Model Drivers & Forecasting

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Agenda

- Outcomes for the day:
  - Telling a financial story
  - Key metrics
  - Required Inputs
  - Templates with Key Inputs
  - Common mistakes
  - Rolling up your sleeves

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About Dave

- 5X founder, Board Member, former SVP Programs at UP Global (Startup Weekend + Startup America)
  - Startup Next creator and Startup Week

- Senior Partner, Fearless.fund

- Author – "Trajectory: Startup – Ideation to Product Market/Fit"

- >15 transactions – 8 sell side, 2 buy side now with NextPath Advisors

- WTIA Startup Programs Board Chair

FEARLESS fund

WTIA
Startup Program

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Telling a Financial Story

- Finance is the language of business

- The story comes down to numbers, in cells on a spreadsheet, the model validates the story.

- Investors want to stress test the models and assumptions

- Models serve multiple purposes
  - Fundraising – pitch deck
  - Budgeting and forecasting – scalable revenue
  - Cashflow forecasting – runway

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The Model Supports the Deck

- The pitch deck provides a 3-5 year summary
    - You need to know the numbers

- The summary at a high level
    - Revenue, cost of revenue and gross margin ($/%)
    - Operating expenses
    - Profitability and cashflow breakdown
    - Headcount
    - Key drivers (unit economics/customers)

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Financial Model Best Practices

- ☐ The success drivers (metrics, KPI's) are simple and easy to understand. Avoid complicated formulas

- ☐ The revenue categories map to one or more of the 14 models

- ☐ The five-year ramp is realistic (not $100M)

- ☐ Cost of revenue is complete, so gross margin is correct:
  - ☐ Hosting, fulfillment, shipping
  - ☐ Labor (customer service)
  - ☐ Production costs

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Financial Model Best Practices

- Operating expenses are complete:
    - Expenses grouped by department (fixed vs. variable, cost of sales, etc)
    - Headcount – roles, compensation, benefits
    - Contractors – HR, Accounting, Engineering
    - Travel expense
    - Marketing – reflects go-to-market strategy
    - G&A – facilities, insurance, other operating expenses

- Investments are reasonable to estimate:
    - Intellectual property, equipment

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Financial Model Best Practices

- GAAP/Accrual based accounting

- Revenue recognition

- A great model answer the burning questions:
  - What are the business drivers?
  - When does cash flow breakeven occur?
  - How much investor capital is needed?
  - Will more than one round of funding be necessary?

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Forecast vs Actual

- Four dimensions of financial reporting:
    - Actuals – QuickBooks (accrual)
    - Operating Plan – Budget (roadmap for the quarter & year)
    - Forecasting
    - Variance analysis
        - Actual to plan
        - Actual to forecast

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Required Inputs

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Inputs

- Product Roadmap – what and when

- Staffing

- Go-to-Market – Marketing, Sales, and BD

- Pricing

- Revenue Model – it's not a surprise

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Big Rocks/Big Levers

□ What are the "Big Rocks" milestones you're going to hit in each of the upcoming quarters?

□ What are the big levers?

□ Move the big items first

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Quarterly Roadmap – 18 Months

Quarterly Milestones	Q1 2021	Priority (ABC)	Impact (HML)	Q2 2021	Priority (ABC)	Impact (HML)	Q3 2021	Priority (ABC)	Impact (HML)	Q4 2021
Marketing Customer Acquistion (Owner)										
Marketing Budget	$4,500									
Marketing Channels	Trade Show						Trade Show			
New Marketing Qualified Leads	22			30			38			45
Leads passed to sales										
Return on Adversiting Spend (ROAS)										
LTV:CAC Ratio	4.7			5.1			5.5			5.7
Sales										
Reps headcount										
SDR/Customer Success headcount										
New Sales Qualified Leads	8			10			12			15
New Closed Customer	2			3			4			5
Time to Close										
Average Contract Value (ACV)										
Repeat Customers	4			6			8			10
Revenue (Owner)										
Billings	Revenue Splits									
Major Accounts										

Marketing/Sales

- Marketing Funnel is linked to but not in the model

- What channels

- When

- What outcomes

- Sales conversion metrics
  - Data comes from CRM
  - Forecast to actual

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Pricing/Product Roadmap

- ▫ What's the product pricing

- ▫ When do you release new features

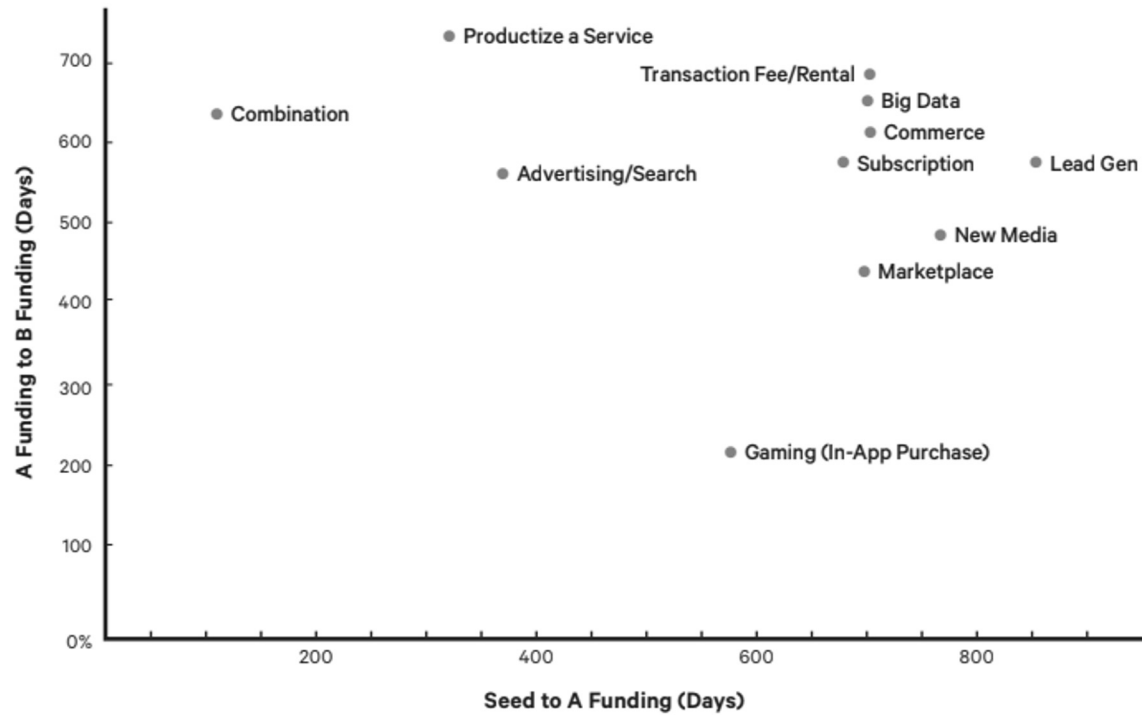- ▫ When are new products scheduled

- ▫ Are services included

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Staffing

- Key hires
  - Budget
  - When

- Time to recruit

- Cost to recruit

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Templates

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How to Monetize: Revenue Models

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The Data

- Background – revenue templates
  - 2654 companies from Crunchbase
  - 5+ year tracking
  - Surprises
    - Seed 1-10
    - Combinations models
      - * on short time from Seed to A
    - Failures
      - Wayback Machine
      - >80% lacked clear CTA and Value Prop

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1. Fee for Service

- Example: Accenture, Stride (Education)

- Use: B2B & B2C

- Key Metrics
  - Project Revenue
  - Cost of delivering (usually time)
  - Gross Margin

- Services are hard to scale because they require people to deliver including Restaurant, Contractors, etc.

- Services include markup on cost of goods sold

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2. Productize a Service

- Example: SW Airlines, Guidant Financial, IBM

- Your offerings is generally complex and requires services to deploy
  - Gross margin on Services >35%
  - Product development comes with services

- Use: B2C & B2B

- Examples: Moz, service company convert to tools.

- Challenges – difficult to make the transition away from services

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3. Commerce

- Example: Wayfair, Lululemon

- Use: B2C & B2B

- Key Metrics:
  - Wholesale or cost of goods sold
  - Average Margin %
  - Average Basket

- Commerce – Physical Goods- Wholesale, cost of goods, retail, average margin, physical good

- Notes: Can mature into marketplace

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4. Subscription

- Example: Salesforce, Spotify

- Use: B2C & B2B

- Key Metrics
  - Average Revenue Per User (ARPU)
  - Conversion ratio – e.g. trial to purchase
  - Churn

- Tiered pricing to optimize customer profiles/revenues

- Notes: High multiple, forecastable revenue

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5. Metered Service

- Example: Twilio, AWS, UIPath, Plaid Tech

- Use: Favors B2B

- Key Metrics
    - Average Revenue Per User (ARPU)
    - Usage growth over time
    - Churn

- Challenges: infrastructure required at launch

- Notes: Highest multiple, forecastable revenue

The API Economy

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6. Transaction Fees/Rental

- Example: Stripe, Chegg

- Use: B2C & B2B

- Key Metrics
  - Average transaction revenue
  - Fee % per transaction
  - Number of transactions

- Challenges: Margins are small (15%), need efficiency

- Notes: Don't start too low

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7. Marketplaces

- Example: eBay, Alibaba, Uber

- Use: B2C & B2B

- Key Metrics
  - Average Transaction Amount
  - Number of Monthly Transactions
  - Commission %

- Challenges: two sided marketplaces require you start with one side, value to seller & Product market fit (x2)

- Notes: critical mass or marketplace required

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8. Combinations

- Example: SmartSheet, conglomerates at scale

- Combination business models happen for two reasons
  - You don't know which model is right
  - At scale you can expand revenue sources

- Examples: Hardware sensors + software services to create data analytics. At Scale, Amazon, Microsoft

- Challenges – most require scale or at least traction

- Mature faster

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9. Gaming

- Example: King.com/Candy Crush, Blizzard

- Use: B2C Only

- Key Metrics:
  - Downloads
  - % play
  - Average in app purchase

- Challenges – tends to be "hit driven business"

- Notes: use in first 21 days is a predictor of success

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10. Advertising/Search

- Example: Google, Facebook

- Use: B2B – advertisers pay, users are free

- Key Metrics
  - Traffic
  - Click
  - Avg. revenue/click

- Challenges – Scale, need >1M uniques/month to consider the option

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11. New Media

- Example: SnapChat, Clubhouse

- Use: B2C only

- Key Metrics:
  - K-Factor (Viral Co-efficient)
    - Network effect of inviting others to join

- Challenges – K-Factor is hard. Little revenue until scale

- Notes: Everyone wants to! Not happening in B2B

- No revenue actually required – GREAT mulitple

This is the Non-Revenue Model

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12. Big Data

- Examples: PatientsLikeMe, Splunk

- Use: B2B

- Key Metrics:
  - Per API Call
  - Per record pricing
  - Frequency/recency

- To monetize data, you need to have the data in advance or massive cash

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13. Lead Generation

- Example: Mint.com, Chime.com, AllStarDirectories,

- Use: B2C (selling consumers data), B2B

- Key Metrics
    - Cost to generate traffic
    - % conversion of form data
    - Price per lead

- Challenges: Highly competitive, barrier of entry is low

- Notes: Conversion rates average 0.06%

14. Licensing

- Example: Think Microsoft office license or server license – before subscription. Content Licensing

- Use: B2B

- Key Metrics:
  - Duration of license
  - Upgrades & maintenance (20-25% annually)

- Use can be based on vertical market or geography

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Revenue Models– Primary/Secondary

1. Fee for Service
2. Commerce
3. Subscription
4. Metered Service
5. Transaction Fee/Rental
6. Productize a Service
7. Combinations

8. Marketplace
9. Lead Generation
10. Gaming
11. Advertising/Search
12. New Media
13. Big Data
14. Licensing

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Top Templates

- ◻ Subscription
  - ◻ Recurring revenue, churn, ARR/MRR, LTV:CAC Ratio

- ◻ Transaction Fee/Rental (not booking topline revenue)
  - ◻ Avg transaction amound, % commission, # transactions/mo, LTV: CAC

- ◻ Productize a Service – people are required for some portion – most robust model, includes subscription
  - ◻ Split of revenue between product/services

- ◻ Marketplace –
  - ◻ Two funnels, buy/sell side, % fee, 2X LTV:CAC

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3. Subscription

- Example: Salesforce , Box, Spotify

- Use: B2C & B2B

- Key Metrics
  - Average Revenue Per User (ARPU)
  - Conversion ratio – e.g. trial to purchase
  - Churn

- Challenges: MVP won't be enough to be Kick Ass Product

- Notes: Highest multiple, forecastable revenue

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5. Transaction Fees/Rental

- Example: 99Designs, KickStarter, Elance, Chugg

- Use: B2C & B2B

- Key Metrics
    - Average transaction revenue
    - Fee % per transaction
    - Number of transactions

- Challenges: Margins are small (15%), need efficiency

- Notes: Don't start too low

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8. Marketplaces

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Inc 500 Data – Quiz: How much revenue to you need in three year to end up on the Inc 500 List?

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Inc 500 List

- **Data from Top 10 over eight years**
  - Avg $50.64M
  - High Average $147.78M
  - Low Average $20.44
  - All from a baseline revenue of $1M in first of three years

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Common Mistakes

- Complex and confusing assumptions - not on one tab

- Confusing model design

- Metrics and success factors not defined

- Overly aggressive revenue ramp

- Understanding expenses and cash needs (optimism)

- Key milestones not clearly outlined

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Corp Hygiene Note

- Museum Quality
  - Fully executed contracts
    - In OneHub, Drive, etc.
  - Offer letters, W-4, I-9, options, PIIA
  - Termination procedures
  - Contractor files – NDA, Inventions Agreements
  - Closed monthly books
  - Payroll and tax payments

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Templates

1. Choose a template

2. Familiarize yourself

3. Startup with Assumptions

4. Move to Compensation and people

5. Revenue next

6. Forecast

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