U.S. Direct</td>
<td>100</td>
<td>$100</td>
<td>$10,000</td>
</tr>
<tr>
<td>Product A - Europe Direct</td>
<td>75</td>
<td>$125</td>
<td>$9,375</td>
</tr>
<tr>
<td>Product B - U.S. Partners</td>
<td>40</td>
<td>$75</td>
<td>$3,000</td>
</tr>
<tr>
<td>Product B - Europe Partners</td>
<td>50</td>
<td>$90</td>
<td>$4,500</td>
</tr>
<tr>
<td>Service - U.S.</td>
<td>-</td>
<td>15%</td>
<td>$1,950</td>
</tr>
<tr>
<td>Service - Europe</td>
<td>-</td>
<td>17%</td>
<td>$2,359</td>
</tr>
<tr>
<td><strong>Total Revenues</strong></td>
<td></td>
<td></td>
<td><strong>$31,184</strong></td>
</tr>
</tbody>
</table>

- 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. Sensitivity - 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 - $$

Total Venture Capital Dollars Annually

Data Source: The MoneyTree Report by PwC and NVCA; Data: Thomson Reuters

Total Venture Capital Investment Dollars Quarterly Q4 2009

Data Source: The MoneyTree Report by PwC and NVCA; Data: Thomson Reuters
VC Investment History - # Deals

Total Venture Capital Deals Annually

Total Venture Capital Deals Quarterly Q4 2009

DATA SOURCE: THE MONEYTREE REPORT BY PWC AND NVC; DATA: THOMSON REUTERS

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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 **15% increase in # deals** vs. 3Q09
  - Increases in the **number** 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

- **Idea is Feasible**
  - P(success) = 30%
  - Req’d IRR = 100%

- **Technology Works**
  - P(success) = 40%
  - Req’d IRR = 70%

- **A Customer Buys**
  - P(success) = 80%
  - Req’d IRR = 25%
  
  - P(success) = 50%
  - Req’d IRR = 50%

- **Risk (β) Capital**

- **Valuation**
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