Moolman Institute
of Technology Commercialization

How to Tell Your Business' Financial Story

2 September 2021

AFRICA'S BUSINESS HEROES

SA INNOVATION SUMMIT.

Photo by Fabian Blank on Unsplash


Humans love stories…
Photo by Andrew Neel on Unsplash

LinkedIn Is Professional People Search 2.0

Find and Contact the People You Need Through
the People You Already Trust

August 2004
CONFIDENTIAL

AirBed&Breakfast

Book rooms with locals, rather than hotels.

A web platform where users can rent out their space to host travelers to:

SAVE MONEY when traveling	**MAKE MONEY** when hosting	**SHARE CULTURE** local connection to the city

AirBnB's first pitch deck – 2009/11. Source: http://www.businessinsider.com/airbnb-a-13-billion-dollar-startups-first-ever-pitch-deck-2011-9

Dropbox

Moving the world's files

http://www.getdropbox.com

Dropbox's first pitch deck - seed round of $1.2m in 2007: https://www.cbinsights.com/research/billion-dollar-startup-pitch-decks/

Storage is a mess

Dropbox

- Keeps files:
  - In sync across computers
  - Backed up
  - Accessible from anywhere
  - Easy to share
- It just works

Where will our journey take us today?

1. Why Financials & Financial Modelling are Important for Entrepreneurs & Startups
2. The Big 3 Financial Statements
3. The Basics of Valuation
4. How to Tell Your Business' Financial Story
5. Valuation for Fundraising: a Balancing Act

1 Why Financials & Financial Modelling are Important for Entrepreneurs & Startups

1 Need it to help you build a **financially viable** business model & plan

- Understand levers of profitability
- Understand impact of changes (scenarios)
- Plan milestones & set targets

2 Need it for **fundraising**

- Investors want to see the potential for high return – a compelling story & vision, supported by financials

3 Need it to **manage your business** and **inform** yourself and stakeholders

- Progress against plans
- Scorecard of business' performance & success
- Help you manage cash flow
- Optimise resource use
- Manage runway
- Refine model based on actuals

Where will our journey take us today?

AFRICA'S BUSINESS HEROES · SA INNOVATION SUMMIT. · Moolman Institute

1	Why Financials & Financial Modelling are Important for Entrepreneurs & Startups
2	The Big 3 Financial Statements
3	The Basics of Valuation
4	How to Tell Your Business' Financial Story
5	Valuation for Fundraising: a Balancing Act

2 The Big 3 Financial Statements

What?	Lebombo bone (baboon fibula)
Where?	Border of Swaziland &South Africa
When?	**41 000 – 42 000 BCE** “Upper paleolithic”

2 The Big 3 Financial Statements

AFRICA'S BUSINESS HEROES SA INNOVATION SUMMIT. Moolman Institute

Statement	Definition	Purpose	Time
Income Statement	**Financial performance** of an entity over a specific period. Shows how the entity incurs revenues and expenses – both operational and non-operational.	Did the company make or lose money?	Over a **period of time**
Balance Sheet	Shows the **financial position** of an entity at a specific point in time. A **snapshot** of the entity's financial health. Assets = Equity + Liabilities	Answers the following questions: 1. What assets does the entity own? 2. How did it pay for them? 3. What does it owe (its liabilities)? 4. What is the amount left after satisfying the liabilities?	At a specific **point in time**
Cash Flow Statement	**Summary of cash inflows and outflows** for an entity over a specific period.	How much cash was generated by the entity? How did changes in the balance sheet and income affect the entity's cash?	Over a **period of time**

The Income Statement

AFRICA'S BUSINESS HEROES SA INNOVATION SUMMIT. Moolman Institute

	Structure	Description
	Net Sales	Sales (net of taxes, returns, duties)
-	**Cost of Sales**	Costs directly attributable to products or services
	Gross Profit	Direct profit on business activity
-	**Operating Expenses**	All expenses relating to operations excl. direct costs
	Operating Profit	Profit based on all operating activities (also called EBITDA)
-	**Depreciation & Amortization**	Decrease in value of assets: tangible (depreciation), intangible (amortization)
	Earnings Before Interest & Tax (EBIT)	Measure of profitability that includes all expenses except interest and taxes
+	**Non-Operating Income (Expense)**	Gains and losses not related to the company's business activities
	Earnings Before Tax (EBT)	Measure of profitability including all company activity, before tax
-	**Tax**	Tax payable to tax authority
	Net Profit	Final measure of company profitability

The Balance Sheet

AFRICA'S BUSINESS HEROES

SA INNOVATION SUMMIT.

Moolman Institute

Assets = Equity + Liabilities

Current Assets
- Cash & cash equivalents
- Short-term investments
- Trade / Accounts receivable
- Prepaid tax
- Inventory
- Tax receivable (e.g. VAT)

Non-Current Assets

Fixed
- Property, plant and equipment
- Furniture & fixtures
- Long-term investments

Intangible
- Intellectual Property (IP)
- Goodwill

Equity
- Retained earnings / income
- Shares / stock

Current Liabilities
- Trade / Accounts Payable
- Tax payable (e.g. VAT)
- Short-term debt

Long-Term / Non-Current Liabilities
- Long-term debt
- Contingent liabilities (e.g. lawsuits, warranties)

The Cash Flow Statement

AFRICA'S BUSINESS HEROES
SA INNOVATION SUMMIT.
Moolman Institute

Cash Pool

	Operating Activities	Investing Activities	Financing Activities
Cash flows	*Cash received from sales of goods and services* - *Cash paid to produce and deliver goods and services*	*Cash received from sales of investments and capital* - *Cash paid to purchase capital and for investment*	*Cash received from borrowings or issuing stock* - *Cash paid for dividends, debt or repurchasing stock*
How it is calculated	**Net income**, adjusted by: Depreciation / amortization Changes in working capital Net receivables Net payables Deferred Taxes Other	Changes in capital Changes in investments Changes in loans to others Other	Dividends paid Issuance / repurchase of stock (shares) Net borrowing (debt) Other (e.g. foreign exchange effects)

Where will our journey take us today?

AFRICA'S BUSINESS HEROES
SA INNOVATION SUMMIT.
Moolman Institute

1. Why Financials & Financial Modelling are Important for Entrepreneurs & Startups
2. The Big 3 Financial Statements
3. The Basics of Valuation
4. How to Tell Your Business' Financial Story
5. Valuation for Fundraising: a Balancing Act

What is the **difference** between **value** and **price**?

Valuation	→	**Pricing**
Various techniques Different answers An opinion		A negotiation One outcome An offer / commitment

Without a valuation basis... ...You negotiate on **emotion**

With a valuation basis... ...You negotiate the **basis**

What creates (financial) value in a business?

Positive Cash Flows!

Valuation Process

1. Establish overall context & purpose of valuation
2. Collect information & do due diligence
3. Make decisions based on context, purpose & information
4. Do valuation
5. Risk analysis, sensitivity analysis, further due diligence
6. Conclusion of value

Valuation Methodologies

AFRICA'S BUSINESS HEROES · SA INNOVATION SUMMIT · Moolman Institute

Cost *Looking Back*	Replication / Replacement Cost				
Market *Looking Around*	Market comparables	Industry Multiples	Venture Capital Method		
Income *Looking Ahead*	Discounted Cash Flow (DCF)	First Chicago Method	Risk-adjusted DCF	Monte Carlo	Real Options
Risk / Status	Berkus Method	Scorecard & Risk Factor Summation Methods			

Discounted Cash Flow (DCF)

3 Basic Factors Determine Company Valuation:

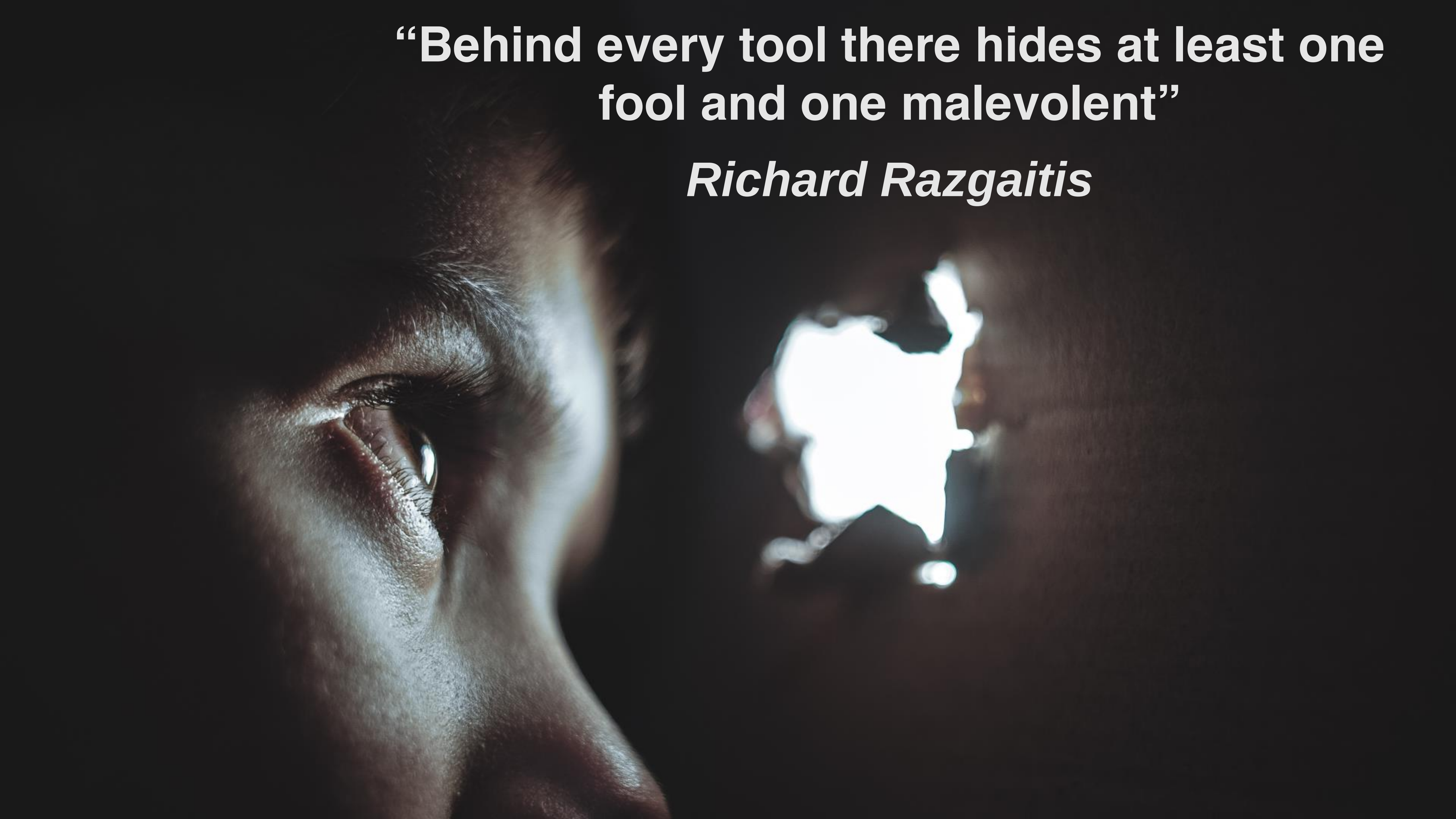
- Cash Flow
- Growth
- Risk

Berkus Method

(Pre-revenue)

Hurdle: **Gross revenue projected at end of 5 years > $20m**

Then If Exists:	**Add to Company Value MAXIMUM of:**
Sound Idea *(**basic value**)*	**$0.5 million**
Prototype *(reducing **technology** risk)*	**$0.5 million**
Quality Management Team *(reducing **execution** risk)*	**$0.5 million**
Strategic Relationships *(reducing **market** risk)*	**$0.5 million**
Product Rollout or Sales *(reducing **production** risk)*	**$0.5 million**
	$2.5 million


“Behind every tool there hides at least one fool and one malevolent”
Richard Razgaitis

Where will our journey take us today?

AFRICA'S BUSINESS HEROES
SA INNOVATION SUMMIT
Moolman Institute

1	Why Financials & Financial Modelling are Important for Entrepreneurs & Startups
2	The Big 3 Financial Statements
3	The Basics of Valuation
4	How to Tell Your Business' Financial Story
5	Valuation for Fundraising: a Balancing Act

How do your **compelling vision** and your **business model & plan** translate into a **financial story?**

How to Tell Your Business' Financial Story

compelling vision business model & plan	? ⟷	financial story
Business objectives & milestones	⟷	Financial targets & fundraising points
Sources of competitive advantage	⟷	Higher profit margins
Market need, product-market fit, territories, channels, competition	⟷	Sales volumes & sales prices
Business model	⟷	Financial model

4 How to Tell Your Business' Financial Story

AFRICA'S BUSINESS HEROES SA INNOVATION SUMMIT. Moolman Institute

~~Clear and compelling **business** story~~ ↔ ~~Clear and compelling **financial** story~~

But **HOW**?

Try to distil everything
you're doing into a
simple idea
that expresses the
emotional power
your product brings to its users.

Source: https://bradberens.medium.com/ride-hailings-ipod-moment-8b76097c045a

What are you all about?

One Simple Thing (OST)

"If you don't create an OST for the market, the market will create an OST for you"

Source: https://www.forentrepreneurs.com/clarity-of-message/

AFRICA'S BUSINESS HEROES
SA INNOVATION SUMMIT.
Moolman Institute

One Simple Thing (OST)

*For **[TARGET]** who are **[SEGMENT]**, **[BRAND]** provides the **[CATEGORY]** with **[DISTINCTION]** because of **[PROOF]***

Source: https://www.forentrepreneurs.com/clarity-of-message/

One Simple Thing (OST)

*For **[TARGET]** who are **[SEGMENT]**, **[BRAND]** provides the **[CATEGORY]** with **[DISTINCTION]** because of **[PROOF]***

amazon

circa 2001

For World Wide Web users who enjoy books, Amazon.com is the online bookseller that provides instant access to over 1.1 million books.

4 How to Tell Your Business' Financial Story

Search for Product-Market Fit → **Scale the Business**

Source: https://forentrepreneurs.com

4 How to Tell Your Business’ Financial Story

AFRICA'S BUSINESS HEROES
SA INNOVATION SUMMIT.
Moolman Institute

Search for Product-Market Fit

1. Test hypothesis
2. Prove the value
3. Prove it can be sold

Search for Repeatable, Scalable & Profitable Growth Model

4. Find repeatable sales motion
5. Prove non-founders can sell
6. Make it scalable
7. Ensure customer success
8. Make it profitable

Scale the Business

9. Hit the gas and scale
10. Scale org and its processes
11. Etc.

Source: https://forentrepreneurs.com

4 How to Tell Your Business' Financial Story

AFRICA'S BUSINESS HEROES · SA INNOVATION SUMMIT. · Moolman Institute

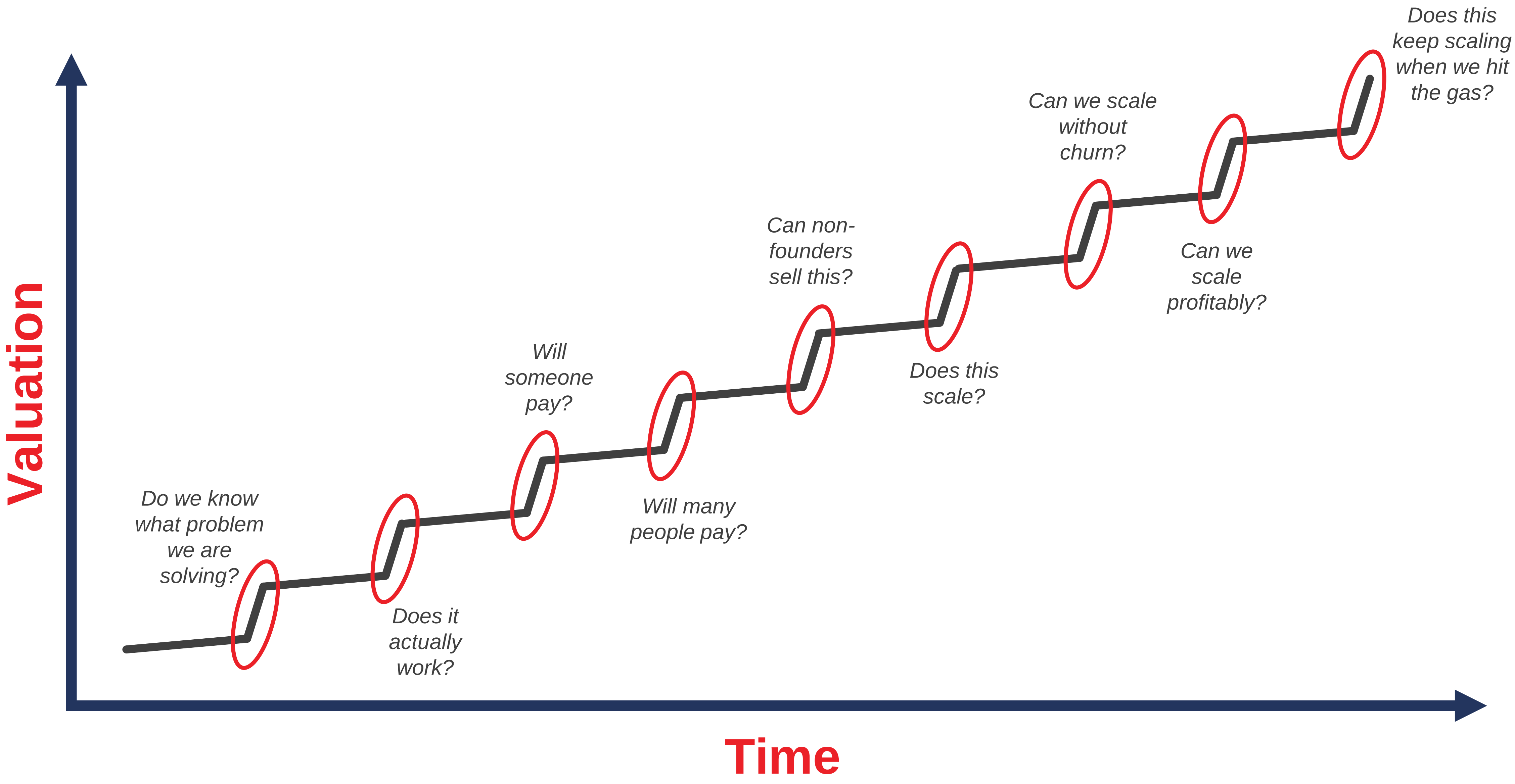
Search for Product-Market Fit

Search for Repeatable, Scalable & Profitable Growth Model

Scale the Business

1	2	3	4	5	6	7	8	9	10	11
Test hypothesis	Prove the value	Prove it can be sold	Find repeatable sales motion	Prove non-founders can sell	Make it scalable	Ensure customer success	Make it profitable	Hit the gas and scale	Scale org and its processes	Etc.
Do we know what problem we are solving?	*Does it actually work?*	*Will someone pay?*	*Will many people pay?*	*Can non-founders sell this?*	*Does this scale?*	*Can we scale without churn?*	*Can we scale profitably?*	*Does this keep scaling when we hit the gas?*		

4 Key Startup Inflection Points



Key Elements of Your Business' Financial Story

1

How you'll make money

(business model, revenue & costs)

2

How much money you think you'll make & when

(cash flow projections)

3

Money needed to get to next inflection point & how you're going to use it

(budget)

4

How you'll finance the business

(equity, debt financing)

5

What your key assumptions are

6

How sensitive your projections are to changes

(sensitivity analysis, scenarios)

Photo by Linus Sandvide on Unsplash

How **Credible** is your story?

for example…

Track record of founders

Current traction

Did you achieve previous promises?

Inflection points already achieved?

Market response to MVP?

Any off-take agreements?

Where will our journey take us today?

AFRICA'S BUSINESS HEROES SA INNOVATION SUMMIT Moolman Institute

1	Why Financials & Financial Modelling are Important for Entrepreneurs & Startups
2	The Big 3 Financial Statements
3	The Basics of Valuation
4	How to Tell Your Business' Financial Story
5	Valuation for Fundraising: a Balancing Act

5 Valuation for Fundraising: a Balancing Act

Size of funding round?

Valuation?

Size of funding round?

"Seek the right funding, not the most funding"

Too little funding

- **Permanently in fundraising mode** instead of focusing on build-measure-learn
- **Not enough funding to get to next inflection point** – dilution & unhappy shareholders

Too much funding

Risk of:

- **Overspending**
- **Complacency**
- **Defocusing** - side-tracks & chasing non-core business and opportunities

5 Valuation for Fundraising: a Balancing Act

Valuation?

Too low valuation

Dilute too quickly:

- **Loss of value** for founders & earlier round investors
- Risk of **founders losing motivation** due to too small share in business

Too high valuation

- Risk of future "**downround**"
- **Loss of credibility**
- Forced to accept anyone willing to invest
- Inability to raise further investment

Valuation - Possible Solutions

Phased release of funding *based on reaching milestones & adjusting valuation*

Expect multiple rounds *& plan accordingly*

SAFE *Simple Agreement for Future Equity – postpone valuation to next round (with cap, discount, downside protection)*

https://www.ycombinator.com/documents/ https://seriesseed.co.za/

Convertible loan *Loan converts to equity later (at a discount)*

Where will our journey take us today?

AFRICA'S BUSINESS HEROES SA INNOVATION SUMMIT. Moolman Institute

1. Why Financials & Financial Modelling are Important for Entrepreneurs & Startups
2. The Big 3 Financial Statements
3. The Basics of Valuation
4. How to Tell Your Business' Financial Story
5. Valuation for Fundraising: a Balancing Act

Moolman Institute Online Courses

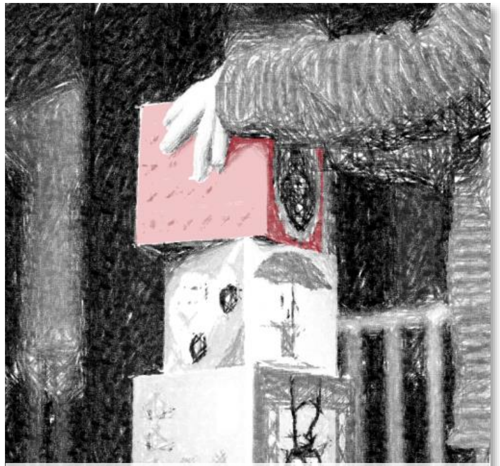
AFRICA'S BUSINESS HEROES

SA INNOVATION SUMMIT.

Moolman Institute

Financial Modelling for Entrepreneurs 101

Master the Key Financial Concepts



Make **Better Financial Decisions**

Financial Modelling for Entrepreneurs 201

Kickstart Your Spreadsheet Skills

Build Spreadsheet Models & Charts and **Check for Errors**

Financial Modelling for Entrepreneurs 301

How to Understand & Analyze Fin Statements

Interpret and Analyze the **3 Main Financial Statements**

Financial Modelling for Entrepreneurs 401

Build Your Own Financial Model

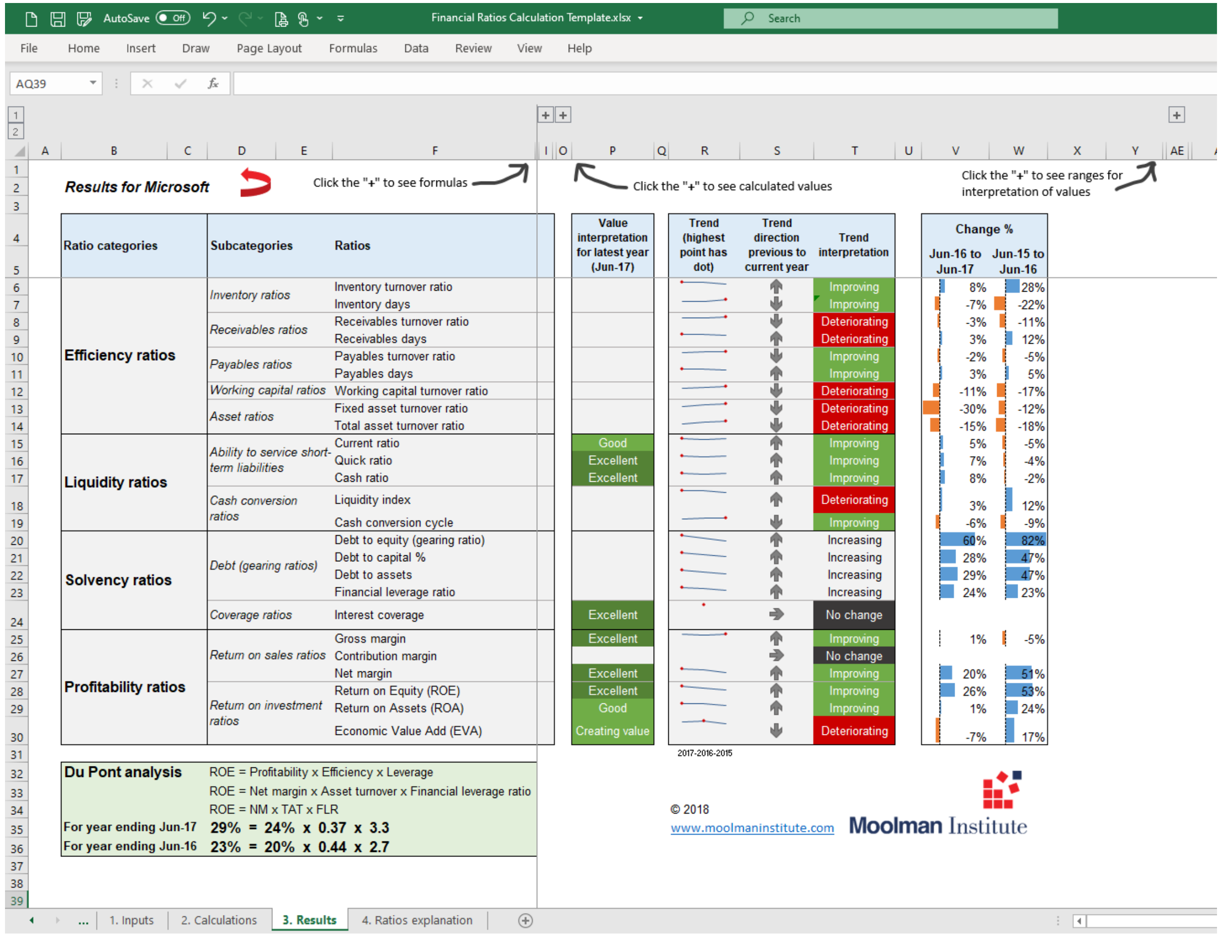
Build a Financial Model for **Your Business or Tech**

Opportunity Assessment for Entrepreneurs & Innovators

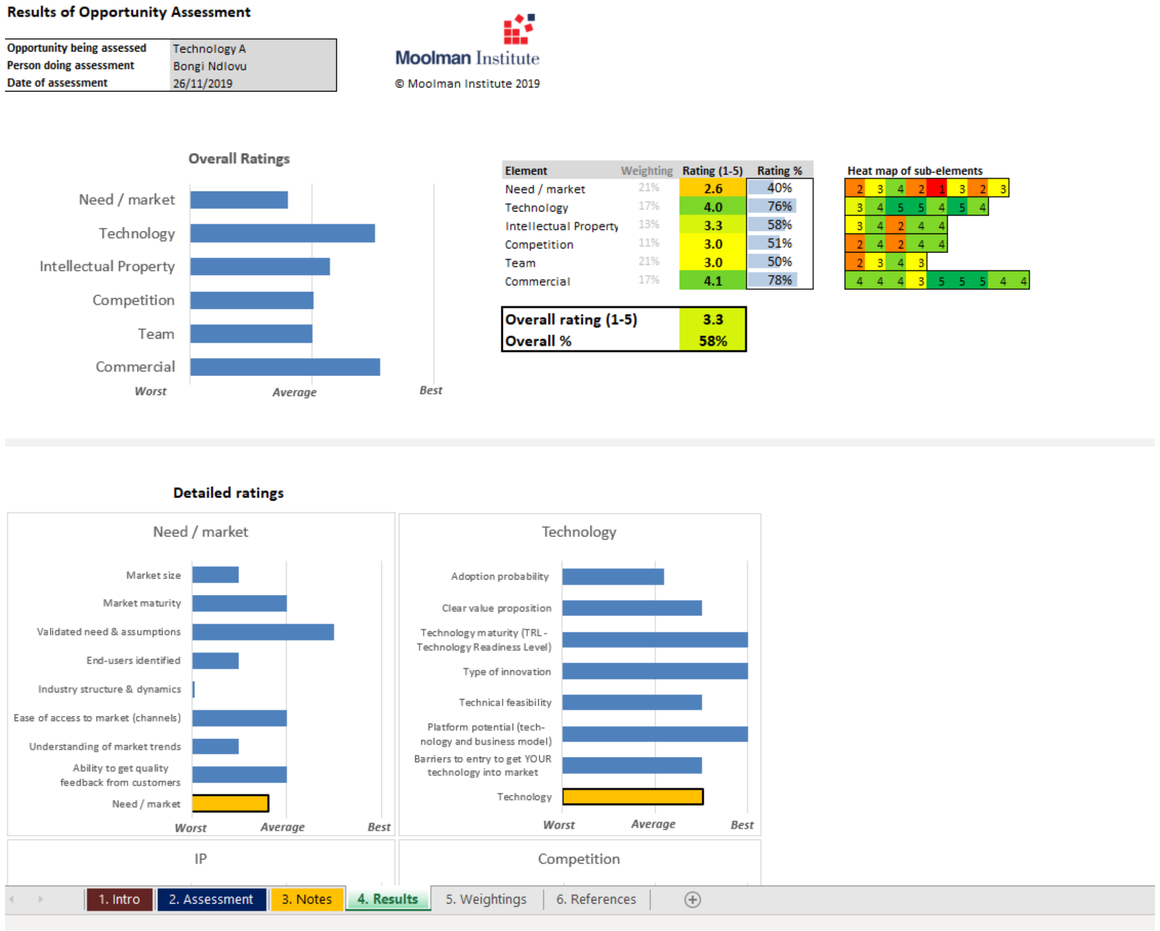
Figure out whether to Build It, Sell It, Share It or Shelve It

Examples of templates & tools included in the courses

Financial Ratios Calculation Template



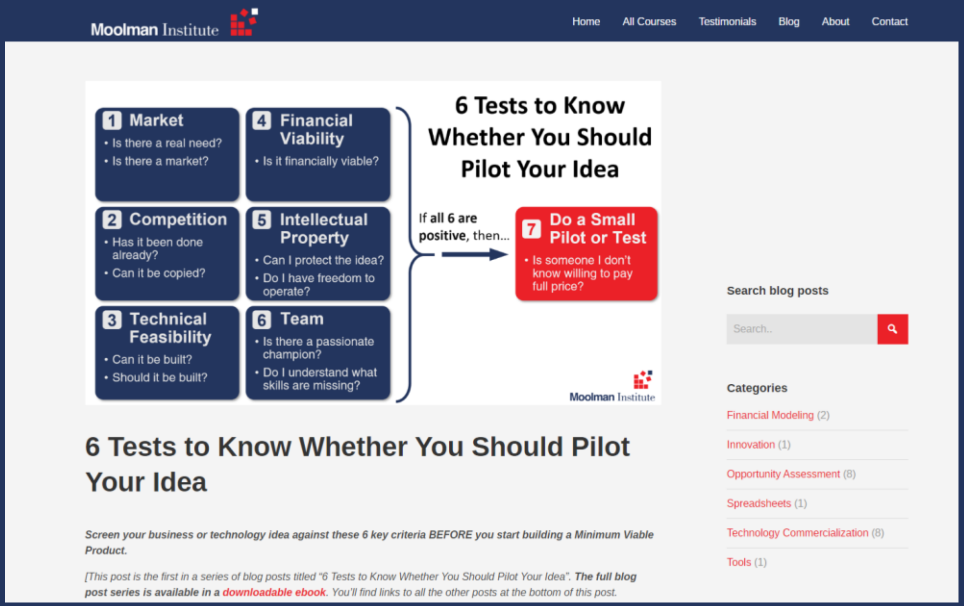
Opportunity Assessment Tool



Read more about the 6 key factors for innovation and start-up success...

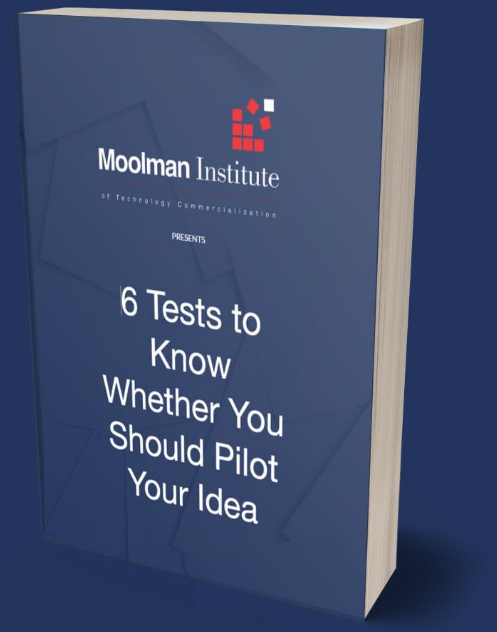
Moolman Institute

...at the Moolman Institute blog:



(Click on image to go to blog)

...or download the free ebook:



(Click on image to go to download page)

Thank you!
Questions?

Success is the hangover of hard work
– *Robin Kirkpatrick*

sean@moolmaninstitute.com

AFRICA'S BUSINESS HEROES

SA INNOVATION SUMMIT

Moolman Institute

of Technology Commercialization

Some Additional Information

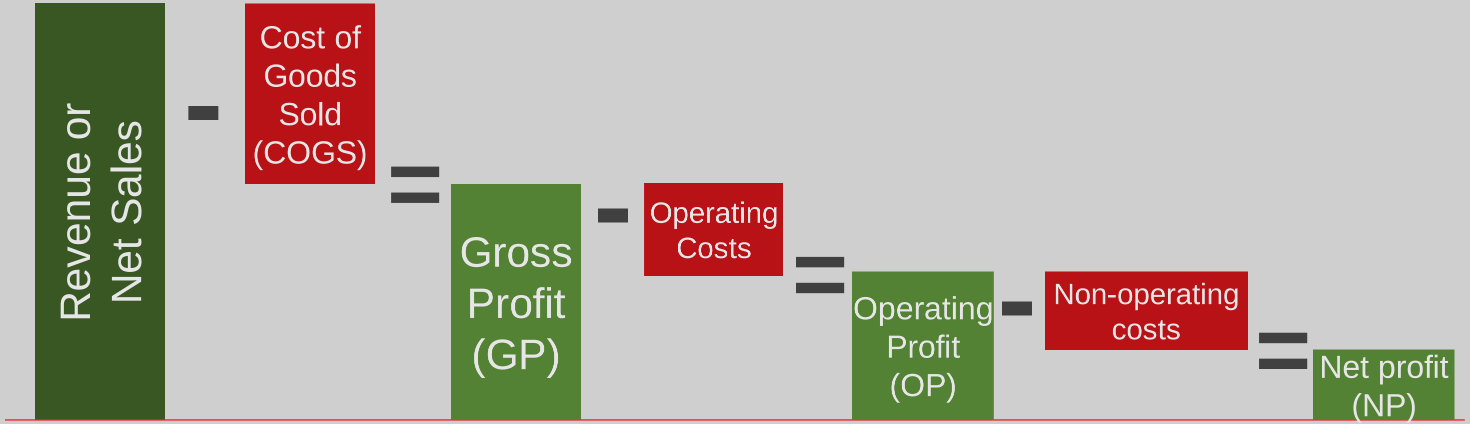
Moolman Institute
of Technology Commercialization

AFRICA'S BUSINESS HEROES

SA INNOVATION SUMMIT.

Photo by Fabian Blank on Unsplash

Concepts: Gross vs Net

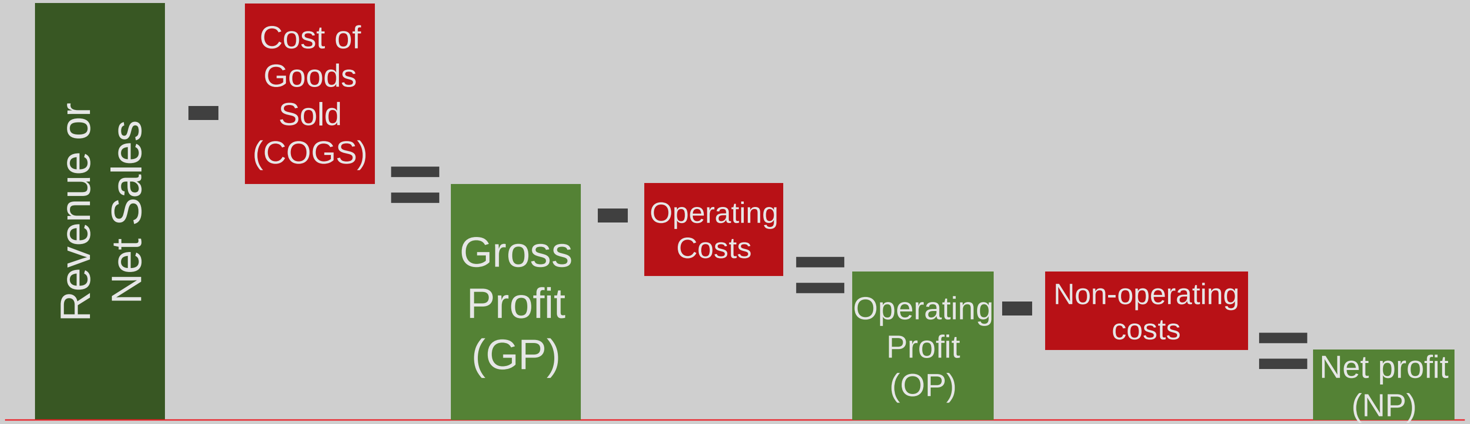


Gross Profit (GP)
GP = Revenue – Costs of Goods Sold
= Revenue – Direct Costs

Operating Profit (OP)
OP = GP – Operating Costs

Net Profit or Net Income (NP)
NP = OP – Non-operating income & costs

Concepts: Profit, Margin & Markup



Gross Profit (GP)
GP = Revenue – Costs of Goods Sold
= Revenue – Direct Costs

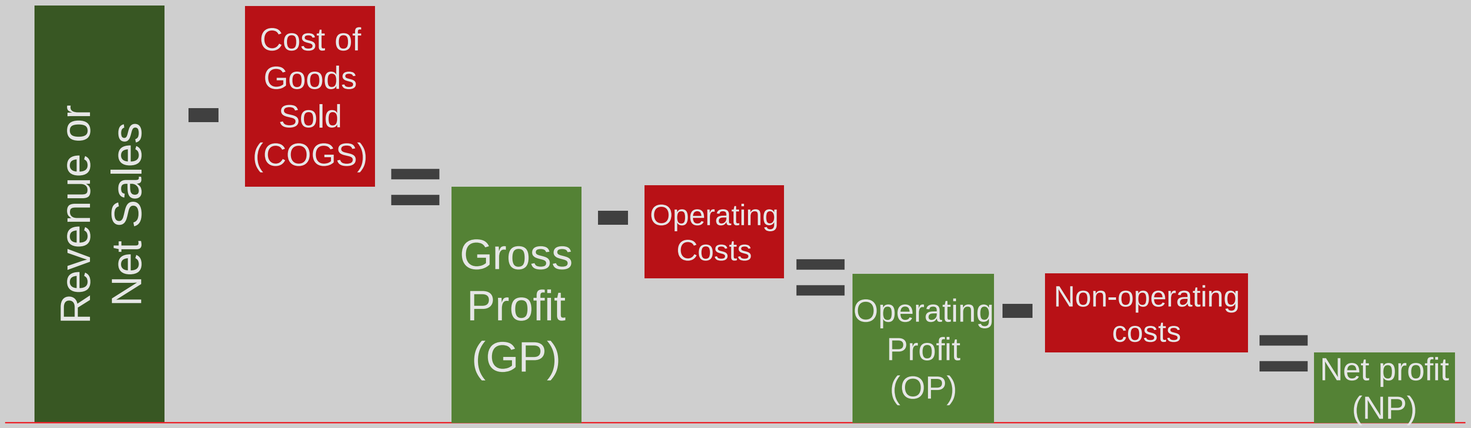
Operating Profit (OP)
OP = GP – Operating Costs

Net Profit or Net Income (NP)
NP = OP – Non-operating income & costs

Concepts: Profit, Margin & Markup

$

Profit is a **value** in dollars (currency)



Gross Profit (GP)
GP = Revenue – Costs of Goods Sold
= Revenue – Direct Costs

Operating Profit (OP)
OP = GP – Operating Costs

Net Profit or Net Income (NP)
NP = OP – Non-operating income & costs

%

Margin is a **percentage** of **Revenue**

Gross Margin %

$$= \frac{\text{GP}}{\text{Revenue}} \times \frac{100}{1}$$

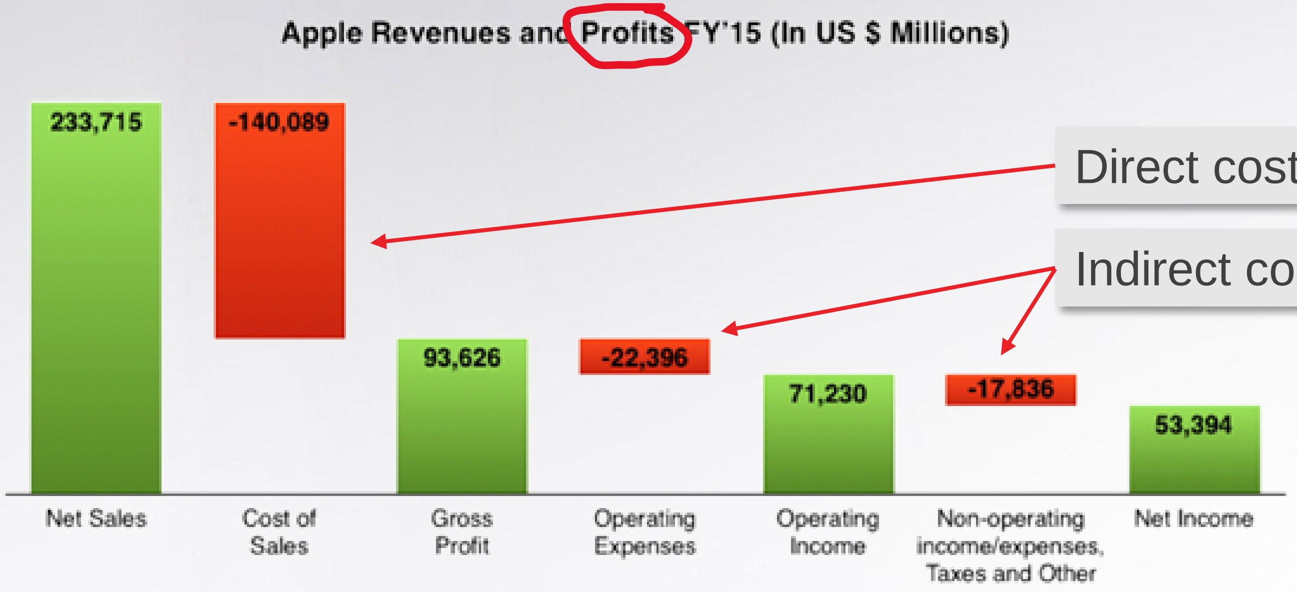
Operating Margin %

$$= \frac{\text{OP}}{\text{Revenue}} \times \frac{100}{1}$$

Net Margin %

$$= \frac{\text{NP}}{\text{Revenue}} \times \frac{100}{1}$$

Apple Profits and Profit Margins - FY'15



Direct costs

Indirect costs

* Apple FY (Fiscal Year) ends in September

Apple profits image source: https://revenuesandprofits.com/how-apple-makes-money/.
Apple logo image source: victoria white2010 on flickr

Concepts: Profit, Margin & Markup

What is the difference between markup and margin?

Markup

Mark-up is a **RATIO** - can be any number (e.g. 200%)

$$\text{Markup} = \frac{(\text{Revenue} - \text{COGS})}{\text{COGS}} \times \frac{100}{1}\%$$

$$= \frac{\text{Gross profit}}{\text{COGS}} \times \frac{100}{1}\%$$

Based on **COST**

Margin

Margin is a **PROPORTION** or **FRACTION** – can never be more than 100%

$$\text{Margin} = \frac{(\text{Revenue} - \text{COGS})}{\text{Revenue}} \times \frac{100}{1}\%$$

$$= \frac{\text{Gross profit}}{\text{Revenue}} \times \frac{100}{1}\%$$

Based on **PRICE**

Concepts: Profit, Margin & Markup

$$\text{Revenue or Net Sales} = \text{Gross Profit (GP)} + \text{Cost of Goods Sold (COGS)}$$

$$\textbf{Markup} = \frac{\text{Gross Profit (GP)}}{\text{Cost of Goods Sold (COGS)}} \times \frac{100}{1}\%$$

$$\textbf{Margin} = \frac{\text{Gross Profit (GP)}}{\underbrace{\text{Cost of Goods Sold (COGS)} + \text{Gross Profit (GP)}}_{\textbf{Revenue}}} \times \frac{100}{1}\%$$

Concepts: Profit, Margin & Markup

AFRICA'S BUSINESS HEROES
SA INNOVATION SUMMIT.
Moolman Institute

$$\text{Revenue or Net Sales} = \begin{array}{c}\text{Gross Profit (GP)} \\ \text{Cost of Goods Sold (COGS)}\end{array}$$

$$\textbf{Markup} = \frac{\text{Gross Profit (GP)}}{\text{Cost of Goods Sold (COGS)}} \times \frac{100}{1}\%$$

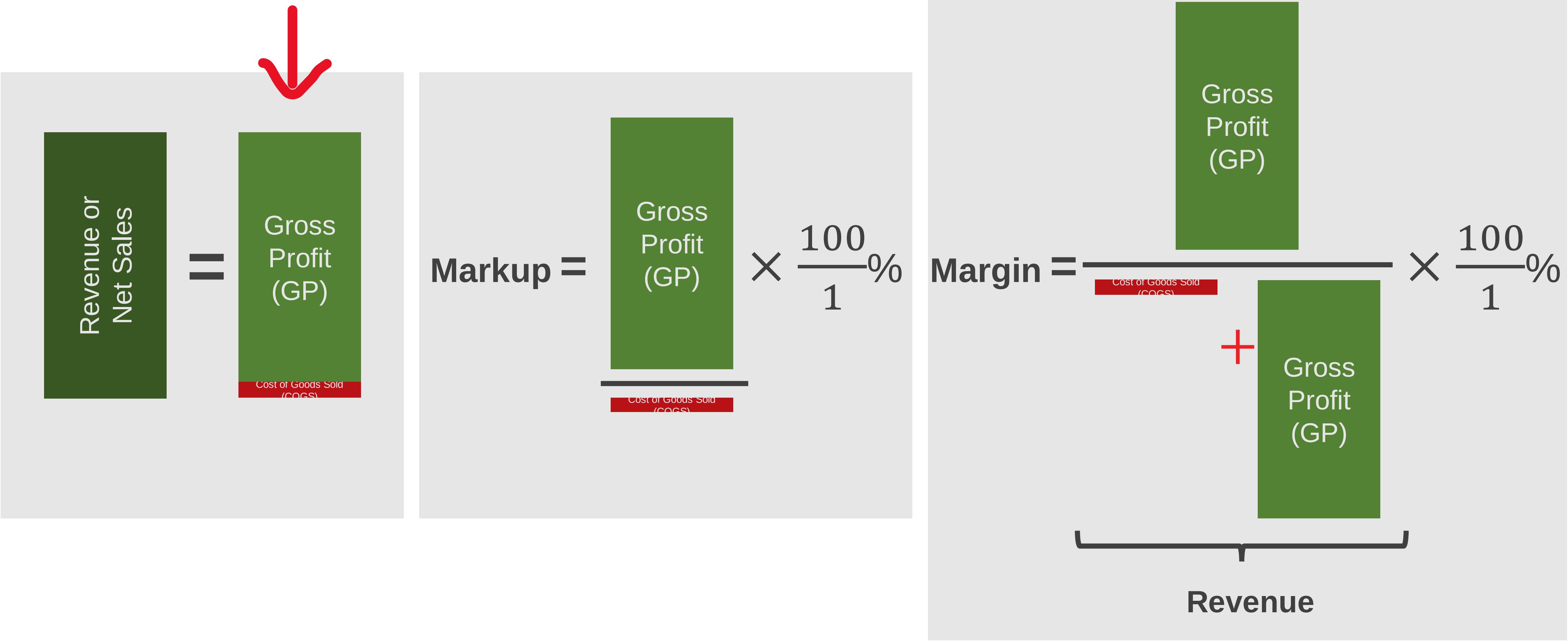
$$\textbf{Margin} = \frac{\text{Gross Profit (GP)}}{\underbrace{\text{Cost of Goods Sold (COGS)} + \text{Gross Profit (GP)}}_{\textbf{Revenue}}} \times \frac{100}{1}\%$$

Concepts: Profit, Margin & Markup

AFRICA'S BUSINESS HEROES

SA INNOVATION SUMMIT.

Moolman Institute



⇆ Present Value ⇆ Future Value

AFRICA'S BUSINESS HEROES

SA INNOVATION SUMMIT.

Moolman Institute

Present Value: the **value in the present** of one or more **future cash flow(s)** given a specified rate of return or cost of capital.

Future Value

$$P = \frac{F}{(1+r)^n} \quad \leftrightarrows \quad F = P(1+r)^n$$

Present Value

Interest Rate per period

No. of periods

Present Value ⇆ Future Value

Present Value: the **value in the present** of one or more **future cash flow(s)** given a specified rate of return or cost of capital.

Discounting

$$P = \frac{F}{(1+r)^n}$$

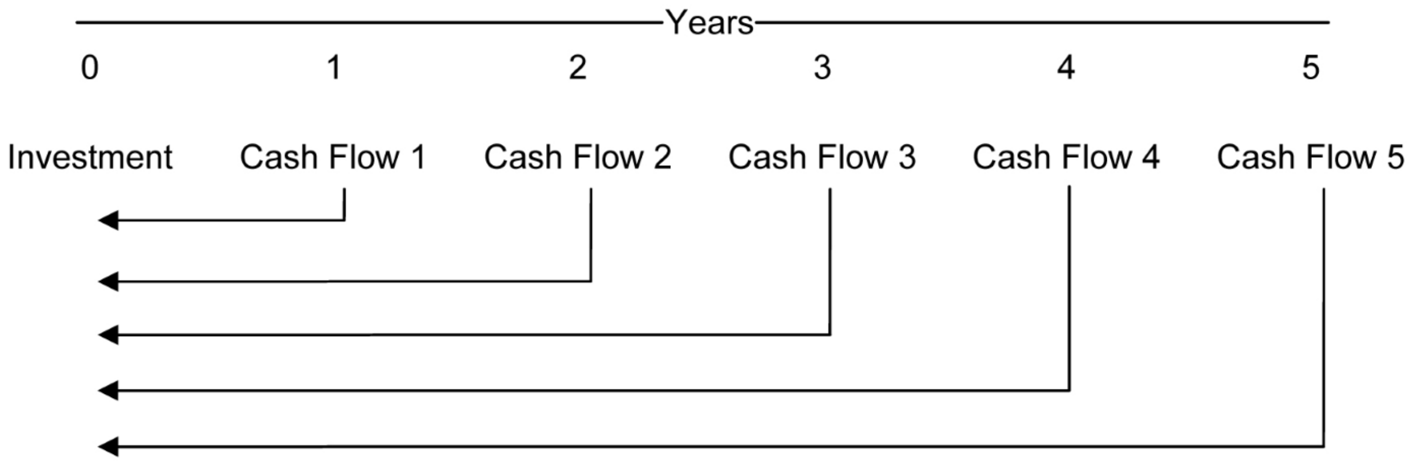
Discount rate

$$F = P(1+r)^n$$

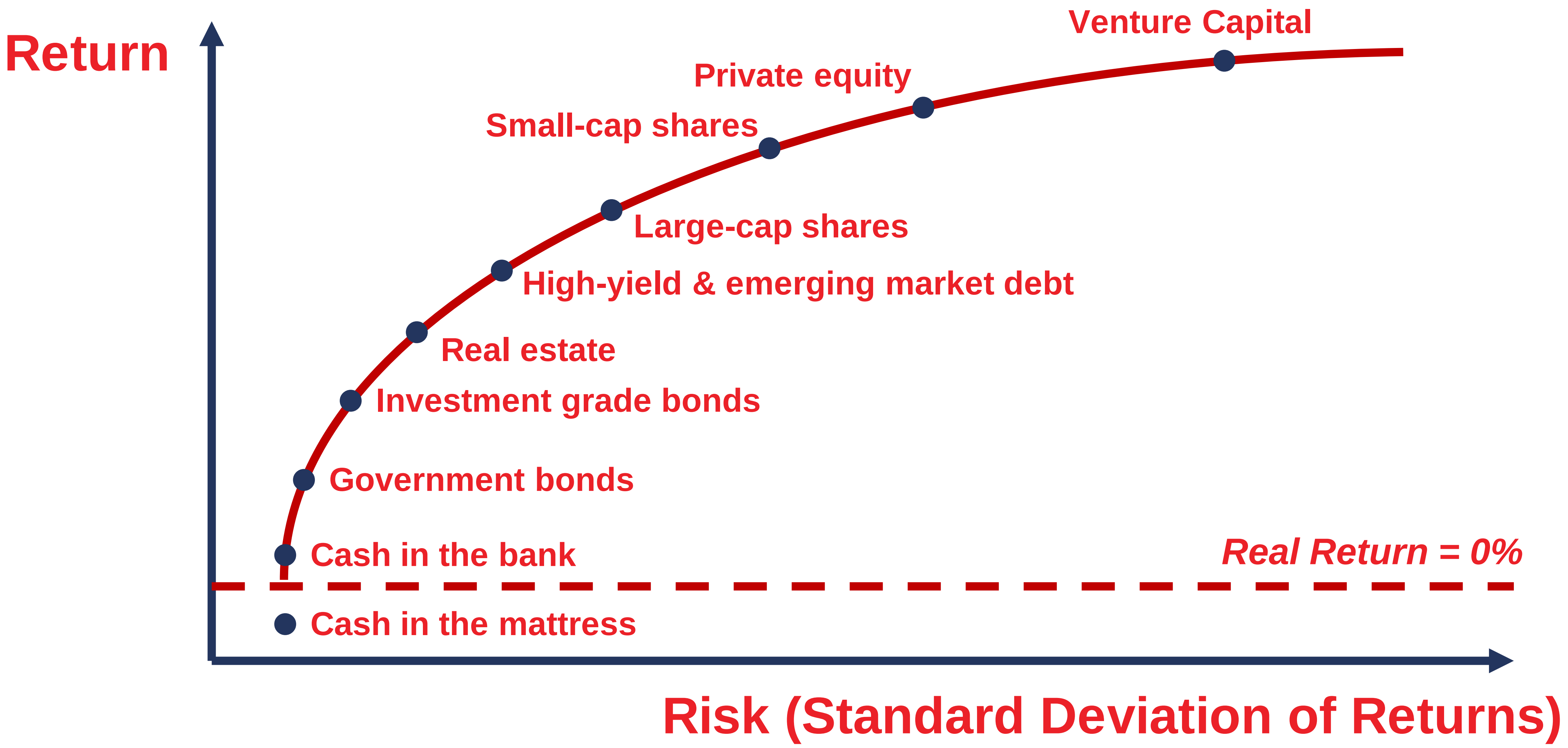
Compounding

Discounted Cash Flow (DCF)

Discounted Cash Flow: a **method of valuing** a project, company, or asset using the concept of the **time value of money**. All **future cash flows** are estimated and discounted to give their **present values**.



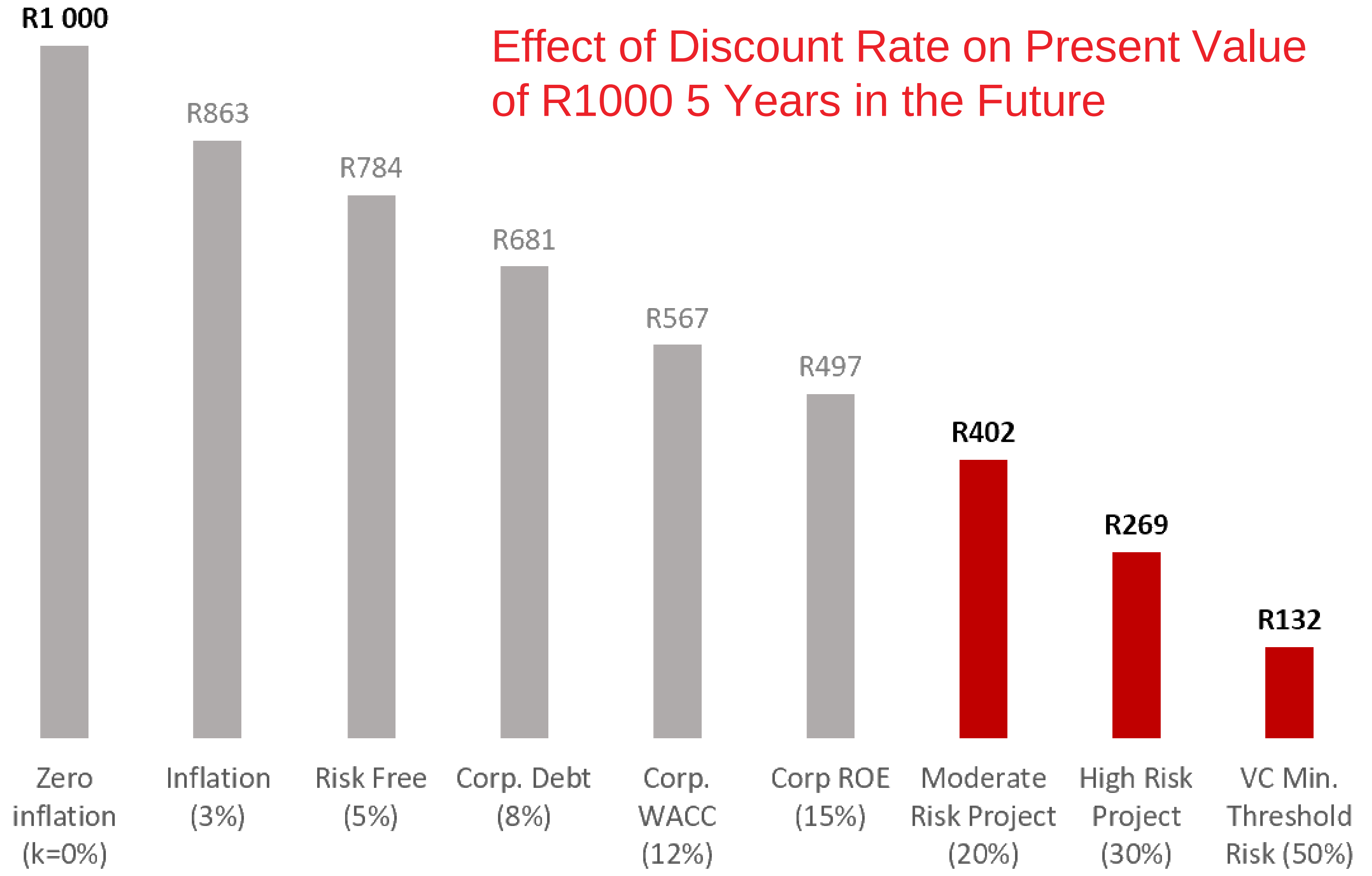
Risk vs Return



Source: http://economaniac.be/getting-started-with-stock-market-investing-risk-vs-return/. Last accessed: 2019/06/02.

Risk-Adjusted Hurdle Rate (RAHR)

RAHR (Risk-Adjusted Hurdle Rate): minimum rate of return required by an investor that adequately compensates for risk



Risk-Adjusted Hurdle Rate: Technology

AFRICA'S BUSINESS HEROES SA INNOVATION SUMMIT. Moolman Institute

Risk level	Description	Discount rates
Risk free	Building a duplicate plant to make more of a currently made and sold product in response to presently high demand approximates corporate rate of borrowing	**10-18%**
Very low risk	Incremental improvements with a well-understood technology into making a product presently made and sold in response to existing demand	**15-20%**
Low risk	Making a product with new features using well-understood technology into a presently served and understood customer segment with evidence of demand for such features	**20-30%**
Moderate risk	Making a new product using well-understood technology to a customer segment presently served by other products made by the corporation and with evidence of demand for such a new product	**25-35%**
High risk	Making a new product using a not well-understood technology and market it to an existing segment or a well-understood technology to a new market segment	**30-40%**
Very high risk	Making a new product with new technology to a new segment (IP development)	**35-45%**
Extremely high risk	Creating a start-up company to go into the business of making a product not presently sold or even known to exist using unproven technologies (IP development)	**50-70%**

The 10 steps in building a financial model

01 Inputs & assumptions

Collect data and information. Document initial assumptions and estimates. Note ranges of validity.

02 Market information

Collect information on market sizes and growth rates for target market segments.

03 Sales projections

Estimate the projected sales (volumes & prices) over the modeling period.

04 Cost of Goods Sold

Estimate the direct costs of producing the product or delivering the service.

05 Capital expense

Estimate the cost of any capital equipment or other capital investment required.

06 Expenses

Estimate all other operating expenses apart from direct costs.

07 Financial statements

Produce financial statements based on the outputs from the previous steps.

08 Calculate key model outputs

Calculate the key financial outputs from the model based on the modeling objectives (e.g. NPV, IRR).

09 Error checking & validation

Do error checking. Validate & compare outputs where possible.

10 Scenarios & sensitivity analysis

Generate different scenarios (e.g. base case, low road, high road). Do sensitivity analysis.