



Michael Gonnerman, Inc.

FINANCIAL MANAGEMENT FOR HIGH TECH COMPANIES

Presenting Your Financial Statements

So you can communicate your financial results
clearly and elegantly.

2009

Why can't I communicate?

1. Financial data is inherently complex – many data points, many categories
 - “85% of all managers and workers do not understand the financial or operating reports they receive”

Dr. Irwin Jarett – Tomorrow's Software

1. Some concepts are not intuitive
 - “I'm embarrassed to tell you I don't know the difference between cash and accrual accounting.” CEO of major company
2. Many audiences, with different frames of reference

Topics

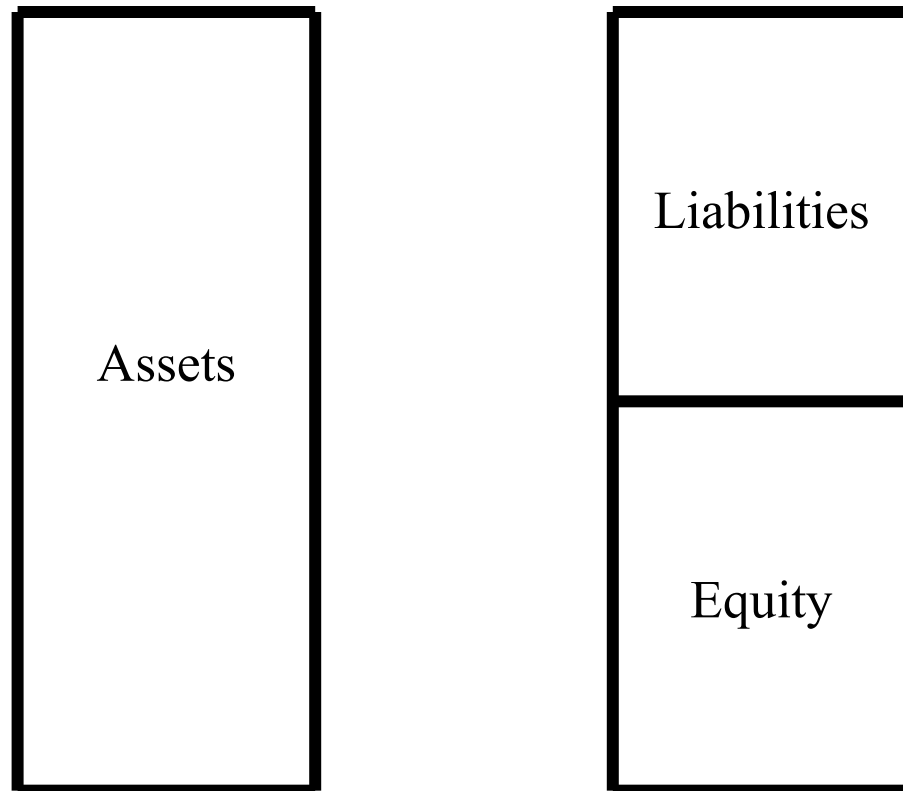
2. The balance sheet
3. Current financial reports
4. Forecasts
5. Dynamic models

I – The balance sheet

- 3. The single most important financial report
- 5. Also, the single most difficult report for communicating and persuading

How to understand the balance sheet

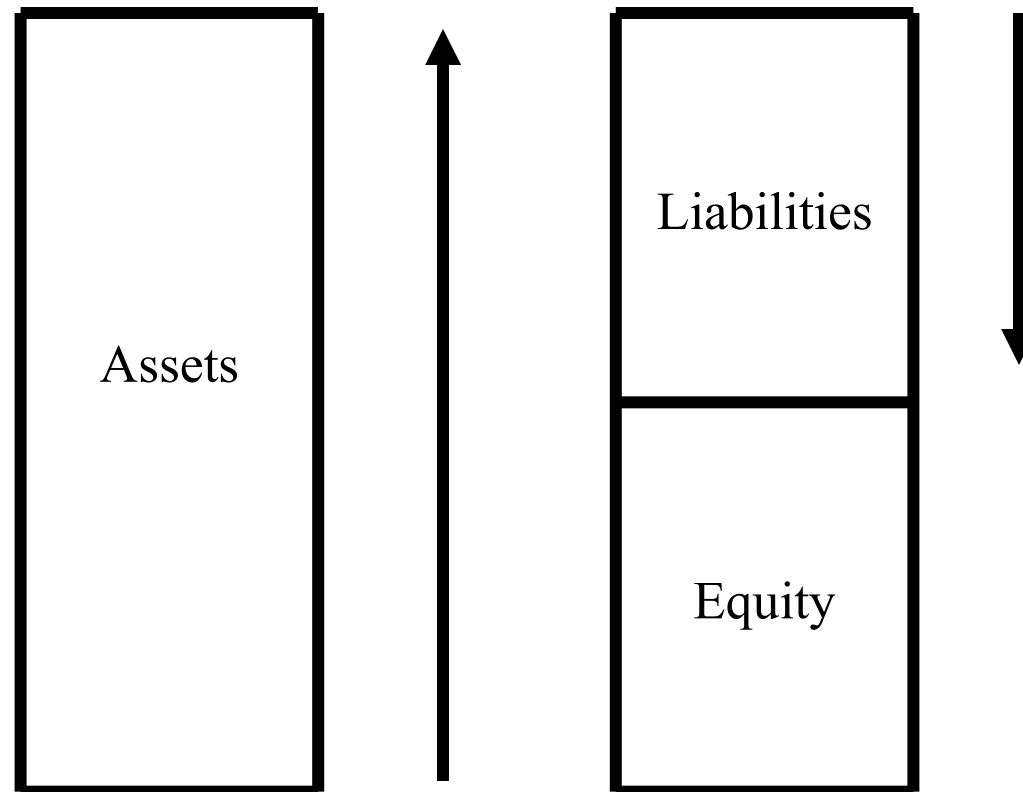
- Company's equity is same as your personal net worth
- But, the algebra is confusing
 - Personal situation: $\text{Assets} - \text{liabilities} = \text{equity}$
 - Company position: $\text{Assets} = \text{liabilities} + \text{equity}$



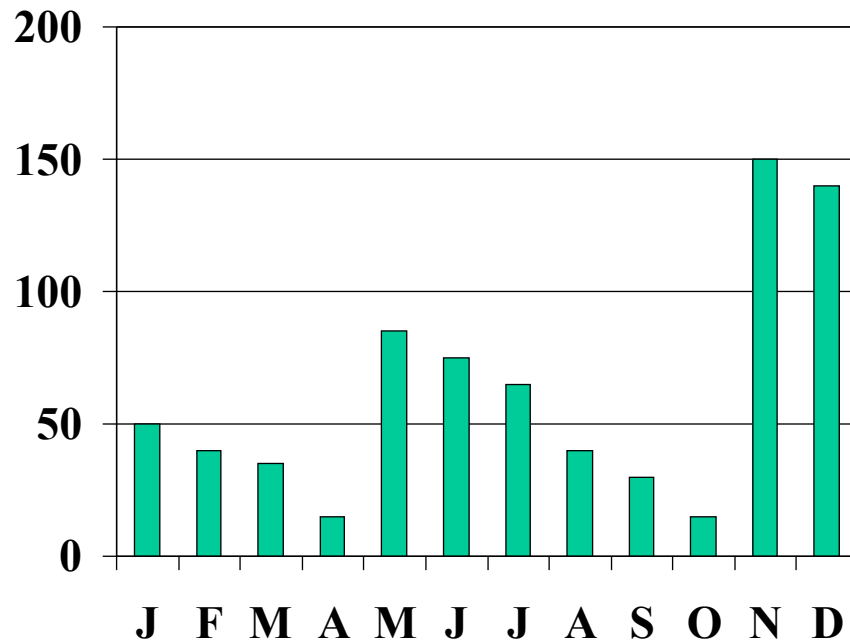
What to focus on when presenting the balance sheet

2. Liquidity – near term financial situation
3. Changes in cash
4. Timing of assets and liabilities
5. Individual line items
6. Balance sheet ratios (relationships)

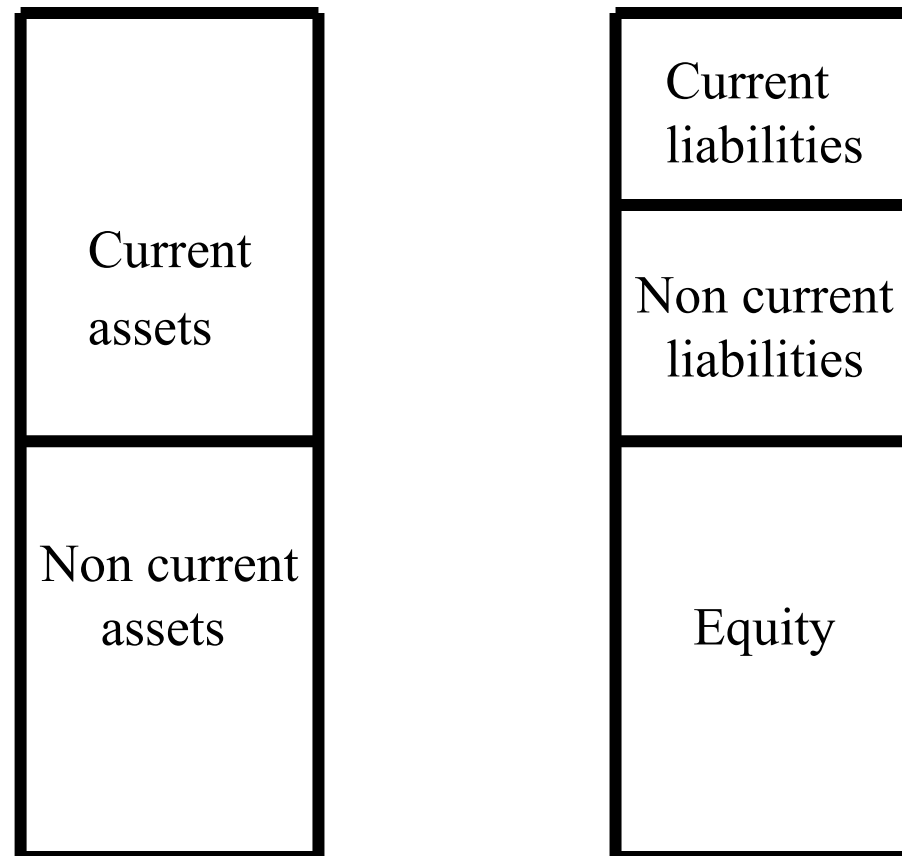
The liquidity issues



The changes in cash

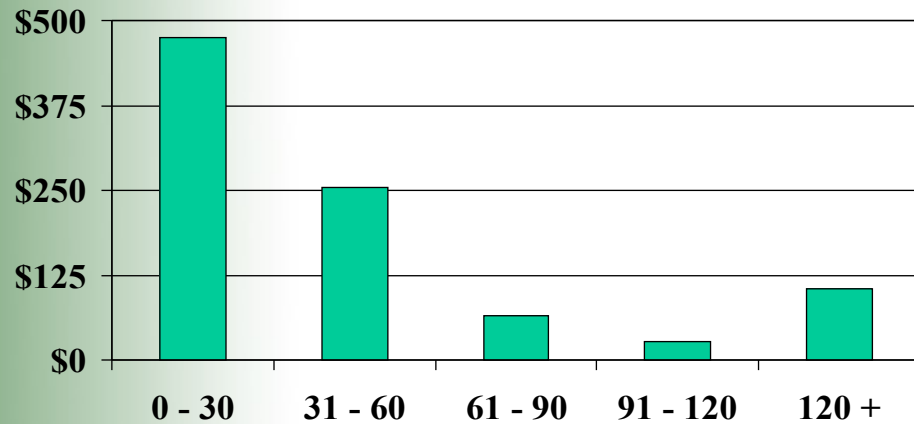


The timing of assets and liabilities

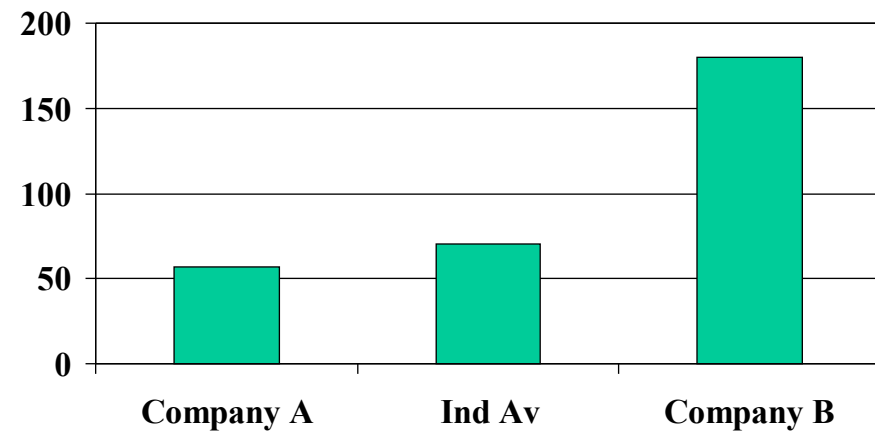


The individual line items and ratios

A/p aging



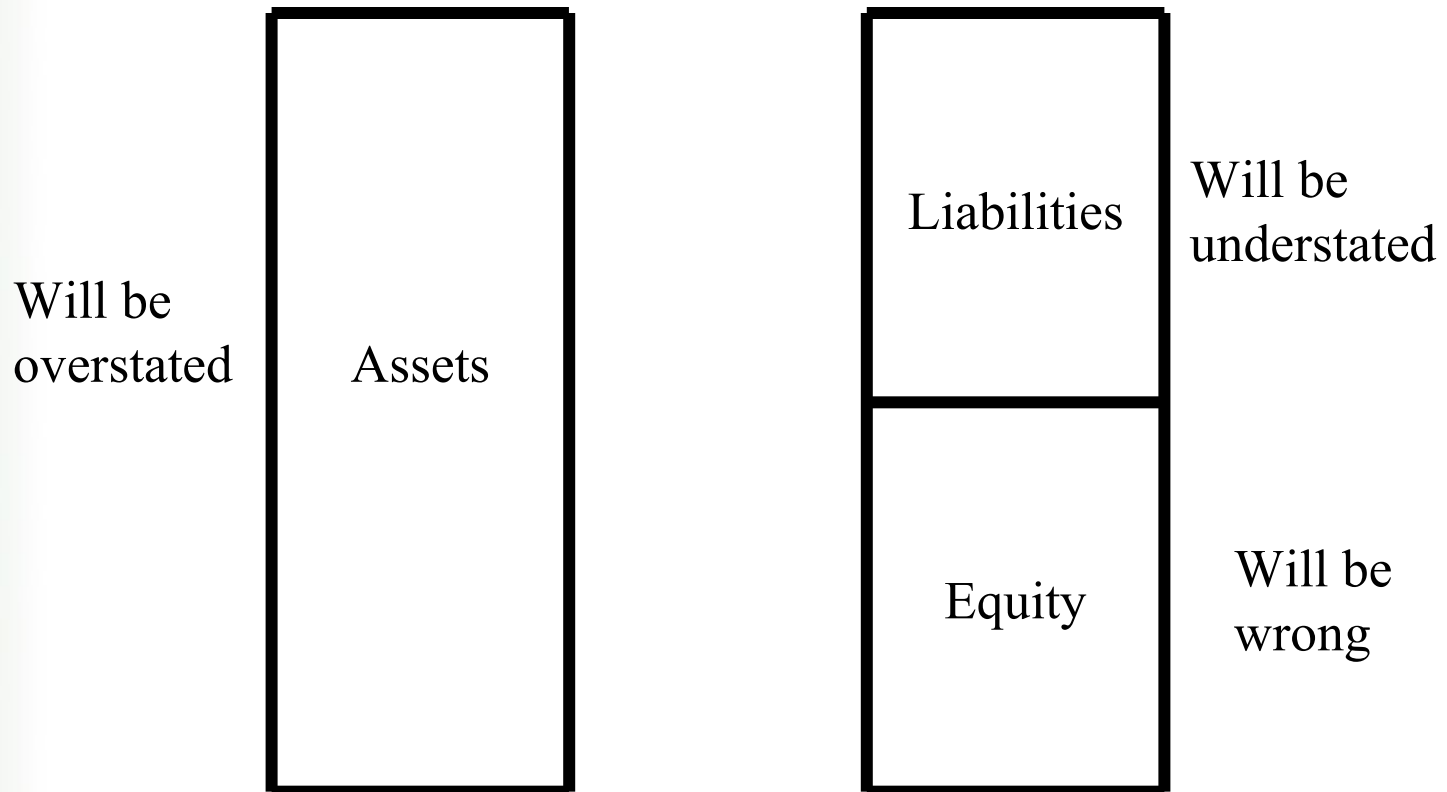
Days payable



The balance sheet relationships

2. Equity – assets less liabilities
3. Liquidity – near term financial situation
4. Leverage – assets financed with debt
5. Debt to equity – assets available to repay debt (cushion)

Poorly designed reports may mask financial fraud



Topics

2. The balance sheet

3. Current financial reports

4. Forecasts

5. Dynamic models

II – Current financial reports

- Basic part your job – daily, monthly, etc.
 - “Now I know what a CFO does.” CEO (Harvard MBA) after seeing a well designed monthly financial report.
- 3. Different audiences, different priorities
 - “You mean we are big enough to have graphs?” CEO on seeing a monthly financial report with graphs
- 4. Goal: make sure reports are absolutely clear
 - Poorly designed reports can mask fraud
- 5. Goal: avoid too much paper

Question -- What numbers do you look at first?

Sales	
Profits	
EPS	
Cash	
Cash flow	
Net worth	
Working capital	
Act vs. plan/std	

Question -- What numbers do they look at first?

	Empl	Dir	Investor	Banker
Sales	1	3	4	
Profits	2	4		
EPS	3			
Cash	4	1	1	4
Cash flow		2	2	3
Net worth				1
Working capital				2
Act vs. plan/std			3	

Step #1 -- create a financial dashboard

1. 7 points you need to know
 - Cash position
 - Receivables (future)
 - Billings (future)
 - Bookings – orders received this period
 - Backlog – orders unfilled at end of period
 - Headcount and turnover
 - Open to hires (positions to fill)
2. Updated weekly
3. Small companies – simple, Excel based
4. Large companies – complex, system generated

Financial dashboard

	Wk 1	Wk 2	Wk 3	Wk 4
Cash position	10.2	11.7	12.2	12.3
Receivable position	4,982	3,487	2,853	2,820
Billed this month	807	812	946	1,013
Backlog	2,750	2,257	2,257	2,257
Booked this month	0	0	512	1,212
Headcount	127	127	127	123
Open to hires	8	8	7	6

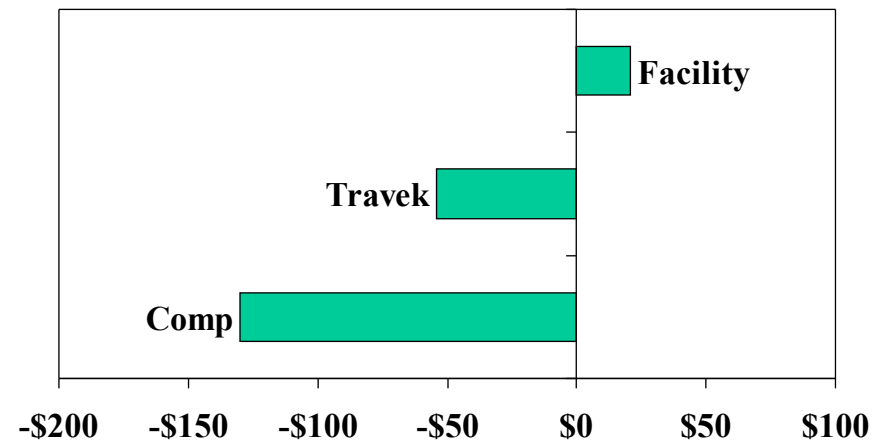
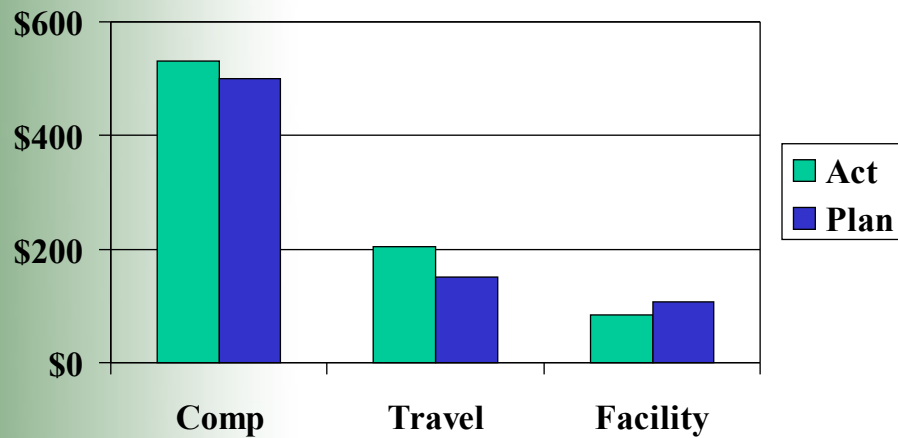
Step #2 – use template-driven monthly reports

1. Charts
2. Text
3. Numbers
 - This period
 - Income statement
 - Actual compared to Plan
 - Month, quarter, year-to-date
 - Balance sheet
 - Cash flow statement
 - Balance sheet details
 - Forecast for rest of year

Form is substance

2. Number the pages
4. Use the right charts to tell your story
 - Not just bar, column and pie charts
 - Consider doughnut, area, waterfall, tornado, Gantt, totem pole, histogram, bubble, and org charts, as well as maps

Measure p/l variances

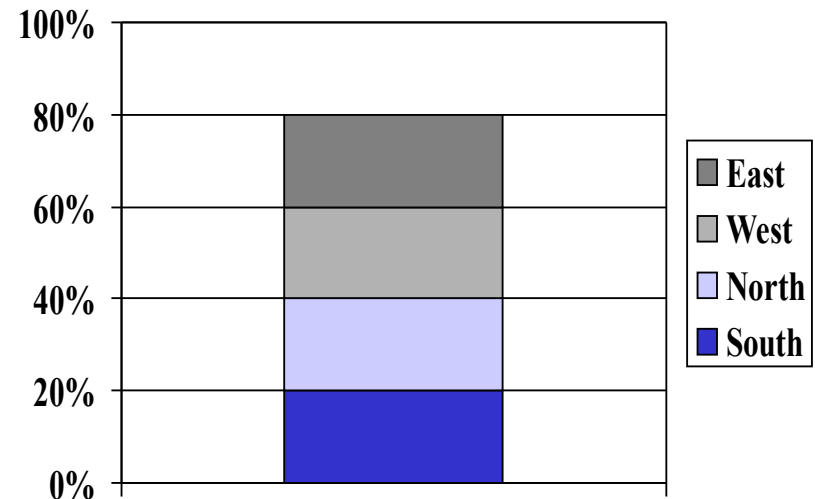


Note – negative variances are “bad”, positive are “good”

Measure sales performance



Totem pole chart
% of quota



Monitor changes in sales forecasts

Waterfall chart

Actual compared to Plan/Fcst

	Jan	Feb	Mar	Apr	May	Tot
Plan	10	10	10	10	10	50
J Act/Fcst	9	10	10	10	10	49
F Act/Fcst	9	8	9	9	9	44
M Act/Fcst	9	8	7	8	10	42
A Act/Fcst	9	8	7	8	8	40

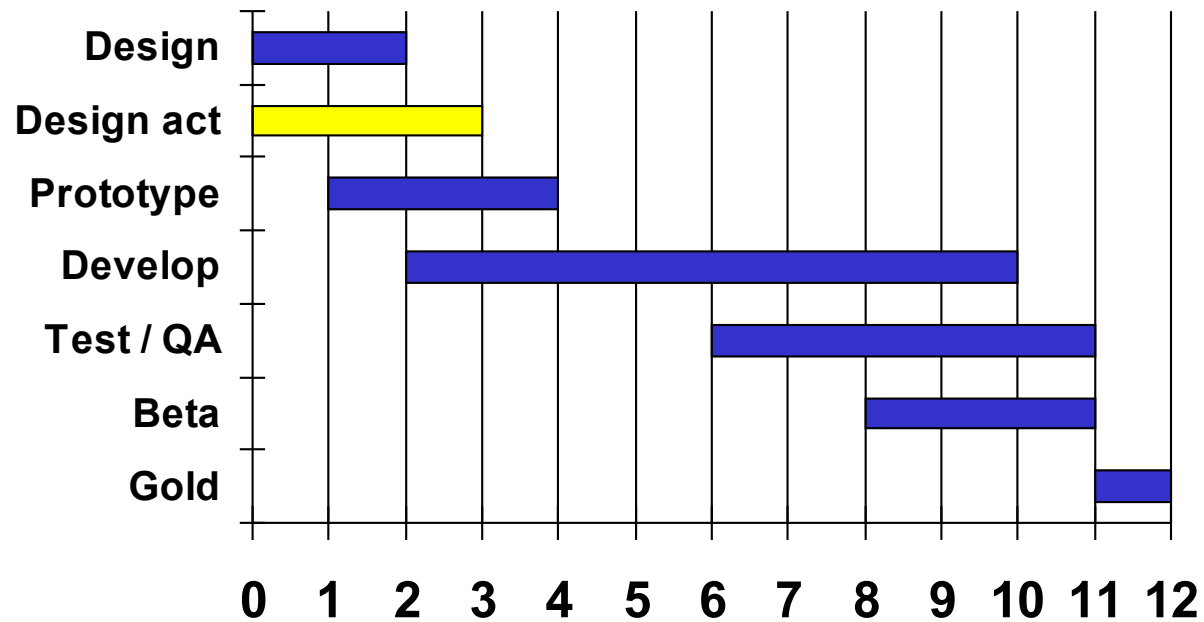
Plan

Act

Fcst

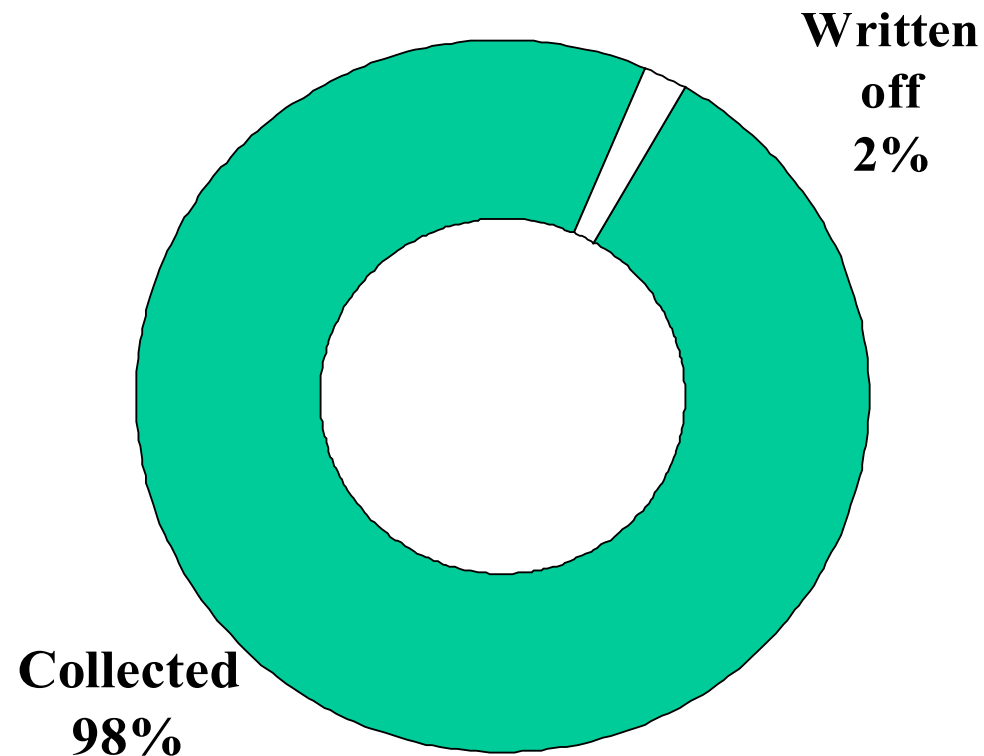
Track developer performance

Product release calendar

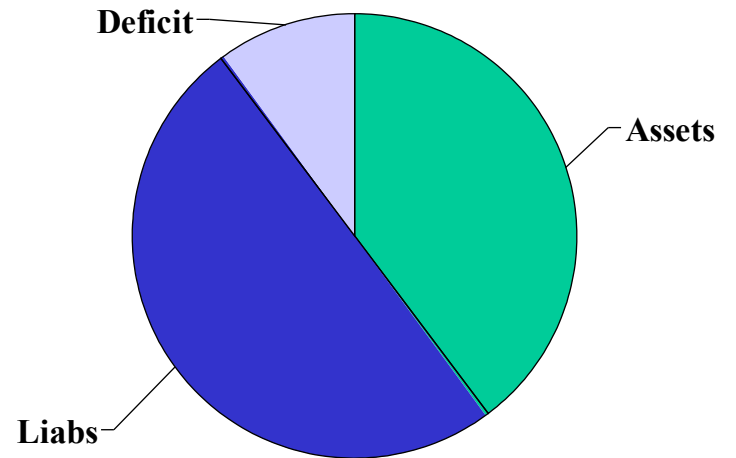
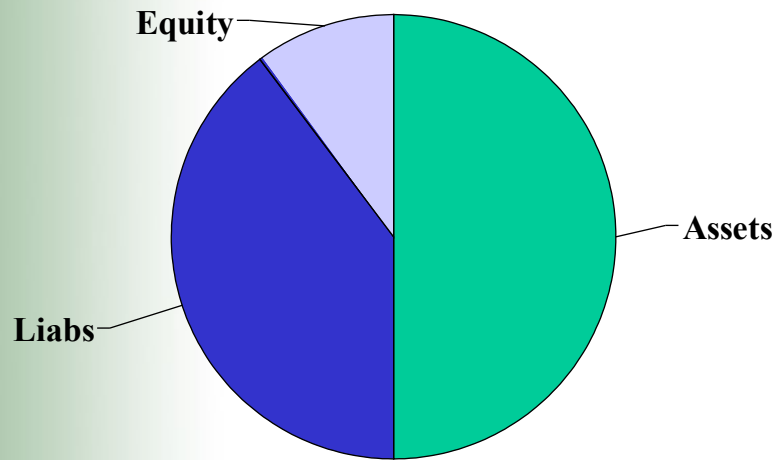


Review f&a performance

Collection history

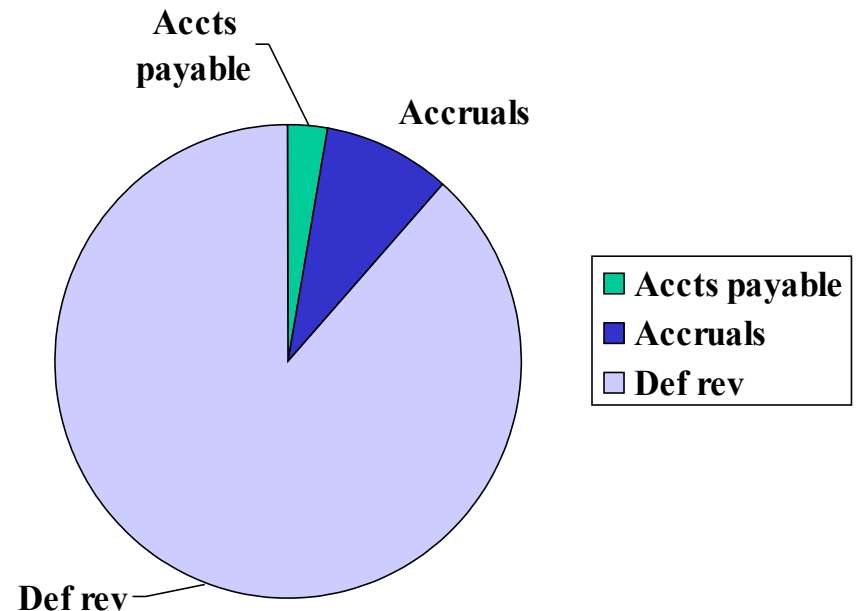


Show balance sheet strength



Analyze balance sheet components

	Bal
Accts payable	32
Accrued liabs	105
Deferred revenue	1,050
	1,187



Step #3 -- Tailor the reports to your audience

1. Banks

- Compliance with covenants
- Adequacy of collateral to ensure repayment

2. Current investors

- Timing and amount of next round
- Management of issues that will drive next financing or liquidity event (sale, ipo, bankruptcy)

3. Employees

- Operations (sales, profits)
- EPS
- Cash
- Will I earn my bonus/commission?

Topics

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III – Forecasts

1. Current financial statements serve one purpose – they are the basis for the financial outlook
 - “What will your low cash balance be during the rest of the year?” -- VC investor in first Board meeting after investing \$6m
2. Update frequently (weekly is sometimes appropriate)
 - “I hired two Sloane MBA’s, and they ran our financial model every day.” CFO of a company when it grew from \$10m to \$400m
3. Format – same as basic financial statements

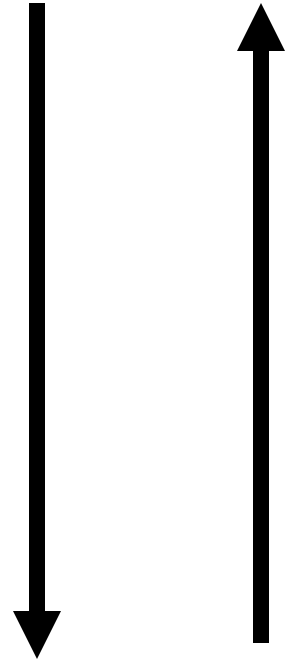
The general rules

1. Answer the “what if” questions
 - Cash forecast – can you meet payroll?
 - Cash forecast – amount of cushion?
 - Cash – how much should we raise?
 - Covenant compliance?
 - Comparison to prior forecast?
 - Effect of major transaction?
 - Sensitivity – to changes in DSO, inventory turnover, days payable, productivity?

The forecast structure

2. Top level financials
 - Income statement, balance sheet, cash flow
4. Revenue and expense summaries
 - By type/function, by region/dept, staffing
6. Expenses by department
 - Sales, development, other
7. Assumptions

CEO's Accts



Create the forecast – steps 1 - 3

1. Set up the financial model
 - Same format as monthly financial statements
 - Populate actual monthly results ytd
2. Develop the revenue forecast -- assumptions include
 - Productivity of sales forces
 - Time to become productive
 - Effectiveness of marketing programs
3. Next, forecast expenses – assumptions include
 - Headcount
 - Other expenses, like travel, facilities and interest rates

Create the forecast – steps 4 – 6

1. Generate a balance sheet from the drivers for each line item
 - A/r from DSO, inventory from turns, a/p from days payable
 - Fixed asset from cap spending (capital budget)
 - Debt from financing plans (banks, mezzanine)
 - Invested equity from financing plans (FFF, angel, VC)
 - Earned equity from the income statement
 - Process iteratively to “get it right”
2. Develop the cash flow forecast
 - Checkbook format
3. Present the results
 - Summary – graphs, text, top level numbers
 - Details – by department

Question – what 3 charts must be in your business plan?

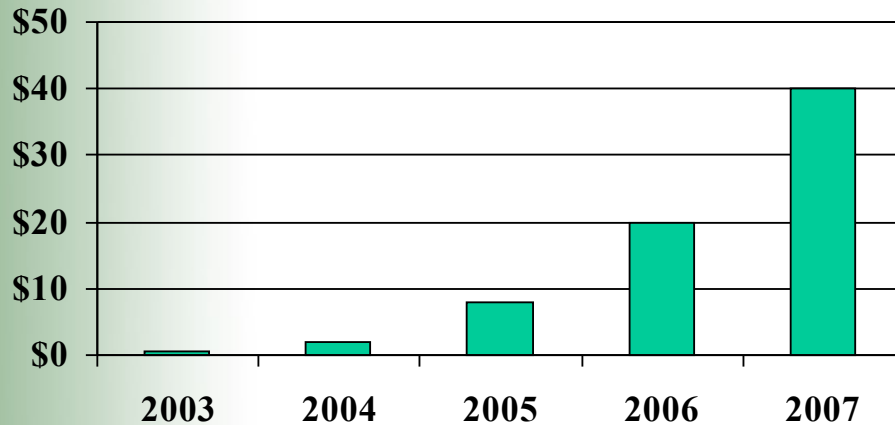
3. ?

4. ?

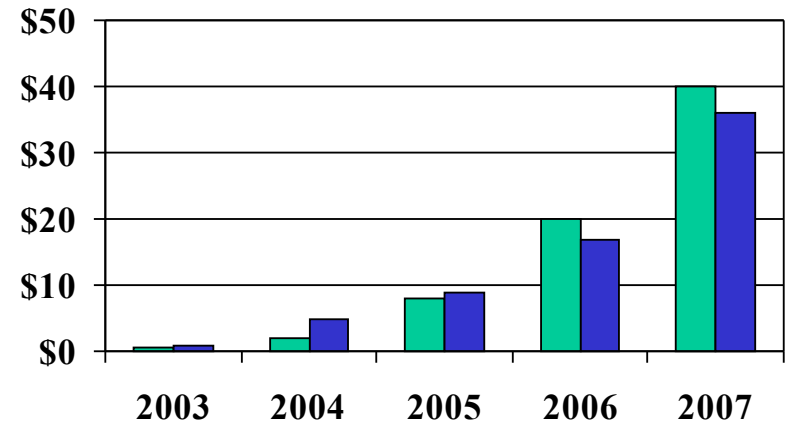
5. ?

Put these charts in your business plan.

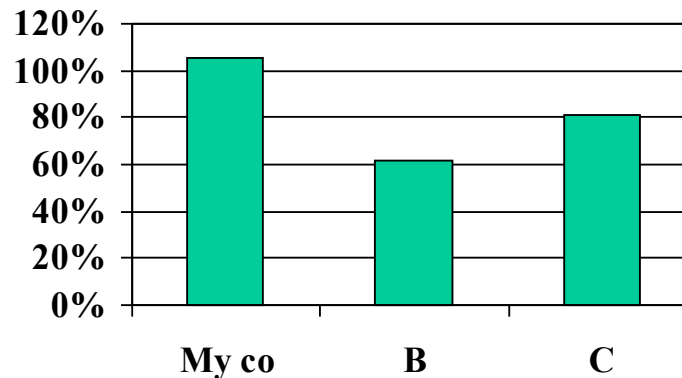
Revenues



Profitability



Compound annual growth rate



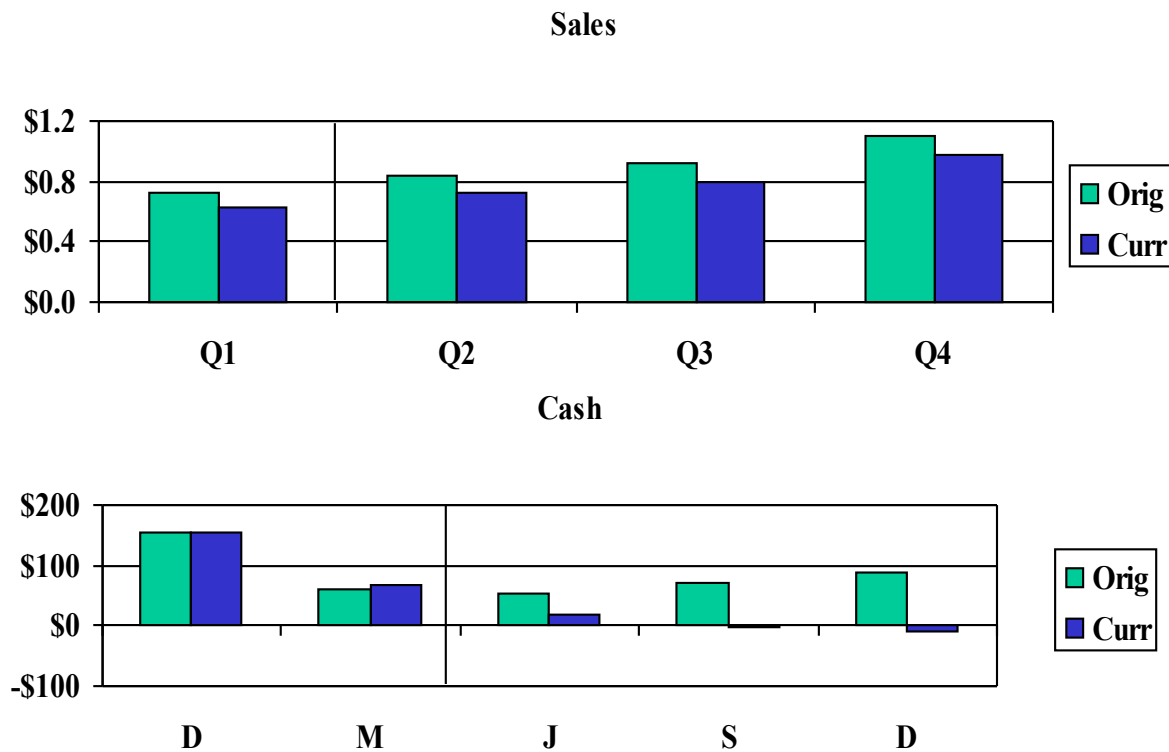
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IV -- Dynamic models

2. This is the best way to communicate how a business changes
3. Immediate feedback to “what if” questions
 - “You did that forecast last week just before sending out the Board package. What do you now think?” – Director at company that just raised \$20m.
4. Run the financial model, real time, and see the effect of changes in graphs and numbers

Dynamic model graphs



Model background

1. Income statement forecast
 - Revenues \$3.6m
 - Profitable -- \$230k
 - Headcount increases from 14 to 26 this year
2. Balance sheet forecast
 - Cash EOY = \$88k
 - Receivables EOY = \$744k

Question – which assumptions are the most significant?

	PLAN
Sales performance vs. quota	91%
Annual maintenance fees	15%
Commission rates	8%
Annual travel expenses	\$30,000
% of R&D costs capitalized	35%
Spending on marketing programs	\$350,000
How fast customers pay	50 days
How fast we pay creditors	35 days
Spending on new computers for each hire	\$3,000
% of equipment purchases financed	60%
Interest rates paid	18%
Executive compensation	\$100,000

Here are the most significant assumptions

		Annual		One quarter	
	PLAN	\$ effect on cash of a (10%) dif	Rank	\$ effect on cash of a (10%) dif	Rank
Sales performance vs. quota	91%	-127	1	-2	
Annual maintenance fees	15%	-26		-3	
Commission rates	8%	-10		+2	
Annual travel expenses	\$30,000	-6		-1	
% of R&D costs capitalized	35%	+6		+2	
Spending on marketing programs	\$350,000	-18		-5	
How fast customers pay	50 days	-75	2	-55	1
How fast we pay creditors	35 days	-14		-16	2
Spending on new computers for each hire	\$3,000	-2		--	
% of equipment purchases financed	60%	-3		-1	
Interest rates paid	18%	-1		--	
Executive compensation	\$100,000	-7		-2	42

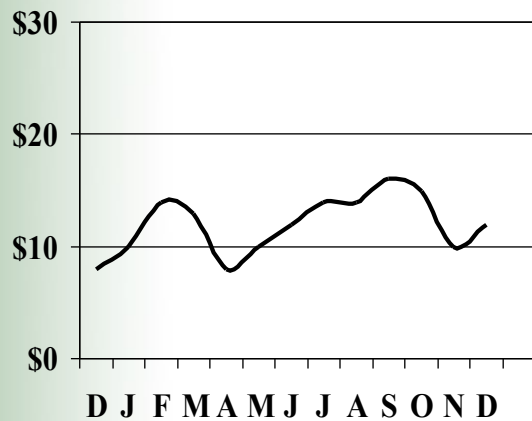
The next steps -- #1

2. Probabilistic modeling

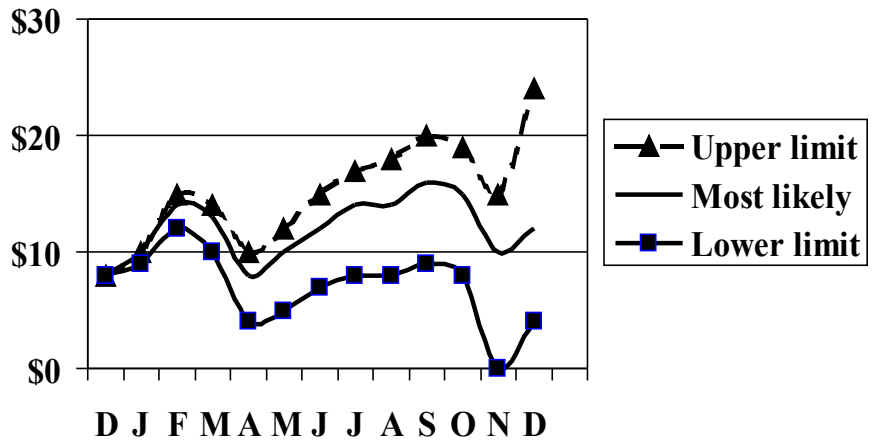
- Fortune 500 approach – GM, Merck, Microsoft, Ford, USDOT
- Assign probabilities to each assumption (Monte Carlo)
- Result – calculate the probability of a series of outcomes, over time

Cash forecast

Traditional



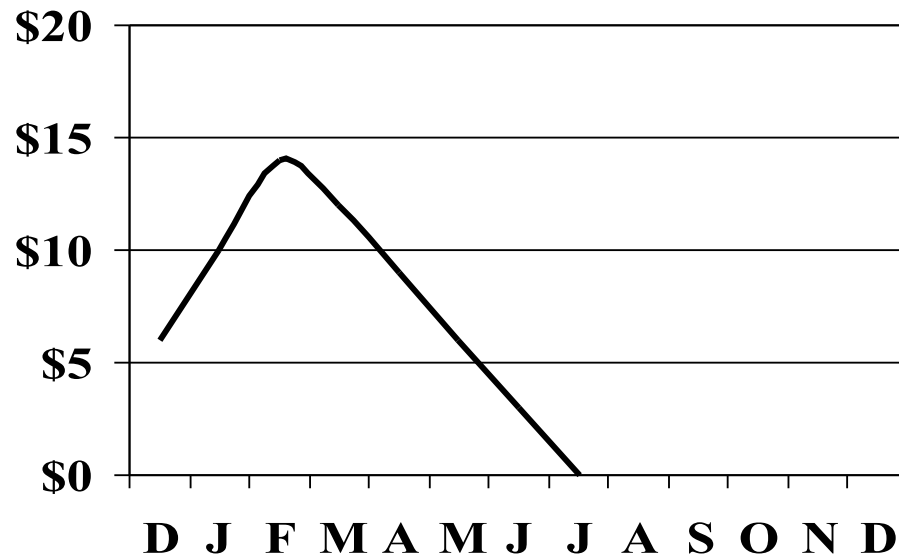
Probabilistic



Cash forecast

"Real" worst case

Don't underestimate worst case likelihood



The next steps -- #2

1. Management team simulation gaming
2. 2 to 5 teams begin with same balance sheet, headcount, etc.
3. Which team will wind up with the largest market share?

Final Market Share of Teams A - D

