Happiness is Positive Cash Flow

Preparing Proforma Financial Statements

By

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Reporting vs Forecasting

- Reporting: What happened?
  -factual information
  -basic accounting
  -reporting based on accepted standards (GAAP, ASPE, IFRS)
- Forecasting: What will happen?
  -estimating (guesstimating) or planning?
  -based on practical experience
  -assumptions are key!

Why do Companies Fail?

They run out of money!

i.e. mismanagement of cash flow

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Example: Y-T-D Actual vs Budget (Plan)

Board Report Financials														
	OCTOBER		SEPTEMBER		AUGUST		JULY		JUNE		MAY		YTD 2018	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
Net Sales	**82,866**	**145,430**	**108,628**	**134,947**	**129,510**	**128,703**	**101,064**	**135,597**	**129,756**	**162,683**	**115,471**	**150,821**	**1,115,221**	**1,333,619**
COGS	61,176	82,043	64,410	64,591	116,875	61,801	51,308	65,159	58,433	77,846	53,096	72,071	626,609	652,125
Contribution	21,690	63,387	44,218	70,356	12,635	66,902	49,756	70,438	71,323	84,837	62,375	78,750	488,612	681,494
Margin	***26%***	***44%***	***41%***	***52%***	***10%***	***52%***	***49%***	***52%***	***55%***	***52%***	***54%***	***52%***	***44%***	***51%***
Overheads	53,478	45,110	50,634	43,472	47,842	44,054	36,707	44,947	41,442	50,048	40,307	48,508	451,525	470,500
Other Exp/Recoveries	(56)	(665)	(4,552)	(673)	(1,399)	(681)	12,601	(689)	23,820	(1,352)	(1,139)	(1,382)	21,564	(11,006)
Net Income	**(31,844)**	**17,612**	**(10,968)**	**26,211**	**(36,606)**	**22,167**	**25,650**	**24,802**	**53,701**	**33,437**	**20,929**	**28,860**	**58,651**	**199,988**
Profit	*-38%*	*12%*	*-10%*	*19%*	*-28%*	*17%*	*25%*	*18%*	*41%*	*21%*	*18%*	*19%*	*5%*	*15%*
Cash (Burn)/increase	**(21,753)**		**(55,016)**		**26,821**		**20,773**		**(31,657)**		**59,445**		**15,964**	
Cash	78,357		100,110		155,126		128,305		107,532		139,189		17,351	
Debt	(96,354)		(97,547)		(98,751)		(99,943)		(101,127)		(102,301)		4,922	
Net Cash/(Debt)	**(17,997)**		**2,563**		**56,375**		**28,362**		**6,405**		**36,888**		**22,273**	
AR	125,032		109,622		109,779		105,435		105,372		117,464		(1,365)	
Inventory	46,427		56,951		51,938		54,904		42,963		53,396		327	
AP	142,052		140,543		133,005		91,747		82,277		136,129		12,745	

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It's all about Cash Flow

What is the difference between…..

a cash flow statement in annual reports

and

a cash flow projection for the coming year?

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Cash Flow Statement

HISTORICAL – what happened?

Startup X
Cash Flow Statement
For the Year Ending December 31, 2018

Operating activities		
Cash received from customers	$ 72 000	
Cash received for interest	1 500	
Cash paid for salaries	(24 000)	
Cash paid for rent	(11 500)	
Cash paid for other items	(30 000)	
Cash provided by operating activities		$ 8 000
Investing activities		
Purchase of land		(25 000)
Financing activities		
Payment of dividends		(3 500)
Decrease in cash		$(20 500)
Cash, January 1		39 700
Cash, December 31		$ 19 200

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Cash Flow Forecast – what will happen?

	Month#1	Month#2	Month#3	Month#4	Month#5	Month#6	Month#7
CASH FLOW #1 ($):							
Open Cash Balance:	0	-7680	-26748	-46964	-73712	-94523	-102641
Add Cash from Sales:	0	11200	27720	54886	97806	142552	186394
Less Cash re Expenses:	0	-11260	-10300	-14567	-20867	-22857	-27450
Less Cash for Prod'n:	-7680	-19008	-37636	-67067	-97750	-127813	-162688
Closing Cash Balance:	-7680	-26748	-46964	-73712	-94523	-102641	-106385

This shows future month-by-month cash balances using Income Statement projections

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Ask:

- What's the Cash on Hand?
  Really – what's in/will be in the bank account?
- What's the *Burn Rate (net or gross)?
- Can all obligations be met?

[*Burn = net monthly cash outflow]

Best Tool: The Spreadsheet

- A spreadsheet (e.g. Microsoft XL file) is best
- Why?
  - helps you understand *your* numbers
  - customize it for your specific business

Cash Flow Spreadsheet

- Start with the P&L
- What are the assumptions regarding accruals?
- What is the timing of real cash?
- Calculate month-end cash balances
  (This is what's in your bank account!)
- Go to XL File: mikevolker.com/finproj.xls

Example XL: Monthly P&L Forecast

		Millenium Tech Corp					Last Updated:		16-Jan-19				
	Month#1	Month#2	Month#3	Month#4	Month#5	Month#6	Month#7	Month#8	Month#9	Month#10	Month#11	Month#12	FYTOTAL
SALES:													
#Dealers:	5	10	10	15	15	20	20	20	25	25	25	30	
Sales/Dlr:	3	4	8	10	15	15	20	20	20	20	20	20	
Dealer Sales:	15	40	80	150	225	300	400	400	500	500	500	600	
Direct Sales:	5	10	20	30	40	50	50	50	50	50	50	50	
TOTAL UNITS:	20	50	100	180	265	350	450	450	550	550	550	650	4,165
AVG. SELLING PRICE:	560.00	554.40	548.86	543.37	537.93	532.55	527.23	521.96	516.74	511.57	506.45	501.39	451.25
GROSS REVENUE($):	$11,200	$27,720	$54,886	$97,806	$142,552	$186,394	$237,253	$234,880	$284,205	$281,363	$278,550	$325,903	$2,162,713
(Annual Growth Rate)													
Unit Costs:	384	380	376	373	369	365	362	358	354	351	347	344	340
COST OF GOODS SOLD:	$7,680	$19,008	$37,636	$67,067	$97,750	$127,813	$162,688	$161,061	$194,884	$192,935	$191,005	$223,476	$1,483,003
GROSS MARGIN:	3520	8712	17250	30739	44802	58581	74565	73820	89322	88428	87544	102427	679710
	31%	31%	31%	31%	31%	31%	31%	31%	31%	31%	31%	31%	31%
EXPENSES:													
Sales:	$9,060	$8,167	$12,222	$15,389	$13,386	$14,917	$17,773	$19,966	$21,455	$21,121	$22,927	$23,573	$199,954
R&D:	$1,100	$867	$1,022	$2,764	$4,761	$6,292	$9,148	$10,416	$12,955	$12,671	$14,677	$15,373	$92,044
G&A:	$1,100	$1,267	$1,322	$2,714	$4,711	$6,242	$9,098	$10,416	$13,005	$12,921	$15,227	$15,923	$93,944
TOTAL EXPENSES:	$11,260	$10,300	$14,567	$20,867	$22,857	$27,450	$36,018	$40,797	$47,414	$46,714	$52,830	$54,868	$385,942
NET PROFIT (BT):	-$7,740	-$1,588	$2,683	$9,872	$21,945	$31,131	$38,547	$33,023	$41,908	$41,714	$34,714	$47,559	$293,768
NPBT (%)	-69%	-6%	5%	10%	15%	17%	16%	14%	15%	15%	12%	15%	14%

Download this spreadsheet at mikevolker.com/finproj.xls

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Reminder: Cash vs Accrual

- What does the P&L say about cash?
- How much cash do you need?
- You do not have unlimited credit!
- Suppliers and employees will not wait.

Example XL: Monthly Cash Flow

	Month#1	Month#2	Month#3	Month#4	Month#5	Month#6	Month#7	Month#8	Month#9	Month#10	Month#11	Month#12
CASH FLOW #1 ($):												
Open Cash Balance:	0	-7680	-26748	-46964	-73712	-94523	-102641	-106385	-66211	-67011	-23154	20489
Add Cash from Sales:	0	11200	27720	54886	97806	142552	186394	237253	234880	284205	281363	278550
Less Cash re Expenses:	0	-11260	-10300	-14567	-20867	-22857	-27450	-36018	-40797	-47414	-46714	-52830
Less Cash for Prod'n:	-7680	-19008	-37636	-67067	-97750	-127813	-162688	-161061	-194884	-192935	-191005	-223476
Closing Cash Balance:	-7680	-26748	-46964	-73712	-94523	-102641	-106385	-66211	-67011	-23154	20489	22733
CASH FLOW #2($):												
Open Cash Balance:	-26688	-64324	-142651	-239501	-354161	-482830	-568942	-648723	-691282	-685832	-721842	-484350
Add Cash from Sales:	0	0	11200	27720	54886	97806	142552	186394	237253	234880	284205	281363
Less Cash re Expenses:	0	-11260	-10300	-14567	-20867	-22857	-27450	-36018	-40797	-47414	-46714	-52830
Less Cash for Prod'n:	-37636	-67067	-97750	-127813	-162688	-161061	-194884	-192935	-191005	-223476		
Closing Cash Balance:	-64324	-142651	-239501	-354161	-482830	-568942	-648723	-691282	-685832	-721842	-484350	-255817

Both of these are based on the same P&L numbers. The only difference is assumptions regarding the timing of payments:

#1:Pay for production materials (CoGs) in month of shipment; collect payment from customers after one month
#2:Pay for production materials (CoGs) two months before shipment; collect payment from customers after 2 months

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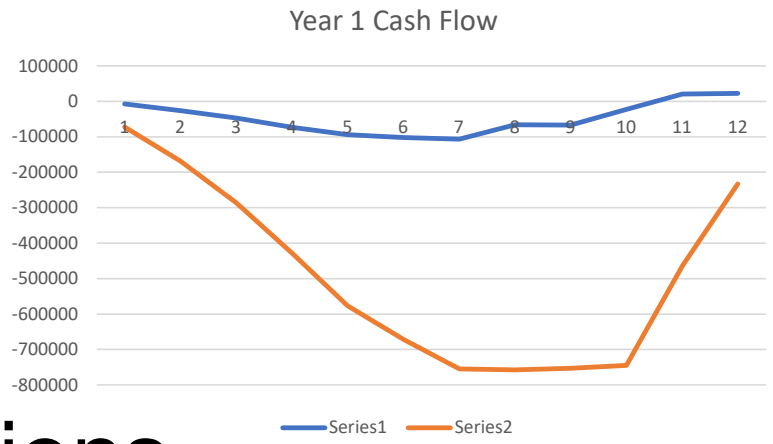
Which is correct?



- $106,385 or $721,842?
- It depends on the assumptions
- How much capital should you raise?
- Better too much than too little
- Be realistic!

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Matching Sources to Needs

- $106K may be easy to raise
  Is it enough?
- $721K may be out of reach
  Perhaps reduce revenues

What about Capital Expenses (CapEx)?

- Caveat: The Example excludes CapEx
- Expenses include:
  - Monthly rent & utilities
  - Monthly salaries
  - Misc. minor general & admin supplies
- Capital Expenses (eg > $1K) include:
  - Equipment, machinery, property

Recap: How to account for CapEx?

- CapEx items are amortized over time (non-cash)
- CapEx items are assets on the Balance Sheet
- But – keep off Balsheet when possible (lease) (i.e. convert CapEx to monthly “rent”)
- Insert CapEx items in Cash Flow as required

How to add in CapEx Items

- Just add more rows to your cash flow:

	Month#1	Month#2	Month#3	M
CASH FLOW #1 ($):				
Open Cash Balance:	0	-7680	-26748	
Add Cash from Sales:	0	11200	27720	
Less Cash re Expenses:	0	-11260	-10300	
Less Cash for Prod'n:	-7680	-19008	-37636	
Init Closing Cash Balance:	-7680	-26748	-46964	
Less Cash for Fixed Assets	-120000	0	-10000	
Cumulative cash for Fixed Ass	-120000	-120000	-130000	
Closing Cash Balance:	-127680	-146748	-176964	

FIXED ASSETS:			
Open Bal:	0	119000	119000
Equipment:	40000		
Furnishings:	25000		
Tooling, Molds:	40000		10000
Intellectual Property:	15000		
Depreciation (add to expenses	-1000		
= amt to add to CashFlow**	120000	0	10000
= Fixed Asset Balance	119000	119000	129000

Break these line items into more granular details to help in your planning

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Sensitivity Analysis

- Spreadsheets allow you to try many scenarios
- Ask: What is the ideal situation?
  What is the worst-case situation?
- E.G. What if revenues are 50% less?
  What if expenses are double?

How Many Months?

- Do monthly until cash flow is positive
- Then complete for at least 5 years
  (see example – mikevolker.com/finproj.xls)
- Update regularly

5 Year Projection

	FYTOTAL	FY2	FY3	FY4	FY5
GROSS REVENUE($):	$2,162,713	$3,608,560	$6,125,530	$8,912,647	$12,967,901
(Annual Growth Rate)		167%	170%	146%	146%
Unit Costs:	340	272	245	233	221
COST OF GOODS SOLD:	$1,483,003	$2,268,238	$3,572,474	$5,090,776	$7,254,356
GROSS MARGIN:	679710	1340322	2553056	3821871	5713545
	31%	37%	42%	43%	44%
EXPENSES:					
Sales:	$199,954	$399,908	$599,862	$749,828	$899,793
R&D:	$92,044	$138,066	$172,583	$207,099	$248,519
G&A:	$93,944	$140,916	$197,282	$256,467	$307,761
TOTAL EXPENSES:	$385,942	$678,890	$969,727	$1,213,394	$1,456,073
NET PROFIT (BT):	$293,768	$661,432	$1,583,329	$2,608,477	$4,257,473
NPBT (%)	14%	18%	26%	29%	33%

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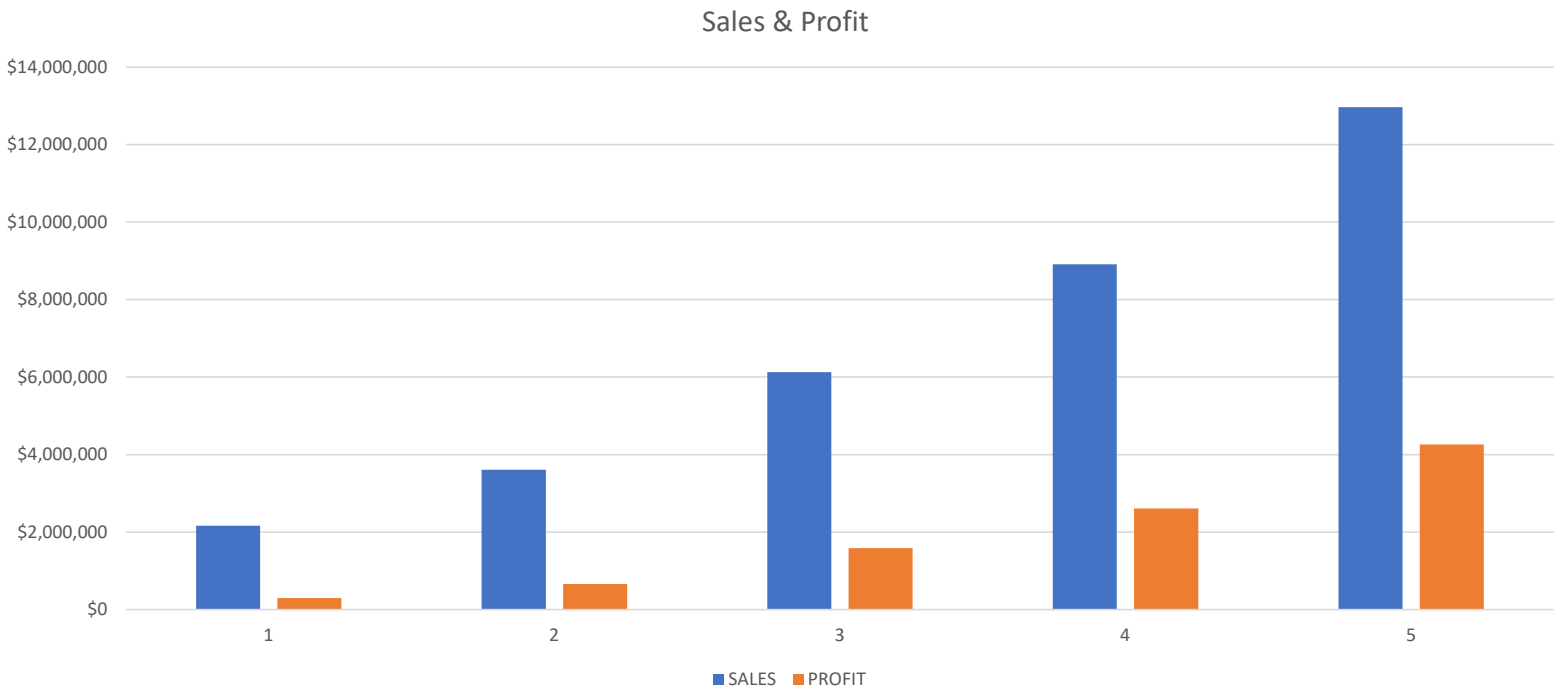
Is this “good”?



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It Depends….

- It drives EXIT valuation
- Is it achievable?
- Is it realistic (check against comparables)?
- Do you want to commit 5+ years to it?

Bonus

From the cash flow, you can easily do month-end balance sheets in addition to reliable proforma income statements!

(refer to example)

Sanity Checks

- Do revenues seem unrealistically high?
- Are my margins similar to other similar firms?
- Have I overlooked any expenses?
- Have I build in some contingencies?
- Do I have a sales plan or a sales forecast?
- Are my assumptions reasonable?

Summary

- Using XL can give you a hands-on financial understanding of your company
- From the P&L, you can get cash flow and balance sheets
- Test your assumptions – do worst/best cases
- Investors love to see solid financial planning
- Remember – *Happiness is Positive Cash Flow!*

Download: mikevolker.com/finproj.xls

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