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**Building the Business Case – Forecasting Customer Revenue**

How did you go?

You started the year. You've got a brand new product. You don't have any customers at all. You start with zero. When you get to the end of the first year, you've got 29,000 customers. Day one, you don't have 29,000 customers on the very first day of opening. By the end of the first year you do. It's to do with the timing, the way that you've calculated these customers. You would be grossly over estimating if you were to be calculating like this.

What we need to do here is to say this is going to be our gross cumulative number of customers at year end but in order to calculate the revenue we are going to take the average. You say you are going to start the year with zero customers and you end the year with 29,000 customers. We will say on average you had about 15,000 for the entire year and we are going to use that number to calculate the revenue. It's going to be a much more sensible number to use for our revenue calculation. Let's change that here and call it "at year end" and this is going to be "average cumulative number of customers". It's important to be very descriptive about those titles. This is going to be divided by two. There isn't an easier way of doing it. We do try to have consistency of formulas all the way across. It's not always possible and this is one of those situations because in the second year here, we are going to say average. You are going to say you finish the first year at 29,000 customers, that is going to be the beginning of year two and then you end the year with 59,000 therefore the average number of customers for year two is going to be the average between the first year and the second year which is 44,500 customers. We can then take that formula and copy it across. Your formula should look like that. For the first year, it's just going to be divided by two because you are starting with a zero. If you have decided that you do need to

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have inconsistent formulas, it is good practice and go in and perhaps use a double red line and make that a red border.

Once you have the cumulative average number of customers, we then need to calculate some churn. You can't expect that you are going to keep 100% of your customers. We have to expect that people will change their minds and they will drop off. We call it persistency in insurance, churn, lost customers, attrition - whatever you call it, it would be over-ambitious to expect that you are going to keep 100% of your customers. We have to expect that a few pets will die. You might want to have a look at some pet mortality rates and consider how many customers we might lose. We don't really know as we haven't sold this product before. We need to put something in there. What do you guys think? Ten percent? Let's put in ten percent and see how we go with that. We can always put in some scenario analysis on that later. Sometimes we say that we don't put any churn in for the first year because we assume that if someone signed up for a new product they are going to stick around for at least twelve months. We will put that in as 10% and as a named range called Churn. Come back to your revenue page. Sometimes we base on the average number of customers, sometimes we base it on the year end number of customers. It doesn't really matter as long as you document it. A lot of this is open to interpretation. I know financial modelling is supposed to be a hard subject; it's right or wrong. But in fact there is quite a bit of interpretation. If I let you guys go away and create this model from scratch you would probably all come up with something slightly different at least, because it all depends on how you interpret it.

Let's say that we will base it on the year end number of customers. Yearend number of customers multiplied by churn. We will make that a negative amount and copy that across. I haven't forgot to document my assumptions. I'm not going to leave it to the end. I am going to do it when I think of it. Go back to the Assumptions page and go to Churn and say "based on prior year end balance of customer not average". Just so there can be no possible misinterpretation about what I've put in to my financial model.

From that we can then calculate our net cumulative number of customers which is going to be our average number of customers plus the churn because that is a negative amount. That

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gives us our cumulative net number of customers so we can then calculate our revenue from that.

Now that we've got our number of customers, we can use that to calculate the revenue. Our premiums can be calculated based on the number of customers. Our premiums are \$400. We will put that in as a named range, Premium. Go back to Revenue page. It is net cumulative customers multiplied by premium. The premium is going to increase by inflation. We are going to use exactly the same method as we did with our staff costs. We will say multiplied by one plus inflation, just like what we did before, to the power of and we will use the years again. To the power of B2 minus B2. The second B2 is going to have dollar signs in it. And just copy that across. Get out your calculator and make sure it is calculating correctly. Make sure that you are happy with it before we move on.

Once you've got your premiums calculated, we can then work out what revenue. We are working as the reseller of this product. We actually only get 10% of it. 90% of it goes to the underwriter. We are just going to calculate our premium profit which is going to be ten percent. Go into here. Put that in as 10%. We will call it premium\_profit as a named range. We can go back to our Revenue page, take the 5.9 million and use premium profit multiply that out and copy it across.

There we go, that is our revenue. Once you have got that working, we will go back to the Summary page and link that through. Go to hear and link your revenue through and you can copy that across. That's your revenue.