

EPISODE 3

How to talk to VCs about your finances

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Overview

- Financial statements – Cash Flow, P&L, Balance Sheet
- Create a 5-year plan in 3 scenarios (basic, worst, best)
- Discussion on valuation & funding topics
- The Farseer journey: interview with Matija
- Q&A

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Financial Statements & KPIs

\$23,685

Deposits: \$10,000

+5.2% (\$456)

ADD FUNDS

Goal: \$55,000

Duration: 4y

HISTORY

All time

\$52,00
July 2021

2012

2014

2015

2016

2017

— Your balance

— Market value

--- Your deposits

PROJECT RISK

5

Balanced

Change your risk

Nr
AWS 2455

Created
22 Dec 2013

Download overall report

Allocation

Geo

Europe

45%

DETAILS

Show list

Europe

45%

North America

35%

Japan, South Korea

10%

Others

10%

Europe

Qty
45%

Valorisation
\$72.80

Profit
+35.2%

Profit and Loss Statement

EUR	2020	2019
Net Sales	200.000 €	140.000 €
Cost of Sales	- 205.000 €	- 153.750 €
Gross Profit	- 5.000 €	- 13.750 €
Gross Margin %	-2,5%	-9,8%
Operating Expenses		- €
Sales & Marketing	- 16.500 €	- 11.550 €
Research & Development	- 5.000 €	- 3.500 €
General or Administrative	- 32.000 €	- 22.400 €
Total Operating Expenses	- 53.500 €	- 37.450 €
EBITDA (Earnings before Interest, Tax, Depreciation, Amortization)	- 58.500 €	- 51.200 €
EBITDA Margin %	-29%	-37%
Depreciation & Amortization	- 2.500 €	- 1.750 €
EBIT (Earnings before Interest and Tax)	- 61.000 €	- 52.950 €
Interest (over total funding needed)	- 1.000 €	- 700 €
Financial Cost	- 1.000 €	- 700 €
EBT (Earnings before tax)	- 62.000 €	- 53.650 €
Tax	- 10.000 €	- 8.000 €
Net Income	- 72.000 €	- 61.650 €

Cash Flow statement.

	Jan-21	Feb-21	Mar-21
Cash In	Cash In		
	Cash from sales		
	Cash collected from debtors		
	Other income		
	Cash from Loans		
Cash Out	Cash from Investors (Equity sale)		
	Total Cash Inflow		
	Cash out for cost of sales		
	Purchases/Materials		
	Licences		
	Hosting		
	Online payment costs		
	Other		
	Total Cost of sales		
	Cash out for Expenses		
	Salaries		
	Lease payments		
	Commissions		
	Repairs & Maintenance		
	Office supplies equipment		
	Advertising & promotions		
	Travelling		
	Accounting		
	Legal		
	Professional services		
	Rent		
	Telephone		
	Internet		
	Utilities		
	Insurance		
	Other Expenses		
	Interest on loans		
	Bank charges		
	VAT+ & VAT-		
	Company income tax		
	Total Cash Expenses		
	Cash Capital payments		
	Dividends		
	Loan repayments		
	Assets purchased		
	Owner cash withdrawals		
	Total Cash Capital payments		
	Total cash outflow		
	Opening Balance		
	Net cash receipts/expenses		
	Closing Balance		

Cash	2021	2022	2023
Cash from operations	-685.583	-2.403.932	-3.085.831
Cash in	41.257	938.612	1.412.673
Cash out	726.840	3.342.544	4.498.504
Cash from investing	0	240.000	480.000
Cash from financing	1.000.000	5.468.000	8.000.000
Net cash	314.417	2.824.068	4.434.169

Balance Sheet Statement

	2020	2019
Current assets		
Cash and Cash Equivalents		
Marketable Securities		
Accounts Receivable		
Inventory		
Prepaid Expenses		
Non - current assets		
Long term Investments & Funds		
Property, Plant, Equipment (PPE)		
Intangible Assets		
Accumulated Depreciation/Amortization		
Total Assets		
Current liabilities		
Short term debt payable		
Current portion of long-term debt payable		
Accounts Payable		
Current tax liabilities payable		
Long-term liabilities		
Non - current portion of long-term debt		
Other long term lease and financing obligations		
Deferred Revenue		
Deferred tax liability		
Total Liabilities		
Shareholders Equity Capital		
Net Profit		
Owners deposits(withdrawls)		
Retained Earnings		
Total Equity		

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

How are the statements connected?

Balance sheet	Profit and loss account	Cash flow statement
<div>Fixed assets</div> <div>Buildings</div> <div>Machinery</div> <div>Current assets</div> <div>Accounts receivable</div> <div>Inventory</div> <div>Cash</div> <div>Total assets</div>	<div>Equity</div> <div>Long term liabilities</div> <div>Bank loan</div> <div>Needed funding</div> <div>Short term liabilities</div> <div>Accounts payable</div> <div>Payable taxes/VAT</div> <div>Total financing of assets</div>	
	<div>Turnover</div> <div>Cost of goods sold</div> <div>Gross margin</div> <div>Rent building</div> <div>Personal costs</div> <div>Management fee</div> <div>Other costs</div> <div>Total operating costs</div> <div>Earnings before interest, tax, depreciation and amortisation (EBITDA)</div> <div>Depreciation</div> <div>Earnings before interest and tax (EBIT)</div> <div>Interest payments</div> <div>Earnings before tax (EBT)</div> <div>Tax</div> <div>Profit after tax</div>	<div>EBIT</div> <div>Tax</div> <div>Investment in working capital</div> <div>Depreciation</div> <div>Cash from operational activities</div> <div>Investments in fixed assets</div> <div>Cash from investment activities</div> <div>Interest payments</div> <div>Change in long term liabilities</div> <div>Change in equity</div> <div>Cash from financing activities</div> <div>Total cash flow</div> <div>Cash begin of year</div> <div>Movement in cash</div> <div>Cash end of year</div>
<div>Link between cash in the balance sheet and cash in the cash flow statement. These two positions must exactly match.</div>	<div>Profit after tax must be added to equity.</div>	<div>Depreciation is not an actual cash out. Therefore depreciation is added back in the cash flow statement.</div> <div>Investments are added in balance sheet and the cash flow statement.</div>

KPI Metrics

- **Revenue:** Revenue, Revenue Growth, MRR/ARR trends
- **Profitability:** EBITDA Margin trend
- **Customer Metrics:** Conversion Rate & Customer/Revenue Churn rate
- **Unit Economics:** LTV, CAC, LTV/CAC, Months to recover CAC, Contribution Margin, Breakeven
- **Asset Turnover:** Revenue per Commercial, or Non-commercial employee
- **Cash Flow Situation:** DSO, DPO, AR Ageing, Cash Burn Rate, Cash Runway
- **Capital structure:** Debt vs Equity

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Create a 5yr Plan in 3
scenarios (base,
good, bad)

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Scenarios on your drivers

- **Revenue** over time (pipeline, conversion, retention, upselling, price increase)
- **Cost** over time
- **Burn Rate** or **Profit Margin**
- **Cash Runway**

Assumptions that drive scenarios

- Events that might affect the amount and timing of cash in and cash out flows:
 - ✓ New pipeline opportunities
 - ✓ Higher/lower conversion rates
 - ✓ Higher/lower churn
 - ✓ Upselling opportunities
 - ✓ Improve your product and go to market strategy
 - ✓ Change in cost drivers
 - ✓ Speed of your invoice to cash cycle
 - ✓ External factors

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Key points

- Provide detail
- Provide drivers and assumptions
- Start early, update often

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Discussion on Valuation & Funding Topics

Sources of Funding

- **Direct revenue** streams on your product, or side projects
- FFF: **Friends, Fools and Family** and from your own pocket
- Government / EU/ Private **grants**
- Bank **loans**/ Credit cards/ Recurring credit lines for working capital
- Angel **Investors** & VCs
- Startup incubators/ accelerators/ competitions
- Other

What drives valuation from founder perspective?

- **How much equity you're prepared to give** to your VC?
- **How much funding you absolutely need** to get to your next funding milestone?
- Current company performance and **interest from customers and investors**

Valuation Methods

- **Previous funding rounds** of your start up
- **Founder red lines:** Min amount of funds your need, max equity you are willing to give
- **Cost plus method:** Value = cost to build and replace, plus an industry average profit margin
- **Comparable methods:** Multiples of Public companies, previous deals
- **Scorecard methods:** assign a monetary value or a score to a risk factor or a value driver based on comparable companies
- **Discounted Cash Flow Method (DCF):** NPV of FCF discounted at the WACC usually for 5 years plus a terminal value.
- **Capital Market Pricing Methods (CAPM):** “risk-free” return plus “risk premium”, based on capital markets pricing of similar stocks (*usually used to calculate cost of equity for WACC*)

What do investors mainly look at?

- **Product**
- Market & Competition
- Business Model
- Go-to-Market Strategy
- Traction
- Cash Flow situation
- **Team**
- Size & length of investment, ROI, Exit
- Psychological factors

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Product

- What is the **key problem you are solving**?
- **How are you solving** this key problem?
- Demonstrate a **Minimum Viable Product**.
- What is your **unfair advantage**?
- Is your product **scalable**?

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Market & Competition

- What is the **market size** and **growth potential**?
- What is the market **competition** landscape?

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Business Model: the total picture

- **What** do you make?
- **How** do you make it?
- How do you **earn money from it**?
- Is your model **scalable**?

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Go-to-Market Strategy

- How do you **reach** and **acquire** your **customers**?
- How do you **price** your product?

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Traction & Current Performance

- Who is **interested** in and/or **using** your product?
- Show and explain your **current revenue and profit trends**
- Know your Customer/Revenue **Churn**

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Future Growth

➤ Are you going to **grow** and make a lot of money with this?

➤ **Why?**

➤ What is your **plan** to make it happen?

➤ **Scenarios:** base, best, worst

The Cash Flow Situation

- What is the current and expected **Cash Flow situation**:
 - ✓ Cash Flow forecast and expected cash gaps
 - ✓ DSO, DPO, AR ageing
 - ✓ Starting Capital
 - ✓ **Cash Burn Rate**
 - ✓ **Cash Runway** & Zero cash date
 - ✓ Access to funding & current credit lines
 - ✓ Fixed vs variable costs: can costs be adjusted and how quickly?
- **Operating performance**: How well is the team currently managing above topics?

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Team

- Why you and your co-founders are **the right people to solve the problem**?
- Are there any **key roles missing**?
- Has the team **worked together** already? What were the **results**?
- Do you **work full time** on this idea? If not, **when** do you plan to do it?
- How **passionate** and **convicted** is the team about this idea?
- Who are the other investors, partners and advisors you're working with?

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What do you need?

- Know **how much money** you need and explain **why**
- Know the **priorities, goals** and **timeframe**:
 - ✓ if I give you X, how will you spend it?
 - ✓ What will you achieve?
 - ✓ How quickly you will achieve it?

What kind of returns the VCs typically look for and in what timeframe?

- Investors also consider:
 - ✓ Current Equity structure
 - ✓ Size & length of investment required
 - ✓ Balancing the portfolio risk of their fund
 - ✓ Dilution, future funding needs
 - ✓ ROI
 - ✓ Exit strategy
- The industry standard is usually to aim for a min 10x return on investments.
- Typically, a VC fund's lifecycle is 5 -10 years.

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FOMO vs FOLS and the Power of the story

- VCs have **FOMO**: Fear of missing out
- VCs have **FOLS**: Fear of looking stupid
- Convince them for the idea and for the team with **confidence** and a **powerful story!**

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Are VCs ok with founders using funds to pay themselves salaries?

- Investors will usually set a threshold for salaries, but they take a **pragmatic** approach.
- They typically want you to be financially comfortable so that you can **focus full-time** and grow your business.

Why should you start looking for funds early?

- It takes lot of time to complete the fundraising process.
- The sooner you learn the better.
- Later, you could have less favorable metrics or financials.
- You raise funds with better terms when things look good vs when you are in need.
- You can use funds earlier to survive & grow much faster.
- Being VC ready enforces a better management and tracking of your business.
- The right VC partners can offer business expertise, additional resources, connections early on.

What are the risks of fundraising too soon?

- You don't raise enough capital, or you don't manage to raise at all
- You give away too much equity
- You raise at a valuation that's too high
- You put yourself under more time & performance pressure
- Opportunity cost

How can I find out which VCs are likely to be interested in my company?

- Start by looking for funds that invest in your **startup stage and sector**
- You can look for their criteria on **VC websites**. Or look at their **portfolio** and see if your startup is aligned to their current investments.
- Start from your **network**, expand connections with founders, accelerators and incubators
- Find a way in through a **trusted referral**, where possible.
 - ✓ Portfolio company CEOs/Founders
 - ✓ Other investors/VCs
 - ✓ Former colleagues, fellow board members and personal friends
- It goes **both ways**. Find the investor who is **right for you**.

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Thank you for your time.

If you are interested in a product demo or a free consultation meeting, please contact:

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