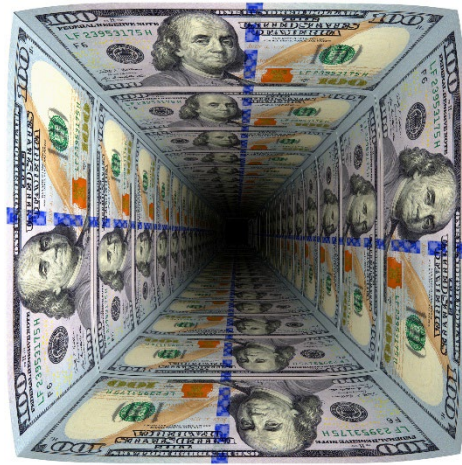


# The Top Financial Modeling Mistakes: How to Avoid Balance Sheet Black Holes and Fake Projections



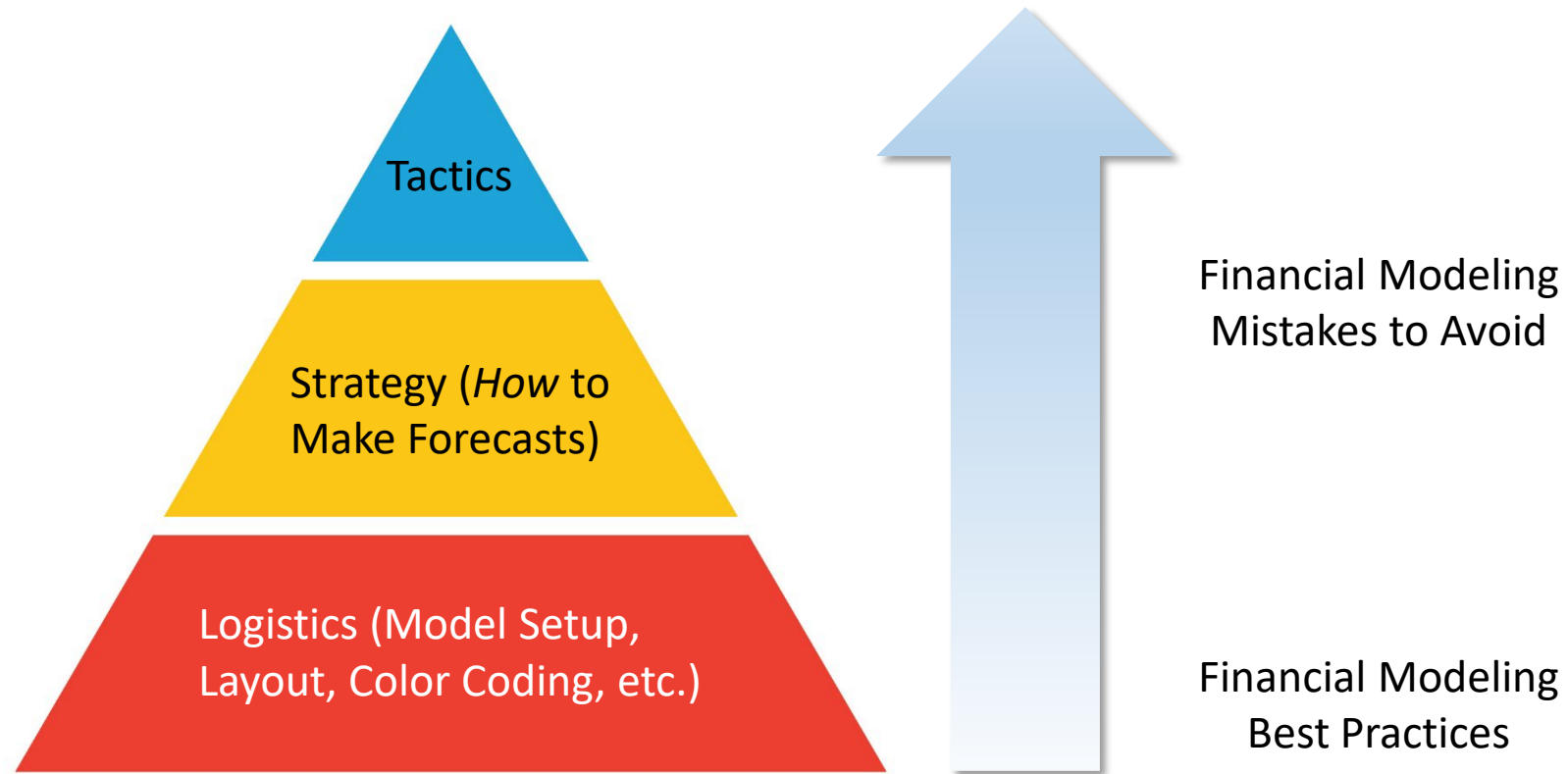
Templates, Company  
Docs, Processes,  
Checklists, and  
Reasonable Assumptions

# Top Financial Modeling Mistakes

We covered **financial modeling best practices** in a previous video, and this is mostly an **extension** of that.

The **difference** is that best practices are about **logistics**, while these **mistakes** are more about **strategy and tactics**.

# Top Financial Modeling Mistakes



# Top Financial Modeling Mistakes

I'll focus on the **top 3 mistakes** we see in shorter/simpler, on-site models given in case studies and other evaluations.

For each one, I'll give a **specific example of the problem**, explain how to **fix it**, and point out possible exceptions.

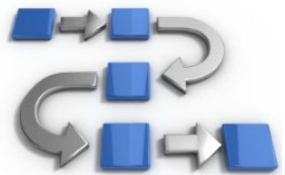
# Top Financial Modeling Mistakes

For the written version, images, Excel files, and additional tips, go to:

<https://breakingintowallstreet.com/kb/3-statement-models/financial-modeling-mistakes/>

# Top Financial Modeling Mistakes

- **MISTAKE #1:** Relying too much on templates or company-provided statements – NOT the same as making your models “too complicated”
- **Solution:** Be flexible and willing to modify everything; use the “10% rule” to consolidate aggressively
- **MISTAKE #2:** No clear modeling process or guidelines for what to forecast or how to do it
- **Solution:** Use a checklist, focus on 2 – 3 key drivers per company, and always follow a set financial statement order



# Top Financial Modeling Mistakes

- **MISTAKE #3:** Using unrealistic or indefensible assumptions, such as revenue growth and margins that rise *at the same time*
- **Solution:** Always check for declining growth, growth vs. margin levels, CapEx vs. D&A, and the Change in Working Capital based on simple guidelines

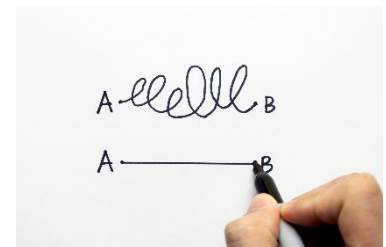


# Outline for This Tutorial:

- **Part 1:** Over-Reliance on Templates and Company Statements **4:30**
- **Part 2:** No Clear Modeling Process or Guidelines **8:00**
- **Part 3:** Indefensible Assumptions **12:25**

# Part 1: Over-Reliance on Templates / Statements

- **Often:** People say that you should avoid making models “too complicated”
- **Real Issue:** Not exactly complexity, but being *inflexible* – must be comfortable making major changes
- **EX:** For Monster Beverage, don’t just import the statements as-is and start forecasting (too many line items)
- **SOLUTION:** Simplify and consolidate the Balance Sheet to ~5 items on each side (or close to it), with a similar ~5 lines in each section of the Cash Flow Statement



# Part 1: Over-Reliance on Templates / Statements

- **10% Rule:** If an item represents 10% or less of a bigger category, like Revenue or CFO, **consolidate it**
- **Sometimes:** You might need *more detail* on certain lines, such as Revenue (can be helpful to see segments)
- **Exceptions:** Conglomerate-type companies or others with operations across multiple industries (may not be able to simplify that much)

10%



# Part 2: No Clear Modeling Process or Guidelines

- **Poor Practice:** Open a company's annual/interim filings and just start entering numbers, drivers, etc.
- **EX:** Look at pg. 90 of Monster's 10-K with the sales by region and product line split – should you create a forecast like this?
- **NO!** Most segments are not that important (< 10% of sales), and no unit/pricing data is broken out this way
- **SOLUTION:** Follow a clear process checklist and set of guidelines for everything in your model



# Part 2: No Clear Modeling Process or Guidelines

1. **Gather Data** – Annual/interim reports and investor presentations
2. **Enter the Historical Statements** – And consolidate/simplify
3. **Set Up Revenue and Expense Drivers** – Aim for 2 – 3 key lines (stores, units sold, capacity, employees, etc.)
4. **Forecast the Financial Statements** – IS, Working Capital on BS, CFS, link the remaining BS items to CFS, and Interest
5. **Check/Verify** – Declining growth, stable margin, etc.



# Part 3: Indefensible Assumptions

- **EX:** As in this Monster example, *rising* revenue growth + *rising* margins at the same time
- **OR:** CapEx equaling D&A by the end, Change in Working Capital that goes against historical trends, etc.
- **SOLUTION:** Growth rates should decline over time (outside of acquisitions), growth and margins should have trade-offs,  $\text{CapEx} > \text{D\&A}$ , and Change in WC should follow historical trends (negative vs. positive when sales grow)



# Recap and Summary

- **Part 1:** Over-Reliance on Templates and Company Statements
- **Part 2:** No Clear Modeling Process or Guidelines
- **Part 3:** Indefensible Assumptions

