Cash Rules Everything Around Me
C.R.E.A.M., get the money
Dollar, dollar bill y'all
- Wu Tang Clan

The great Wu Tang Clan figured it out in the 1990's. Cash does, as a matter of fact, rule everything around us. There is no company in the world where this doesn't apply. Even pre-revenue businesses with massive valuations are pitching the *prospect* of massive cash generation in the future.

This memo is all about cash and the goal is for us to refine what has been a bit of a blurry model on how we think about cash as a company. I fully expect for this to evolve as we evolve as a business, but for now in 2024, this is how I think about cash for the business. Unfortunately, our business doesn't lend itself to a simple definition of "how much cash do we have in our bank account?" As with everything in life, it's more nuanced and requires a little more perspective.

You can go **here** for a simplified corporate projection model where you can toggle cases in C7, or directly edit cases as you please to see the change in cashflow in H9:N19.

So to start with a simple framework for the importance of cash (beyond the extreme basics of "oh you need cash to operate"), but I figured it provides a framework for why a whole memo is dedicated to just a cash mental model:

1. **Surviving 3 Sigma Tail Events**: By definition, tail events are extremely low probability. But low probability (0.3%) is not 0 probability. The COVID pandemic in 2020 was a once in a century occurrence. The Global Financial Crisis in 2008 was a once in a 20 year occurrence. These tail events don't happen *often*… but the point is that they *do* happen. I've told every one of my management teams of my portfolio companies that "If your business can't survive tail events, your business isn't really that good." The best way to survive tail events? A war chest of cash on the balance sheet. This gives you both a strong defensive posture (to meet short term liabilities like payroll, interest expense, COGS) *and* offensive posture (to take advantage of businesses who need cash who are selling at bottom dollar discounts, to take market share from failing businesses).

2. **Investing Flexibility**: Having cash on hand allows a business to respond quickly to opportunities and take big swings on bets, such as investing in new game changing technology, acquiring other attractive businesses to enter new verticals or investing into high ROI new projects. This flexibility is crucial for maintaining competitive advantage. It's frankly why I have so much conviction that the Mag 7 is positioned for consistent strength. Apple has $200B of cash on its balance sheet!!! When they shut down their self-driving car endeavor, all the headlines talked about how they just burned $10B. My only response was, "um, generated $30B of cash… last quarter".

3. **Creditworthiness**: Lenders and investors assess a company's cash reserves and ability to generate cash when evaluating creditworthiness. A strong cash position can lead to

better financing terms and can reassure stakeholders of the company's financial health. I believe it is a large contributing factor for how we generated the terms that we did with JPM. This is a virtuous cycle – companies with better cash positioning have better credit terms (read: cheaper debt), so spend less on debt, which bolsters their cash positions… and so on!

4. **Growth**: Especially in capital intensive businesses (like ours), in order to acquire new clients OR serve existing clients, businesses require cash. Note that this is independent of CAC or the sales and marketing required to get these clients. This is purely on a unit economics perspective top of house perspective. We get into more on this later in the document, but it's important to think about every new client as an investment where you are putting out capital day 1 (for example, HCP pay) and seeking to earn a return on that investment 40-50 days later (upon repayment). I put together a client-level model here on how to think about each new client investment and Zack had a nice writeup on it here which elaborates how he thinks of us as a VC investing in small businesses and corresponding payback periods and returns. You simply can't grow in a capital intensive business without cash.

Before we dive deeper, let's get some definition straight:

Asset Backed Line ("ABL"): Our business unfortunately has a slower cash conversion cycle. We charge HCF's $100. We pay HCP's $80. That's a 20% take rate. With UBER or DASH, they get that cash almost instantly via credit card transactions. For us, with our current DSO at ~50 days, it takes us, on average, 50 days to get that cash back from the HCF's. But we still have to pay out HCP's during that period. So we use our Accounts Receivable ("AR") balance as collateral for an ABL with JP Morgan as a way to generate liquidity from our AR until we get that actual cash paid back from the HCF's. At any given point in time, our ABL will be drawn, and we call that the "Outstanding ABL Amount".

Restricted Cash: As part of our negotiations with JP Morgan on our ABL, we agreed to just stow away a portion of our cash in a bank account that they control in exchange for not having any type of loan covenants. In normal ABL's, they require operating covenants (called incurrence or maintenance covenants), which state that your debt service coverage (EBITDA / debt service) needs to be >1.5x, you need to maintain a net worth > 2x your loan balance, your DSO needs to be <40 days, etc. Given we're never going to a business that runs cash at a $0 balance, this felt like an easy give in exchange for never having to sweat over operating covenants. For all intents and purposes, our current Restricted Cash Balance w/ JPM is $15M. We will likely start adding "earmarked" settlements and regulatory liabilities in the future in this Restricted Cash Balance line item.

Unrestricted Cash: This is basically all the cash we have on our balance sheet that *isn't* part of the "restricted cash" bucket. As a mental framework, so long as it's not in that $15M Restricted Cash bucket, it's unrestricted, and we are free to use the cash as we please.

Net Cash, Including Restricted Cash: *Restricted cash + Unrestricted cash - Outstanding ABL Amount*
This is the tail scenario where JPM becomes a bad actor and we need to pay them off and retire our entire ABL. The net is how much cash we have remaining. I will rarely, if ever, use this metric in evaluating our business.

Net Unrestricted Cash: *Unrestricted cash - Outstanding ABL Amount*
Net Cash less the Restricted Cash amount, informing us of how much unrestricted cash we would have left if we decided to pay our ABL amount down to $0. This comes into play if were to opt to pay down our facility but still keep optionality to draw from it in the future. Reasons this might happen are if we had too much cash on hand, couldn't find other places to invest the capital, and opted to pay down the ABL. You may hear me refer to this as "unencumbered" because this figure does *not* include restricted cash and any cash that would in theory be used to pay down the Outstanding ABL Amount.

Available Liquidity: Unrestricted cash + undrawn ABL availability
This is a metric to use when you think about "how much can I freely spend as a business". In theory (but to be clear, *never* in practice), if you wanted to take all of your Available Liquidity and buy a startup that creates artificial surf waves[1] or the 9th best surf magazine in the world[2], you could. I don't recommend it and this is how you destroy billions of shareholder capital. But Available Liquidity is literally any and all cash that you have access to that you are free to invest as you so please. You may have heard me refer to Available Liquidity as Freely Deployable Cash before. Available Liquidity is probably a better name for this.

Guardrails: Expense Guardrails we maintain for margin for error. Note that these Guardrail figures are based on Unrestricted Cash, not Freely Deployable Cash, as

> We have 3 Guardrails:
>
> *6 months of Op Ex Guardrail*
> This is a metric that we created for ourselves where a 3 sigma event shuts down our marketplace, which means that we are no longer paying out nurses and all the other associated costs of revenues. This is simply a calculation of a rolling 6 months of our historical operating expenses, which have been +/-$7M, so roughly +/-$45M total.
>
> I should note that this is an exorbitantly conservative metric, in that a.) we still have a receivables balance that should continue to generate cash as it winds down to $0, and b.) we are assuming we continue to spend on functions like sales and marketing ($4M saved over 6 months) and don't fire a single person (~$5-7M saved over 6 months).

---

1 https://www.businessinsider.com/wework-ceo-adam-neumann-invested-in-wavegarden-wave-startup-2019-9

2 https://www.businessinsider.com/adam-neumanns-apartment-bought-a-montauk-surfing-magazine-whalebone-2024-5

While there are countless scenarios you could model here on a “run off / pivot”, this crude metric would more likely than not give us another year of runway to figure out a way to pivot assuming that we took the decision to start collecting AR and driving the business to be more lean. Yes, there will be a lot of pain and tears along the way, but the business would likely have ~12 months with this metric to pivot and lift back off the ground.

>1 month of GSV
This guardrail was set up as a simple proxy for a conservative view for the highest Cost of Revenue we’ve realized over the past 12 months to ensure we have enough liquidity to meet this in the tail event that we somehow got 0 cash collections in a month. Note that I call this conservative because unless we have a 0% take rate, our actual Cost of Revenue will always be lower than GSV.

>1 month of Total Costs (Cost of Revenue + Op Ex)
Similar to the above, this guardrail was set up to take the highest total cost we’ve realized over the past 12 months to ensure we have enough liquidity to meet this in the tail event that we somehow got 0 cash collections in a month. So not only are we covering for HCP pay, but also payroll, fixed costs, sales and marketing, interest expense, etc. Again – we are talking 3 sigma events… but as we saw in 2020 and 2008, these 3 sigma events do happen.

How Cash Flows at CBH

Let's first simplify the business to its core so everyone has a crystal clear understanding for how the business as a whole operates and how cash moves around. Many of you have already seen this several times, so feel free to skip if this is too rudimentary, but I feel I need to make this abundantly clear so folks have a crystal clear understanding for how this business operates and why cash rules everything around us.

Here is a simple example for how our business works:

	Month 1		Month 2	
GSV	$100	(1)	$120	(6)
HCP Pay	(80)		(96)	(8)
Net Revenue	$20	(2)	$24	
Bad Debt	(1)		(1)	
Net Revenue (post Bad Debt)	$19		$23	
GSV Growth Rate			20.0%	(6)
Take Rate	20.0%	(2)	20.0%	
Bad Debt	1.0%		1.0%	
Take Rate (post Bad Debt)	19.0%		19.0%	
Net Revenue Deterioriation	(5.0%)		(5.0%)	
HCP Cash Outflow	(80)		(96)	
GSV Collections		(3)	20	(7)
Accounts Receivable Balance	100	(5)	200	(7)
DSO		(3)	50	
Cash Balance				
Beginning of Period	100		20	
(-) Outflows	(80)	(4)	(96)	
(+) Inflows	0		20	
End of Period	20		(56)	(9)

Month 1

1. During Month 1, we book a total of $100 of GSV
2. Our take rate is 20%, which means we pay out $80 in Month 1
3. However, with a DSO of 50 days, we don't actually receive the full $100 of revenue until 50 days later (and start seeing it trickle in Month 2).
4. Our cash outflow is $80 (what we paid to the nurse) in Month 1
5. Our AR balance is $100 (how much the HCF owes us)

Month 2

6. At the end of Month 2, we grow like crazy and book $120 of revenue (good!)
7. Assume that our DSO is at 50 – this means that our AR balance is $200 at the end of the Month (AR = DSO / 30 * Sales), which means that our AR grew by $100 from Month 1 (not good)
    a. What does this mean? It means that, assuming we booked 100% of our $120 in revenue into AR because it won't be collected for 50 days, you only actually collected $20 from Month 1 (remember – DSO is an average figure, and when you're trending at 50 days, you basically only collect $20 in Month 2 and the majority in Month 3)
8. Our take rate is still 20%, which means we pay out $96 in Month 2 (really not good)
9. So put together, in Month 2
    a. Beginning cash balance of $20
    b. (+) We realized $20 in cash from Month 1

c. (-) We paid out $96 to nurses in Month 2
d. = -$56 cash balance in Month 2

Key Variables for Cash Movement at CBH (helpful to toggle the model to see this live)

1. Take rate

   This is how much cash we have to pay to HCP's for that period and how much we're collecting from HCF's in the future. *This is arguably the most important metric in this entire business*. Its flow through implications are massive. The take rate is quite literally our revenue generation engine. And the flow through effects are almost 100% to profit or loss. In other words, for every $1 I increase my take rate, that $1 flows down to my bottom line. Of course at 100% take rate you have no customers, but you ideally want to be on the efficient frontier for take rate.

   I have heard a lot of people say any $1 of additional net revenue is positive for the business. I could not disagree with this more and this mentality could lead to very dangerous cash predicaments for the business in the future.

   a. We have direct costs associated with a shift below the net revenue line (most notably, interest expense and credit risk associated with financing customer GSV),
   b. We also have costs associated with acquiring and maintaining HCFs as well as maintaining a scaled business
   c. Any time an HCP works a shift at a low or unprofitable HCF when they could have worked at a more profitable HCF we have lost the opportunity to better service our better customers in addition to earning more revenue for that HCP's shift
   d. In a business with finite cash, we are floating that 99% COGS for 60+ days just to make $1 back, meaning we are burning through cash for 60+ days in hopes of making $1 on the back end, while also praying that HCF pays us back the full 100%
   e. To the degree we aren't focused on turning "bad" customers into good ones, we are losing opportunities to potentially have a better relationship.

   What is my ideal take rate? Obviously, the higher the better (we used to do 28% in 2022!!), but based on some high level modeling, **20%+ is where we should be aiming for, as this allows for us to continue generating cash even in higher GSV growth scenarios.** For context, even at a 1% / month GSV growth rate at 16% (where we are today), we continue burning cash.

2. Bad Debt

   A way to think about our business is we are levered 4:1 – 5:1 from GSV to Net Revenue (assuming 17-20% take rates). In other words, for $100, there is $80 of nurse pay and $20 of net revenue to us (80:20 -> 4:1 leverage). Why is this relevant? Because bad debt on the gross revenue figure is very much amplified. 1-3% bad debt at the GSV ("asset") level may seem innocuous (and is decent by most lending measures),but from the net revenue ("equity") level, the levered compounding effect massively deteriorates our cash collection.

So assuming a 20% take rate (levered 4:1), if you have 1% bad debt, that is at the GSV level – which may seem innocuous, but your Net Revenue just dropped by 5% (from $20 to $19). You move to 3% bad debt (which is roughly where we are), and that just moved to 15% (3% * 4x multiplier + 3%). Bad debt incurrence is especially bad in levered business, and it is crucial that this be minimized.

We should be **targeting <50bps of bad debt** in this business, especially given the massively diverse facility pool we have. Having 0 is an unreasonable assumption, as we inevitably will have bad payers – but we should strive to catch them early and not let them get out of hand for the sake of "growing GSV". **Because at the end of the day, GSV is meaningless if we don't get any of it back.**

3. DSO / Collections

This is how long it takes us to collect on the cash we're owed from HCF's. The higher the DSO, the longer it's taking us to collect cash. In a business where we are extending net 30-45 terms, there is simply no reason that our DSO should be at 50 today. Quite simply, the issues with higher DSOs are:

a. Quite obviously, it takes longer for money to come back in the door. And remember, we've already spent $'s on the nurse pay side, so we are waiting to collect our margin on that
b. The longer it takes money to come back, the more things that can go wrong. The macro environment can change, the facility could end up accruing more debt and filing for bankruptcy, etc. This then funnels into #2 on the bad debt side
c. The sooner we can make collections from prior periods, the better we can float existing period nurse pay. The cash implications are that we then draw less on our facility or we burn less cash.

Given we predominantly have net 30 terms with some net 45, **we should be targeting 40 days DSO**. I would say that this is the lowest hanging fruit of everything here to fix. I would boil down to 3 points:

a) Early detection: Catch bad payers early (this is an easy signal - are they paying on time?)
b) Monitoring / red flags: are we seeing any stress with existing payers that we need to get in front of more quickly? If so, we should be lowering credit limits until they become current
c) Mindset shift: We need to start actively thinking about "to whom do we want to lend?" I'll give you an example – if Fidelity Credit Cards called me and said, "great news, we are offering a promotion where you get 0% APR for 12 months!" I would say, "great, but this is not exciting to me at all." Simply put, people with good credit do not care for the extra 2 months of float. Naturally, people who want more time are folks who are more cash strapped – and riskier.

   And the reality is that there are some folks who very clearly are taking advantage of the system and seeing how far they can stretch "free labor" from us. These

folks are NOT our friends and not customers we want. Early detection and monitoring should cut these quickly going forward.

4. GSV Growth

   GSV growth is a sneaky one. In almost all businesses, you look at top line growth, and you are ecstatic. However, in a business with high DSO (where you aren't collecting cash as soon as you book revenue), you start running into cash crunches with rapid GSV growth. **If this were a 1-2 day DSO business, I would feel very differently about striving for GSV growth.**

   Specifically, going back to the mechanics of our business, each month we are collecting revenue from prior booked months (~50 days after booking revenue).

   Put all together, this is why DSO, take rate and bad debt are so important – it enables us to use cash generated to grow the business. How much cash we collect from #2 and #3 is used to pay the HCP's in #1, which is driven by take rate and GSV growth (#4). In a slow growing (or even steady state business), the cash trickles in, and assuming you have a high enough take rate, we should be generating enough cash from prior month collections to pay for current month nurse pay.

   However, for what we are seeking, hyper growth in this business means that we are floating dollars. And high growth, put in conjunction with high DSOs (read: slow collections), low take rates (read: high nurse pay), high bad debt (read: lower collections) all put together would lead to a bad liquidity situation for the business.

   There is no real target here I would offer up – we are never going to artificially constrain growth of the business to manage cash. What I've traditionally told management teams is, "If something is a good for business, we'll figure it out later." We should be setting up the business optimally so that we have the liquidity to hit real growth. So if we hit 1, 2 and 3 well, we can handle GSV growth (4). But what I need to emphasize here is that **GSV is just one data point. It cannot be the only metric we are measuring our success on**.

The Different Seasons

Peacetime

This marks a time where there is neither contraction nor growth in the marketplace. There are two ways to think approach this season, depending on our comfort level with our existing liquidity levels:

1. Bolster cash position

   When growth is stagnant, the good news is that this business can and will produce cash. The easy answer is always "Um yes, let's just print more cash." However, that's not always necessary (despite every CFO's push to print more cash). If we've met and feel

comfortable with our Net Unrestricted Cash position, we can and should pursue high ROI strategies that could help drive growth in the future (both inside and outside the core business).

2. Experiment

   Again, the good news is that we are producing cash on a monthly basis. If we feel good about our balance sheet, we should be diverting that cash production to figure out how to fortify our current market share, find attractive acquisition targets, re-invest in our marketing, or otherwise engaging in high ROI strategies that can and will yield more cashflow in the future.

Wartime

This season marks a season where the business (and/or market) are shrinking. Note that this is why you want we keep emphasizing building a strong liquidity profile. We want a war chest going into this type of period, and on top of this, we should be battening down the hatches. We should be in strict cash conservation mode and doing what we can do stay profitable. This means maniacal focus on contribution profit (which could mean increasing take to increase margins OR decreasing take to take market share), collecting receivables as aggressively as we can, cutting hiring and non-essentials, limited new bets, and maniacally cutting any client that may smell like bad debt to us.

Note that this does NOT mean we are not trying to pursue new clients and grow. Again – we need to be focused on maximizing contribution profit by any lever we can. Churn will likely be much higher during this period, so we'll need to do what we can to replace that churn. However, given the burndown of our receivables, **our cash balance will actually *grow*, which can be quite misleading**. We can't let that deceive us – the organization will need to be rightsized to appropriately accommodate for this business shrinkage.

Hypergrowth

I define anything as >5% per month as hyper growth (~70% annual growth over the course of 12 months) season. Similar to Wartime, you need to be prepared from a balance sheet liquidity perspective going into this. However, I would note that if we are, in fact, experiencing this type of growth at this point of the business cycle, we have the luxury of being picky. We can choose the best customers (minimize bad debt), we can force tighter credit terms (minimize DSO), and we can probably charge more (maximize take rate).

Note that we should not be "forcing" growth and making bad operational decisions just to make GSV look better. I've said it before, and I'll say it again: GSV growth doesn't matter if you can't collect on it or aren't profiting from it. Forcing growth looks like:

- Lowering charge and take rates on a recurring basis with no plan to "normalize"

- Continuing to keep bad customers on the platform who haven't paid us the past 3 months
- Extending net 60+ terms to customers who are heavy users for extended periods without any evidence of repayment

If you do some of these on a temporary basis to "win" business that you expect to be repeatable, that's okay – we can just wrap the mistakes into CAC. But while GSV growth looks nice on paper, it's the wrong metric to focus. What actually matters is our contribution profit, net income and Net Unrestricted Cash positions.

So next time we start feeling a big push on the hypergrowth front, be prepared to consume cash – but also sit back and say "Wait – we have a great product, and let's get compensated for it!"