How to prepare your budget?

Steven & Jochem de Ruig

Content



- Basic Corporate Finance
 - 3 Basic Ingredients: Profit & Loss, Balance Sheet and Cash Flow
- Where to put what? OPEX vs CAPEX
- Planning & control cycle
- How to prepare your budget?
- Business Case
- Close

Intro - Who are we?

- Steven de Ruig
 - 8 years Senior Pricing Architect at Getronics
 - Before Business Control at KPN
 - Brother of...
- Jochem de Ruig
 - 15 years CFO at RIPE NCC
 - Currently CFO at Freedom Internet
 - Brother of...

Intro -Finance is not an exact science

- Reflect the performance of the company in financial figures...
- A lot of differences, to name a few
 - According to what rules...NLGAAP, USGAAP, IFRS,....
 - Fiscal / commercial sales/costs/profit
 - Who the figures are presented to....
 - What is an asset (OPEX/CAPEX) SW development...
 - Intercompany items, dots and comma's....
- Every company, every country, every 'financial': different views
- Interpretation is everything and Cash is King

Intro - Finance has company specific 'traits'

- Every company has there one set of guidelines which adhere to overall local guidelines specific to them
 - The company registration & structure determines the rules, the locality etc.
- Financing & bookkeeping choices
- Start up company, large corporation etc. different complexities, focus points
 - Start up often focus on cash, large corps focus on margin
- Understand/know your company specific set up, focus points etc.

Basic Corporate Finance

Debit / Credit

Balans – assets, equity, liabilities

• A photograph - On a specific date

Profit & Loss – how are we performing over period x

• A video - Over a specific period

Cash Flow – How much cash do we really have and how did that happen

• Cash is King....

Basic Corporate Finance – Debit / Credit

- Any transactions creates a booking (a journal entry)
- Debit and Credit
- Debtors for a company (not a bank...) are third parties that pay to the company
- Creditors for a company are third parties you have to pay

Basic Corporate Finance - Balans

Balans						
Intangible assets (goodwill, software)	Equity					
Fixed assets (equipment, buildings)	Long Term Debt					
Other assets (financial assets, etc.)						

Debtors	Creditors				
Cash	Other Short Term debt				
Other					

Basic Corporate Finance – P&L

Revenue

- -/- Purchase costs of the revenue
 - **Gross Margin**
- -/- Personnel (Direct & Indirect)
- -/- Suppliers costs (consultancy, maintenance, etc.)
- -/- Other costs (IT, overhead, etc.)
 - Earnings Before Income Taxes Depreciation Amortization (EBITDA)
- -/- Depreciation (Amortization)
 - Earnings Before Income Taxes (EBIT)
- -/- Financial costs (income) & Taxes
 - Net result

Basic Corporate Finance – CF



Cash Flow

Cash position on 1/1/2020

Cash Inflow

- Payments from customers
- Tax returns

Cash Outflow

- Payments to vendors (CAPEX + OPEX)
- Tax payments
- Dividend payments

Cash postion on 31/12/2020

OPEX vs CAPEX

• Operational Expenses (OPEX)

- Recurring expenses like Service Fees, monthly fees, one off smaller items (roughly below € 500,-, cables, etc....)

- Directly taken in the Profit & Loss (NOT on Balance Sheet)

• Capital Expenses (CAPEX)

- One-off larger purchases, investments like Servers, Routers, Switches, other HW but can also be 'intangible' SW development

- On Balance Sheet
- Asset has a lifespan (Commercial & Fiscal)
- Depreciated over time depreciation taken on Profit & Loss

Why difference between OPEX / CAPEX important

- Different impact on Profit & Loss in a year
 - OPEX larger impact, CAPEX lower impact
 - OPEX variable component, CAPEX fixed component
- CAPEX more often part of Strategic (Long Term) plan (investment)
- Different financing possible for CAPEX financial, operational lease etc.
 - Cash Flow improvement

- Every Finance department operates on a Planning and Control Cycle
- It reports every month, Quarter, year management reports, financial reports
- To prepare these a control takes place on the 'books'
 - Check for errors, completeness, financial impact of certain activities, valuation etc.
- A budget (forecasting) is essential to the Planning & Control cycle

Planning & Control Cycle



Planning & Control Cycle

Cost Management: Four Primary Phases



Planning & Control Cycle

Your role / influence in the P&C cycle

- You are an essential part of the P&C cycle
- Your main role is in the planning which is the crucial operational part
- But of course you also play a vital part in the cost control

How to prepare your budget - Why budgetting?

- Part of Planning & Control Cycle
- Financial planning for the business
- Give a financial insight in the future based on history, current affairs
- Internal process
- Set a financial framework for the planning

How to translate your plans into a budget?

- Start with working out your plans (you probably have already done that...)
- Start considering and thinking about the details of the plans (how many servers, what connections do I need, what third party help, how many racks etc.)
- Work out your plans in as much detail as possible....you build a better case with detailed plans
- Don't underestimate....
- Don't overestimate
- So in short be realistic....

How to help your finance department

- Prepare a detailed well thought out budget
- Think a further than one year...the cost of your case, project will have a longer term effect... takes these into account.
- Give clear reasoning why the project is necessary and when it will not take place what the consequences (costs) are...
- Example: 'New piece of SW to support patching on the servers, saves us an hour per month in maintenance so that we can quicker resolve customer issue and have an increase in CS'

How your finance department can help you!

- Give clear guidelines on the budgeting process, timelines, clear templates for the budget etc....
- Give indications on the budget direction xx% more sales estimated...
- Other considerations like a contingency budget....sometimes possible in organisations

How does the Finance department work on the budget....

- In most cases....start with overall picture...
 - Xx% growth in sales, increase in costs....always lower than xx% growth...
- Increase the Sales estimates...
- Lower the cost estimates...
- Top down or bottom up....

Business case substantiation & control

- Costs & Revenue:
 - Determine expenses & income during the lifespan, control correctness, timeliness, completeness and relevance
- Risks:
 - Execute risk analysis, process risk into the costs/cost price
- Margin:
 - Control of Profit Margin, meets internal set targets?
- Cash Flow:
 - If Cash Flow is positive and meets internal targets rate of return (NPV, WACC)
- Process control:
 - Information control, verify offer/investment proposal matches business case, verify if the correct procurement process has been met

Business case



- Sales 3 different 'opportunities' with different lifespans (3/4/5 yrs)
- Total costs in all 3 'opportunities' is the same
- Annual costs Maintenance, personnel other direct and indirect costs are a % of the investment value

Business case – Total cost overview

Costs	Value
Investment	€ 600,000
Maintenance (50%)	€ 300,000
Personnel (50%)	€ 300,000
Other direct costs (30%)	€ 180,000
Indirect costs (27.5%)	€ 165,000
Total projectcosts	€ 1,545,000

Business case – Case overview

Projectcosts	Cost Category		Case A - 3yr		Case B - 4 yr		Case C – 5 yr
€ 300,000	Maintenance	€	100,000	€	75,000	€	60,000
€ 300,000	Personnel (50%)	€	100,000	€	75,000	€	60,000
€ 180,000	Other direct costs (30%)	€	60,000	€	45,000	€	36,000
€ 165,000	Indirect costs (27.5%)	€	55,000	€	41,250	€	33,000
€ 600,000	Depreciation costs	€	200,000	€	150,000	€	120,000
€ 1,545,000	Total project costs	€	515,000	€	386,250	€	309,000
	Income per year	€	600,000	€	472,500	€	392,000
	Profit per year	€	85,000	€	86,250	€	83,000
	Profit Margin per year %		14%		18%		21%

Business case - Analysis



- Net Present Value (NPV) Recalculate all future Cash Flows into current value
- Payback time The time it takes to recoup the initial investment

Business case - Analysis

		Case A – 3yr	Case B - 4 yr			Case C – 5 yr
Total revenue	€	1,800,000	€	1,890,000	€	1,960,000
Total EBIT	€	255,000	€	345,000	€	415,000
Revenue per year	€	600,000	€	472,500	€	392,000
EBIT per year	€	85,000	€	86,250	€	83,000
Net Present Value	€	73,575	€	79,937	€	77,637
Payback period		2,5		3,1		3,6

- Green most positive case for a given parameter
- Orange most negative case for a given parameter

Business case - Analysis

- Focus on different financial parameters will lead to different choices
 - In different companies different cases will prevail
 - Understand company focus...on Cash, NPV, Revenue....

Conclusions

- Make sure you differentiate between OPEX/CAPEX
- Think longer term
- Engage with Finance on Budget
-and love MS Excel....

THE END