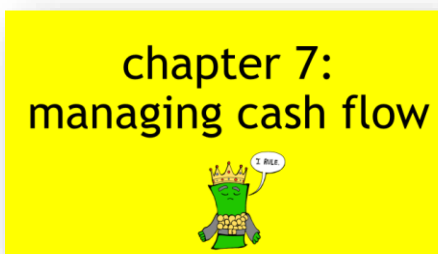
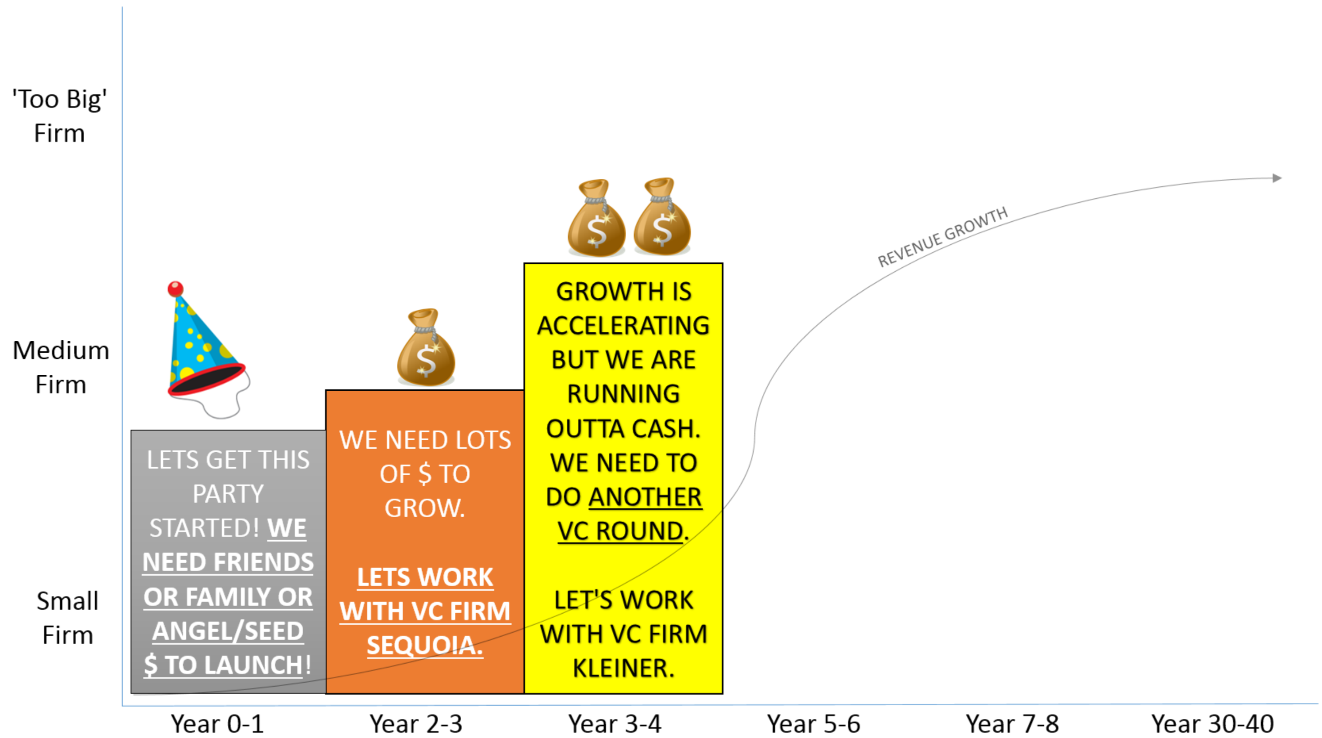
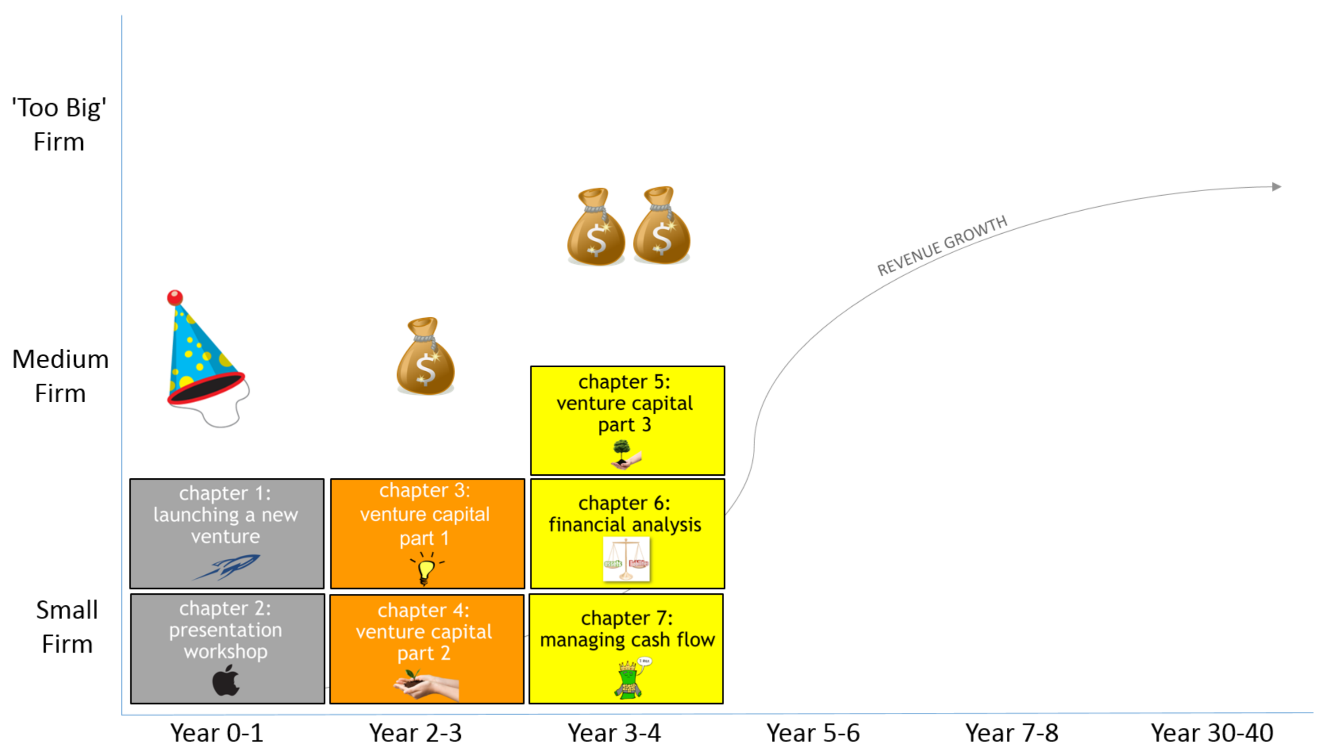
CHAPTER 7: MANAGING CASH FLOW

"I have pledged… to always run Berkshire with more than ample cash… I will not trade even a night's sleep for the chance of extra profits."

\- *Warren Buffett*




'Too Big' Firm
Medium Firm
Small Firm
LETS GET THIS PARTY STARTED! WE NEED FRIENDS OR FAMILY OR ANGEL/SEED $ TO LAUNCH!
WE NEED LOTS OF $ TO GROW.
LETS WORK WITH VC FIRM SEQUOIA.
GROWTH IS ACCELERATING BUT WE ARE RUNNING OUTTA CASH. WE NEED TO DO ANOTHER VC ROUND.
LET'S WORK WITH VC FIRM KLEINER.
REVENUE GROWTH
Year 0-1
Year 2-3
Year 3-4
Year 5-6
Year 7-8
Year 30-40


'Too Big' Firm
Medium Firm
Small Firm
chapter 1: launching a new venture
chapter 2: presentation workshop
chapter 3: venture capital part 1
chapter 4: venture capital part 2
chapter 5: venture capital part 3
chapter 6: financial analysis
chapter 7: managing cash flow
REVENUE GROWTH
Year 0-1
Year 2-3
Year 3-4
Year 5-6
Year 7-8
Year 30-40

MAKING FORECASTS

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how do companies make budgets?

forecasting is not hard.

all forecasts are based on
% of sales

then you make assumptions…

forecasts are never
100% accurate

forecasting is easy.

forecast sales and then the
rest of the model is simple.

Percent of sales analysis is the most important quantitative concept in business.

We will go through this in great detail soon.

public companies forecast quarterly.

start-ups forecast monthly.

why?

because survival is the goal.

all successful entities have budget forecasts

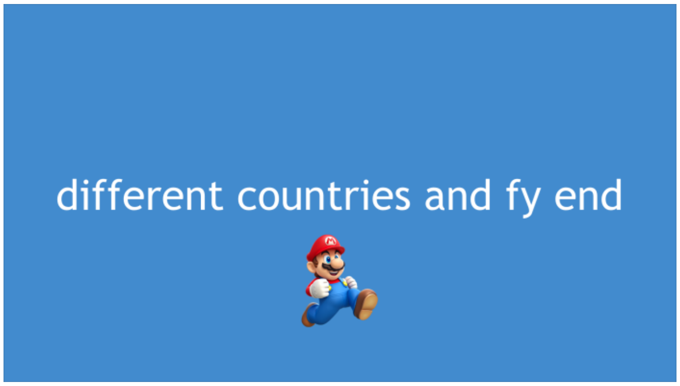
Every company, successful business person or even countries has to make budgets: www.tiny.cc/chris61

Most companies end their accounting or 'fiscal' year on December 31st. However, some companies end their fiscal years at different times. Why? Because some companies started their companies in the summer. As a result, they start their accounting years then, like Microsoft and Oracle, whose accounting years end and begin in the summer.

seasonality & fy end

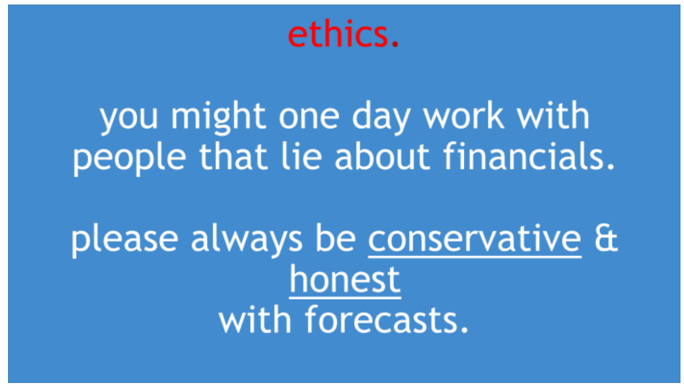
Interestingly enough, retail companies have their fiscal years ending in January and not December. Why? Because they make most of their money in the holiday shopping season. This is why they call it 'Black Friday'…because they go from losing money (in the red) to making money every year by black Friday where they are 'in the black'.

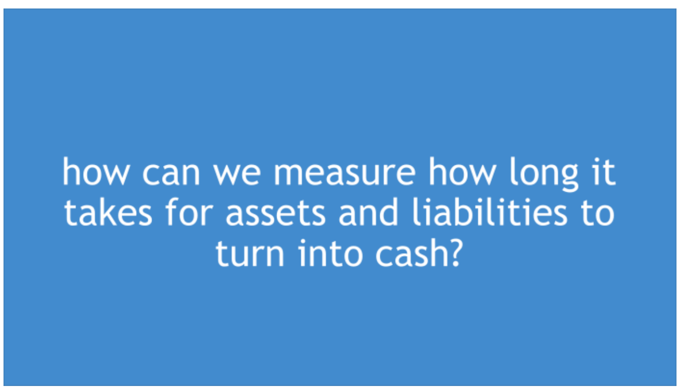
We need to understand seasonality too when making forecasts. Most companies have their best quarter of the year in calendar Q4 (October through December) and their lowest in calendar Q1 or during the summer (especially in Europe where business can grind to a halt there in the summer).



Japanese companies almost always end their fiscal years in March.

When making business forecasts, I can almost guarantee that you will come across people that fudge or make up numbers. Please be careful of liars in business: www.tiny.cc/chris63 .





Cash conversion ratios tell us how many days it takes to convert something into cash.

COGS stands for the cost of goods sold.

another way to think about it is...

If we put another $1 into inventory, it won't be converted into cash (or COGS) for another 50 days.

inventory issues can destroy a company.

Inventory to sale conversion period
=
average inventories
/
COGS
/365

The inventory to sale conversion period tells us how many days it takes to convert inventory into a sale. Understand this equation. Please don't memorize it.

if we sell our product on credit...can we track how long it takes us to collect cash?

sale to cash conversion period

=
average receivables
/
sales/365

The sale to cash conversion period tells us how many days it takes to convert sales into cash!

it is good practice to pay bills as late as you can (without incurring fees or upsetting your business partners).

how can we measure this?

If you replace 365 with 90 then grab the latest quarterly average payable and average accrued liabilities numbers to calculate quarterly ratios instead of annual ratios.

purchase to payment conversion period

=

average payables + average accrued liabilities
/
cogs/365

Questions Based on Chapter 7:

1: The most important forecasting rule is:

a) Most forecasts are based on a percent of revenue.
b) Most forecasts are based on a percent of income.
c) Most forecasts are based on a percent of revenue.
d) Most forecasts are based on a percent of equity.

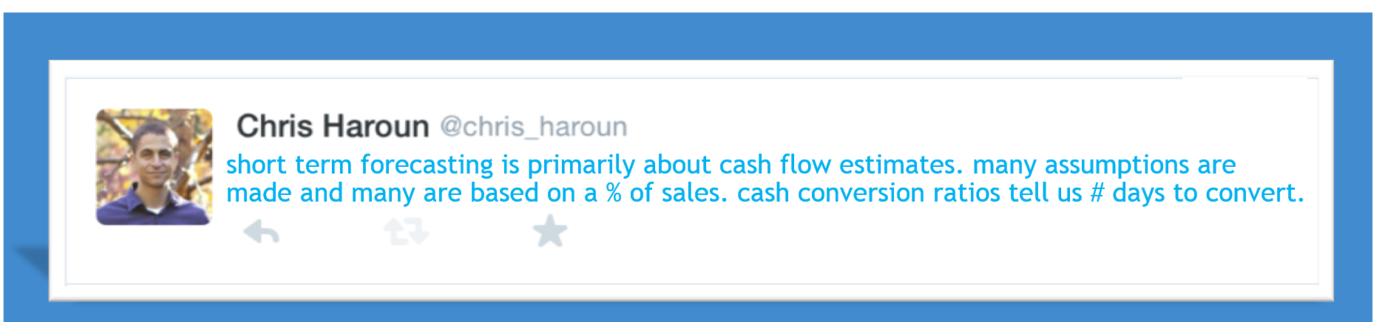
2: Early stage start-ups are more likely to forecast revenue:

a) On a yearly basis
b) On a decade basis
c) On a monthly basis
d) On a quarterly basis

3: Fiscal and calendar years are always the same for every company.

True or False

CHAPTER SUMMARY



Since I am Canadian, I have to end this chapter with the funniest Canadian ever! www.tiny.cc/chris64 :)