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Agenda:
Cash and Burn Rate Management in Today's Economy

a. Why companies get in trouble

b. Are you headed there?

c. Immediate actions to take

d. Managing cash burn

a. Why Companies Get in Trouble

- Timing & slope of revenue ramp optimistic
- Cash forecasting & discipline often poor and infrequent
- Working capital management inadequate
- Delay in dealing with rapid drain of cash
- Previous round will not fund to a value milestone leading to an up round
- Previous round investors will not participate

Processes that Affect Cash

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Let’s Talk Cash Awareness

- Not just revenue, payroll, rent & CapEx (the obvious)
- Includes every balance sheet account
- Affected by every internal process
- Individual contributors can (and often do) leak cash unknowingly
- **IT’S ALL ABOUT VELOCITY**

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The Sales Order Fulfillment Process

- Design win → Order → Ship → Bill → Collect
- Sales forecast accuracy is usually poor
- Supply chain management is minimal
- Contract manufacturer must be managed
- Startups must build to forecast, not to order
- Above = problems in inventory management
- Unique capex often required to test products
- Collections usually not staffed at revenue start

The Product Development Process

- Business case – financial justification
- Staffing
  - regular EEs (fixed cost) vs. consultants (variable)
- Outside development services and NRE
- Equipment & design tools – lease vs. buy
- Time-to-market – "time is money"

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Financial & Administration

- Approval processes
  - Staffing
  - Purchase requisitions
  - Capital budgeting
  - Facilities
  - Travel
- Contract terms and conditions, esp. RevRec
- IP - patent processing & maintenance
- Cash management & investment management

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b. Are You Headed for Trouble?

How Reliable is Your Forecasting?

Rolling 13 Week Cash Forecast

WEEK ENDING	12/19/08	12/26/08	1/2/09	1/9/09	1/16/09	1/23/09	1/30/09	2/6/09	2/13/09	2/20/09	2/27/09	3/6/09	3/13/09	Total
Beginning Cash Balance	$ 2,015.0	$ 1,730.5	$ 1,676.1	$ 1,333.9	$ 1,275.9	$ 961.5	$ 914.3	$ 512.1	$ 4,441.8	$ 4,355.6	$ 4,098.4	$ 3,912.3	$ 3,537.6	$ 2,015.0
Receipts														
Bank LOC	-	-	-	-	-	-	-	4,000.0	-	-	-	-	-	4,000.0
Customer Receipts	-	-	-	-		-	31.0	-	-	3.0	-	-	-	34.0
Interest Income	-	-	-	6.6	-	-	1.0		0.9	-	-	1.0	-	9.5
Total Reciepts	-	-	-	6.6	-	-	32.0	4,000.0	0.9	3.0	-	1.0	-	4,043.5
Disbursements														
Salaries, Benefits, etc.	213.6	-	225.1	-	213.4	-	213.4	-	-	223.1	-	223.1	-	1,311.9
T&E	1.6	4.6	4.6	7.1	7.1	7.1	7.1	7.1	4.6	4.6	4.6	4.6	4.6	68.9
Marketing & Sales Expense	-	0.8	-	-	-	-	-	5.8	-	-	55.8	-	-	62.3
Consulting	-	-	57.5	-	48.1	-	48.1	-	44.1	-	44.1	-	34.6	276.4
Recruiting	-	-	-	-	-	-	-	-	-	-	21.7	-	-	21.7
Legal & Professional	2.0	-	11.5	-	-	-	27.5	-	-	-	27.5	-	-	68.5
Other Outside Services	-	0.1	-	0.1	-	-	-	-	0.1	-	-	-	-	0.3
Development	58.0	40.3	40.3	36.9	36.9	36.9	36.9	36.9	29.3	29.3	29.3	29.3	29.3	469.8
Lease	-	-	-	13.0	-	-	-	13.0	-	-	-	13.0	-	39.1
CAM & Maintenance	-	-	-	4.3	-	-	-	4.3	-	-	-	4.3	-	13.0
Utilities	-	2.0	-	-	3.5	-	-	-	3.5	-	-	-	-	9.0
Telecom	4.4	3.4	-	-	2.3	-	-	-	2.3	-	-	-	-	12.5
Other Facilities	0.1	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	30.1
Office Expense	4.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	13.0
Product Manufacturing Cost	-	-	-	-	-	-	98.1	-	-	-	-	98.1	-	196.1
Total Disbursements	284.6	54.4	342.1	64.6	314.5	47.1	434.2	70.3	87.1	260.2	186.1	375.7	71.6	2,592.6
Net Cash Increase/(Decrease)	(284.6)	(54.4)	(342.1)	(58.0)	(314.5)	(47.1)	(402.2)	3,929.7	(86.2)	(257.2)	(186.1)	(374.7)	(71.6)	1,450.9
Ending Cash Balance	$ 1,730.5	$ 1,676.1	$ 1,333.9	$ 1,275.9	$ 961.5	$ 914.3	$ 512.1	$ 4,441.8	$ 4,355.6	$ 4,098.4	$ 3,912.3	$ 3,537.6	$ 3,466.0	$ 3,466.0

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Cash Waterfall Example

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC	TOTAL
CASH													
BUDGET	**4,784**	**3,797**	**2,562**	**1,373**	**264**	**(763)**	**(2,412)**	**(4,333)**	**(5,796)**	**(7,129)**	**(8,667)**	**(10,201)**	**(10,201)**
JAN YTD + FORECAST	4,747	3,909	2,981	1,924	767	(230)	(1,401)	(2,708)	(4,220)	(5,782)	(7,159)	(8,518)	(8,518)
FEB YTD + FORECAST	4,747	3,909	2,981	1,924	767	(230)	(1,401)	(2,708)	(4,220)	(5,782)	(7,159)	(8,518)	(8,518)
MAR YTD + FORECAST	4,747	3,909	2,981	1,936	828	(5)	(1,033)	(2,458)	(3,970)	(5,582)	(6,959)	(8,318)	(8,318)
APR YTD + FORECAST	4,747	3,909	2,981	1,924	828	(5)	(1,033)	(2,458)	(3,970)	(5,582)	(6,959)	(8,318)	(8,318)
MAY YTD + FORECAST	4,747	3,909	2,981	1,924	904	925	(103)	(1,528)	(3,040)	(4,652)	(6,029)	(7,388)	(7,388)
JUN YTD + FORECAST	4,747	3,909	2,981	1,924	904	947	5,168	3,736	2,508	1,374	164	3,762	3,762
JUL YTD + FORECAST	4,747	3,909	2,981	1,924	904	947	5,170	3,736	2,508	1,374	164	3,762	3,762
AUG YTD + FORECAST	4,747	3,909	2,981	1,924	904	947	5,170	4,324	3,296	2,387	1,424	248	248

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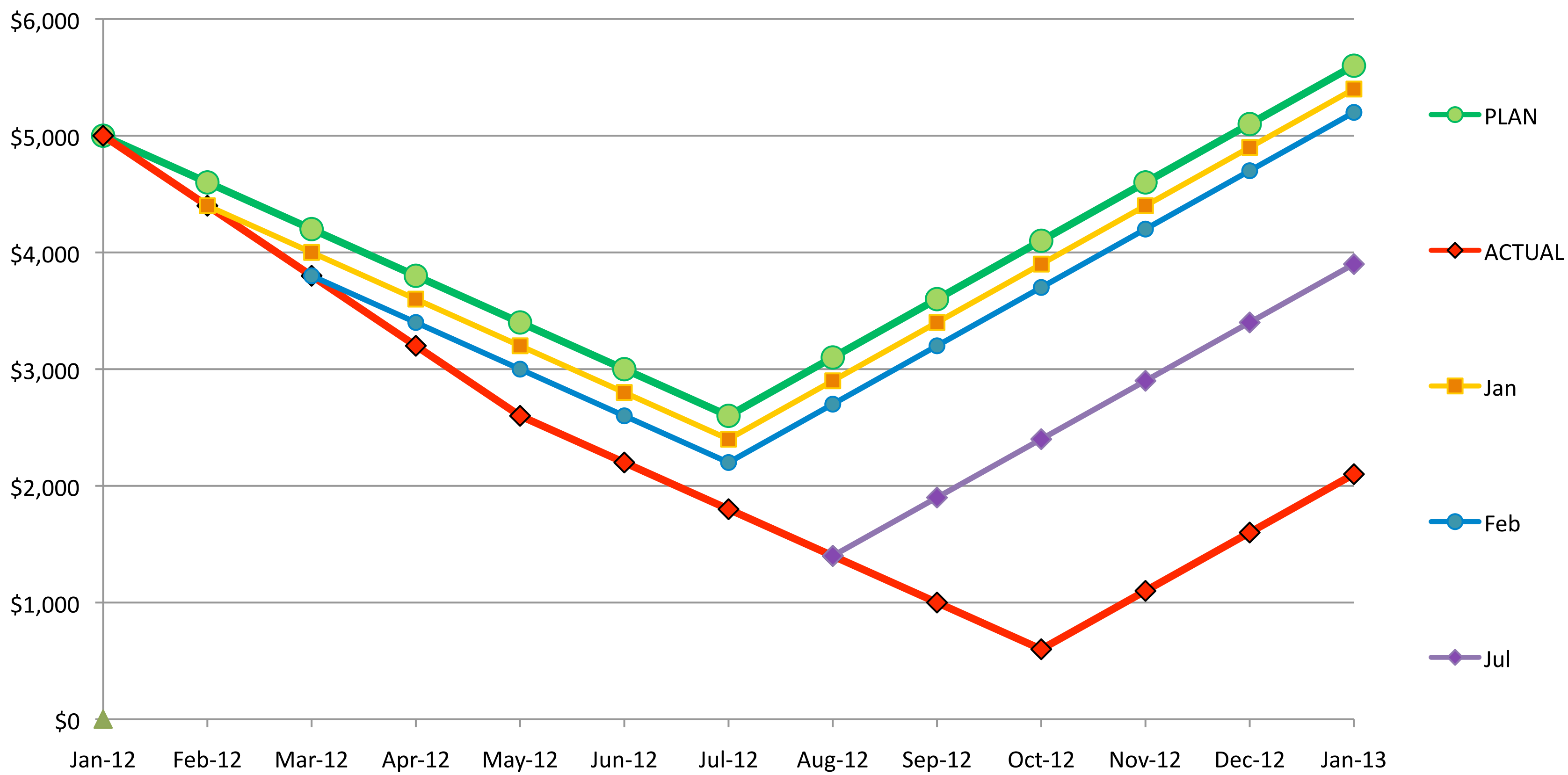
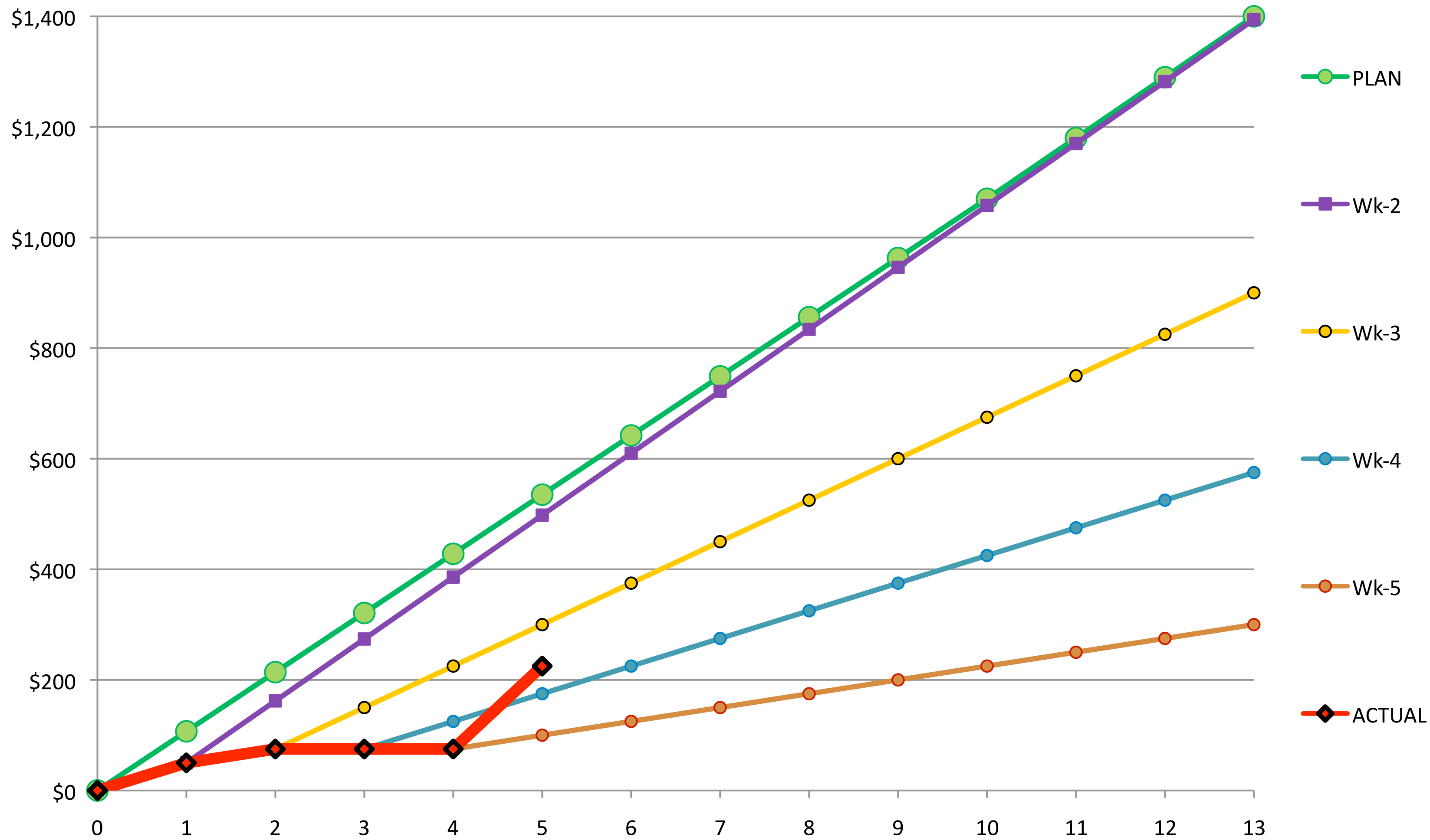
Cash Forecast Waterfall Example



Sales Forecast Waterfall Example



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Waterfalls Improve Forecasts

- Are a record of <u>change</u> in forecasts
- Trends what changed when and by whom
- Sharpens your forecasting skills
- Not just for cash
  - Sales forecasts, down to the individual level
  - Inventory
  - R&D
  - Other

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c. Immediate Actions to Take

Driving a Decisive Burn Cutback

Need a RIF? Do Only One!

Avoid the Big Mistakes

Driving a Decisive Burn Cutback Process

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A Decisive Burn Cut Process

- **Driven by CEO and CFO as a team**
- **CFO needs experience with process and industry**

------ TOP DOWN PROCESS---------

- **Set tentative burn goals based on time to new financing**
  – Time next round after achievement of value-inflecting milestones
  – Forecast cash by month or week to next round or cash breakeven
- **Analyze alternative scenarios that best preserve value**
  – Minimize impact on new product and/or market programs
  – Defer, cancel or downsize new product and/or market programs
- **Consider activities that might be outsourced saving cash**
  – Sales – greater use of indirect channels
  – Product design – discrete elements to contractors
  – Reference platforms, test programs, API support, etc.

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A Decisive Burn Cut Process

- - - - - - T O P D O W N P R O C E S S (continued) - - - - - - - - - -

- **Investigate quick new sources of revenue, such as:**
  – NRE from large customers
  – License IP to companies in non-strategic markets
  – Sublet a portion of the office
  – Second source agreement with up-front fee
- **Set top-down goals based on above considerations by dept**:
  – Headcount reductions (backed into without naming individuals)
  – Capital expenditures eliminated, or pushed out
  – Projects or programs that can be terminated, deferred or outsourced
  – Salaries to be cut, compensation to be deferred
- **CEO & CFO meet w/ Board to agree on burn goals & timetable**

A Decisive Burn Cut Process

------ BOTTOMS UP PROCESS---------

- **Meet with Sr. Staff to convince necessity, not "if" but "how"**
  - Present inescapable consequences of existing burn
  - Describe process to be followed to cut burn
  - Direct each VP to hold a similar meeting with reports
  - Task VPs with developing their proposed plans for reducing burn
- **CEO & CFO present each VP written cash spending goals by**
  - Headcount
  - CapEx
  - Discretionary department spending
- **Hold a 2nd burn cut meeting with entire senior staff to:**
  - Restate overall goal in terms of burn rates and runway
  - Debate products, programs, activities that might be:
    - Discontinued or deferred
    - Done less frequently
    - Done less well

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A Decisive Burn Cut Process

- Review with each VP to review implementation proposals by dept.
- Evaluate separate and cumulative impact of proposals
- Negotiate with each VP final plans by element – heads, etc.
- Determine if goals presented to BOD must be altered
- Meet w/Board & w/Counsel to agree final cut plans
- Hold final 2-on-1s with each VP to confirm & document:
  - Staff reductions, severance provided
  - Salary reductions, deferrals, effective dates
  - Functions to be outsourced
  - CapEx to be cancelled, cut or deferred
  - Projects, programs, products to be eliminated, pushed out or cut back
  - Department and other discretionary spending to be reduced
- VPs and dept. heads meet with each EE & contractor affected
- All-hands meeting to explain cutback, answer questions

Need a RIF? Do Only One!

- One RIF is bad enough, multiple RIFs are a disaster
- Remember: your first cut must be your best cut
- Optimism clouds reality and first cut is often not deep enough; make sure yours is
- Cut more than fear or optimism suggest
- You can always re-hire EEs
- If necessary, temps and consultants can always be brought in later

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Do It Right

- Involve legal counsel early in RIF process
- Be fair, but not generous with severance – save cash for the business and employees that are staying
- No sacred cows – everyone, especially senior management, must sacrifice
- Put incentives in place to motivate & reward surviving employees
- Avoid the Big Mistakes

The 10 Big Mistakes

1. Denial

- Sales forecasting is often very inaccurate
- Sales cycle always takes longer than you think (and extends in a bad economy)
- Fundraising is always harder and takes longer than you think
- Preserving sacred cows destroys credibility
- Boards <u>hate</u> short-sighted management and surprises

2. Misalignment of Expectations

- CEO and CFO
- CEO/CFO and other top management
- Company and board
- Company and lenders
- Company and key critical suppliers
- Company and key customers
- Company and key employees

3. Wrong Sizing of Burn Goal

- How long cash should last
- How much cash is needed to reach milestones
- Goal interdependencies
- Obstacles to meeting milestone and financial plans
- Underestimating market or economic conditions

4. Inadequate Process Control

- Not sticking to tops-down goal
- Not sticking to bottoms-up justification
- Allowing infighting over limited resources
- Not sticking to implementation timeframes
- Not thoughtfully assessing consequences

5. Unrealistic Forecasting Accuracy

- Sales close cycle
- R&D timeframes
- Project acceptances
- Supply chain
- Inventory turnover and supplier demands
- DSO & DPO
- OpEx
- Headcount requirements

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6. Decision Paralysis

- Focusing too long on *If*, not *How*
- Delaying tough decisions
- Iteration do-loops
- Foot dragging
- Turf protecting

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7. Products/Markets Not Thought Out

- Developing products with low probable returns
  - High R&D costs without high sales & margin
  - Small competitive advantage vs. incumbents
  - Poor value propositions vs. cost of producing
- Addressing the wrong markets
  - Markets dominated by large incumbents, even with inferior solutions
  - Markets that don't emerge as forecast

8. Lack of Measurement Process

- Non-current & inaccurate actuals
- Not measuring frequently enough
- Not facing surprises immediately and honestly
- Not determining root causes & taking immediate corrective actions
- Not addressing critical slippages
  - Product development
  - Targeted design wins
  - Sales cycle

9. Not Linking Slippage to Spend Decisions

- Sales results and inventory builds
- Hiring before threshold achievement
- Entering commitments early and too loosely
- Blindly following budgets instead of resetting them

10. Not Keeping Finger on Pulse

- Not shortening the measurement interval
- Not requiring approvals at higher levels
- Not holding cross-functional reviews of objectives and key results frequently enough
- Not knowing status of critical customer wins
- Not indentifying true root causes
- Not monitoring daily cash balances

d. Managing Your Cash

Instrumenting Your Company

Re-Evaluating Your Practices

Instrumenting Your Company

Instrumenting Your Company

- Insist on transparency & enforce accountability
- Extensive use of waterfalls everywhere
- Sales pipeline analysis
- Bookings & billings backlog
- 13 week rolling forecasts
- Headcount & staffing
- Development & project status
- Inventory, on-order & WIP
- Monthly budget & forecast updates
- Policies & procedures for all types of spending

Instrumenting Your Company

- CapEx review committee
  - Budget ≠ Commitment
- Weekly tracking of DSO & DPO
- Weekly aged AP & AR review by controller & CFO
- Weekly payment selection & check run review by CFO

Re-evaluating Collection and Disbursement Practices

Make Collections a Priority

- A/R and credit departments should not be "back office" functions – especially now
- Make it easy for customer to pay
  - Follow POs carefully; give the customer no excuse
  - Make sure the invoice is accurate!
  - Establish relationship with customer A/P
  - Call before invoice is due to ensure payment scheduled
- Involve salespeople in collections
- Consider discount term
- Recheck the credit on your customers

Integrate Collections in Business Process

- Too often, the end point is getting the customer order
- Make clear that the cycle is not complete until customer pays
- Require linking sales commissions to customer payments
- Publish DSO and other receivable statistics in dashboard
- Consider lockboxes, wires, ACH and multiple collection points to reduce payments in transit
- Remember, bad receivables can hurt <u>thrice</u>
  - Slower collections
  - Smaller borrowing base
  - Dollar-for-dollar cash forecasting error

Disbursement Practices

- Disbursement is the final step before cash leaves the company
- To be effective must also look at policies and practices where the purchase / expense occurs
- Know your vendors' collection practices
- Nonetheless, the last step is extremely important - pay only when you must!

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Pay Smart

- Re-evaluate the cost-benefit of discount terms
- "Vendor financing" always an option, but abuse has consequences
  - Always keep most important vendors satisfied
  - You need 3 vendors that will always be good references
- Don't forget about cross-default and timely payment covenants

Buck Stops Here

- At most venture backed companies, CFO or CEO (sometimes both) sign all checks
- Know when you need to get the board involved and don't hesitate when you do
- This isn't so much a cash control, as it is a means of knowing where every dollar is spent

Conclusion & Discussion