

Presentation to  
Finalist in the  
MIT 50K Business Plan Contest



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# Agenda



- Background
- Sources of Funding we've used at NetScout Systems
- Sample Business Model
- Financial Plans - From the ground up
- The Entrepreneur's Paradoxes
- Hallmarks of a Good Business Plan
- Observations of the VC World
- Valuation, Valuation, Valuation
- Recommendations

# Background



- 78-89 Programmer, Project Leader, Project Manager
- 89-91 MIT Sloan School of Management -  
Concentration in Entrepreneurial Finance
- 1990 Summer Intern - Boston Capital Ventures
- 91 - 00 NetScout Systems
  - Phase I Trying to Raise VC \$
  - Phase II Running Business WITHOUT VC \$
  - Phase III Raising VC \$ on our terms
  - Phase IV IPO - on the horizon

# NetScout's Sources of Capital



- 1) Don't Spend It
  - Borrow Equipment
  - Pay Holiday (when necessary)
  
- 2) Don't Spend Much of It
  - Used Furniture
  - Cheap Rent
  - Personal Equipment
  
- 3) Borrow from Yourself
  - Home Equity Loan

# Sources of Capital Used at NetScout cont'd.

## 4) Use Other People's Money (OPM) - Phase I

Trade Credit (30 days to 90 days)

Lease Equipment (18%)

## 5) Use Other People's Money (OPM) - Phase II

Partners: Funded R&D (we paid royalty based on our sales)

Partners: Technology Licensing (we received royalties based on their sales)

Customers: Perform porting in return for Minimum Purchase Orders

## 6) Line of Credit

Find a bank that focuses on high-tech lending

## 7) Venture Capital Funding

# Business Model - Sample

Sales	100%
Cost of Sales (25 - 40%)	<u>40%</u>
<b>GROSS PROFIT</b>	<b>60%</b>
Engineering (10-15%)	10%
Marketing*	8%
Sales*	22%
Admin (4-6%)	<u>5%</u>
<b>TOTAL EXPENSES</b>	<b>45%</b>

<b>PRE-TAX PROFIT (15-25%)</b>	<b>15%</b>
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\* Marketing and Sales should be 25-35% combined.





# Ask Jeeves - Model 99-02

	1999	2000	2001	2002	1999	2000	2001	2002
<b>Revenue</b>	\$ 22	\$ 86	\$ 205	\$ 350	100%	100%	100%	100%
<b>Cost of Goods Sold</b>	\$ 14	\$ 42	\$ 63	\$ 79	64%	49%	31%	23%
<b>Gross margin</b>	\$ 8	\$ 44	\$ 142	\$ 271	36%	51%	69%	77%
<b>Expenses:</b>								
<b>Sales &amp; Marketing</b>	\$ 35	\$ 75	\$ 128	\$ 138	159%	87%	62%	39%
<b>Research &amp; Development</b>	\$ 9	\$ 27	\$ 34	\$ 41	41%	31%	17%	12%
<b>General &amp; Administrative</b>	\$ 8	\$ 21	\$ 25	\$ 27	36%	24%	12%	8%
<b>Total Expenses</b>	\$ 52	\$ 123	\$ 187	\$ 206	236%	143%	91%	59%
<b>Operating Profit</b>	\$ (44)	\$ (79)	\$ (45)	\$ 65	-200%	-92%	-22%	19%

# The Entrepreneurs Paradoxes

## ■ Part 1 - Revenue Projections

- If they're too low, VC's aren't interested
  - Need to show growth to at least \$50MM per year
- If they're too large, you have no credibility
  - How many \$500MM companies have you run?

## ■ Part 2 - Market Size

- If market is too large, you're not a player
  - Your market share must get over 10%
- If market is too small, they're not interested
  - Even if you get 100% of the market, who cares!

## ■ Part 3 - Cash Projections

- If you show that you really need it
  - You're too risky
- If you show that you don't need it
  - Why are you here?

# Hallmarks of a Good Plan



- Explains your Business Model
  - The Bottom Line starts at Gross Margin
  - Don't ignore your Operating Profit
- Revenue per Employee
  - \$100K is too low
  - \$500K is too high
  - \$250K is pretty good
- Cash is King - Happiness is a Positive Cash Flow
- Steady, Consistent Growth - No Hockey Sticks

# Hallmarks of a Good Plan cont'd



- Revenue per Salesperson
  - Average Order Size (new and repeat)
  - Orders per Salesperson per month
- Include Product Development Plan
- Show when you expect the first customer sale
- Identify your first corporate customer
  - If you can, provide names of a contact there
- Sustainable Competitive Advantage
  - What are your next three products

# Some Observations on VCs



- Unique relationship (similar to pilots and ATC)
- Lots of money available (\$ Billions raised)
- VCs look for opportunities to get:
  - Three to five times (300%-500%) return on investment
  - Within 4 to 6 years
  - QED: Your company's value must increase 3 to 5 times
- Average investment is increasing to \$5+ million
- Increasing Preference for later stage companies

## Some Observations on VCs cont'd

- Good Probability of getting funding
- You'll never hear "No", just "not now"
- You want more than money
  - Knowledge/experience
  - Contacts (customers, bankers)
  - Credibility
  - Visibility (e.g. attract employees/board members)
- Prefer management with a track record
- Valuation - Good old fashioned horse trading

# Valuation (A Primer)

Pre-money Valuation	\$6 million	\$8 million
Amount Invested	<u>\$2 million</u>	<u>\$2 million</u>
Post-money Valuation	\$8 million	\$10 million
Percentage Dilution*	25% (2/8ths)	20% (2/10ths)

**THE ONLY VARIABLE NUMBER IN THE DILUTION  
CALCULATION IS PRE-MONEY VALUATION**

\* Percentage Dilution = Amount-Invested divided by Post-Money Valuation

# Recommendations



- Get a good lawyer
- Build a **GREAT** team
  - Finance
  - Marketing
  - Sales
- A Big-5 accountant adds to your credibility
- Build relationships with the financial community **BEFORE** you need them

# Recommendations



- Research VC Firms. Approach one appropriate for:
  - Your Business Stage
  - Your Business Size
  - Your Industry
- Consider Massachusetts-focused companies:
  - Commonwealth Capital
  - Massachusetts Capital Resource Company (MCRC)
  - Massachusetts Technology Development Corporation (MTDC)
- Recognize that it is a Partnership - How will they act when things go bad?

# Notes to Cash Flow Projections

- Cells surrounded by boxes are plugged in. The rest are calculated according to the following formula:
- Cash is King
  - Beginning balance is set equal to the "Paid-in Capital" (see below)
  - Balances in other months are calculated from the Cash Flow Statement
- Accounts Receivable (A/R) is what your customers owe to you
  - Set to the prior two months sales
- Inventory is components you hold to build product
  - Set to three times the current month's COGS
- Accounts Payable (A/P), is what you owe to your vendors
  - Set to the sum of current purchases (expenses) plus current COGS plus the increase in inventory

# Notes to Cash Flow Projections cont'd



- Bank Loans, is money you have borrowed.
  - Somewhat unrealistically, I assume that you can borrow as much as you want whenever you want. This at least let's you know how much you would need
- Paid-In Capital - Money invested in the company (e.g. VC money)
  - I assume that you can get as much money as you want to start "the game"
- Current Earnings - The CUMULATIVE profit (or loss) for the year
  - Calculated as prior month's Current Earnings plus the current month's earnings from the Income Statement

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TOTAL
<b>Unit Sales</b>														
	Model1001	200	200	200	225	225	225	250	250	250	300	300	300	2925
	Model2001	0	0	0	0	150	150	150	200	200	200	250	250	1550
	Total Units	200	200	200	225	375	375	400	450	450	500	550	550	4475
<b>List Price</b>														
	Model1001	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500	\$ 500
	Model2001	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750	\$ 750
<b>Avg Discount</b>														
	Model1001	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
	Model2001	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
<b>Avg Selling Price</b>														
	Model1001	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300	\$ 300
	Model2001	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525	\$ 525
<b>Revenue</b>														
	Model1001	\$ 60,000	\$ 60,000	\$ 60,000	\$ 67,500	\$ 67,500	\$ 67,500	\$ 75,000	\$ 75,000	\$ 75,000	\$ 90,000	\$ 90,000	\$ 90,000	\$ 877,500
	Model2001	\$ -	\$ -	\$ -	\$ -	\$ 78,750	\$ 78,750	\$ 78,750	\$ 105,000	\$ 105,000	\$ 105,000	\$ 131,250	\$ 131,250	\$ 813,750
	Total Revenue	\$ 60,000	\$ 60,000	\$ 60,000	\$ 67,500	\$ 146,250	\$ 146,250	\$ 153,750	\$ 180,000	\$ 180,000	\$ 195,000	\$ 221,250	\$ 221,250	\$ 1,691,250
<b>Unit Costs</b>														
	Model1001	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35	\$ 35
	Model2001	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50	\$ 50
<b>Cost of Goods</b>														
	Model1001	\$ 7,000	\$ 7,000	\$ 7,000	\$ 7,875	\$ 7,875	\$ 7,875	\$ 8,750	\$ 8,750	\$ 8,750	\$ 10,500	\$ 10,500	\$ 10,500	\$ 102,375
	Model2001	\$ -	\$ -	\$ -	\$ -	\$ 7,500	\$ 7,500	\$ 7,500	\$ 10,000	\$ 10,000	\$ 10,000	\$ 12,500	\$ 12,500	\$ 77,500
	Total COGS	\$ 7,000	\$ 7,000	\$ 7,000	\$ 7,875	\$ 15,375	\$ 15,375	\$ 16,250	\$ 18,750	\$ 18,750	\$ 20,500	\$ 23,000	\$ 23,000	\$ 179,875

# Headcount

HIRING PLAN														
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TOTAL
<b>Engineering</b>														
	CTO	1	1	1	1	1	1	1	1	1	1	1	1	1
	Programmer	2	2	2	2	3	3	3	3	4	4	4	4	4
	Tech Writer	-	-	-	-	-	-	1	1	1	1	1	1	1
	<b>Total Eng</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>4</b>	<b>4</b>	<b>5</b>	<b>5</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>6</b>
<b>Marketing</b>														
	VP Marketing	1	1	1	1	1	1	1	1	1	1	1	1	1
	Product Manager	-	-	1	1	1	1	2	2	2	2	2	2	2
	<b>Total Mktg</b>	<b>1</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>
<b>Sales</b>														
	VP Sales	1	1	1	1	1	1	1	1	1	1	1	1	1
	Regional Sales	-	-	-	1	1	1	1	1	2	2	2	2	2
	Support	-	-	-	-	-	1	1	1	1	1	1	1	1
	<b>Total Sales</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>4</b>	<b>4</b>	<b>4</b>	<b>4</b>	<b>4</b>
<b>General &amp; Admin</b>														
	VP Finance	1	1	1	1	1	1	1	1	1	1	1	1	1
	Admin Support	1	1	1	1	2	2	2	2	2	2	2	2	2
	<b>Total G&amp;A</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>3</b>
	<b>TOTAL EMP.</b>	<b>7</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>11</b>	<b>12</b>	<b>14</b>	<b>14</b>	<b>16</b>	<b>16</b>	<b>16</b>	<b>16</b>	<b>16</b>
	<b>Annual Rev/Emp</b>	<b>102,857</b>	<b>102,857</b>	<b>90,000</b>	<b>90,000</b>	<b>159,545</b>	<b>146,250</b>	<b>131,786</b>	<b>154,286</b>	<b>135,000</b>	<b>146,250</b>	<b>165,938</b>	<b>165,938</b>	<b>165,938</b>



# Other Expenses

Non-Salary Expenses		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TOTAL
<b>Engineering</b>														
	Tech Supplies	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 60,000
	Misc	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 5,000	\$ 60,000
	<b>Total Eng</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 10,000</b>	<b>\$ 120,000</b>
<b>Marketing</b>														
	Literature	\$ 2,000	\$ 2,000	\$ 2,000	\$ 4,000	\$ 4,000	\$ 4,000	\$ 6,000	\$ 6,000	\$ 6,000	\$ 8,000	\$ 8,000	\$ 8,000	\$ 60,000
	Trade Shows	\$ -	\$ -	\$ -	\$ 10,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 10,000	\$ -	\$ -	\$ 20,000
	<b>Total Mktg</b>	<b>\$ 2,000</b>	<b>\$ 2,000</b>	<b>\$ 2,000</b>	<b>\$ 14,000</b>	<b>\$ 4,000</b>	<b>\$ 4,000</b>	<b>\$ 6,000</b>	<b>\$ 6,000</b>	<b>\$ 6,000</b>	<b>\$ 18,000</b>	<b>\$ 8,000</b>	<b>\$ 8,000</b>	<b>\$ 80,000</b>
<b>Sales</b>														
	Travel (\$3k per emp)	\$ 3,000	\$ 3,000	\$ 3,000	\$ 6,000	\$ 6,000	\$ 9,000	\$ 9,000	\$ 9,000	\$ 12,000	\$ 12,000	\$ 12,000	\$ 12,000	\$ 96,000
	Commission (5% Rev)	\$ 3,000	\$ 3,000	\$ 3,000	\$ 3,375	\$ 7,313	\$ 7,313	\$ 7,688	\$ 9,000	\$ 9,000	\$ 9,750	\$ 11,063	\$ 11,063	\$ 84,563
	<b>Total Sales</b>	<b>\$ 6,000</b>	<b>\$ 6,000</b>	<b>\$ 6,000</b>	<b>\$ 9,375</b>	<b>\$ 13,313</b>	<b>\$ 16,313</b>	<b>\$ 16,688</b>	<b>\$ 18,000</b>	<b>\$ 21,000</b>	<b>\$ 21,750</b>	<b>\$ 23,063</b>	<b>\$ 23,063</b>	<b>\$ 180,563</b>
<b>General &amp; Admin</b>														
	Rent	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,000	\$ 24,000
	Telephone & Postage	\$ 2,000	\$ 2,000	\$ 2,000	\$ 2,500	\$ 2,500	\$ 2,500	\$ 3,000	\$ 3,000	\$ 3,000	\$ 4,000	\$ 4,000	\$ 4,000	\$ 34,500
	<b>Total G&amp;A</b>	<b>\$ 4,000</b>	<b>\$ 4,000</b>	<b>\$ 4,000</b>	<b>\$ 4,500</b>	<b>\$ 4,500</b>	<b>\$ 4,500</b>	<b>\$ 5,000</b>	<b>\$ 5,000</b>	<b>\$ 5,000</b>	<b>\$ 6,000</b>	<b>\$ 6,000</b>	<b>\$ 6,000</b>	<b>\$ 58,500</b>
<b>Total Non-Salary Exp</b>		<b>\$ 22,000</b>	<b>\$ 22,000</b>	<b>\$ 22,000</b>	<b>\$ 37,875</b>	<b>\$ 31,813</b>	<b>\$ 34,813</b>	<b>\$ 37,688</b>	<b>\$ 39,000</b>	<b>\$ 42,000</b>	<b>\$ 55,750</b>	<b>\$ 47,063</b>	<b>\$ 47,063</b>	<b>\$ 439,063</b>

# Income Statement

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TOTAL	
<b>Revenue</b>															
	Model1001	\$ 60,000	\$ 60,000	\$ 60,000	\$ 67,500	\$ 67,500	\$ 67,500	\$ 75,000	\$ 75,000	\$ 75,000	\$ 90,000	\$ 90,000	\$ 90,000	877500	52%
	Model2001	\$ -	\$ -	\$ -	\$ -	\$ 78,750	\$ 78,750	\$ 78,750	\$ 105,000	\$ 105,000	\$ 105,000	\$ 131,250	\$ 131,250	813750	48%
	<b>Total Revenue</b>	<b>\$ 60,000</b>	<b>\$ 60,000</b>	<b>\$ 60,000</b>	<b>\$ 67,500</b>	<b>\$ 146,250</b>	<b>\$ 146,250</b>	<b>\$ 153,750</b>	<b>\$ 180,000</b>	<b>\$ 180,000</b>	<b>\$ 195,000</b>	<b>\$ 221,250</b>	<b>\$ 221,250</b>	<b>\$ 1,691,250</b>	<b>100%</b>
<b>COGS</b>															
		\$ 7,000	\$ 7,000	\$ 7,000	\$ 7,875	\$ 15,375	\$ 15,375	\$ 16,250	\$ 18,750	\$ 18,750	\$ 20,500	\$ 23,000	\$ 23,000	\$ 179,875	11%
	<b>Gross Profit</b>	<b>\$ 53,000</b>	<b>\$ 53,000</b>	<b>\$ 53,000</b>	<b>\$ 59,625</b>	<b>\$ 130,875</b>	<b>\$ 130,875</b>	<b>\$ 137,500</b>	<b>\$ 161,250</b>	<b>\$ 161,250</b>	<b>\$ 174,500</b>	<b>\$ 198,250</b>	<b>\$ 198,250</b>	<b>\$ 1,511,375</b>	<b>89%</b>
<b>Expenses</b>															
	Engineering	\$ 31,667	\$ 31,667	\$ 31,667	\$ 31,667	\$ 38,333	\$ 38,333	\$ 41,667	\$ 41,667	\$ 48,333	\$ 48,333	\$ 48,333	\$ 48,333	\$ 480,000	28%
	Marketing	\$ 8,667	\$ 8,667	\$ 13,667	\$ 25,667	\$ 15,667	\$ 15,667	\$ 22,667	\$ 22,667	\$ 22,667	\$ 34,667	\$ 24,667	\$ 24,667	\$ 240,000	14%
	Sales	\$ 16,000	\$ 16,000	\$ 16,000	\$ 27,708	\$ 31,646	\$ 39,646	\$ 40,021	\$ 41,333	\$ 52,667	\$ 53,417	\$ 54,729	\$ 54,729	\$ 443,896	26%
	Admin	\$ 14,417	\$ 14,417	\$ 14,417	\$ 14,917	\$ 17,833	\$ 17,833	\$ 18,333	\$ 18,333	\$ 18,333	\$ 19,333	\$ 19,333	\$ 19,333	\$ 206,833	12%
	<b>Total Exp</b>	<b>\$ 70,750</b>	<b>\$ 70,750</b>	<b>\$ 75,750</b>	<b>\$ 99,958</b>	<b>\$ 103,479</b>	<b>\$ 111,479</b>	<b>\$ 122,688</b>	<b>\$ 124,000</b>	<b>\$ 142,000</b>	<b>\$ 155,750</b>	<b>\$ 147,063</b>	<b>\$ 147,063</b>	<b>\$ 1,370,729</b>	<b>81%</b>
	<b>Pre-tax Profit</b>	<b>\$ (17,750)</b>	<b>\$ (17,750)</b>	<b>\$ (22,750)</b>	<b>\$ (40,333)</b>	<b>\$ 27,396</b>	<b>\$ 19,396</b>	<b>\$ 14,813</b>	<b>\$ 37,250</b>	<b>\$ 19,250</b>	<b>\$ 18,750</b>	<b>\$ 51,188</b>	<b>\$ 51,188</b>	<b>\$ 140,646</b>	<b>8%</b>