**FINANCIAL PROJECTIONS**

1. **ASSETS AND SOURCES OF FINANCING**

**Assets**: required fixed (patent, license, land, buildings, machinery, office equipment…) and current assets (inventories, receivables, cash…).

**Sources of financing**: Capital + Borrowings (Liabilities).

**Recommendation**: Fixed assets should be financed from long term sources (Capital + Long term Debt).

***Balance sheet equation - Total Assets = Capital + Liabilities***

|  |  |
| --- | --- |
| **Balance sheet element** | **Amount (€, £, $...)** |
| Intangibles |  |
| Land |  |
| Buildings |  |
| Machinery |  |
| Office Equipment |  |
| Other fixed assets |  |
| ***Total Fixed Assets***  |  |
| Inventories |  |
| Receivables |  |
| Cash |  |
| Other current assets |  |
| ***Total Current Assets*** |  |
| **Total Assets** |  |
| Paid in capital |  |
| Retained earnings |  |
| ***Total shareholder capital*** |  |
| Long term borrowings |  |
| Short term borrowings |  |
| Suppliers payables |  |
| Tax payables |  |
| Other current payables |  |
| ***Total liabilities*** |  |
| **Total Capital and Liabilities** |  |

Long and short term borrowings require calculation of payment plan (interest rate (%); number of payment periods; loan annuity; interest; principal…). Annuity consists of portion of principal and portion of interest. Paid principal affects only cash flow, while interest affects P&L and cash flow.

1. **PROJECTION OF REVENUES**

**Revenue** represents a positive element in P&L statement, which is result of sale of goods and services. For each product/service it is required to make projection of quantity (Q) and unit price (P). Revenue can be calculated by the following formula:

***Revenue = Quantity (Q) \* Price per unit (P)***

Monthly revenue projection

|  |  |
| --- | --- |
| Revenue | Month |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
| Product A |  |  |  |  |  |  |  |  |  |  |  |  |
| Product B |  |  |  |  |  |  |  |  |  |  |  |  |
| Product C |  |  |  |  |  |  |  |  |  |  |  |  |
| Product D |  |  |  |  |  |  |  |  |  |  |  |  |
| … |  |  |  |  |  |  |  |  |  |  |  |  |
| Total |  |  |  |  |  |  |  |  |  |  |  |  |

Annual revenue projection

|  |  |
| --- | --- |
| Revenue | Year |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Product A |  |  |  |  |  |  |  |  |  |  |
| Product B |  |  |  |  |  |  |  |  |  |  |
| Product C |  |  |  |  |  |  |  |  |  |  |
| Product D |  |  |  |  |  |  |  |  |  |  |
| … |  |  |  |  |  |  |  |  |  |  |
| Total |  |  |  |  |  |  |  |  |  |  |

According to the accounting standards revenue is recorded when transaction of sale occurs. In the case of retail business revenue is quickly transformed into cash in the bank account. However, in the case of wholesale business longer period (few month) can pass before revenue is converted into the cash. In that case business plan must project appropriate cash “reserve” in order to finance regular business cycle (paying wages, taxes, suppliers, leases and other operating expenses).

1. **PROJECTION OF EXPENSES**

**Expense** represents a negative element in P&L statement, which is result of sale of goods/services or business in general. Expenses can be divided into several groups:

1. Costs of Goods Sold - COGS;
2. Selling & Administrative costs - S&A;
3. Interest expense costs.

**COGS** represent direct costs which are caused by sale transaction. This type of cost is variable, i.e. when quantity increases COGS increase and vice versa. COGS can consist of:

* Direct material;
* Workers wages;
* Amortization of product patent/license;
* Depreciation of production facilities.

**S&A** costs are not directly caused by each sale transaction, but they are rather caused by business activity in general. This type of cost is mainly fixed, i.e. when quantity increases/decreases S&A cost often remain at the same level. S&A cost can consist of:

* Administrative and selling personnel wages;
* Depreciation of office equipment;
* Marketing costs;
* Travelling costs;
* Education costs;
* Other non-production costs.

**Interest expense costs** are defined by loan payment plan, while its pattern depends on type of loan amortization.

1. **P&L STATEMENT**

**Profit and loss statement (or Income Statement)** represents measure of business success defined by revenues/expenses, i.e. on accrual basis. P&L statement of often calculated on annual basis:

Annual P&L

|  |  |
| --- | --- |
| Element | Year |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Revenue |  |  |  |  |  |  |  |  |  |  |
| -COGS |  |  |  |  |  |  |  |  |  |  |
| Gross profit |  |  |  |  |  |  |  |  |  |  |
| -S&A costs |  |  |  |  |  |  |  |  |  |  |
| Operating profit |  |  |  |  |  |  |  |  |  |  |
| -Interest cost |  |  |  |  |  |  |  |  |  |  |
| Profit Before Tax |  |  |  |  |  |  |  |  |  |  |
| -Income Tax |  |  |  |  |  |  |  |  |  |  |
| **Net profit** |  |  |  |  |  |  |  |  |  |  |

Previously described form of P&L statement classifies costs according to their function (production, S&A activities and financing). After subtracting COGS, S&A costs and Interest costs from the earned revenues “Profit Before Tax” is calculated. However, on this profit business must pay corporate income tax according to national tax regulation.

Net profit is final measure of business project success and this profit can be distributed to the business owner (Dividends) or it can be reinvested in business (Retained Earnings).

1. **CASH FLOW STATEMENT**

**Cash flow statement** represents measure of business success defined by cash inflows/cash outflows, i.e. on cash basis. This statement has three sections:

* Operating cash inflows/outflows;
* Investing cash inflows/outflows;
* Financing cash inflows/outflows.

In order to obtain sustainable business project in long term operating cash flow should be positive. In short term negative cash flow from operations if often “covered” by cash inflows from financing activities (shareholder capital and borrowings). Total annual cash flow must be 0 or positive, i.e. all cash outflows should be covered by cash inflows.

Annual CF statement

|  |  |
| --- | --- |
| Element | Year |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| Cash collection from buyers of goods/services |  |  |  |  |  |  |  |  |  |  |
| -Payment for materials |  |  |  |  |  |  |  |  |  |  |
| -Payment of wages |  |  |  |  |  |  |  |  |  |  |
| -Payment of leases |  |  |  |  |  |  |  |  |  |  |
| -Payment for other services |  |  |  |  |  |  |  |  |  |  |
| -Payment of taxes |  |  |  |  |  |  |  |  |  |  |
| **Net cash flow from operations** |  |  |  |  |  |  |  |  |  |  |
| Cash collection from buyers of fixed assets |  |  |  |  |  |  |  |  |  |  |
| -Payment for land and buildings |  |  |  |  |  |  |  |  |  |  |
| -Payment for equipment |  |  |  |  |  |  |  |  |  |  |
| **Net cash flow from investing** |  |  |  |  |  |  |  |  |  |  |
| Paid in capital from the shareholders |  |  |  |  |  |  |  |  |  |  |
| Cash from the borrowings |  |  |  |  |  |  |  |  |  |  |
| -Loan principal payment |  |  |  |  |  |  |  |  |  |  |
| -Loan principal payment |  |  |  |  |  |  |  |  |  |  |
| -Payment of dividends |  |  |  |  |  |  |  |  |  |  |
| **Net cash flow from financing** |  |  |  |  |  |  |  |  |  |  |
| **Total cash flow** |  |  |  |  |  |  |  |  |  |  |