SALIENCE · A FORECAST FROM WHAT YOU KNOW

Easy as 1, 2, 3, (4).

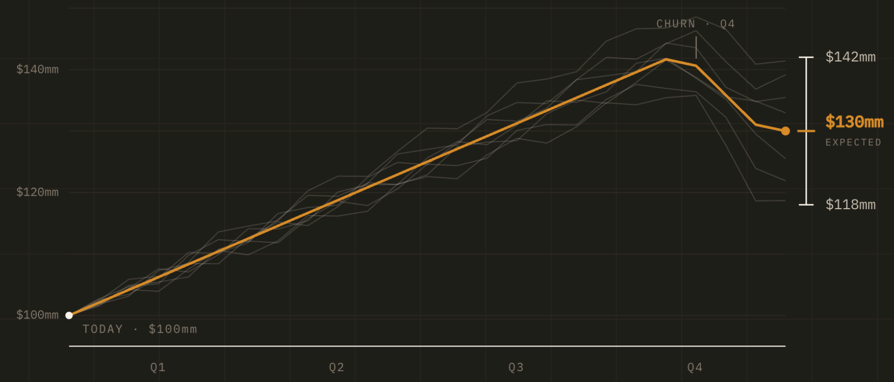
Numbers you already have on hand.

1 What's your revenue, and what's the target?

2 What's a typical deal, plus or minus what?

3 What do you lose, plus or minus what?

(4) Is it lumpy in arrival over the fiscal year?



When talking about Salience, I regularly encounter two surprises. The first relates to how little data is needed to get started. The second is how much insight Salience provides a sales process. The conversation usually goes something like this:

PROSPECT: This seems like it needs a lot of data?

ME: Surprisingly little. Do you know your current revenues and forecast growth rate?

PROSPECT: Of course. $100mm current revenues. 30% growth. Board wants a decent step up from last year.

ME: Is the 30% net of churn?

PROSPECT: Net. We're subscription, and we lose about 20% of the base every year.

ME: Plus or minus what on that 20% churn?

PROSPECT: About five points.

ME: What's your average ticket size?

PROSPECT: About $1mm.

ME: Plus or minus what?

PROSPECT: About $500k.

ME: And how big are the contracts you lose?

PROSPECT: They're mostly legacy, so smaller. Average $750k, plus or minus $150k.

ME: Any seasonality to the churn?

PROSPECT: Yes, it's pretty much all at year-end.

ME: That's all I need. You're expecting to close 50 deals and lose 27 contracts. Given the nature of your sales, expect to finish the year at $130mm, and somewhere between $118mm and $142mm. Also, that revenue variance will usually explain about 90 percent of your earnings variance. CFO might like that info.

PROSPECT: From eight numbers?

ME: Yep. Eight numbers you had on hand. Also, most of that risk sits in one number. Fifty-seven percent of your uncertainty lives in how many new deals close. Twenty-nine percent is churn. Only fourteen percent is ticket size.

PROSPECT: So do we hit 30%?

ME: That's your target. You set and own that expected outcome. But with every target and sales process comes a natural range of outcomes. Yours is about 9% on a net basis. Firms who know that range are more informed. They make better decisions before, during, and after creating the forecast. The number to take to the board is 18%; that's the growth you clear nine years out of ten. With a forecast of 30% you also naturally own a 1 in 10 chance of 18 percent or worse.

PROSPECT: I don't know if my board would like this. They might feel it was a dodge.

ME: Depends on the board. You can also wait and use the number to explain performance. Performance will land somewhere in a band whose width is described by the variance. You can use this information to separate noise from signal. In that context the board will be interested, and it also gets them to see the utility of including the number when budgeting sales.

PROSPECT: Why is churn that big a piece of my uncertainty?

ME: Because you told me twice that it's lumpy. Twenty percent churn plus or minus five points is more spread than twenty-seven contracts of $750k should produce on their own. Another lump is timing. When it all lands at the end of the fiscal year, you only get one draw instead of twelve. Seasonality amplified the risk already present in the churn uncertainty.

PROSPECT: Nobody's ever asked me for a plus or minus before.

ME: That's the trick. You don't need a data warehouse. You only need to answer four questions:

1. What's your revenue, and what's the target?
2. What's a typical deal, plus or minus what?
3. What do you lose, plus or minus what?
4. Is it lumpy in arrival over the fiscal year?

Easy as 1, 2, 3 and 4 when needed. Fifty deals and $50mm of new business. $20mm of it replaces churn, and the other $30mm is growth. We can rinse and repeat if there is more than one sales channel. Is that $50mm of new business all one channel?

PROSPECT: No. To keep it simple, I just told you about enterprise. That's about $35mm of direct sales. The rest is self-serve.

ME: Average ticket on the self-serve side?

PROSPECT: Fifty thousand, give or take half that.

ME: And what churns out of self-serve?

PROSPECT: Not much. It's a newer book and it's small. Almost all the $20mm is enterprise renewals.

ME: So the $750k contracts that churn and the year-end timing are still enterprise. Your churn risk sits in one channel, in one month. But now you have two forecasts. Enterprise is 35 deals. Self-serve is 300 transactions.

PROSPECT: Same money either way.

ME: Not the same risk. Enterprise on its own carries $6.6mm of uncertainty. Self-serve carries $970k.

PROSPECT: Why so lopsided?

ME: Because some risk comes from the count, and 300 is a big number. Individual transactions land high and low and they cancel each other out around the average. Thirty-five deals don't cancel. Five of them slipping past December is fourteen percent of the channel. And risks don't add the way revenue does. They combine like the sides of a right triangle, so a small one sitting next to a big one nearly disappears.

PROSPECT: So the number you gave me before was wrong.

ME: It was incomplete. Split properly, your range tightens to $119mm and $141mm, and the blended number for the board goes from 18% to 19.3%. But don't give them one floor. Give them two. Nine years out of ten enterprise books at least $26.5mm, which is 76% of its plan. Self-serve books at least $13.8mm, which is 92% of its plan. Same confidence, two very different commitments.

PROSPECT: So $40mm is my floor for gross new business.

ME: $41.4mm is. You don't simply add floors. Both channels having a bad year at the same time is rarer than either one having a bad year, and the combined number reflects that. They should be different reviews, too. Down twenty percent on self-serve in Q1 is a real signal, down twenty percent on enterprise is a Tuesday.

PROSPECT: Explain that one.

ME: A quarter of enterprise is about nine deals. Missing by two sits inside the noise on a lumpy process. A quarter of self-serve is seventy-five transactions. Missing by fifteen is nearly twice the swing that process produces on its own; something has actually changed. If you report one blended growth number to your board, you throw away the only early warning you have.

In the vein of that last exchange, another surprise I regularly encounter is how Salience can help a user quickly determine if a forecast remains intact as events unfold. Three months later, same prospect, new conversation.

PROSPECT: We're 27% behind on new business through March. The board thinks the forecast was fantasy.

ME: Behind where?

PROSPECT: Enterprise, mostly. Six deals instead of nine. $6mm against an $8.75mm plan.

ME: And self-serve?

PROSPECT: $3.1mm against $3.75mm. Nobody's worried about that one, it's small.

ME: The enterprise miss is noise. Six deals against nine is less than one standard deviation. Years that finish on plan start this way all the time. The self-serve miss is the one I'd worry about.

PROSPECT: Self-serve is a fifth of the shortfall.

ME: This quarter, in dollars, yes. For the year the two misses cost you almost exactly the same. $2.75mm from enterprise, $2.6mm from self-serve.

PROSPECT: How does the smaller miss cost the same?

ME: Because of what each one tells you. You did seventy-five self-serve transactions and came in 17% light. That's enough observations to question whether your original forecast assumptions have changed; conversion, pricing, traffic, something.

PROSPECT: So one is a bad quarter and the other is a bad year.

ME: The enterprise damage is done and it's bounded. You didn't get 3 deals, but the rest of the year could run as planned. The self-serve damage is mostly still in front of you because the underlying assumptions may have changed, or your execution is lacking. You've lost $650k so far and you'll lose another $1.95mm if the rate stays where it is.

PROSPECT: Where does the year land?

ME: 24.7% if the current rate holds, instead of 30%. Ending revenue $125mm, with a range of $115mm to $134mm. The number for the board moves from 19% to 15%.

PROSPECT: And if we fix conversion in Q2?

ME: Then you get most of the $1.95mm back. You'll know whether you fixed it inside six weeks, because at twenty-five transactions a month the signal arrives fast. You will not get that kind of read on the enterprise channel all year.

PROSPECT: That's the opposite of how we run pipeline reviews.

ME: Most people run them the same way you do. Weekly on the lumpy channel, where a week means nothing. Quarterly on the smooth channel, where a week means everything.

PROSPECT: And churn's been zero so far, as planned.

ME: Right. Sales risk burns off as the year goes; every deal you close is uncertainty you've removed. Churn risk doesn't burn off at all until December. In January churn was 36% of everything you didn't know. By October it's most of your remaining uncertainty.

PROSPECT: Given the time I have until churn hits, what can I do to manage it?

ME: That's a longer conversation, but here's a hint; it starts with your renewal list.
