

# *FINANCIAL ANALYSIS OF A HUNGARIAN STARTUP*

Capstone Project Summary

*Gábor Zsarnóczy*

*Central European University | MS in Finance*

## **The Project**

My capstone project was about the financial projection and valuation of a Hungarian startup that aims to secure investment in the near future. The client was an external consultant of the startup and hired me to prepare the projections and the valuation. Though the company itself was not my client, throughout the project I regularly had discussions with them. Part of the inputs that appear in the financial model are from the startup, part of it is from online research. This is because the founders not only required the raw numbers but also my opinion if their ideas make business sense or not.

## **The Startup**

The company, whose projection and valuation I created operates in the healthcare industry, more specifically it produces healthcare devices. The core business is about offering machines that can personalize and dose the vitamin cocktails for people (to put it simply, the startup is somewhat similar to Nespresso, but instead of coffee, it offers vitamin cocktails and a machine learning algorithm personalizes the specific ingredients). The startup targets four main types of customers: 1/ people who actively do sports, 2/ bariatric customers (people who would like to lose weight), 3/ elderly people and the 4/ Lohas group (Lifestyle of Health and Sustainability) and offers services both in B2C (sells machines to customers) and in B2B (sells machines to offices, hotels...). The company would like to follow the so-called razorblade model where they sell the razor (machine) on a low profit margin and then sell the blade (vitamin cartridges) on a high profit margin.

## **My tasks**

At the beginning of the project together with the client we created a timeline and assigned tasks to certain dates. Three main elements were identified:

- 1/ Revenue projections,
- 2/ cost element projections
- 3/ key financial statements and valuation.

Then, I was introduced to the founders of the company and we had some initial discussions with their goals and plans. Also, I was handed materials about the company.

The first week of the approximately 1.5 month long project was about getting to know the company and reading about the industry. Then, I delved into the revenue projections which

turned out to be the most difficult task. It was hard to get a grasp on some topics I was hardly familiar with. To overcome these obstacles, I started to do more research on the internet about similar solutions and some publicly available data helped me begin the calculations which were later validated by the founders. Also, another issue was about the depth of the forecasts: first I wanted to be very detailed but then I was the only one who could understand the model. Then I simplified it but at some points I felt like not doing a proper analysis. With the client we resolved it by looking at the final goal of the project – receiving investment – and deemed that the potential investor will want to quickly understand the model. Therefore, we stucked to the simplified version.

After finishing the first stage (revenue projections) I delved into the main cost segments: personnel, material, services, sales&marketing, r&d and capex. This segment of the project was more straightforward with more inputs from the client side and also online. The challenge here – opposed to the revenue part – was to be as detailed as possible. One example is that the company orders materials for the machine, then a contract manufacturer manufactures the machine, then it is transported to a warehouse so that it can be shipped to the US. This same process happens with other elements. The timing of the orders and the optimization of the scale was challenging because these calculations are all interconnected.

Finally, the third part of the task was about preparing the key financial statements and the valuation. I had to create two income statements – one according to IFRS and one according to Hungarian rules. It was because the startup is in contact with both local and international investors. Besides the income statements, I created a balance sheet and a cash flow statement. Based on the cumulative free cash flow line I could tell that the minimum investment need of the startup is around USD 3.300.000.

Finally, I prepared a three-stage discounted cash flow valuation. The three stages are as follows: the first stage is the projected 5 years, the second stage is a 5-year steady high growth period, while the third stage is a steady low growth period till infinity. I used benchmarks and the capital asset pricing model to get the cost of capital and projected the growth for the periods. The fair value of the startup (based on the DCF valuation) is around USD 27.500.000.

## **Benefits to the client**

In this section I will treat the founders of the startup as my client and not my actual client. The reason behind it is that my actual client's goal was to provide an excellent service to the startup, so my goal was the same.

The main benefit for the client is that I have created a financial projection that can not only tell them the value of the company but also helps them improving their business. To demonstrate it with an example, I created a supply chain framework that they can use when calculating with the production need. Also, throughout the project one of the main goals was to create a model that is dynamic and can be altered easily. This was more like a technical challenge but Microsoft Excel was a great tool for this.

## **Learning experience**

I would like to divide this section into two parts: 1/ skill improvements 2/ interpersonal challenges

1/ Skill improvements: During the academic year and also at my prior jobs I had to create financial projections but I have never been required to do one so detailed. What is more, the core business of this startup is far from my area of expertise so understanding the main drivers of the industry served as a great challenge.

2/ Interpersonal challenges: During the project I consulted regularly with the founders of the startup. In many cases they could provide precise answers to my questions but in some occasions there were debates about how to go forward with certain topics (e.g.: should they target four customers segments right away or should they wait with that and target only two at a time). In these issues I usually told them my opinion, however if they did not agree, I had to stick to their ideas. Since I was not motivated (financially) in them getting the investment, I should not have cared too much but I always tried to deliver the best work I could. Sometimes it led to hard discussion but in the end, I am convinced that these confrontations resulted in a better, more realistic financial plan.

Overall, I enjoyed the project since it involved financial challenges, business decisions and a great deal of human interaction. The startup is now in the midst of fundraising and I really hope that my work will contribute to their success.