An Entrepreneur’s Guide to Financial Statements
Fernando Alvarez

Begin the Beguine
First things first
- Business concept
- Marketing Plan
- Operations Plan
- Economics of the business
- Conosco el monstruo, porque viví en sus entranas
- Touch it, smell it, lick it

What is CFO?
Why is CFO one of the most important elements of a business plan?
Principal Financial Statements

• Balance Sheet
• Income Statement
• Statement of Cash Flows (FASB 95)

The Entrepreneur’s Perspective

Financial Statements

• Balance Sheet
  – Assets, liabilities, owner’s equity
• Income Statement
  – Revenues, expenses, earnings
• Statement of Cash Flows
  – Operating, investing, financing
What’s the Purpose of Financial Statements?

Dividend Discount Model

\[ P_0 = \frac{D_1}{k - g} \]

Keys to Getting Cheap Money

- Manipulate earnings
- Minimize cost of capital
- Maximize growth expectations
Limits to Continued Growth

- Saturation
- Entry of competition
- Increasing base
- Market share constraints

Two Approaches to the Statement of Cash Flows

- FASB 95
- Robert Morris Associates

FASB 95
Statement of Cash Flows

Operating Cash Flows
Investment Cash Flows
Financing Cash Flows
Robert Morris Associates
Uniform Credit Analysis (I)

- Cash from Sales
- Cash Production Costs
- Gross Cash Profits
- Cash Operating Expenses
- Cash After Operations
- Net Cash After Operations

Robert Morris Associates
Uniform Credit Analysis (II)

- Net Cash After Operations
- Financing Costs
- Net Cash Income
- Cash after Debt Service
- Financing Surplus/Requirements
- Total External Financing
- Change in Cash

Dividends
in the Entrepreneurial Firm

- Expense preference behavior
- Life style choices
- Keep the IRS out of your pocket
- Paying the piper at harvest time
Cash Flow Analysis

Happiness is

- Buy low, sell high
- Collect early, pay late
- Lease your plant and equipment
- Outsource your logistics
- Have somebody else hold your inventory

Cash Flow Dimensions

\[ V_0 = \sum_{t=1}^{T} \frac{CF_t}{(1+k)^t} \]

- Amount
- Timing
- Risk
- Duration
Cash Flow Profile
Visualizing Risk and Reward

Burn, baby, burn
What is the burn rate of a business, and why should entrepreneurs pay so much attention to it?

Cash Flow Limbo Rock
How low can you go?

It depends on the credit facilities and/or cash reserves you have established.
Every time you get financing cash flows, the downside barrier is lowered, and the burn rate increases due to additional debt service.
Back to the Future

- Forecasting cash flows in the entrepreneurial firm
- The role of pro-forma statements
  - From statements to ratios and vice-versa
- Industry Data Sources
  - Standard and Poor's Research Insight
  - RMA Annual Financial Studies

Cash Flow Statement Frequency

- Annual
- Semiannual
- Quarterly
- Monthly
- Weekly
- Daily
- Intraday
- The frequency is determined by the largest periodical cash flow (in or out) and/or the largest change in the burn rate.

Money?

You want more money?

- The four F's
  - Founders, Family, Friends, and Fools
- Stake Holders
  - Employees, Suppliers, Customers
- Angel Investors
- Venture Capital Funds
- Bank Loans
Structuring the Deal

- Venture Capital
  - Risk commensurate with 60% rate of return
  - Convertible Bonds
  - Ownership and control
- Bank Loans
  - Fixed rate Vs. Variable rate
  - Secured and Unsecured

Convertible Bonds

It is essential for entrepreneurs to understand how to price the option-like features of convertible bonds. Else, they may find themselves in a market “in suspension” where the reservation price of the seller is much higher than the best bid of the buyer.