

# Financial Models used in Corporate Finance



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- ❖ As a postscript to our discussion of DCF modelling, I wanted to raise your awareness of the different types of models you may come across in Corporate Finance
- ❖ Most of these derive from the Three Statement Financial model which is why we are discussing them here

# Financial Models used in Corporate Finance

- ❖ The starting point then is the Three Statement Financial model
- ❖ The inputs enable us to create assumptions which are dynamically reflected in the three financial statements which are linked through Excel formulas

Inputs

Income Statement

Balance Sheet

Cash Flow

# Financial Models used in Corporate Finance

- ❖ The Discounted Cash Flow model then takes the Free Cash Flows from the Cash Flow Statement or the Dividends and calculates a Net Present Value
- ❖ This uses the XNPV function and a discount rate based on the WACC using the CAPM

Inputs

Income Statement

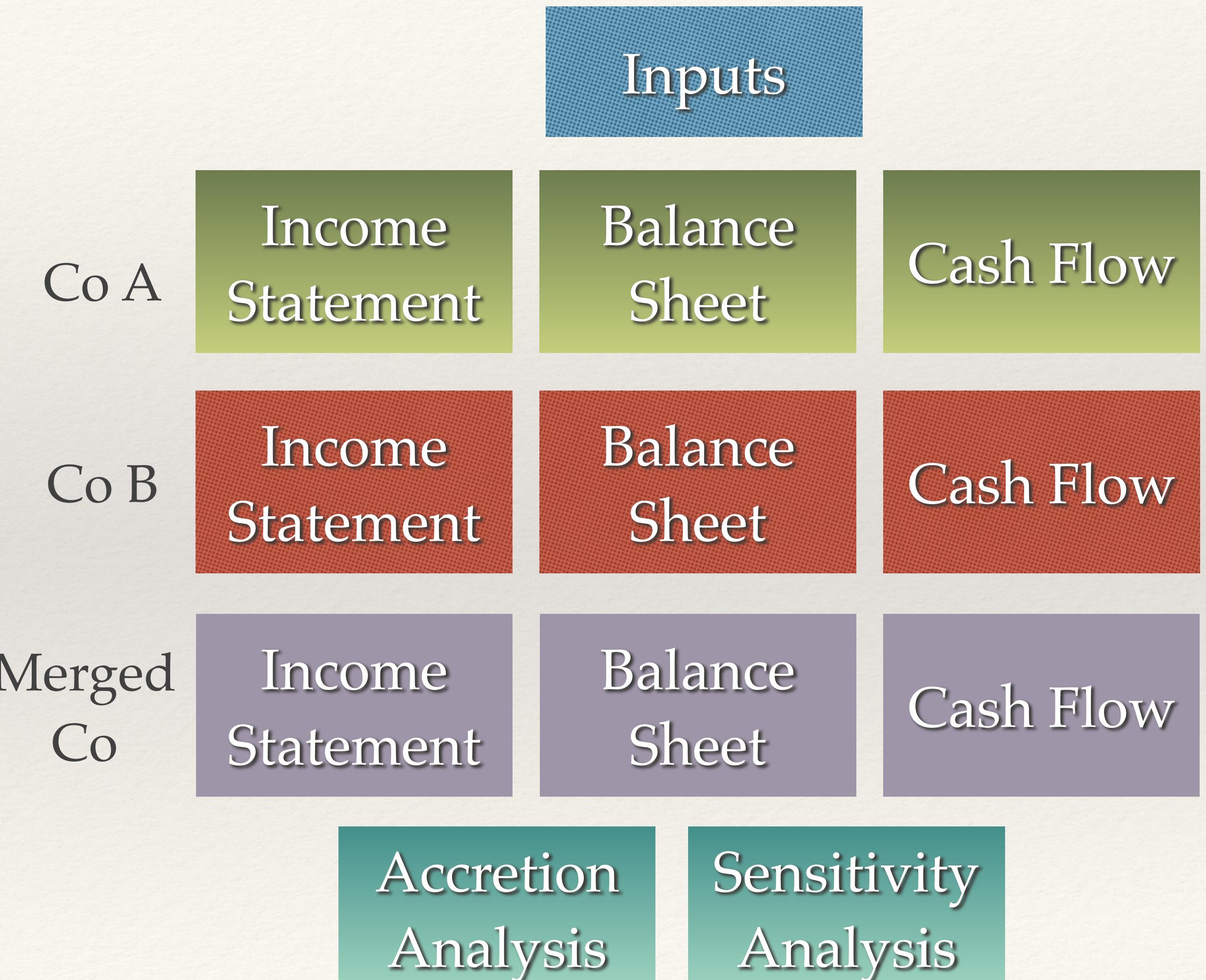
Balance Sheet

Cash Flow

DCF Valuation

# Financial Models used in Corporate Finance

- ❖ A Merger Model takes two 3 statement financial models and combines them in a third to reflect the merger
- ❖ The inputs now have to include the transaction assumptions and the impact of synergies
- ❖ Outputs focus on whether the deal is earnings enhancing (accretive) or not (dilutive)



# Financial Models used in Corporate Finance

- ❖ An IPO Model assess not the value of a company but what investors are prepared to pay for it
- ❖ This means looking at comparable companies, estimating how much is to be raised and at what price
- ❖ In its most simplified terms, you could dispense with the 3 Statement Financial Model and just work on given inputs to calculate the pricing
- ❖ You would be expected to have some justification for your company valuation beyond comparable companies analysis.

Inputs

Income Statement

Balance Sheet

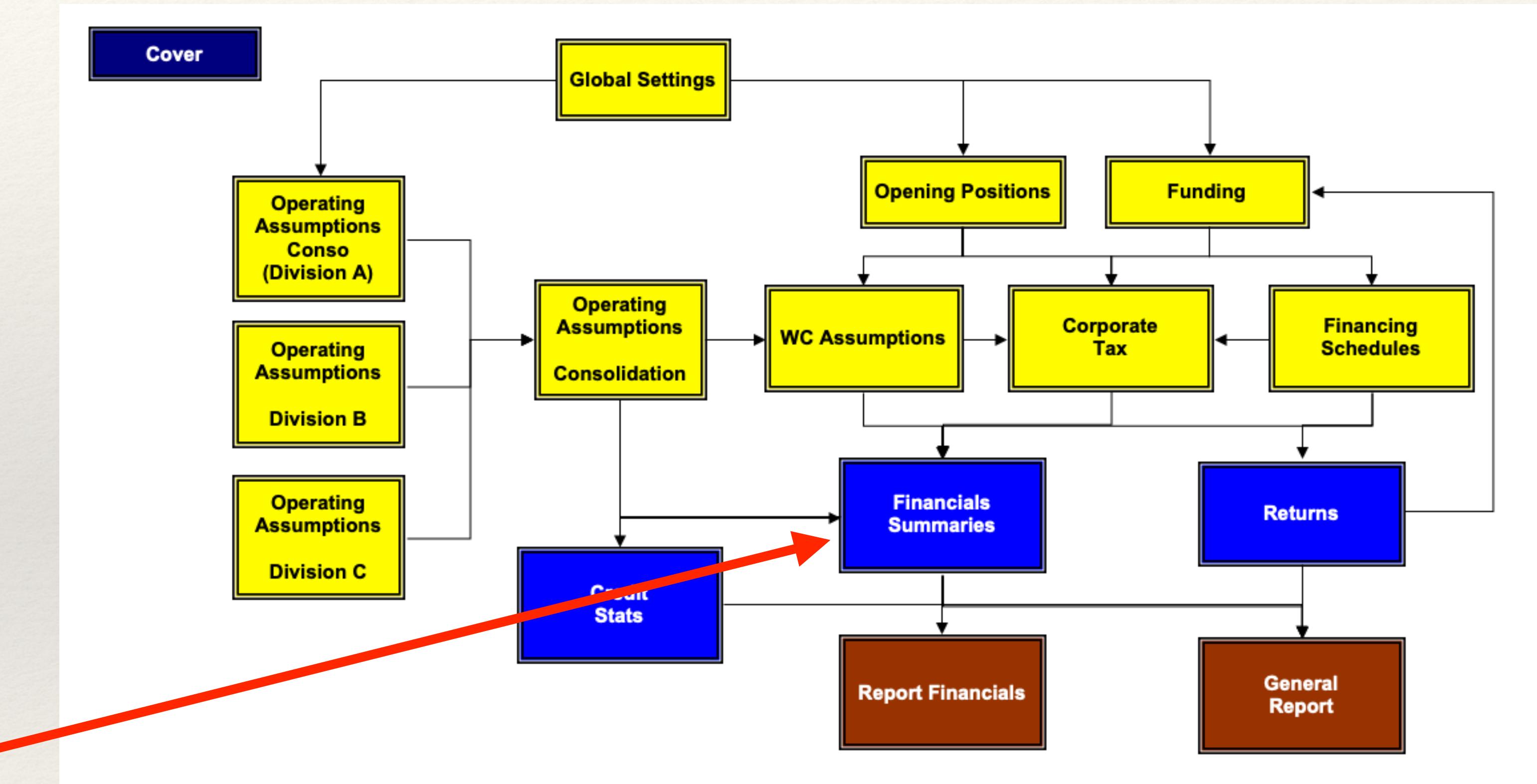
Cash Flow

Comparable Companies

IPO Pricing

# Financial Models used in Corporate Finance

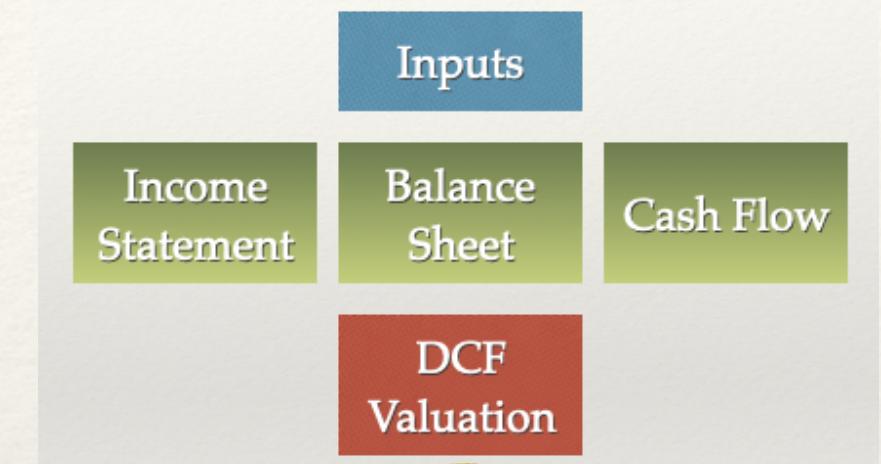
- ❖ Leveraged Buyout Model
- ❖ One of the most complex models
- ❖ At its heart you will still find the 3 Statement Financial Model



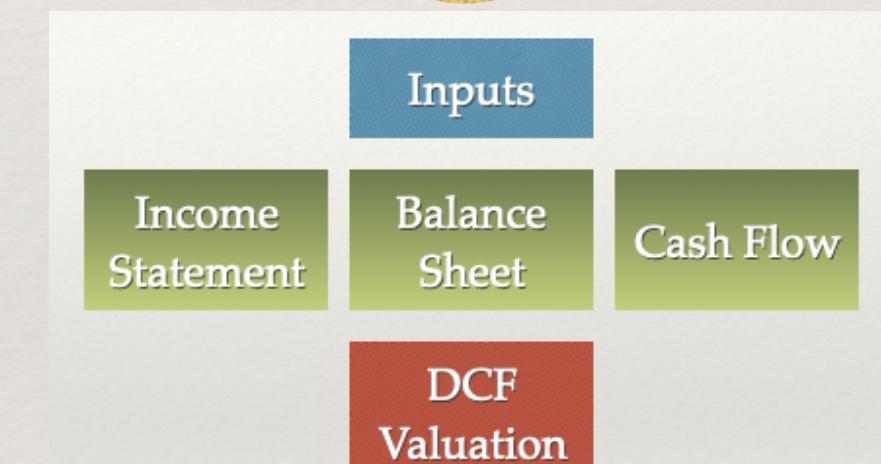
# Financial Models used in Corporate Finance

- ❖ Sum of the Parts Model
- ❖ Combines a series of DCF models, plus any cash or marketable securities to derive a value for the whole
- ❖ Each business has its own assumptions, inputs and unique factors

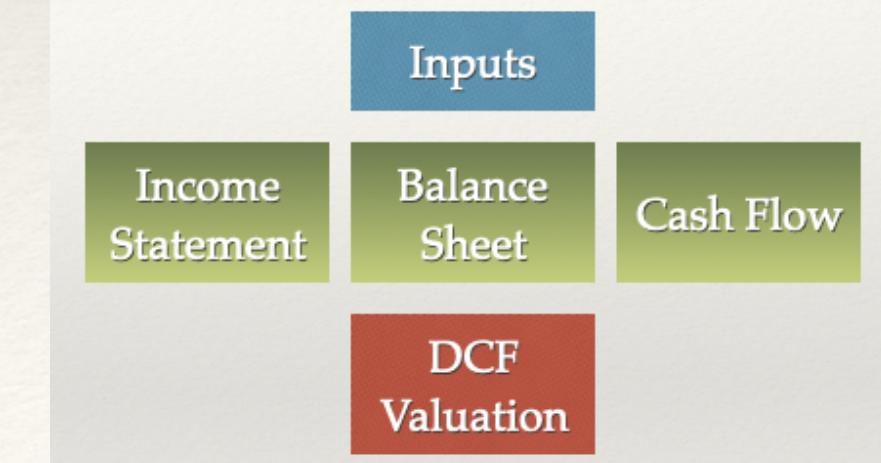
Business A



Business B

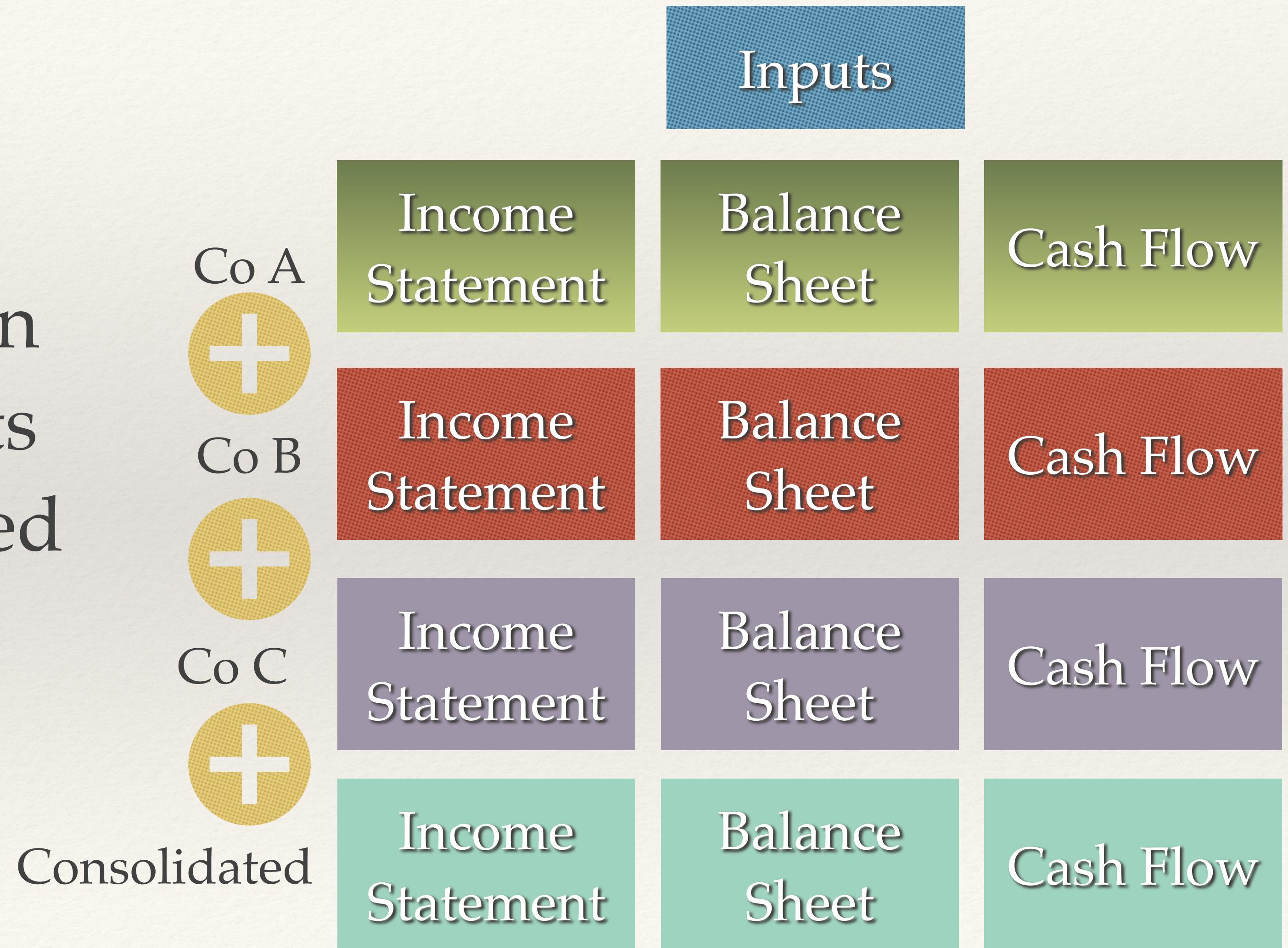


Business C



# Financial Models used in Corporate Finance

- ❖ Consolidation Model
- ❖ Each business has its own set of financial statements and these are consolidated into a total in a final worksheet



# Financial Models used in Corporate Finance

- ❖ Budget Model
- ❖ The objective here is corporate finance budgeting
- ❖ Focus on the Income statement which is presented monthly (or even weekly)
- ❖ Assumptions focus on driving the Sales and Costs

Inputs

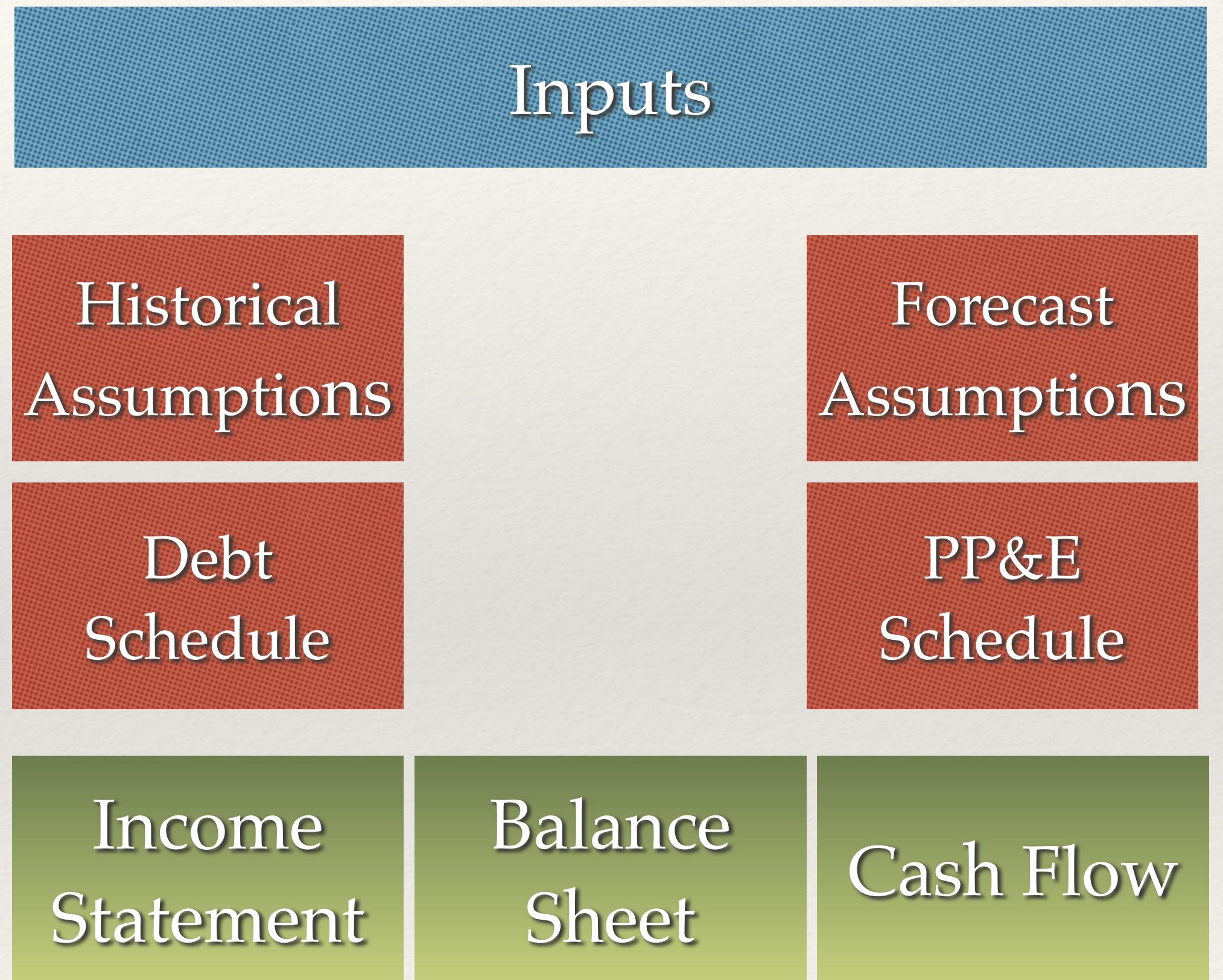
Income Statement

Balance Sheet

Cash Flow

# Financial Models used in Corporate Finance

- ❖ Forecasting Model
- ❖ The objective here is corporate forecasting - next 12 months
- ❖ Very detailed input assumptions
- ❖ Bottom up
- ❖ Often with a number of detailed supporting schedules



# Financial Models used in Corporate Finance

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- ❖ Demonstrate complexity of financial modelling
- ❖ Importance of Three Statement Financial Model

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