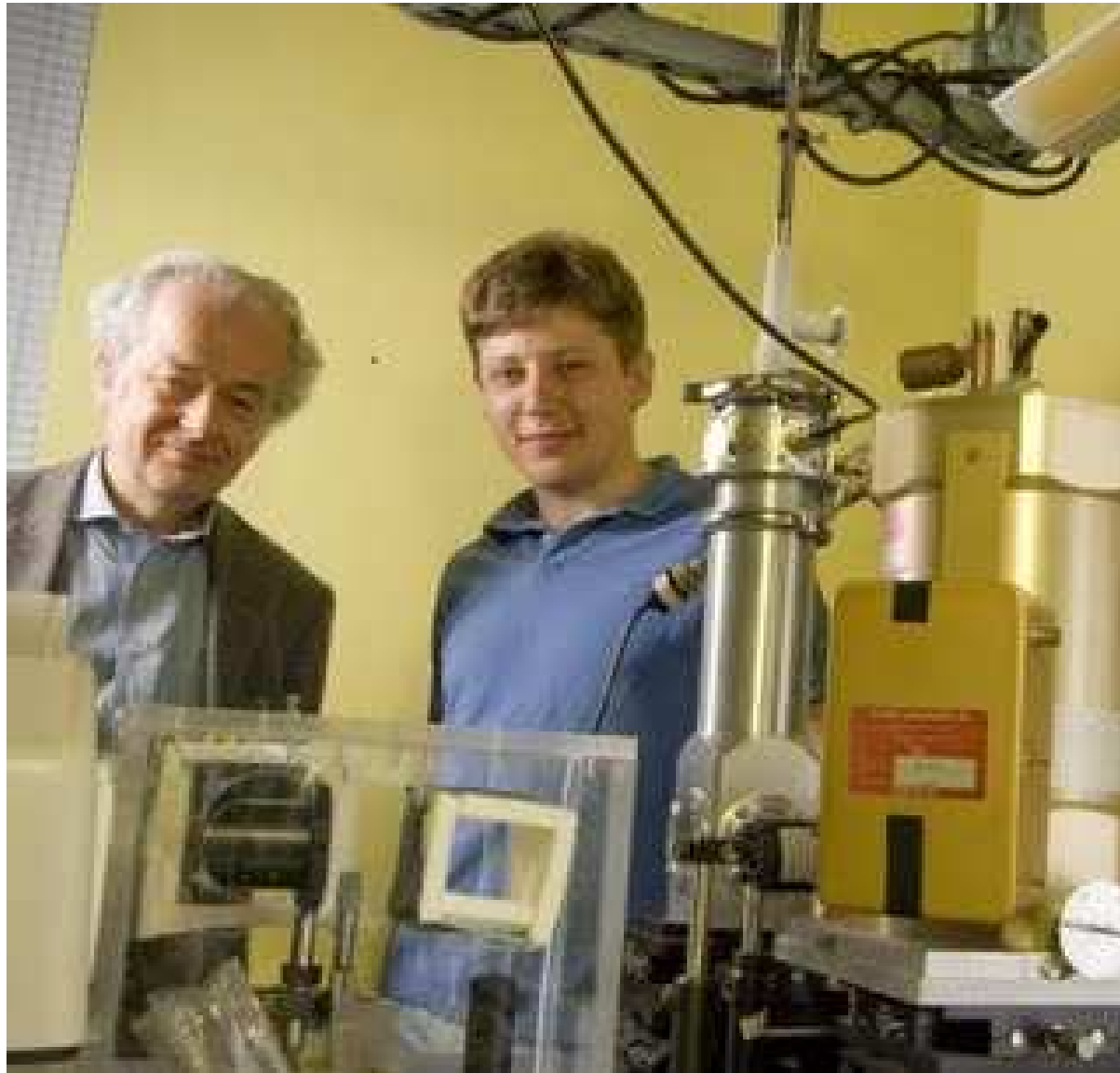


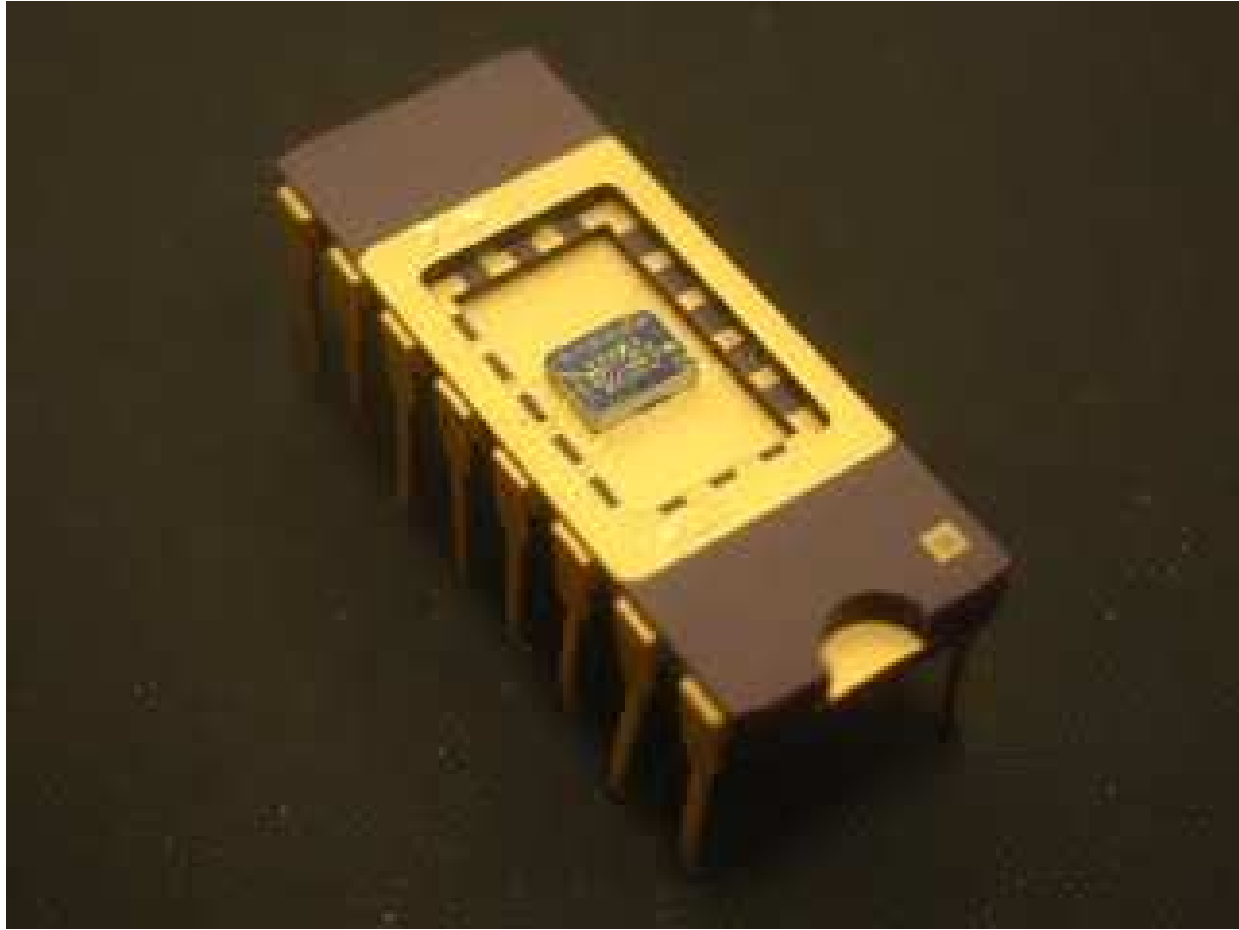


Research Discovery to Commercial Success

October 29, 2009

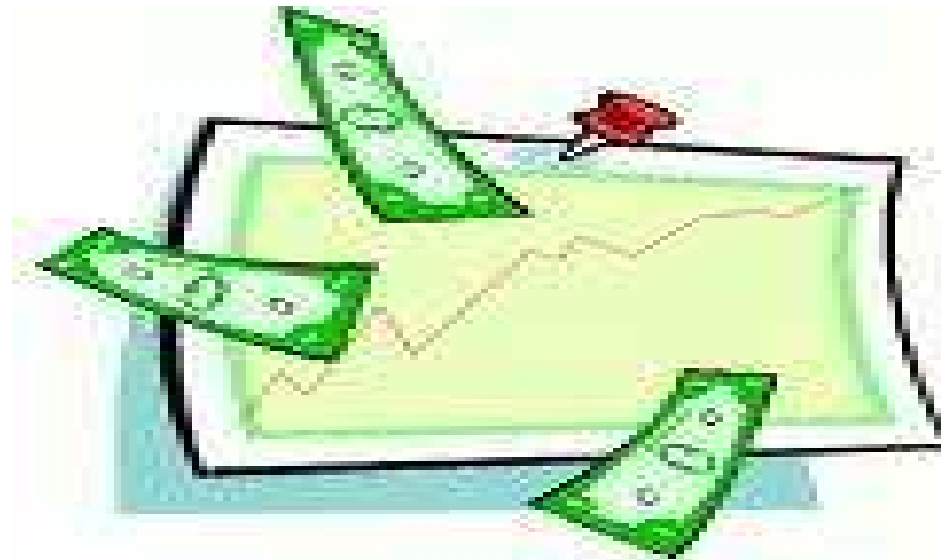
*Professor of Practice Mike Arnold
Department of Systems & Industrial Engineering
School of Sustainable Engineered Systems
College of Engineering
University of Arizona
mjarnold@email.arizona.edu*





The Pathway from Discovery to Commercial Success

Starts with an Economic Model



Economic Models

- Determine the profitability of the Opportunity
- Estimate the amount of needed financing
- Convince Management (Investors) of the financial soundness of the Opportunity

L. van Beethoven Op 27 No2

The image displays a page of musical notation for the second movement of Beethoven's Opus 27, No. 2. The score is written for piano and consists of six systems, each with a treble and bass staff. The key signature is three sharps (F#, C#, G#) and the time signature is common time (C). The first system includes the instruction "sempre *pp* e senza sordini" and features four triplet markings over the first four notes of the treble staff. The music is characterized by flowing sixteenth-note passages in the right hand and sustained chords or simple rhythmic patterns in the left hand. The notation includes various articulations such as slurs, ties, and accents.

The Three Key Financial Statements

- 1) Income Statement
- 2) Cash Flow Statement
- 3) Balance Sheet

The 4th Conserved Quantity

1. Mass
2. Momentum
3. Energy
- 4. Money**

The Accounting Equation

$$\text{ASSETS} = \text{LIABILITIES} + \text{OWNERS' EQUITY}$$

Income Statement

- Projects Revenue & Expense
 - Illustrates Profitability
 - Segregates Direct Expenses from Indirect Expenses
 - Basis for Income tax calculations
 - Income is NOT equal to cash
 - Provides Income for Market based valuation

Az Mfg 094	Year 1	Year 2	Year 3	Year 4	Year 5
Projected Income Statements (\$s)					
SALES					
Gross Sales	361,350	5,920,249	14,611,595	52,681,430	68,428,663
NET SALES	361,350	5,920,249	14,611,595	52,681,430	68,428,663
COST OF SALES					
Materials	55,560	829,740	2,004,727	7,320,848	9,476,947
Labor	18,341	455,444	1,259,526	4,082,266	5,446,146
Other	50,440	1,160,813	3,193,078	10,331,185	13,784,965
TOTAL COST OF SALES	124,342	2,445,997	6,457,331	21,734,299	28,708,058
GROSS MARGIN	237,008	3,474,252	8,154,264	30,947,130	39,720,605
OPERATING EXPENSES					
Salaries and wages	559,310	1,053,329	1,983,698	3,735,828	7,035,554
Payroll taxes	42,787	80,580	151,753	285,791	538,220
Employee benefits	83,897	157,999	297,555	560,374	1,055,333
Depreciation	211,229	328,464	361,798	313,048	299,964
Additional Operating Expenses	892,561	1,322,888	1,960,687	2,905,987	4,307,040
TOTAL OPERATING EXPENSES	1,789,784	2,943,261	4,755,491	7,801,028	13,236,111
OPERATING PROFIT (LOSS)					
BEFORE INTEREST AND TAXES	(1,552,776)	530,991	3,398,773	23,146,102	26,484,495
INTEREST EXPENSE	(43,903)	(63,959)	(81,788)	(78,211)	(56,561)
PROFIT (LOSS) BEFORE TAXES	(1,596,679)	467,032	3,316,986	23,067,891	26,427,934
INCOME TAXES	-	-	(656,202)	(6,920,367)	(7,928,380)
NET PROFIT (LOSS)	(1,596,679)	467,032	2,660,784	16,147,524	18,499,554

Cash Flow Statement

- Basis for estimating required investment
- Illustrates all transactions involving cash.
- Projects the cash balance at end of each period
- Reveals the Cash Flow for valuing company by discounted Cash Flow Method.
- Profitable companies can go bankrupt because Cash not income pays bills!

Az Mfg 094	Year 1	Year 2	Year 3	Year 4	Year 5
Projected Cash Flows (\$s)					
CASH FLOWS FROM OPERATIONS					
Net income	(1,596,679)	467,032	2,660,784	16,147,524	18,499,554
Adjustments to reconcile net income					
Depreciation	211,229	328,464	361,798	313,048	299,964
Accounts receivable	(137,115)	(514,095)	(581,269)	(3,111,294)	(1,505,678)
Inventory	(30,660)	(169,239)	199,898	(2,639,272)	(910,255)
Accounts payable	21,367	47,196	42,078	255,968	120,004
TOTAL CASH FLOWS FROM OPERATIONS	(1,531,857)	159,359	2,683,289	10,965,974	16,503,589
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of equipment	(1,935,287)	-	(1,500,000)	-	-
TOTAL CASH FLOWS FROM INVESTING ACTIVITIES	(1,935,287)	-	(1,500,000)	-	-
CASH FLOWS FROM FINANCING ACTIVITIES					
Borrowing of long-term debt	1,499,787	-	1,350,000	-	-
Repayment of long-term debt	(155,422)	(277,740)	(382,677)	(443,418)	(460,005)
CASH FLOW BEFORE EQUITY FINANCING	(2,122,778)	(118,381)	2,150,612	10,522,556	16,043,584
Sales of Stock	3,700,000	-	-	-	-
TOTAL CASH FLOWS FROM FINANCING ACTIVITIES	5,044,365	(277,740)	967,323	(443,418)	(460,005)
NET CASH FLOWS	1,577,222	(118,381)	2,150,612	10,522,556	16,043,584
CASH, BEGINNING OF PERIOD	-	1,577,222	1,458,841	3,609,452	14,132,008
CASH, END OF PERIOD	1,577,222	1,458,841	3,609,452	14,132,008	30,175,592

Balance Sheet

- Accumulates all you own and all you owe
- Separates Current Assets and Liabilities from Long term Assets and Liabilities
- Highlights the owner's equity
- Show the company's liquidity and ability to service debt
- The Net Worth Statement is equivalent to the Balance Sheet

Az Mfg 094					
	Year 1	Year 2	Year 3	Year 4	Year 5
Projected Balance Sheets (\$s)					
ASSETS					
Current Assets					
Cash	1,577,222	1,458,841	3,609,452	14,132,008	30,175,592
Accounts Receivable	137,115	651,210	1,232,480	4,343,773	5,849,451
Inventory	30,660	199,898	-	2,639,272	3,549,528
Total Current Assets	1,744,996	2,309,949	4,841,932	21,115,053	39,574,570
Property and Equipment	1,935,287	1,935,287	3,435,287	3,435,287	3,435,287
(less accumulated depreciation)	(211,229)	(539,694)	(901,492)	(1,214,539)	(1,514,504)
Net Property and Equipment	1,724,058	1,395,593	2,533,795	2,220,747	1,920,783
TOTAL ASSETS	3,469,054	3,705,543	7,375,727	23,335,801	41,495,353
LIABILITIES AND SHAREHOLDERS' EQUITY					
Liabilities					
Current Liabilities					
Accounts Payable	21,367	68,564	110,642	366,610	486,614
Current Portion of L-T Debt	277,740	292,677	443,418	460,005	275,525
Total Current Liabilities	299,107	361,241	554,060	826,615	762,139
Long-Term Debt	1,066,625	773,948	1,590,530	1,130,525	855,000
Total Liabilities	1,365,733	1,135,189	2,144,590	1,957,140	1,617,139
Shareholders' Equity					
Paid-In Capital	3,700,000	3,700,000	3,700,000	3,700,000	3,700,000
Retained Earnings	(1,596,679)	(1,129,647)	1,531,137	17,678,661	36,178,215
Total Shareholders' Equity	2,103,321	2,570,353	5,231,137	21,378,661	39,878,215
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	3,469,054	3,705,543	7,375,727	23,335,801	41,495,353

		Valuation					
Year Ending	Aug-09	Aug-10	Aug-11	Aug-12	Aug-13	Aug-14	
Year	0	1	2	3	4	5	
Cash Flow before Equity Financing	\$0	(2,122,778)	(118,381)	2,150,612	10,522,556	16,043,584	
Discounted Cash Flow	\$0	(1,326,736)	(46,243)	525,052	1,605,615	1,530,035	
Net Present Value (NPV)	\$2,287,723						
Internal Rate of Return	118%						
Modified Internal Rate of return	87%						

		Valuation Summary				
Valuation Methodology	Discounted Cash Flow	P/E Ratio	P/EBITDA Ratio	P/S Ratio	Replacement	
Pre-Money Value	\$7,281,174	\$6,264,935	\$7,120,750	\$5,514,914	\$6,500,000	
External Investment	\$3,700,000	\$3,700,000	\$3,700,000	\$3,700,000	\$3,700,000	
Post-Money Value	\$10,981,174	\$9,964,935	\$10,820,750	\$9,214,914	\$10,200,000	
External Investors' Ownership %	34%	37%	34%	40%	36%	

Intellectual Property Issues

Confronting Start-up and Early State Enterprises

Lawrence M. Hecker
Hecker & Muehlebach, PLLC
405 W. Franklin Street
Tucson, AZ 85701
520-798-3803
heckyes@hpzlaw.com

BUSINESS FORMATION ISSUES

LAWRENCE M. HECKER, ESQ.

HECKER & MUEHLEBACH
405 W. FRANKLIN
TUCSON, AZ
(520) 798-3803
heckyes@hpzlaw.com

ENTITY CHOICES

- A. CORPORATION
 - 1. C-Corporation
 - 2. S-Corporation

- B. Limited Liability Company
 - 1. Manager-managed
 - 2. Member-managed

- C. Other entities, such as Sole Proprietorship, Partnership, Limited Partnership

