

Study Notes on Financial Modelling using Spreadsheet



Financial modelling refers to the tools used for preparing the expected financial statements predicting the company's performance from a financial point of view soon. It uses logic-backed assumptions and historical performance information. Such models are widely used in Mergers & Acquisitions, Private Equity, DCF Valuations, Project Finance and more. It's all around the web and there has been a lot written about learning Financial Modelling. But the fact is that most of the financial modelling pieces of training are the same. However, this piece of writing will go beyond the usual conventional gibberish and will explore practical Financial Modelling which is used by Research Analysts and Investment Bankers.

Uses of a financial model:

- Raising Capital (debt and/or equity)
- Making acquisitions (businesses and/or assets)
- Selling or divesting assets & business units
- Budgeting & forecasting (planning for the years ahead)
- Capital allocation (priority of which projects to invest in)
- Valuing a business
- Financial statement analysis/ratio analysis
- Management accounting

Building a financial model is an iterative process. You must chip away different sections until you can finally tie them all together. A step-down-step breakdown of where you should start & how to eventually connect all the dots has been presented below:

1. **Historical results and assumptions** of the past three or four years
2. **Start the top of income statement** with revenue, COGS, gross profit etc.
3. **Start the balance sheet** with the top of income statement in place
4. **Build the supporting schedules** for capital assets like property, plant etc.
5. **Complete the income statement & balance sheet** by the information from the supporting schedules
6. **Build the cash flow statement** with the reconciliation method
7. **Perform the DCF Analysis** i.e., perform the business valuation
8. **Add sensitivity analysis & scenarios** once the DCF analysis is complete
9. **Build charts & graphs** since clear communication of results is something that really separates great from merely good analysts
10. **Stress test and auditing of model** to see if model behaves as expected.

It is crucial to draw a clear distinction between inputs and/or assumptions & output and/or calculations which is typically achieved through formatting conventions, say, for example using different font colours. Also, it is critical to structure a model in a logical and easy to comprehend design which typically means that one should build the whole model on 1 worksheet and use grouping to create various sections.

Some general MS Excel tips & tricks

- Try limiting or eliminating the use of mouse and use keyboard shortcuts.
- Use a blue font for inputs and hard codes while keeping formulas black.
- Keep formulae simple and try to break down the complex calculations into simpler steps.
- Ensure that you know how to use most important formulae.
- Prefer MATCH and INDEX instead of VLOOKUP for the purpose of data query.
- You may use the CHOOSE function to build scenarios

There are many different types of professionals who are involved in building financial models. The most common types of career paths are equity research, investment banking, FP&A, corporate development etc. It



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is also relevant to establish a solid base understanding by taking up professional financial modelling training courses.



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