



Getting prepared for investment and early stage growth

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- 9 years experience, mainly at boutique/city firms
- Specialised in growing businesses and tech
- City firm expertise, but at much more affordable rates

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Overview

Part 1

- What investors look for in a business plan
- Execution
- Traction

Part 2

- Building a sales model, P&L and cash flow forecast
- Valuations

Key risks

Majority of businesses fail within 3 years

Many risks, but some key ones are:

- Poor execution
- Nobody wants it
- Run out of money
- Rivals enter the market
- Customers change tastes

Is it worthwhile?

- Before spending time/money, evaluate idea.
- Investor/entrepreneur needs to consider:
 - Is the business viable?
 - Will it generate sufficient returns to justify the investment and risks taken?
- The business plan appraises the business model & the investment case
- Plan can be 1 page or 30 pages

What investors look for

“Startup Genome”:

- Great Idea
- Large/valuable Market
- Credible Team

Idea

- What is so good about your business?
- What problem solved? What benefits?
- Need to know who your customers are and what they need/want and what they can pay
- Once understand, **tailor to their needs/budget**
- E.g. Hunger - Bread or fancy bread?
- What is the story?
- E.g. LinkedIn is like Facebook for business

Labels case study

- Labels: when pressed, a chemical reaction shows how much time has elapsed
- Founders thought of a lot of applications
- Packaging is an enormous market, cheap label could offer many benefits
- Spent a lot of money on R&D
- Ultimately, people didn't want it or care enough
- Maybe with better marketing would have been different (but takes money/luck/PR)

Size of market

- Universe vs. specific segment
- Total universe e.g. globally 700m smartphones sold in 2012 – implies very large market for smartphone retailers
- But what is size for your segment/channel??
- E.g. independent, online retailers based in UK
- Angel/VC investors will want large/valuable market

Rivals

- Who else is doing this? Analyse the competition
- What strengths/weaknesses, good/bad practices – model it
- Really need to focus on **what makes you different**
- Check if you can compete (barriers to entry e.g. brand, licence, advertising, economies of scale/scope)
- If competition, can still enter, especially if going to disrupt the market (e.g. eBay, Google, Facebook)

Why should customers choose you?

- Competitive advantage
 - Core competencies
 - Unique resources
- Cost focus or differentiation?
- Cheap cost to save customer money
- High quality or niche/specialisation
- Better to be #1 in a niche than #300 overall

News website case study

- Infrastructure news: **very niche area**
- **High quality** service, enable users to stay informed, bid for tenders etc
- Sold to banks, lawyers etc.
- Journalism is their **core competency** – customers willing to pay a premium for this, this news doesn't end up in FT etc

Protection / Barriers to entry

- Imitation is the best form of flattery
- If successful, people will copy you
- Need IP or build in infrastructure so that you're product/service not easily replicated
 - E.g. Customer Service – processes/training to ensure customers looked after
- Technology could be a barrier to entry, but can be reverse engineered/copied unless highly specialised

Execution

- Great idea, but poorly executed won't work.
- E.g. Gym in a fantastic location, lots of rich city types nearby.
- But new gym was failing and loss making.
- New owners identified key problems:
- Customer service not good & poor decor
- Fired staff, hired enthusiastic staff, and trained them – instilled processes e.g. smile, take interest in people etc
- Refurbished the gym
- Gym then made money as people enjoyed the experience

Sales / marketing

- Key reason for business failing (in my experience)
- Entrepreneurs underestimate how difficult it is to sell
- Great product/service, but nobody knows they exist
- No clear branding / story
- “If you build it, they will come” - **how will they come if they don't know you exist?**

Team

- **Every business needs a set of core skills**, and founder might not have all of these
- Entrepreneur drives forward, manages it etc
- Sales / Marketing – gain exposure, convince them to buy
- Technology / operations – make product work, good service, be awesome. Need people to enjoy and come back and tell people
- Investors/customers want credibility and expertise
- If Sir James Dyson came to you with an idea, turn £100 into £1,000 would you give it to him?

Traction

- Validate the idea/concept:
- Build a prototype / alpha / beta
- Can you **show that people do care**:
 - Revenue
 - Registered users
 - Website hits
 - Downloads
- (Banks especially will want to see sales)

VOIP telephony

- Cheaper than traditional PBX – installation & ongoing costs, could save £000s
- More functionality e.g. use 1 line and have many seats, easy call divert, could use an 0207 no. but take the call anywhere in the world. Their service looked great.
- Hired a “sales director” from a large corporation. But what did he know about marketing for a startup? Not much?
- Made some bad decisions, cost a lot of wages
- **Company spent all their money on the tech, nothing left for marketing/advertising.**
- Didn't make good use of sales agents.

Online gaming 1

- **Invested £20m** over 5 years, sales peaked around £900k, but eventually fell to £300k
- Online service, but main focus of advertising was offline (now people watch TV with tablets, but back then it just seemed a waste)
- **Marketing spend was sunk cost**, not linked to results, not CPA based
- Marketing strategy was basically all wrong, and didn't get good results
- No in-house marketing director or expert

Online 2

- Sales director from day 1
- Clever online marketing and **cost was results based**. Used affiliates/targeted ads etc
- Only paid if surfers clicked on ad, or signed up
- Used customer bonuses to encourage participation
- Monitored activity and re-engaged old/inactive users
- Spent a lot on marketing, but it really paid off
- **Grew to £150m turnover in 5 years**

Estimating sales

- Sales are impossible to predict for new businesses
- Size of market / total demand *could* be used
- 1) Estimate costs and work backwards
 - Can you break even
 - Add personal expenses
 - Add return on investment / repayments
- 2) Estimate total capacity or max sales in a year
- Try to **model based on assumptions and logical basis**, rather than pure guessing.

Startup costs

• Refurbish premises	5,000
• Equipment	5,000
• Stock	5,000
• Signage	500
• Professional fees	1,000
• Website design	1,000
• Marketing/promo items	3,000
• Total startup costs	£20,500

Admin costs

- Ideally, every cost should be backed up by a calculation/quote/research etc

Item	Assumption	Jan-13
Salaries	Staff 1 £20k pa, 5% rise	1,667
Employers NIC	@ 13.8% above limits	144
Rent	3 yr open lease, no rent free	1,000
Rates	www.gov.uk/calculate-your-business-rates	500
Utilities	ask around / do research	50
Computer costs	Broadband £x, software licences £x,	50
Professional fee	Per quote	100
Bank charges / interest		-
		3,741

Marketing plan

Online	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13
SEO	150	150	150	150	150	150
adwords	500	250	700	100	500	500
affiliate marketing	100	200	300	400	500	600
banner/sponsor ads	500	500	500	500	500	500
	1250	1100	1650	1150	1650	1750
Offline						
Flyers	500					500
Business cards	100					
Telemarketing			1000	1000	1000	
Sales agents						
Buy leads						
Groupon	500					
Promo/discounts	500					
Loyalty scheme						100
	1600	0	1000	1000	1000	600

Estimating CPC spend

- use Adwords tools to find out CPC for chosen keywords & find out/estimate conversion rate
- e.g. 1.5% conversion rate & CPC is £0.75
- Say average spend £50 & want to generate £1,000 sales from Adwords
- £1,000 sales needs 200 customers to spend £50 on average
- so @ 1.5% need 13,000 visitors to site
- Total CPC @ £0.75/click is £9,750

Break even basis

	Break even basis	Living expenses	Investors return
Startup costs	20,500		
Admin costs	92,442		
Marketing costs	26,700		
Add living costs		24,000	
Add funding			20,000
Interest			2,000
Total costs	<u>139,642</u>	<u>163,642</u>	<u>185,642</u>
average contribution per sale	30	30	30
units sold	4,655	5,455	6,188
per month	388	455	516

Max sales capacity

- ▼ Consider the different revenue streams and max sales per resource
- ▼ E.g. training:
 - ▼ Premises can have 2 rooms, 10 people each room
 - ▼ In theory, could run 2 classes simultaneously 5 days a week
 - ▼ Day classes: £100 per person x 2 rooms x 10 ppl = £2,000 per day, £10,000 per week. 48 weeks pa is £480,000 pa
 - ▼ Evening classes: £50 per evening. Same logic is $£50 \times 2 \times 10 \times 5 \times 48 = £240,000$
 - ▼ Total revenue is £720,000

Profit & Loss (P&L)

	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13	Jul-13	Dec-13
Income	1,000	3,000	5,000	7,000	9,000	12,000	11,637	12,230
Cost of sales	- 500	- 1,500	- 2,500	- 3,500	- 4,500	- 6,000	- 5,818	- 6,115
Marketing costs	- 3,600	- 2,000	- 3,000	- 3,000	- 3,000	- 2,100	- 1,150	- 450
Admin costs	- 3,741	- 3,741	- 3,741	- 3,741	- 3,741	- 3,741	- 3,741	- 3,741
Operating profit	- 6,841	- 4,241	- 4,241	- 3,241	- 2,241	159	928	1,925
Taxes	-							
Profit / (loss)	- 6,841	- 4,241	- 4,241	- 3,241	- 2,241	159	928	1,925

Cashflow forecast

	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13	Jul-13	Dec-13
<u>Cash inflows</u>								
Entrepreneurs' capital	22,000	-	-	-	-	-	-	-
External investment	20,000	-	-	-	-	-	-	-
Cash sales	500	1,500	2,500	3,500	4,500	6,000	5,818	6,115
Credit sales (eg 30 days)	-	500	1,500	2,500	3,500	4,500	6,000	6,055
<u>Cash outflows</u>								
Startup costs	- 20,500	-	-	-	-	-	-	-
Costs - cash	- 3,920	- 3,620	- 4,620	- 5,120	- 5,620	- 5,920	- 5,354	- 5,153
Costs - credit	-	- 3,920	- 3,620	- 4,620	- 5,120	- 5,620	- 5,920	- 5,123
Loan repayments								
Interest								
Opening cash position	-	18,080	12,539	8,299	4,558	1,817	777	7,952
Change in cash	18,080	- 5,541	- 4,241	- 3,741	- 2,741	- 1,041	544	1,894
Closing cash position	18,080	12,539	8,299	4,558	1,817	777	1,321	9,846

Sensitivity analysis

				Profit	EBITDA	High	Low
						Cash	Cash
				£	£	£	£
Per forecast			100%	596,314	1,092,950	74,310	(284,635)
Joiners	All		90%	531,175	1,034,478	(15,579)	(378,012)
			80%	359,873	863,175	(21,892)	(556,913)
			70%	188,570	691,873	(28,205)	(735,814)
			60%	17,268	520,571	(34,518)	(914,715)
Lapsers	All		110%	608,606	1,111,909	(11,917)	(297,274)
			120%	514,735	1,018,038	(14,568)	(395,436)
			130%	420,864	924,167	(17,219)	(493,599)
			140%	326,993	830,296	(19,870)	(591,762)
	Joiners	Lapsers					
	90%	110%		437,304	940,607	(18,230)	(476,175)
	80%	120%		172,131	675,433	(27,194)	(753,238)
	70%	130%		(93,043)	410,260	(36,158)	(1,030,302)
	60%	140%		(358,216)	145,086	(45,122)	(1,307,366)

Rough value of business

- ▼ Helps to evaluate if adventure will be worth it
- ▼ Starting a business is hard work, so need to check this, otherwise just wasting time
- ▼ For many small businesses, people just want to earn a living.
- ▼ So can work out the profit pa and see if meets their needs
- ▼ But if want to exit in 3-5 years or raise funds from investors need to know how to value business

Valuations

- ▼ DCF: take cashflows for next few years.
- ▼ Discount by e.g. 10%.
- ▼ Add a terminal value.

- ▼ Turnover/profit multiple: for a lot of small businesses, the valuation if selling up is normally turnover, plus maybe 10-20%.
- ▼ But also depends on consideration, as often have earn out, so not pay cash price upfront

DCF

(assume credit sales/costs minimal and no non-cash items)

	2013	2014	2015	2016	2017	Terminal value
Income	108,590	156,664	172,330	189,563	208,520	
Cost of sales	- 54,295	- 78,332	- 86,165	- 94,782	-104,260	
Marketing costs	- 20,100	- 6,600	- 7,260	- 7,986	- 8,785	
Admin costs	- 44,887	- 47,556	- 52,311	- 57,542	- 63,297	
Operating profit	- 10,692	24,176	26,594	29,253	32,179	
Taxes	-	- 3,067	- 3,374	- 3,711	- 4,082	
Profit / (loss)	- 10,692	21,109	23,220	25,542	28,096	174,553
Discount factor	100%	110%	121%	133%	146%	146%
Present value	- 10,692	19,190	19,190	19,190	19,190	119,222
Net present value	185,291					
Investment	- 42,000					
Net value/return	143,291					

Turnover multiples

<u>Turnover multiple</u>	2013	2014	2015	2016	2017
100%	108,590	156,664	172,330	189,563	208,520
110%	119,449	172,330	189,563	208,520	229,372
120%	130,308	187,997	206,796	227,476	250,224
130%	141,167	203,663	224,029	246,432	271,076

Discounted multiples

100%	108,590	142,422	142,422	142,422	142,422
110%	119,449	156,664	156,664	156,664	156,664
120%	130,308	170,906	170,906	170,906	170,906
130%	141,167	185,148	185,148	185,148	185,148

Supply / demand / potential

- ▼ Tech startups: more about potential of the business
- ▼ Can you achieve hockey stick growth?
- ▼ Investors will look at it in the context of recent deals
- ▼ Different investors have different stomachs for risk
- ▼ Different backgrounds/sectors

- ▼ VC might want 10x-30x return
- ▼ Angels – recent study suggests 2.6x return

Questions?

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