

**MSc Marketing Management**

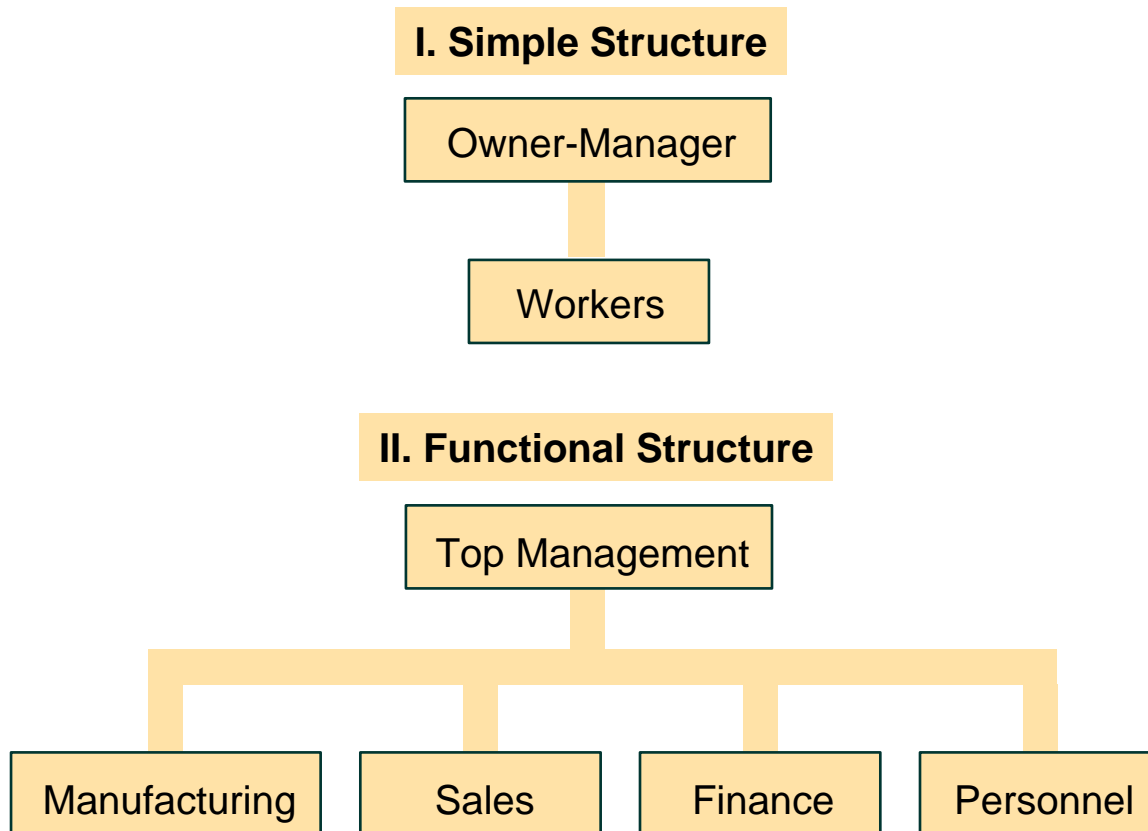
Pre-course Fall 2007

**Corporate Management**

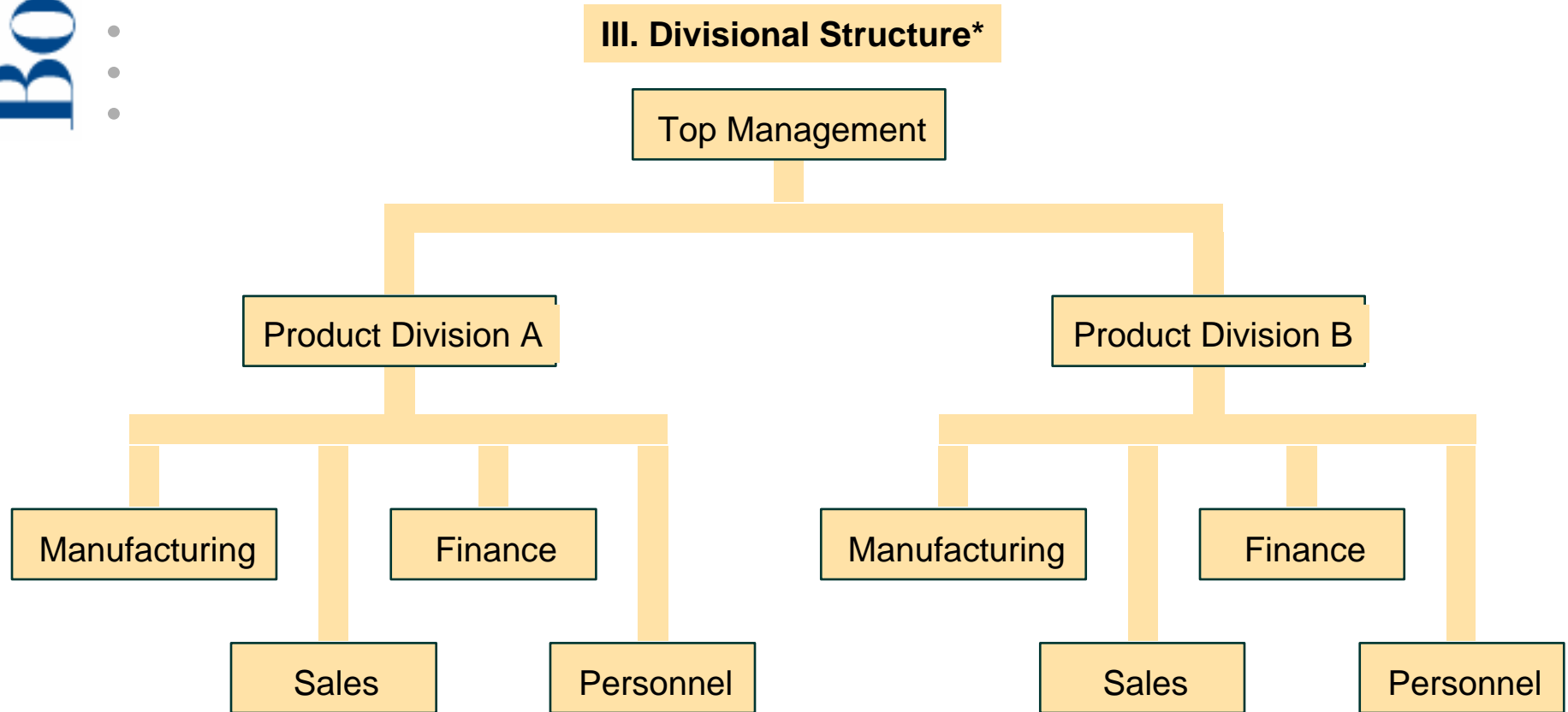
**Session 5.**

**Accounting: Basic concepts. Functional strategies**

# Basic Organizational Structures: Simple and Functional



# Basic Structures of Corporations: Divisional



\*Conglomerate structure is a variant of the division structure.

### Defined:

*Collection of beliefs, expectations, and values learned and shared by a corporation's members and transmitted from one generation of employees to another.*

### Distinct Attributes

#### 1. *Cultural intensity*

- Degree to which members of a unit accept the norms, values, or other culture content associated with the unit.

#### 2. *Cultural integration*

- Extent to which units throughout an organization share a common culture.

## Corporate Culture

### Important Functions

**Sense of identity for employees**

**Generate employee commitment**

**Stability of organization**

**Guide for appropriate behavior**

## Strategic Marketing Issues

### **Market Position:**

- “Who are our customers?”

### **Market Segmentation:**

- Niches, new product development

### **Marketing Mix:**

- Combination of key variables under the corporation’s control used to affect demand and gain competitive advantage.

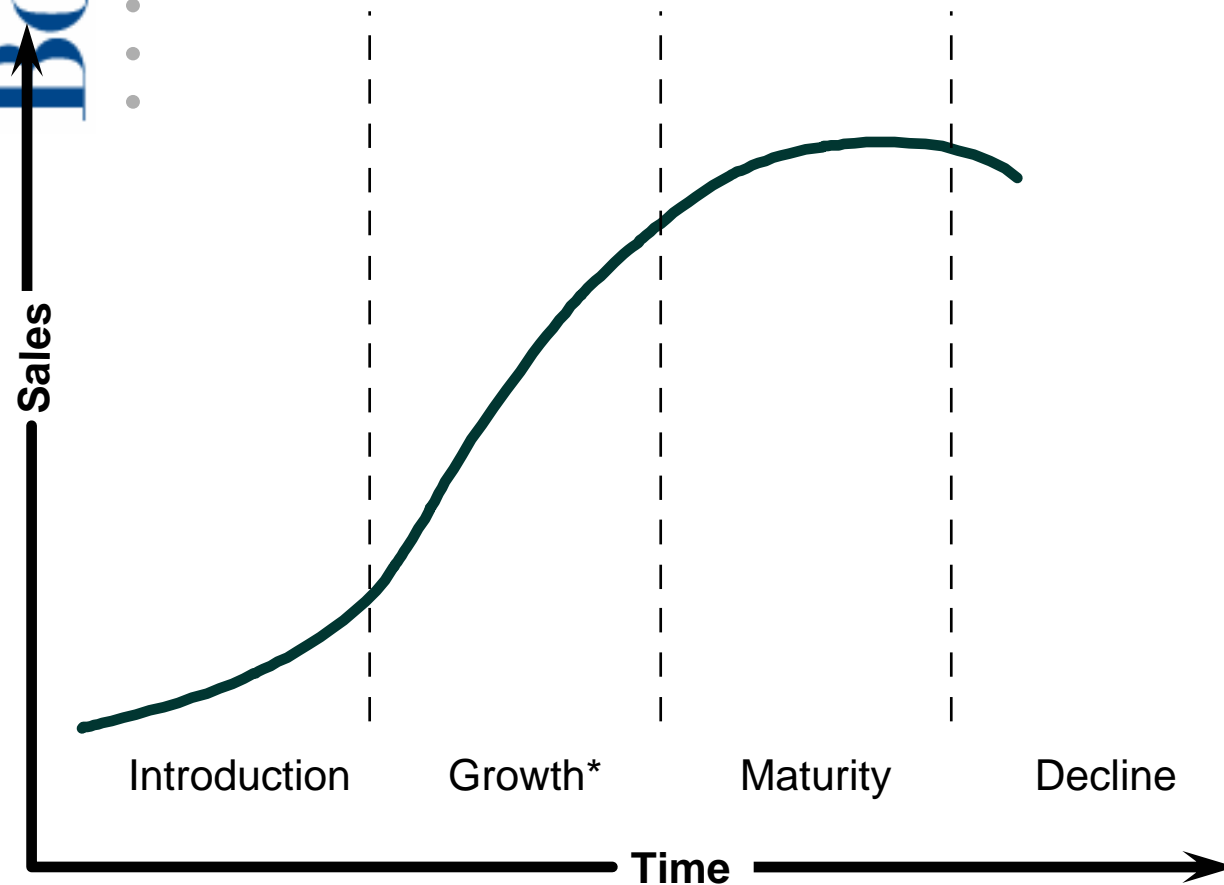
## Marketing Mix Variables

Product	Place	Promotion	Price
Quality	Channels	Advertising	List price
Features	Coverage	Personal selling	Discounts
Options	Locations	Sales promotion	Allowances
Style	Inventory	Publicity	Payment periods
Brand name	Transport		Credit terms
Packaging			
Sizes			
Services			
Warranties			
Returns			

Source: Philip Kotler, *Marketing Management: Analysis, Planning, and Control*, 4th ed. (Englewood Cliffs, N.J.: Prentice-Hall, 1980), p. 89. Copyright © 1980. Reprinted by permission of Prentice-Hall, Inc.



# The Product Life Cycle



\*The right end of the Growth stage is often called Competitive Turbulence because of price and distribution competition that shakes out the weaker competitors. For further information, see C. R. Wasson, *Dynamic Competitive Strategy and Product Life Cycles*, 3rd ed. (Austin, Tex.: Austin Press, 1978).

### **Financial Leverage:**

- Ratio of total debt to total assets.

### **Capital Budgeting:**

- Analyzing and ranking possible investments in fixed assets.

## Strategic R&D Issues

### **R&D Intensity:**

- Spending on R&D as a percentage of sales revenue.

### **Technological Competence:**

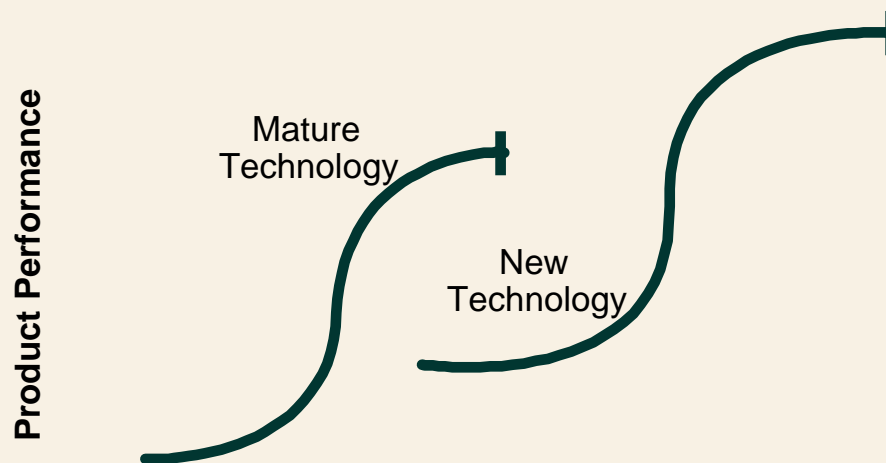
- Development and use of innovative technology.

### **Technology Transfer:**

- Process of taking new technology from the lab to the marketplace.

# Technological Discontinuity

## What the S-Curves Reveal



## Research Effort/Expenditure

In the corporate planning process, it is generally assumed that incremental progress in technology will occur. But past developments in a given technology cannot be extrapolated into the future, because every technology has its limits. The key to competitiveness is to determine when to shift resources to a technology with more potential.

Source: P. Pascarella, "Are You Investing in the Wrong Technology?" *Industry Week* (July 25, 1983), p. 38. Copyright © 1983 Penton/IPC. All rights reserved. Reprinted by permission.

## Strategic Operations Issues

### **Intermittent systems:**

- **Manufacturing systems where items are normally processed sequentially but the work and sequence of the process vary.**

### **Continuous systems:**

- **Laid out as lines where products are continuously assembled or processed.**

## Strategic HRM Issues

### Teams

- Autonomous (self-managing)
- Cross-functional
- Concurrent engineering

### Unionization

- 13.9% of labor force overall
- 12% of private labor force

### Temporary Workers

- Increase flexibility; avoid layoffs

## Strategic HRM Issues

### Quality of Worklife

- Participative problem solving
- Restructuring work
- Innovative reward systems
- Improvements in work environment

### Human Diversity

- Different races, cultures and backgrounds in the workplace.

## Strategic Information Systems Issues

**Automate back-office processes**

**Automate individual tasks**

**Enhance key business functions**

**Develop competitive advantages**



## Strategic Information Systems Issues

### **Intranet:**

- **Information network within an organization that also has access to the external worldwide Internet.**

### **Extranet:**

- **Information network within an organization available to key suppliers and customers.**

# Internal Factor Analysis Summary (IFAS)

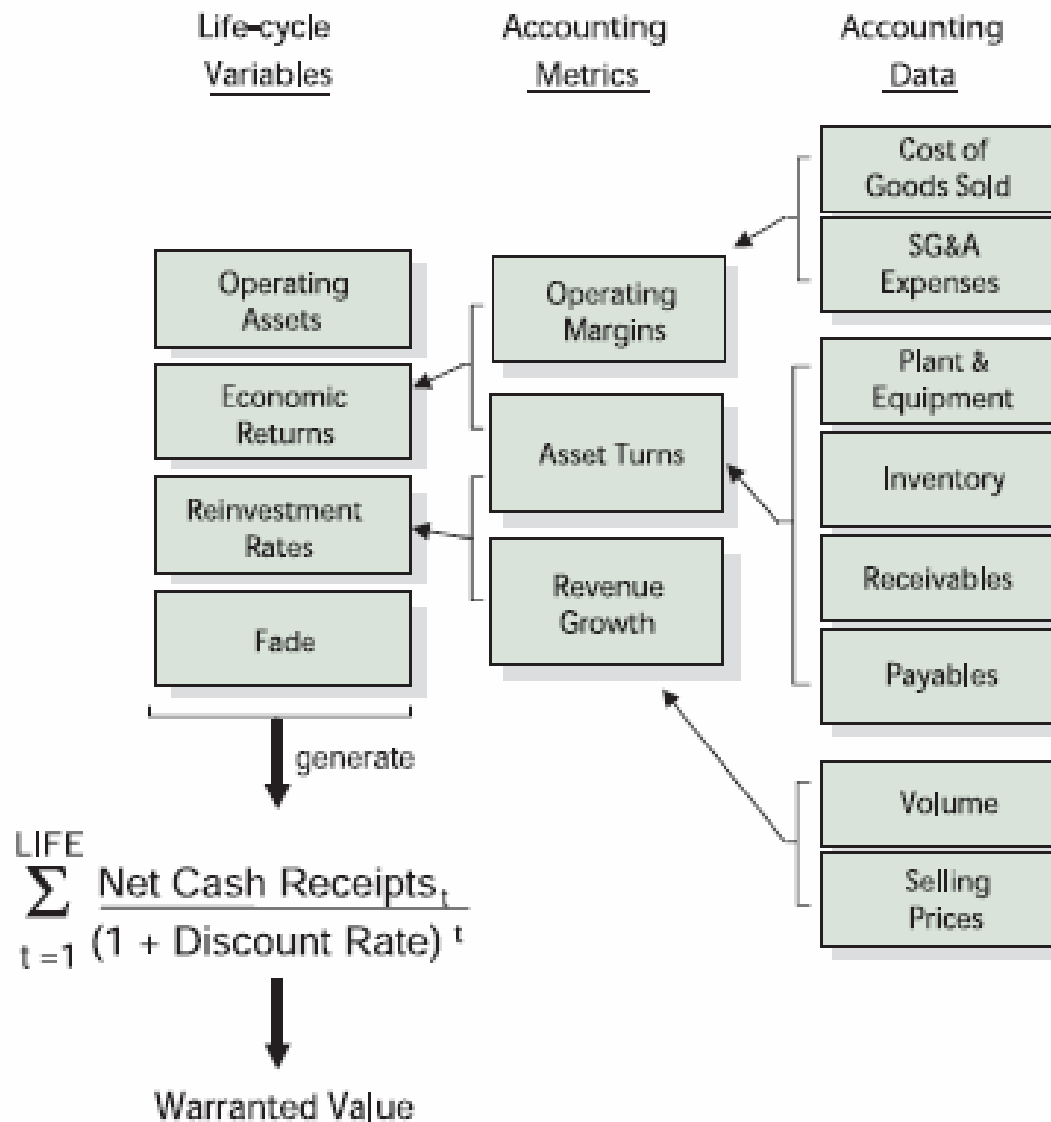
Internal Factors	Weight	Rating	Weighted Score	Comments	
Strengths	1	2	3	4	5
Weaknesses					
Total Weighted Score	<u>1.00</u>		<u>    </u>		



## Internal Factor Analysis Summary (IFAS): Maytag as Example

Internal Factors	Weight	Rating	Weighted Score	Comments	
<b>Strengths</b>					
• Quality Maytag culture	1	2	3	4	5
• Experienced top management	.15	5	.75	Quality key to success	
• Vertical integration	.05	4	.20	Know appliances	
• Employee relations	.10	4	.40	Dedicated factories	
• Hoover's international orientation	.05	3	.15	Good, but deteriorating	
	.15	3	.45	Hoover name in cleaners	
<b>Weaknesses</b>					
• Process-oriented R&D					
• Distribution channels	.05	2	.10	Slow on new products	
	.05	2	.10	Superstores replacing small dealers	
• Financial position	.15	2	.30	High debt load	
• Global positioning	.20	2	.40	Hoover weak outside the United Kingdom and Australia	
• Manufacturing facilities					
	.05	4	.20	Investing now	
<b>Total Weighted Score</b>	<u><u>1.00</u></u>		<u><u>3.05</u></u>		

## Internal Factor Analysis Summary (IFAS): Maytag as Example



## Purpose of Financial Statements

Used by:

- Equity Shareholders
- Banks and Financial Creditors
- Customers and Suppliers
- Potential Investors
- Management and Board

**Relied upon** in gaining  
comfort from risk

## Purpose of Financial Statements

- Equity Shareholders
  - Monitoring Investment & Management
- Banks and Financial Creditors
  - Analyzing Risk For Credit Decisions
- Customers and Suppliers
  - Analyzing Risk For Credit Decisions
- Potential Investors
  - Analyzing Risk for Investment Decision
- Management and Board
  - Business Management / Oversight

## Purpose ---

### Comfort from Risk

- Credit Risk
- Investment Risk
- Management Risk
- Employment Risk
- Purchase Risk

## Example Companies

### Netflix, Inc. (Simpler)

- Symbol: NFLX (NASDAQ)
- Total Revenues of \$150 million
- Rapidly growing, entrepreneurial company

### Aspen Technology, Inc. (Complex)

- Symbol: AZPN (NASDAQ)
- Total Revenues of \$320 million
- Complex, struggling company
- *Core Financial Statements do not tell the whole story*



## Guest Company - NetFlix



Netflix (Nasdaq: NFLX) is the world's largest online DVD movie rental service offering more than one million members access to more than 15,000 titles.

Netflix's appeal and success are built on providing the most expansive selection of DVDs, an easy way to choose movies and fast, free delivery.

## Elements of A Complete Financial Package

Auditors Opinion

Balance Sheet

Income Statement

Statement of Cash Flows

Statement of Equity

Footnotes

Other SEC Disclosures for Public Companies

## Types of Statements – Accountant Opinions

### Audit

- Statements are a fair presentment in accordance with IAS

### Review

- Statements presented in IAS, appear fair.

### Compilation

- Statements have been organized

## Auditor's Opinion - Unqualified

To Aspen Technology, Inc.:

We have audited the accompanying consolidated balance sheets of Aspen Technology, Inc. (a Delaware corporation) and subsidiaries as of June 30, 2000 and 2001, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss) and cash flows for each of the three years in the period ended June 30, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Aspen Technology, Inc. and subsidiaries as of June 30, 2000 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2001 in conformity with accounting principles generally accepted in the United States.

## Auditor's Opinion - Qualified

To the Board of Directors and Stockholders of  
Aspen Technology, Inc.:

We have audited the accompanying consolidated balance sheet of Aspen Technology, Inc. and subsidiaries as of June 30, 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit. The financial statements of Aspen Technology, Inc. and subsidiaries as of June 30, 2001 and for each of the two years in the period then ended were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated August 3, 2001.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Aspen Technology, Inc. and subsidiaries as of June 30, 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed above, the financial statements of Aspen Technology, Inc. and subsidiaries as of June 30, 2001 and for the year then ended were audited by other auditors who have ceased operations. As described in Note 2(p), those financial statements have been reclassified to reflect reimbursements from customers for "Out-of-Pocket" expenses incurred as revenue rather than as a reduction of expenses. We audited the adjustments described in Note 2(p) that were applied to reclassify the 2001 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2001 financial statements of the Company other than with respect to such adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2001 financial statements taken as a whole.

Qualification



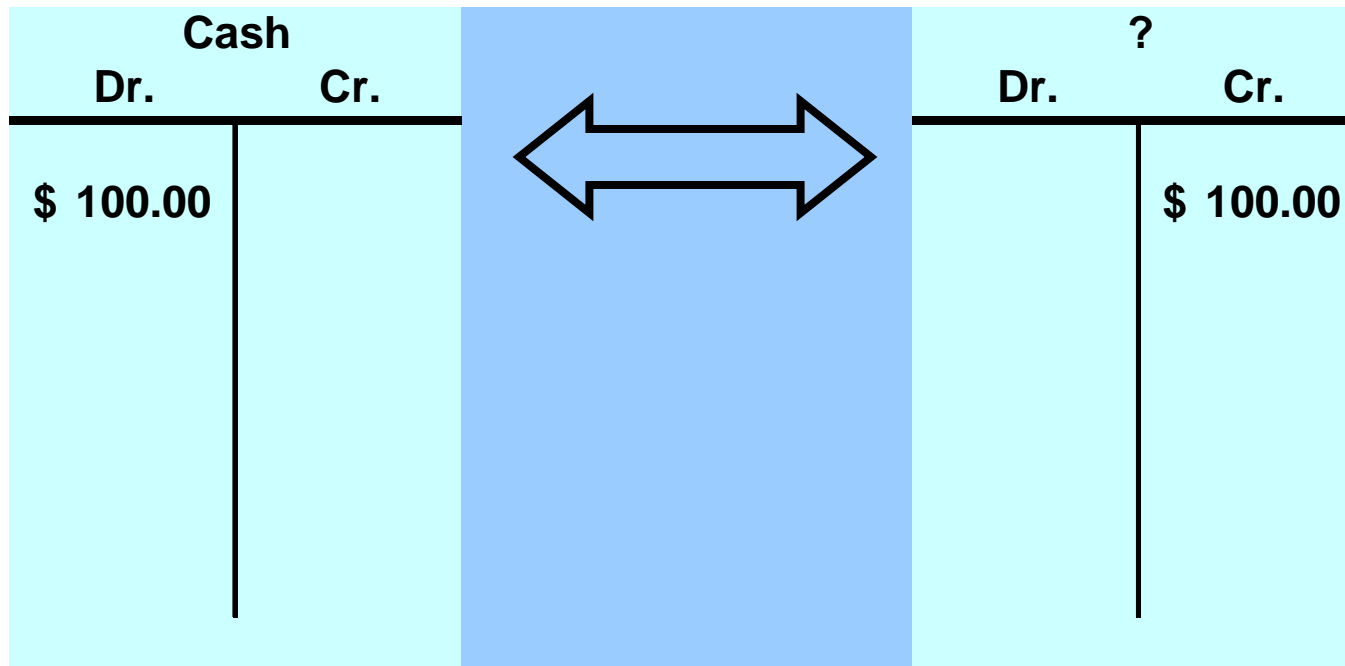


# Dissecting The Balance Sheet

## **ASSETS**

## Fundamentals of Accounting

*For every debit, there must be an equal and corresponding credit(s)*



# The Balance Sheet

## Liquidity

### Current Assets

Assets	As of December 31,	
	2001	2002
<b>Current assets:</b>		
Cash and cash equivalents	\$ 16,131	\$ 59,814
Short-term investments	—	43,796
Prepaid expenses	1,019	2,753
Prepaid revenue sharing expenses	732	303
Other current assets	1,670	409
<b>Total current assets</b>	<b>\$ 19,552</b>	<b>107,075</b>

### Fixed Assets

Fixed assets:	As of December 31,	
	2001	2002
<b>Fixed assets:</b>		
DVD library, net	3,633	9,972
Intangible assets, net	7,917	6,094
Property and equipment, net	8,205	5,620

### Other Assets

Other assets:	As of December 31,	
	2001	2002
<b>Other assets:</b>		
Deposits	1,677	1,690
Other assets	646	79
<b>Total assets</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>

Liabilities and Stockholders' (Deficit) Equity	As of December 31,	
	2001	2002
<b>Current liabilities:</b>		
Accounts payable	\$ 13,715	\$ 20,350
Accrued expenses	4,544	9,102
Deferred revenue	4,937	9,743
Current portion of capital lease obligations	1,345	1,231
Notes payable	1,667	—
<b>Total current liabilities</b>	<b>\$ 26,208</b>	<b>\$ 40,426</b>

Deferred rent	240	288
Capital lease obligations, less current portion	1,057	460
Subordinated notes payable, net of unamortized discount of \$10,851 at December 31, 2001	2,799	—
<b>Total liabilities</b>	<b>\$ 30,304</b>	<b>\$ 41,174</b>

Commitments and contingencies (note 5)		
Redeemable convertible preferred stock	101,830	

Stockholders' (deficit) equity:		
<b>Convertible preferred stock</b> , \$0.001 par value; 8,500,000 and 10,000,000 shares authorized at December 31, 2001 and 2002, respectively; 6,167,499 and no shares issued and outstanding at December 31, 2001 and 2002, respectively; aggregate liquidation preference of \$2,222 at December 31, 2001	6	—
<b>Common stock</b> , \$0.001 par value; 100,000,000 and 150,000,000 shares authorized at December 31, 2001 and 2002, respectively; 2,161,855 and 22,445,795 issued and outstanding at December 31, 2001 and 2002, respectively	2	22
Additional paid-in capital	52,479	259,172
Deferred stock-based compensation	(5,275)	(11,399)
Accumulated other comprehensive income	—	774
Accumulated deficit	(137,266)	(159,213)
<b>Total stockholders' (deficit) equity</b>	<b>\$ (90,504)</b>	<b>\$ 89,356</b>
<b>Total liabilities and stockholders' (deficit) equity</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>

### Current Liabilities

### Long Term Liabilities

### Equity Section



## The Balance Sheet – Current Assets

Assets		As of December 31,		Liabilities and Stockholders' (Deficit) Equity	
		2001	2002		
<b>Current assets:</b>				<b>Current liabilities:</b>	
Cash and cash equivalents	\$ 16,131	\$ 59,814	Accounts payable	\$ 13,715	\$ 20,350
Short-term investments	—	43,796	Accrued expenses	4,544	9,102
Prepaid expenses	1,019	2,753	Deferred revenue	4,937	9,743
Prep					
Othe					
		<b>As of December 31,</b>			
		<b>2001</b>		<b>2002</b>	
<b>Total</b>	<b>Assets</b>				
<b>Fixed</b>	<b>Current assets:</b>				
	Cash and cash equivalents	\$ 16,131	\$ 59,814		
	Short-term investments	—	43,796		
	Prepaid expenses	1,019	2,753		
	Prepaid revenue sharing expenses	732	303		
	Other current assets	1,670	409		
	<b>Total current assets</b>	<b>\$ 19,552</b>	<b>107,075</b>		
	Deposits	1,677	1,690	Deferred stock-based compensation	(5,275) (11,399)
	Other assets	646	79	Accumulated other comprehensive income	— 774
				Accumulated deficit	(137,266) (159,213)
	<b>Total assets</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>	<b>Total stockholders' (deficit) equity</b>	<b>\$ (90,504) \$ 89,356</b>
				<b>Total liabilities and stockholders' (deficit) equity</b>	<b>\$ 41,630 \$ 130,530</b>

Also: A/R & Inv  
Current assets:

## Dissecting the Balance Sheet – Left Side Thinking – Current Assets

### Current Assets

	What	Source of Numbers
<b>Cash</b>	Book balance in bank accounts	The "CheckBook"
<b>Accounts Receivable</b>	List of who owes us	Sales less cash receipts
<b>Inventory</b>	What is in the warehouse	Purchases less cost of goods
<b>Prepaid Expenses</b>	What have we paid in advance	Occasional dr/cr usually coded from A/P

## Dissecting the Balance Sheet – Left Side Thinking – Current Assets

### Current Assets

	Hardside	Softside
<b>Cash</b>	Bank Statements/Reconciliation	
<b>Accounts Receivable</b>	A/R Ledger	Bad debt allowance; failure to recognize the inevitable
<b>Inventory</b>	Inventory Register	Obsolence Allowances, slow-moving product, valuation methods(flow assumptions)
<b>Prepaid Expenses</b>		Amortization methods; validity

## The Balance Sheet – Fixed Assets

Assets	As of December 31,		Liabilities and Stockholders' (Deficit) Equity	As of December 31,	
	2001	2002		2001	2002
<b>Current assets:</b>			<b>Current liabilities:</b>		
Cash and cash equivalents	\$ 16,131	\$ 59,814	Accounts payable	\$ 13,715	\$ 20,350
Short-term investments	—	43,796	Accrued expenses	4,544	9,102
Prepaid expenses	1,019	2,753	Deferred revenue	4,937	9,743
Prepaid revenue sharing expenses	732	303	Current portion of capital lease obligations	1,345	1,231
				1,667	—
				<b>26,208</b>	<b>\$ 40,426</b>
<b>Fixed assets:</b>				240	288
				1,057	460
				2,799	—
DVD library, net			3,633	9,972	30,304
Intangible assets, net			7,917	6,094	\$ 41,174
Property and equipment, net			8,205	5,620	01,830
				6	—
<b>Other assets:</b>			<b>Common stock</b> , \$0.001 par value; 100,000,000 and 150,000,000 shares authorized at December 31, 2001 and 2002, respectively; 2,161,855 and 22,445,795 issued and outstanding at December 31, 2001 and 2002, respectively	2	22
Deposits	1,677	1,690	Additional paid-in capital	52,479	259,172
Other assets	646	79	Deferred stock-based compensation	(5,275)	(11,399)
			Accumulated other comprehensive income	—	774
			Accumulated deficit	(137,266)	(159,213)
<b>Total assets</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>	<b>Total stockholders' (deficit) equity</b>	<b>\$ (90,504)</b>	<b>\$ 89,356</b>
			<b>Total liabilities and stockholders' (deficit) equity</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>

## Fixed Assets (Aspen Tech)

	June 30,	
ASSETS	2001	2002
Long-term installments receivable, net of unamortized discount of \$8,437 in 2001 and \$12,990 in 2002	43,428	68,318
Property and leasehold improvements, at cost:		
• Building and improvements	4,639	2,241
• Computer equipment	45,465	48,184
• Purchased software	38,498	55,621
• Furniture and fixtures	16,090	17,552
• Leasehold improvements	8,243	10,078
	112,935	133,676
Less — Accumulated depreciation and amortization	69,659	82,873
	43,276	50,803
Computer software development costs, net of accumulated amortization of \$16,091 in 2001 and \$20,804 in 2002	8,539	13,810
Purchased intellectual property, net of accumulated amortization of \$1,974 in 2002	—	27,626
Other intangible assets, net of accumulated amortization of \$9,970 in 2001 and \$15,232 in 2002	19,612	41,105
Goodwill	24,352	84,258
Deferred tax asset	15,686	15,576
Other assets	15,737	6,708
	\$ 406,594	\$ 548,343

## Dissecting the Balance Sheet – Left Side Thinking – Fixed Assets

	What	Source of Numbers
<b>Land</b>	Price paid for any land owned	Purchase price
<b>Plant</b>	Cost of building or buying building	Purchase Price / Capital Project Ledger
<b>Equipment</b>	Cost of acquisition	Purchase price
<b>Computer Systems</b>	Cost of acquisition	Purchase price
<b>Furniture &amp; Fixtures</b>	Cost of acquisition	Purchase Price
<b>Leasehold Improvements</b>	Cost of improvements	
<b>Other</b>	Usually Cost	
<b>Depreciation</b>	ESTIMATE of allocation of cost of capital item to business operations	Calculation usually done by accounting system

## Dissecting the Balance Sheet – Left Side Thinking – Fixed Assets

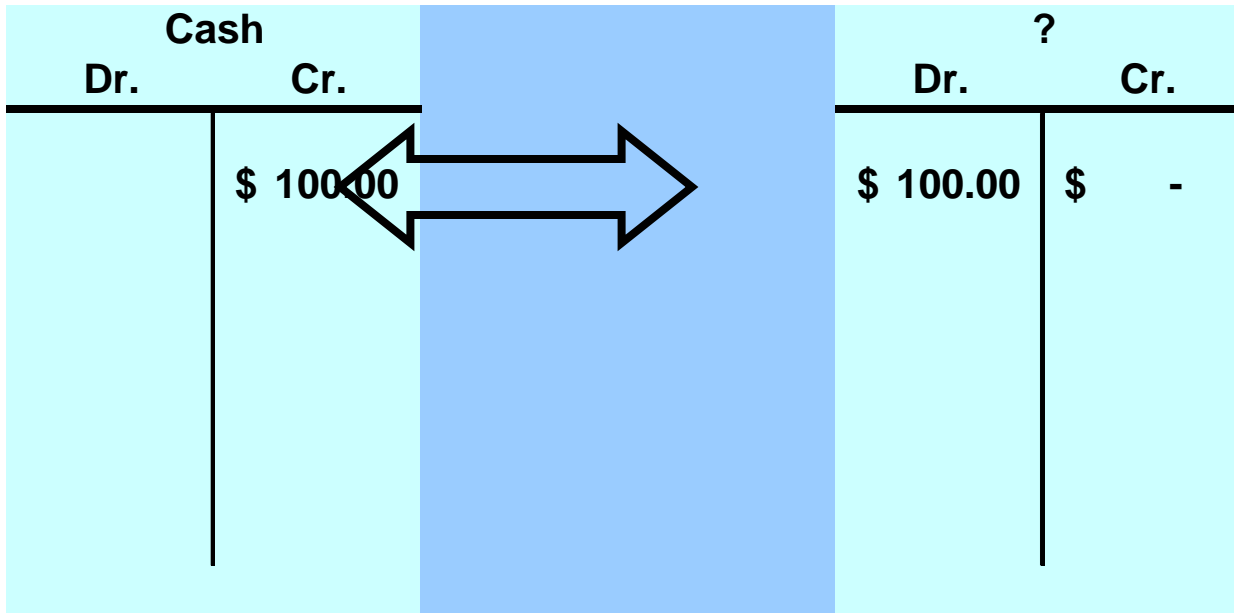
	Hardside		Softside
<b>Land</b>	Fixed Asset Ledgers		Booked at historical cost, current value usually much greater
<b>Plant</b>	"	"	Capitalization policy
<b>Equipment</b>	"	"	Capitalization policy
<b>Computer Systems</b>	"	"	Computers obsolescence not usually consistent with depreciation policies
<b>Furniture &amp; Fixtures</b>	"	"	Capitalization policy
<b>Leasehold Improvements</b>	"	"	Lease Design
<b>Other</b>			
<b>Depreciation</b>	"	"	Depreciation Policy - Judgement

## The Balance Sheet – Intangibles / Other Assets

Assets	As of December 31,		Liabilities and Stockholders' (Deficit) Equity	As of December 31,	
	2001	2002		2001	2002
<b>Current assets:</b>			<b>Current liabilities:</b>		
Cash and cash equivalents	\$ 16,131	\$ 59,814	Accounts payable	\$ 13,715	\$ 20,350
Short-term investments	—	43,796	Accrued expenses	4,544	9,102
Prepaid expenses	1,019	2,753	Deferred revenue	4,937	9,743
Prepaid revenue sharing expenses	732	303	Current portion of capital lease obligations	1,345	1,231
Other current assets	1,670	409	Notes payable	1,667	—
<b>Total current assets</b>	<b>\$ 19,552</b>	<b>107,075</b>	<b>Total current liabilities</b>	<b>\$ 26,208</b>	<b>\$ 40,426</b>
				240	288
				1,057	460
			discount of	2,799	—
				\$ 30,304	\$ 41,174
			(note 5)		
				101,830	
<b>Other assets:</b>					
			00,000 and	6	—
			02, respectively;		
			or 31, 2001 and 2002,		
			December 31, 2001		
			0,000,000 shares	2	22
			161,855 and		
			and 2002, respectively		
Deposits		1,677		52,479	259,172
Other assets		646		(5,275)	(11,399)
				—	774
				(137,266)	(159,213)
				\$ (90,504)	\$ 89,356
<b>Total assets</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>	ity	\$ 41,630	\$ 130,530



## Creating the Intangible *(what to do with the debit)*



## Dissecting the Balance Sheet – Left Side Thinking – Intangibles

	What	Source of Numbers
<b>Capital Software</b>	Internal costs of product development	Capitalization Ledger
<b>Customer List/Non Competes</b>	Allocation of acquisition purchase price	Purchase & Sale Agreements
<b>Organization Expenses</b>	Early costs of starting business	Expense reports
<b>Goodwill</b>	Premuim paid for a business in excess of its identifiable assets	Excess purchase price over assets acquired

## Dissecting the Balance Sheet – Left Side Thinking – Intangibles

	Hardside	Softside
<b>Capital Software</b>		Capitalization policies, cost allocation methods, amortization methods, impairments
<b>Customer List/Non Competes</b>		Judgement. This is an allocated number. Management will tend to allocate as much to this as possible. Amortization policies
<b>Organization Expenses</b>		Capitalized lunch
<b>Goodwill</b>		A soft number. Impairment. Businesses without Goodwill on books often have Goodwill

## Dissecting the Balance Sheet – Left Side Thinking – Other Assets

Deposits

Long-term receivables

Deferred Tax benefits

Long-term prepaids



# Dissecting The Balance Sheet

## **LIABILITIES**

## Netflix – Current Liabilities

	As of December 31,			As of December 31,	
Assets	2001	2002	Liabilities and Stockholders' (Deficit) Equity	2001	2002
<b>Current assets:</b>			<b>Current liabilities:</b>		
Cash and cash equivalents	\$ 16,131	\$ 59,871	Accounts payable	\$ 13,715	\$ 20,350

### Liabilities and Stockholders' (Deficit) Equity

**Current liabilities:**



	As of December 31,	
	2001	2002
Accounts payable	\$ 13,715	\$ 20,350
Accrued expenses	4,544	9,102
Deferred revenue	4,937	9,743
Current portion of capital lease obligations	1,345	1,231
Notes payable	1,667	—
<b>Total current liabilities</b>	<b>\$ 26,208</b>	<b>\$ 40,426</b>

Deposits	1,677	1,690	Additional paid-in capital	52,479	259,172
Other assets	646	79	Deferred stock-based compensation	(5,275)	(11,399)
<b>Total assets</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>	Accumulated other comprehensive income	—	774
			Accumulated deficit	(137,266)	(159,213)
			<b>Total stockholders' (deficit) equity</b>	<b>\$ (90,504)</b>	<b>\$ 89,356</b>
			<b>Total liabilities and stockholders' (deficit) equity</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>

## Dissecting the Balance Sheet Right Side Thinking Current Liabilities

	What	Source of Numbers
<b>Notes payable</b>	Signed debt instruments due within the year	Cash receipt
<b>Current portion of LT</b>	The amount of principal that must be paid in next twelve months	Journal entry
<b>Accounts payable</b>	Bills	Purchases and invoices less payments
<b>Accrued expenses</b>	Recognition that amounts are due before invoices are received	Journal entry
<b>Deferred revenue</b>	Cash receipts in advance of earned revenue. Will be revenue within year	Cash receipts (without invoices)
<b>Taxes payable</b>	Amounts due to taxing authorities	Journal entry from tax return, payroll ledger less payments

## Dissecting the Balance Sheet Right Side Thinking Current Liabilities

	<b>Hardside</b>	<b>Softside</b>
<b>Notes payable</b>	Full balance of a demand or short-term note	
<b>Current portion of LT</b>	Amortization schedule of a note	Conditions could be such that more of note is due than set forth... "skimming bounds of covenants"
<b>Accounts payable</b>	Accounts Payable Ledger / Trial Balance	
<b>Accrued expenses</b>	NONE	Unallocated accruals or insufficient accruals 
<b>Deferred revenue</b>	List / informal subledger	Balance represents future sale (with profit - see Deferred Expense) 
<b>Taxes payable</b>	Tax return, payroll register	



## Netflix – Long Term Liabilities

	As of December 31,		As of December 31,	
	2001	2002	2001	2002
<b>Assets</b>			<b>Liabilities and Stockholders' (Deficit) Equity</b>	
<b>Current assets:</b>			<b>Current liabilities:</b>	
Cash and cash equivalents	\$ 16,131	\$ 59,814	Accounts payable	\$ 13,715 \$ 20,350
Short-term investments	—	43,796	Accrued expenses	4,544 9,102
Prepaid expenses	1,019	2,753	Deferred revenue	4,937 9,743
Prepaid revenue sharing expenses	732	303	Current portion of capital lease obligations	1,345 1,231
Other current assets	1,670	409	Notes payable	1,667 —
<b>Total</b>				
Deferred rent		240		288
Capital lease obligations, less current portion		1,057		460
<b>Fixed</b>				
Subordinated notes payable, net of unamortized discount of \$10,851 at December 31, 2001		2,799		—
				—
				41,174
<b>Total liabilities</b>		<b>\$ 30,304</b>		<b>\$ 41,174</b>
Commitments and contingencies (note 5)				
Redeemable convertible preferred stock		101,830		
<b>Other assets:</b>				
Deposits	1,677	1,690	<b>Common stock</b> , \$0.001 par value; 100,000,000 and 150,000,000 shares authorized at December 31, 2001 and 2002, respectively; 2,161,855 and 22,445,795 issued and outstanding at December 31, 2001 and 2002, respectively	2 22
Other assets	646	79	Additional paid-in capital	52,479 259,172
			Deferred stock-based compensation	(5,275) (11,399)
			Accumulated other comprehensive income	— 774
			Accumulated deficit	(137,266) (159,213)
<b>Total assets</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>	<b>Total stockholders' (deficit) equity</b>	<b>\$ (90,504) \$ 89,356</b>
			<b>Total liabilities and stockholders' (deficit) equity</b>	<b>\$ 41,630 \$ 130,530</b>

## Dissecting the Balance Sheet – Right Side Thinking Long-Term Liabilities

	What	Source of Numbers
<b>Long term debt</b>	The amount of principal from long term debt NOT due within next twelve months	Journal entry
<b>Deferred taxes</b>	Amounts recorded on books for taxes, not really due in current period	Calculation of tax accrual
<b>Convertible Debt</b>	A quasi-equity issue that may be paid in cash or may be turned into equity	Journal entry
<b>Commitments &amp; Contingencies</b>	Entry to balance sheet that warns you to read footnotes	NO NUMBER

## Dissecting the Balance Sheet – Right Side Thinkin Long-Term Liabilities

	Hardside	Softside
<b>Long term debt</b>	Amortization schedule of a note	Conditions could be such that more of note is due than set forth... "skimming bounds of covenants"
<b>Deferred taxes</b>		A soft calculation subject to changes from future events. Generally, little cash consequence. The 2nd set of books.
<b>Convertible Debt</b>	Fixed amount due	Interpretation as to likelihood this becomes equity. May have provisions that change value in certain circumstances
<b>Commitments &amp; Contingencies</b>	NONE	READ footnotes carefully





# Dissecting The Balance Sheet

**EQUITY /  
NET WORTH**

## Netflix – Equity

	As of December 31,		As of December 31,	
	2001	2002	2001	2002
<b>Assets</b>				
<b>Current assets:</b>				
Cash and cash equivalents	\$ 16,131	\$ 59,814	Accounts payable	\$ 13,715 \$ 20,350
Short-term investments	—	43,796	Accrued expenses	4,544 9,102
Prej				9,743
Prej				1,231
Oth				—
<b>Stockholders' (deficit) equity:</b>				
<b>Convertible preferred stock</b> , \$0.001 par value; 8,500,000 and 10,000,000 shares authorized at December 31, 2001 and 2002, respectively; 6,157,499 and no shares issued and outstanding at December 31, 2001 and 2002, respectively; aggregate liquidation preference of \$2,222 at December 31, 2001		6	—	<b>40,426</b>
				288
				460
				—
<b>Common stock</b> , \$0.001 par value; 100,000,000 and 150,000,000 shares authorized at December 31, 2001 and 2002, respectively; 2,161,855 and 22,445,795 issued and outstanding at December 31, 2001 and 2002, respectively		2	22	<b>41,174</b>
Additional paid-in capital		52,479	259,172	—
Deferred stock-based compensation		(5,275)	(11,399)	—
Accumulated other comprehensive income		—	774	22
Accumulated deficit		(137,266)	(159,213)	2,917
<b>Total stockholders' (deficit) equity</b>		<b>\$ (90,504)</b>	<b>\$ 89,356</b>	(11,399)
				774
<b>Total liabilities and stockholders' (deficit) equity</b>		<b>\$ 41,630</b>	<b>\$ 130,530</b>	(159,213)
				<b>89,356</b>
<b>Total assets</b>	<b>\$ 41,630</b>	<b>\$ 130,530</b>	<b>Total liabilities and stockholders' (deficit) equity</b>	<b>\$ 41,630 \$ 130,530</b>

## Dissecting the Balance Sheet Right Side Thinking Equity

	What	Source of Numbers
<b>Common Stock</b>	Shares Out * Par Value	Cash In - Journal Entry
<b>Preferred Stock</b>	Shares Out * Par Value	Cash In - Journal Entry
<b>APIC</b>	Cash Rec'd for Investment less (Shares out * Par Value)	Cash In - Journal Entry
<b>Treasury Stock</b>	Cash Paid to Repurchase Stock	Cash Out - Journal Entry
<b>Retained Earnings</b>	Cumulative Net Income History	Previous Period Retained Earnings plus Current Income
<b>Foreign Exchange Adj</b>	Changes in NW caused by foreign currency changes	Calculation
<b>Other</b>	Stock based compensation	Calculation

## Dissecting the Balance Sheet Right Side Thinking Equity

	Hardside	Softside
<b>Common Stock</b>	Stock Register	Consideration Paid, Non-Cash, etc.
<b>Preferred Stock</b>	Stock Register	Consideration Paid, Non-Cash, etc.
<b>APIC</b>	Stock Register	Consideration Paid, Non-Cash, etc.
<b>Treasury Stock</b>	Stock Register	Alternative Methods for Calc
<b>Retained Earnings</b>	Income Statements	Alternative Presentations; Occasional Direct Entries, see Retained Earning Rollforward Calculation
<b>Foreign Exchange Adj</b>		
<b>Other</b>		Calculation

*Watch stock for .....*



## Dissecting the Balance Sheet – Important Metrics

Current Ratio	Current Assets	/	Current Liabilities	General liquidity	\$ 107,075 / \$ 40,426	<b>2.65</b>
Quick Ratio	(Cash + AR)	/	Current Liabilities	Ability to meet debt with existing resources	\$ 103,610 / \$ 40,426	<b>2.56</b>
Debt/Equity	current Liabilities + Long Term Liabilities	/	Share Holder Equity	Leverage (Owned vs. Owed)	\$ 41,174 / \$ 130,530	<b>0.32</b>
EBITDA	Earnings	+	(Int/Tax/Dep/Amort)	Crude measure of cash flow	\$ (21,967) + \$ 36,772	<b>\$ 14,805</b>
Bad debt reserve *	Allowance for doubtful accounts	/	AR + Allowance	Magnitude of collection issues, particularly in comparison	\$ 1,500 / \$ 28,500	<b>5.3%</b>
Debt Coverage	EBITDA	/	Debt Service	Company's ability to cover its obligations	\$ 14,805 / \$ 1,511	<b>9.80</b>
Free Cash	EBITDA	-	Debt Service	What is true cash flow for business	14,805 - \$ 1,511	<b>\$ 13,294</b>



## Dissecting the Balance Sheet – Other Good Metrics

### Inventory Turnover:

- Cost of Goods/Inventory
- Inventory turnover days:  $365/\text{Inventory Turnover}$

### A/R Turnover

- Sales/Accounts Receivable
- A/R turnover days:  $365 / \text{AR Turnover}$

### Cash Cycle

- Add Inventory and A/R days
- Number of days from product to cash



# Dissecting The Income Statement



## Income Statement – Revenue – Growth

	Year Ended December 31,		
	2000	2001	2002
<b>Revenues:</b>			
Subscription	\$ 35,894	\$ 74,255	\$ 150,818
Sales	<u>—</u>	<u>1,657</u>	<u>1,988</u>
<b>Total revenues</b>	<b>\$ 35,894</b>	<b>\$ 75,912</b>	<b>\$ 152,806</b>
	2000	2001	2002
<b>Revenues:</b>			
Subscription	\$ 35,894	\$ 74,255	\$ 150,818
Sales	<u>—</u>	<u>1,657</u>	<u>1,988</u>
<b>Total revenues</b>	<b>\$ 35,894</b>	<b>\$ 75,912</b>	<b>\$ 152,806</b>
<i>Restructuring charges</i>			
Stock-based compensation *	<u>8,803</u>	<u>5,686</u>	<u>9,831</u>
<b>Total operating expenses</b>	<b>\$ 68,590</b>	<b>\$ 63,232</b>	<b>\$ 86,342</b>
<b>Operating loss</b>	<b>\$ (57,557)</b>	<b>\$ (37,227)</b>	<b>\$ (11,672)</b>
<b>Other income (expense):</b>			
Interest and other income	1,645	461	1,697
Interest and other expense	<u>(1,451)</u>	<u>(1,852)</u>	<u>(11,992)</u>
<b>Net loss</b>	<b>\$ (57,363)</b>	<b>\$ (38,618)</b>	<b>\$ (21,967)</b>
<b>Net loss per share:</b>			
Basic and diluted	\$ (40.57)	\$ (21.15)	\$ (1.56)
<b>Weighted average shares outstanding:</b>			
Basic and diluted	1,414	1,826	14,102

## Income Statement – Revenue - Transition

	Years Ended June 30,		
	2000	2001	2002
	(In thousands, except per share data)		
Revenues:			
Software licenses	\$ 132,843	\$ 147,448	\$ 133,913
Service and other	135,250	179,476	186,691
<b>Total Revenue</b>	<b>268,093</b>	<b>326,924</b>	<b>320,604</b>

*Growth*

*No Growth*

## Dissecting the Income Statement - Revenue

### Types of Revenues

- Goods Sold (Sales)
- Fees
- Subscriptions
- Rents
- Software Licenses
- Maintenance

### Gross vs.. Net

### Project Revenues / Progress Billing

## Income Statement – Revenue – Growth

	Year Ended December 31,		
	2000	2001	2002
<b>Revenues:</b>			
Subscription	\$ 35,894	\$ 74,255	\$ 150,818
Sales	<u>—</u>	<u>1,657</u>	<u>1,988</u>

	Year Ended December 31,		
	2000	2001	2002
<b>Revenues:</b>			
Subscription	\$ 35,894	\$ 74,255	\$ 150,818
Sales	<u>—</u>	<u>1,657</u>	<u>1,988</u>
<b>Total revenues</b>	<b>\$ 35,894</b>	<b>\$ 75,912</b>	<b>\$ 152,806</b>
<b>Cost of revenues:</b>			
Subscription	24,861	49,088	77,044
Sales	<u>—</u>	<u>819</u>	<u>1,092</u>
<b>Total cost of revenues</b>	<b>\$ 24,861</b>	<b>\$ 49,907</b>	<b>\$ 78,136</b>
<b>Gross profit</b>	<b>\$ 11,033</b>	<b>\$ 26,005</b>	<b>\$ 74,670</b>

<b>Weighted average shares outstanding:</b>			
Basic and diluted	1,414	1,826	14,102

## Dissecting the Income Statement – Cost of Goods

	Years Ended June 30,		
	2000	2001	2002
	(In thousands, except per share data)		
Expenses:			
Cost of software licenses	9,605	11,856	11,830
Cost of service and other	85,193	114,595	119,972
Selling and marketing	91,863	113,608	113,225
Research and development	51,567	68,913	74,458
General and administrative	24,736	30,643	34,258
Costs related to acquisitions	1,547	—	—
Restructuring and other charges	—	6,969	16,083
Charges for in-process research and development	—	9,915	14,900
	264,511	356,499	386,726
Income (loss) from operations	3,582	(29,575)	(66,122)
Interest income	9,847	10,268	6,768
Interest expense	(5,563)	(5,469)	(5,591)
Write-off of investments	—	(5,000)	(8,923)
Foreign currency exchange loss	(118)	(81)	(1,073)
Income on equity in joint ventures and realized gain on sale of investments	4	750	180
	7,752	(29,107)	(74,761)
Income (loss) before provision for (benefit from) income taxes			
Provision for (benefit from) income taxes	2,324	(8,732)	2,404
Net income (loss)	5,428	(20,375)	(77,165)

## Dissecting the Income Statement – Cost of Goods

Direct Cost of Revenue

Cost of Sales vs.. Operating Expenses

Should Cost of Sales all be variable?

Allocation of Fixed Expenses to departments/categories



## Aspen Tech – Operating Expenses

	Years Ended June 30,		
	2000	2001	2002
	(In thousands, except per share data)		
Expenses:			
Cost of software licenses	9,605	11,856	11,830
Cost of service and other	85,193	114,595	119,972
Selling and marketing	91,863	113,608	115,225
Research and development	51,567	68,913	74,458
General and administrative	24,736	30,643	34,258
Costs related to acquisitions	1,547	—	—
Restructuring and other charges	—	6,969	16,083
Charges for in-process research and development	—	9,915	14,900
	264,511	356,499	386,726
Income (loss) from operations	3,582	(29,575)	(66,122)
Interest income	9,847	10,268	6,768
Interest expense	(5,563)	(5,469)	(5,591)
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Income on equity in joint ventures and realized gain on sale of investments	4	750	180
	7,752	(29,107)	(74,761)
Income (loss) before provision for (benefit from) income taxes			
Provision for (benefit from) income taxes	2,324	(8,732)	2,404
Net income (loss)	5,428	(20,375)	(77,165)

## Dissecting the Income Statement – Operating Expenses

Types of Expenses – Allocation Discretion

Sales and Marketing

- Advertising, Sales salaries/commissions, T&E

Research & Development

- Development Salaries

General & Administrative

- Rent, Supplies, Utilities

Other Operating Expenses / Non-recurring / Special

Cash vs.. Non-Cash

Capitalized Expenses / Amortization

## Dissecting the Income Statement – Important Metrics & Terms

- Gross Margin / Contribution Margin
- Operating Margin / Return of Sales
- Industry Specific Measures
  - Sales & Marketing / Revenues
  - R&D / Revenues
  - G&A / Revenues
- EBITDA

## Aspen Tech Comparative Income Statement

Fiscal year ending June 30,					
Actual Results	1998	1999	2000	2001	2002
Revenue	252.6	226.6	268.1	326.9	320.6
Cost Of Revenue	76.7	91.8	94.8	126.4	131.8
Gross Margin	<b>175.9</b> 69.6%	<b>134.8</b> 59.5%	<b>173.3</b> 64.6%	<b>200.5</b> 61.3%	<b>188.8</b> 58.9%
Selling and Marketing	74.9	85.7	91.9	113.6	115.2
Research and Development	43.6	48.6	51.6	68.9	74.5
General and Admin	20.2	23.5	24.7	30.6	34.2
OPEX from continuing ops	<b>138.7</b>	<b>157.8</b>	<b>168.2</b>	<b>213.1</b>	<b>223.9</b>
<b>Income from continuing ops</b>	<b>37.2</b>	<b>(23.0)</b>	<b>5.1</b>	<b>(12.6)</b>	<b>(35.1)</b>
Other/One Time Charges	13.5	17.9	1.5	16.9	31.0
<b>Operating Income</b>	<b>23.7</b>	<b>(40.9)</b>	<b>3.6</b>	<b>(29.5)</b>	<b>(66.1)</b>

## Aspen Tech Income Statement Trend Analysis

Fiscal year ending June 30,					
Actual Results	1998	1999	2000	2001	2002
Revenue	252.6	226.6	268.1	326.9	320.6
Cost Of Revenue	76.7	91.8	94.8	126.4	131.8
Gross Margin	175.9	134.8	173.3	200.5	188.8
Selling and Marketing					
Research and Development					
General and Admin					
OPEX from continuing ops					
<b>Income from continuing ops</b>					
Other/One Time Charges					
<b>Operating Income</b>					

Actual Results	1998	1999	2000	2001	2002
<b>EBITDA Calculation</b>					
Income from continuing	37.2	(23.0)	5.1	(12.6)	(35.1)
Depr / Amort	16.0	16.0	16.0	16.0	16.0
<b>EBITDA - continuing</b>	<b>53.2</b>	<b>(7.0)</b>	<b>21.1</b>	<b>3.4</b>	<b>(19.1)</b>

Expense as a % of Revenue	1998	1999	2000	2001	2002
Selling and Marketing	30%	38%	34%	35%	36%
Research and Development	17%	21%	19%	21%	23%
General and Admin	8%	10%	9%	9%	11%
Other/One Time Charges	5%	8%	1%	5%	10%
Total	0%	0%	0%	0%	0%

Employees	1518	1448	1731	1927	1927
Selling/Marketing per Employee	49,341	59,185	53,091	58,952	59,782
Revenue per Employee	166,403	156,492	154,882	169,642	166,373

## Taking a Bath

What companies / CFO's will do in bad years

- Positioning to manage earnings in good years
- Sometimes, they will “profit” from the bathwater
- Many washed up in 2001/02





# Dissecting The Statement of Cash Flows



## What is Cash?

Cash is the money that a person actually has, including money on deposit (Webster's)

Cash is the medium of exchange (Economics)

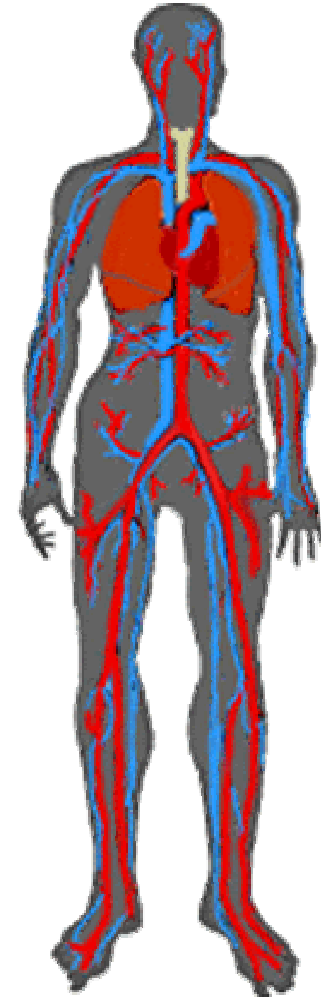
Cash is king (am. slang)





Cash is.....

*The lifeblood of a business. It nourishes all of the arms of an organization. It keeps it alive!*



## Cash consists of

Money on hand (petty cash or cash in the vault)

Cash in the bank

- Deposits in transit (but not O/S checks)

Cash equivalents

- Time deposits

- Repos

- Other

## Cash does not consist of:

Short-term Investments

— Near enough to cash

Long-term Investments

Accounts Receivable

Deposits

## What is cash flow?

Cash that is generated by a business

- Generally customers

Vs. that is demanded by the business:

- including its shareholders,
- financiers
- and vendors

in its normal course.

## Cash comes from:

### **Operations or Operating Activities**

- Sales, usually via accounts receivable (see sources and uses.)

### **Investing Activities**

- Sale of part of the business
- Sale of assets (including factoring)

### **Financing Activities**

- Investors (sale of stock)
- Banks (Loans)

## Cash v. Cash Flow and Income

I made money, but I feel so broke

- Timing differences between net income and cash
  - Receivables vs.. payables
  - Deferred expenses vs.. revenues
  - Capital expenditures and amortization
  - Growth financing

You say I lost money, ha! I have plenty of cash

- For now! There is often a lag between accrual income and cash flow

## Understanding Sources & Uses

### Revenue

- A straight sale for cash is a source of cash
- **However** when the sale becomes a receivable, we have a use of cash. We, in essence, let our customer **use our cash**.
- The payment of a receivable by the customer is a **source of cash**.

## Understanding Sources & Uses

### Expense

- A straight purchase from a vendor \* is a use of cash.
- **However** when that purchase is on account (they will bill and we will pay later) this becomes a **source of cash**.
- When we later pay the bill, it is a **use of cash**.



# The Cash Flow Statement

Largely a “different look” than other financial statements

- Operations
- Financing Activities
- Investing Activities

Only a few items of ‘new information’

- Depreciation / Amortization
- Acquisitions and deletions of fixed assets
- Investment in company / Business Acquisitions

Cash Flow explains changes in cash position as a calculation of other changes

- It is mechanical

# Netflix Balance Sheet

NETFLIX, INC.  
BALANCE SHEETS  
(in thousands, except share and per share data)

	2001		2002		of December 31, 2002
<b>Assets</b>					
<b>Current assets:</b>					
Cash and cash equivalents	\$	16,131	\$	59,814	15 \$ 20,350
Short-term investments		—		43,796	44 9,102
Prepaid expenses		1,019		2,753	57 9,743
Prepaid revenue sharing expenses		732		303	45 1,231
Other current assets		1,670		409	57 —
<b>Total current assets</b>	\$	<b>19,552</b>		<b>107,075</b>	57 —
Deposits		1,677		1,690	08 \$ 40,426
Other assets		646		79	40 288
					57 460
					39 —
					14 \$ 41,174
					30
					6 —
					2 22
					52,479 259,172
					(5,725) (11,399)
					— 774
					(137,266) (159,213)
					\$ (90,504) \$ 89,356
<b>Total assets</b>	\$	<b>41,630</b>	\$	<b>130,530</b>	\$ 41,630 \$ 130,530

Change of  
Cash: \$43,683

## Netflix Cash Flow

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	\$ (22,706)	\$ 4,847	\$ 40,114
<b>Cash flows from investing activities:</b>			
Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988
Deposits and other assets	(1,189)	(586)	554
Net cash used in investing activities	\$ (24,972)	\$ (12,670)	\$ (67,301)
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of redeemable convertible preferred stock	50,011	—	—
Proceeds from issuance of common stock	422	125	88,020
Net proceeds from issuance of subordinated notes payable and detachable	—	12,831	—
Repurchases of common stock	(141)	(12)	(6)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
Net cash provided by financing activities	\$ 48,375	\$ 9,059	\$ 70,870
<b>Net increase in cash and cash equivalents</b>			
	\$ 697	\$ 1,236	\$ 43,683
Cash and cash equivalents, beginning of period	\$ 14,198	\$ 14,895	\$ 16,131
Cash and cash equivalents, end of period	\$ 14,895	\$ 16,131	\$ 59,814
	\$ 697	\$ 1,236	\$ 43,683
<b>Supplemental disclosure:</b>			
Cash paid for interest	948	860	592
<b>Noncash investing and financing activities:</b>			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

*Operations*

*Investing*

*Financing*

*Change in Cash*

*Supplemental*

## Netflix Cash Flow

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	<u>\$ (22,706)</u>	<u>\$ 4,847</u>	<u>\$ 40,114</u>

<b>Cash flows from investing activities:</b>			
Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988

Cash and cash equivalents, beginning of period	\$ 14,198	\$ 14,895	\$ 16,131
Cash and cash equivalents, end of period	\$ 14,895	\$ 16,131	\$ 59,814
	<u>\$ 697</u>	<u>\$ 1,236</u>	<u>\$ 43,683</u>

Net increase in cash and cash equivalents	\$ 697	\$ 1,236	\$ 43,683
Cash and cash equivalents, beginning of period	\$ 14,198	\$ 14,895	\$ 16,131
Cash and cash equivalents, end of period	<u>\$ 14,895</u>	<u>\$ 16,131</u>	<u>\$ 59,814</u>
	<u>\$ 697</u>	<u>\$ 1,236</u>	<u>\$ 43,683</u>

<b>Supplemental disclosure:</b>			
Cash paid for interest	948	860	592
<b>Noncash investing and financing activities:</b>			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

*Change in Cash*

## Cash Flow from Operations

NETFLIX, INC.

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
<b>Net cash (used in) provided by operating activities</b>	<b>\$ (22,706)</b>	<b>\$ 4,847</b>	<b>\$ 40,114</b>
Net increase in cash and cash equivalents	\$ 697	\$ 1,236	\$ 43,683
Cash and cash equivalents, beginning of period	\$ 14,198	\$ 14,895	\$ 16,131
Cash and cash equivalents, end of period	\$ 14,895	\$ 16,131	\$ 59,814

*Lost Money /*

*Positive Cash Flow*

**Supplemental disclosure:**

Cash paid for interest	948	860	592
<b>Noncash investing and financing activities:</b>			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

# Cash from Operations

## Cash from Operations

	What	Source of Numbers
<b>Net Income</b>	Bottom Line of Income Statement	Income Statement
<b>Adjustments: Non Cash</b>		
<b>Amortization / Depreciation *</b>	amount charged against income to match cost of asset to operations	Fixed asset register
<b>Adjustments: changes in working capital</b>	Change in balance of account one year to next	Calculation from Balance Sheet

## Cash Flow from Investing

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384

### Cash flows from investing activities:

Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988
Deposits and other assets	(1,189)	(586)	554
<b>Net cash used in investing activities</b>	<b>\$ (24,972)</b>	<b>\$ (12,670)</b>	<b>\$ (67,301)</b>

*Misleading*

Repurchases of common stock	(141)	(12)	(14)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
<b>Net cash provided by financing activities</b>	<b>\$ 48,375</b>	<b>\$ 9,059</b>	<b>\$ 70,870</b>

<b>Net increase in cash and cash equivalents</b>	<b>\$ 697</b>	<b>\$ 1,236</b>	<b>\$ 43,683</b>
Cash and cash equivalents, beginning of period	\$ 14,198	\$ 14,895	\$ 16,131
Cash and cash equivalents, end of period	\$ 14,895	\$ 16,131	\$ 59,814
	\$ 697	\$ 1,236	\$ 43,683

<b>Supplemental disclosure:</b>			
Cash paid for interest	948	860	592
<b>Noncash investing and financing activities:</b>			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

# Cash used in Investing Activities

## Cash from Investing Activities

	<b>What</b>	<b>Source of Numbers</b>
<b>Purchases of property &amp; equipment *</b>	Total dollars paid for hard assets	Purchases journal
<b>Purchase of subsidiary *</b>	Total dollars paid for hard assets	Acquisition agreements / Cash disbursements journal
<b>Acquisition costs incurred</b>	Amounts paid for attorneys, consultants, etc to do a deal	Purchase or Cash disbursements journal



# Cash Flow

## Cash used in Investing Activities

### Cash from Investing Activities

	<b>Hardside</b>	<b>Softside</b>
<b>Purchases of property &amp; equipment *</b>	Cash paid	Capitalization Policy
<b>Purchase of subsidiary *</b>	Cash paid	Often debt or equity is used, valuation thereof can be very subjective if no market for debt / equity
<b>Acquisition costs incurred</b>	Cash paid	Capitalization Policy, otherwise this would be a period expense

## Cash Flow from Financing

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)

### Cash flows from financing activities:

Proceeds from issuance of redeemable convertible preferred stock  
 Proceeds from issuance of common stock  
 Net proceeds from issuance of subordinated notes payable and detachable  
 Repurchases of common stock  
 Principal payments on notes payable and capital lease obligations  
**Net cash provided by financing activities**

*Sold some*

*Stock*

50,011	—	—
422	125	88,020
—	12,831	—
(141)	(12)	(6)
(1,917)	(3,885)	(17,144)
<b>\$ 48,375</b>	<b>\$ 9,059</b>	<b>\$ 70,870</b>

Proceeds from issuance of common stock	422	125	88,020
Net proceeds from issuance of subordinated notes payable and detachable	—	12,831	—
Repurchases of common stock	(141)	(12)	(6)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
<b>Net cash provided by financing activities</b>	<b>\$ 48,375</b>	<b>\$ 9,059</b>	<b>\$ 70,870</b>

<b>Net increase in cash and cash equivalents</b>	<b>\$ 697</b>	<b>\$ 1,236</b>	<b>\$ 43,683</b>
Cash and cash equivalents, beginning of period	\$ 14,198	\$ 14,895	\$ 16,131
Cash and cash equivalents, end of period	\$ 14,895	\$ 16,131	\$ 59,814
	<b>\$ 697</b>	<b>\$ 1,236</b>	<b>\$ 43,683</b>

<b>Supplemental disclosure:</b>			
Cash paid for interest	948	860	592
<b>Noncash investing and financing activities:</b>			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

# Cash used in Financing Activities

## Cash from Financing Activities

	What	Source of Numbers
<b>Proceeds from Investment</b> <b>Proceeds from Debt</b> <b>Payments on debt</b>	Net amounts of money raised Draws on debt Reduction of debt	Cash receipts journal Cash receipts journal Cash disbursements journal

# Cash used in Financing Activities

## Cash from Financing Activities

	<b>Hardside</b>	<b>Softside</b>
<b>Proceeds from Investment</b>		
<b>Proceeds from Debt</b>		Gross vs net
<b>Payments on debt</b>	Cash paid	Gross vs net
	Cash paid	Gross vs net
	Cash paid	

## Cash Flow – Supplemental Disclosures

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
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Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	\$ (22,706)	\$ 4,847	\$ 40,114
<b>Cash flows from investing activities:</b>			
Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988
Deposits and other assets	(1,180)	(586)	554

**Supplemental disclosure:**

Cash paid for interest	948	860	592
Noncash investing and financing activities:			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

Cash paid for interest	948	860	592
Noncash investing and financing activities:			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

*Stock for Stock  
& Stock for  
Services*

*Supplemental*

# Supplemental Disclosures

## Supplemental Disclosures

	What	Source of Numbers
Cash paid for interest	Interest component of debt service	Cash disbursements journal
Cash paid for income taxes	Actual cash portion of taxes	Cash disbursements journal
Issuance of stock / debt	Value assigned for stock debt issued in acquisition	Acquisition agreements
Other		

# Supplemental Disclosures

## Supplemental Disclosures

	<b>Hardside</b>	<b>Softside</b>
<b>Cash paid for interest</b>	Cash paid	
<b>Cash paid for income taxes</b>	Cash paid	
<b>Issuance of stock / debt</b>	Market value of stock issued, if a public market exists	Often debt or equity is used, valuation thereof can be very subjective if no market for debt / equity
<b>Other</b>		

## Netflix Cash Flow (cont)

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	\$ (22,706)	\$ 4,847	\$ 40,114
<b>Cash flows from investing activities:</b>			
Purchases of short-term investments	—	—	(43,022)
Proceeds from sale of short-term investments	6,322	—	—
Purchases of property and equipment	(6,210)	(3,233)	(2,751)
Acquisitions of DVD library	(23,895)	(8,851)	(24,070)
Proceeds from sale of DVDs	—	—	1,988
Deposits and other assets	(1,189)	(586)	554
Net cash used in investing activities	\$ (24,972)	\$ (12,670)	\$ (67,301)
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of redeemable convertible preferred stock	50,011	—	—
Proceeds from issuance of common stock	422	125	88,020
Net proceeds from issuance of subordinated notes payable and detachable	—	12,831	—
Repurchases of common stock	(141)	(12)	(6)
Principal payments on notes payable and capital lease obligations	(1,917)	(3,885)	(17,144)
Net cash provided by financing activities	\$ 48,375	\$ 9,059	\$ 70,870
<b>Net increase in cash and cash equivalents</b>			
	\$ 697	\$ 1,236	\$ 43,683
<b>Cash and cash equivalents, beginning of period</b>			
	\$ 14,198	\$ 14,895	\$ 16,131
<b>Cash and cash equivalents, end of period</b>			
	\$ 14,895	\$ 16,131	\$ 59,814
	\$ 697	\$ 1,236	\$ 43,683
<b>Supplemental disclosure:</b>			
Cash paid for interest	948	860	592
<b>Noncash investing and financing activities:</b>			
Purchase of assets under capital lease obligations	3,000	520	583
Discount on capital lease obligation	105	172	—
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830



*Operations*



*Investing*



*Financing*



*Change in Cash*



*Supplemental*



## What is E.B.I.T.D.A.

- Earnings Before
  - Interest
  - Taxes
  - Depreciation
  - Amortization
- It is a crude measure of cash flow
- *What it is NOT: true cash flow*

## Calculating EBITDA

	Year Ended December 31,		
	2000	2001	2002
<b>Revenues:</b>			
Subscription	\$ 35,894	\$ 74,255	\$ 150,818
Sales	<u>—</u>	<u>1,657</u>	<u>1,988</u>
<b>Total revenues</b>	<b>\$ 35,894</b>	<b>\$ 75,912</b>	<b>\$ 152,806</b>
<b>Cost of revenues:</b>			
Subscription	24,861	49,088	77,044
Sales	<u>—</u>	<u>819</u>	<u>1,092</u>
<b>Total cost of revenues</b>	<b>\$ 24,861</b>	<b>\$ 49,907</b>	<b>\$ 78,136</b>
<b>Gross profit</b>	<b>\$ 11,033</b>	<b>\$ 26,005</b>	<b>\$ 74,670</b>
<b>Operating expenses:</b>			
Fulfillment *	10,247	13,452	19,366
Technology and development *	16,823	17,734	14,625
Marketing *	25,727	21,031	35,783
General and administrative *	6,990	4,658	6,737
Restructuring charges	—	671	—
Stock-based compensation *	<u>8,803</u>	<u>5,686</u>	<u>9,831</u>
<b>Total operating expenses</b>	<b>\$ 68,590</b>	<b>\$ 63,232</b>	<b>\$ 86,342</b>
<b>Operating loss</b>	<b>\$ (57,557)</b>	<b>\$ (37,227)</b>	<b>\$ (11,672)</b>
<b>Other income (expense):</b>			
Interest and other income	1,645	461	1,697
Interest and other expense	<u>(1,451)</u>	<u>(1,852)</u>	<u>(11,992)</u>
<b>Net loss</b>	<b>\$ (57,363)</b>	<b>\$ (38,618)</b>	<b>\$ (21,967)</b>

	2000	2001	2002
<b>EBITDA #1</b>	<b>\$ (57,363)</b>	<b>\$ (38,618)</b>	<b>\$ (21,967)</b>
<b>Net Loss</b>			
Item			
Source			
IS			

## Calculating EBITDA

	Year Ended December 31,					
	2000	2001	2002	2000	2001	2002
<b>Revenues:</b>						
Subscription Sales	\$ 35,894	\$ 74,255	\$ 150,818			
	<u>—</u>	<u>1,657</u>	<u>1,988</u>			
<b>Total revenues</b>	<b>\$ 35,894</b>	<b>\$ 75,912</b>	<b>\$ 152,806</b>			
<b>Cost of revenues:</b>						
Subscription Sales	24,861					
	<u>—</u>					
<b>Total cost of revenues</b>	<b>\$ 24,861</b>	<b>\$ 24,861</b>	<b>\$ 24,861</b>			
<b>Gross profit</b>	<b>\$ 11,033</b>	<b>\$ 51,051</b>	<b>\$ 127,945</b>			
<b>Operating expenses:</b>						
Fulfillment *	10,247	13,452	19,366			
Technology and development *	16,823	17,734	14,625			
Marketing *	25,727	21,031	35,783			
General and administrative *	6,990	4,658	6,737			
Restructuring charges	—	671	—			
Stock-based compensation *	8,803	5,686	9,831			
	<u>8,803</u>	<u>5,686</u>	<u>9,831</u>			
<b>Total operating expenses</b>	<b>\$ 68,590</b>	<b>\$ 63,232</b>	<b>\$ 86,342</b>			
<b>Operating loss</b>	<b>\$ (57,557)</b>	<b>\$ (37,227)</b>	<b>\$ (11,672)</b>			
<b>Other income (expense):</b>						
Interest and other income	1,645	461	1,697			
Interest and other expense	<u>(1,451)</u>	<u>(1,852)</u>	<u>(11,992)</u>			
<b>Net loss</b>	<b>\$ (57,363)</b>	<b>\$ (38,618)</b>	<b>\$ (21,967)</b>			

	2000	2001	2002
<b>EBITDA #1</b>			
<b>Net Loss</b>	<b>\$ (57,363)</b>	<b>\$ (38,618)</b>	<b>\$ (21,967)</b>
<b>Interest</b>	(194)	1,391	10,295
<b>Taxes</b>	0	0	0

# Calculating EBITDA

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue			4,806
Deferred rent			48
Net cash (used in) provided by operating activities			\$ 40,114
<b>EBITDA #1</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Item			
Net Loss	\$ (57,363)	\$ (38,618)	\$ (21,967)
Interest	IS	(194)	1,391
Taxes	IS	0	0
Depr / Amort	CF	\$ 19,832	\$ 29,797
EBITDA		\$ (37,725)	\$ (7,430)
		\$ 26,477	\$ 14,805
<b>Supplemental disclosure:</b>			
Cash and cash equivalents, end of period			
Cash paid for interest			
Noncash investing and financing activities:			
Purchase of assets under capital lease obligation			
Discount on capital lease obligation			
Warrant issued as a deposit on operating lease	216	—	—
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318
Unrealized gain on short-term investments	—	—	774
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830

# How Good is EBITDA as a Measure of Cash Flow?

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

		2000	2001	2002
<b>Cash flows from operating activities:</b>				
Net loss		\$ (57,363)	\$ (38,618)	\$ (21,967)
<b>Adjustments to reconcile</b>	<b>EBITDA #1</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Depreciation of property and equipment	Item			
Amortization of DVD library	Source			
Amortization of intangible assets	<b>Net Loss</b>	<b>\$ (57,363)</b>	<b>\$ (38,618)</b>	<b>\$ (21,967)</b>
Noncash charges for equity-based compensation	<b>Interest</b>	(194)	1,391	10,295
Loss on disposal of property	<b>Taxes</b>	0	0	0
Gain on disposal of DVDs	<b>Depr / Amort</b>	\$ 19,832	\$ 29,797	\$ 26,477
Noncash interest and other	<b>EBITDA</b>	<b>\$ (37,725)</b>	<b>\$ (7,430)</b>	<b>\$ 14,805</b>
<b>Changes in operating assets and liabilities:</b>	<b>CF</b>	2,302	2,164	4,806
Prepaid expenses and other assets		102	138	48
Accounts payable		\$ (22,706)	\$ 4,847	\$ 40,114
Accrued expenses				
Deferred revenue				
Deferred rent				
Net cash (used in) provided by operating activities		\$ (22,706)	\$ 4,847	\$ 40,114
Cash and cash equivalents, beginning of period		\$ 14,170	\$ 14,072	\$ 10,124
Cash and cash equivalent	<b>Actual Change in Cash</b>	<b>\$ 697</b>	<b>\$ 1,236</b>	<b>\$ 43,683</b>
	<b>Cash from Operations</b>	<b>\$ (22,706)</b>	<b>\$ 4,847</b>	<b>\$ 40,114</b>
<b>Supplemental disclosure</b>				
Cash paid for interest		3,000	520	583
Noncash investing and financing activities:		105	172	—
Purchase of assets under capital lease obligations		216	—	—
Discount on capital lease obligation		6,128	4,498	1,318
Warrant issued as a deposit on operating lease		—	—	774
Exchange of Series F non-voting convertible preferred stock for intangible asset		—	—	101,830
Unrealized gain on short-term investments		—	—	—
Conversion of redeemable convertible preferred stock to common stock		—	—	—

# How Good is EBITDA as a Measure of Cash Flow?

NETFLIX, INC.  
STATEMENTS OF CASH FLOWS  
(in thousands)

	2000	2001	2002		
<b>Cash flows from operating activities:</b>					
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)		
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>					<b>2002</b>
Depreciation of property and equipment	3,605	5,507	5,919		
Amortization of DVD library	15,681	22,127	17,417	18	<b>\$ (21,967)</b>
Amortization of intangible assets	546	2,163	3,141		
Noncash charges for equity instruments granted to non-employees	598	28	40		
Stock-based compensation expense	8,803	5,686	9,831		
Loss on disposal of property and equipment	145	—	—	391	10,295
Gain on disposal of DVDs	—	—	(1,674)	0	0
Noncash interest and other expense	497	1,017	11,384		
<b>Changes in operating assets and liabilities:</b>				<b>797</b>	<b>\$ 26,477</b>
Prepaid expenses and other current assets	(2,686)	(15)	(44)		
Accounts payable	2,356	6,025	6,635	30	<b>\$ 14,805</b>
Accrued expenses	2,708	(1,375)	4,558		
Deferred revenue	2,302	2,164	4,806		
Deferred rent	102	138	48		
<b>Net cash (used in) provided by operating activities</b>	<b>\$ (22,706)</b>	<b>\$ 4,847</b>	<b>\$ 40,114</b>		
<b>Actual Change in Cash</b>		<b>\$ 697</b>	<b>\$ 1,236</b>		<b>\$ 43,683</b>
<b>Cash from Operations</b>		<b>\$ (22,706)</b>	<b>\$ 4,847</b>		<b>\$ 40,114</b>
<b>Supplemental disclosure</b>					
Cash paid for interest					
Noncash investing and financing activities:					
Purchase of assets under capital lease obligations	3,000	520	583		
Discount on capital lease obligation	105	172	—		
Warrant issued as a deposit on operating lease	216	—	—		
Exchange of Series F non-voting convertible preferred stock for intangible asset	6,128	4,498	1,318		
Unrealized gain on short-term investments	—	—	774		
Conversion of redeemable convertible preferred stock to common stock	—	—	101,830		

What about the other  
“non-cash” items?

## Revised Look at EBITDA

EBITDA #2 Item	Source	2000	2001	2002
<b>Net Loss</b>	<b>IS</b>	<b>\$ (57,363)</b>	<b>\$ (38,618)</b>	<b>\$ (21,967)</b>
<b>Interest</b>	<b>IS</b>	(194)	1,391	10,295
<b>Taxes</b>	<b>IS</b>	-	-	-
<b>Depr / Amort</b>	<b>CF</b>	\$ 19,832	\$ 29,797	\$ 26,477
<b>EBITDA #1</b>		<b>\$ (37,725)</b>	<b>\$ (7,430)</b>	<b>\$ 14,805</b>
Noncash charges for equity instruments granted to non-employees		\$ 598	\$ 28	\$ 40
Stock-based compensation expense		\$ 8,803	\$ 5,686	\$ 9,831
Loss on disposal of property and equipment		\$ 145	—	—
Gain on disposal of DVDs		—	—	\$ (1,674)
Noncash interest and other expense		\$ 497	\$ 1,017	\$ 11,384
<b>EBITDA #2</b>		<b>\$ (27,682)</b>	<b>\$ (699)</b>	<b>\$ 34,386</b>
<b>Cash from Operations</b>		<b>\$ (22,706)</b>	<b>\$ 4,847</b>	<b>\$ 40,114</b>

## Revised Look at EBITDA

	2000	2001	2002
<b>Cash flows from operating activities:</b>			
Net loss	\$ (57,363)	\$ (38,618)	\$ (21,947)
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation of property and equipment	3,605	5,507	5,919
Amortization of DVD library	15,681	22,127	17,417
Amortization of intangible assets	546	2,163	3,141
Noncash charges for equity instruments granted to non-employees	598	28	40
Stock-based compensation expense	8,803	5,686	9,831
Loss on disposal of property and equipment	145	—	—
Gain on disposal of DVDs	—	—	(1,674)
Noncash interest and other expense	497	1,017	11,384
<b>Changes in operating assets and liabilities:</b>			
Prepaid expenses and other current assets	(2,686)	(15)	(44)
Accounts payable	2,356	6,025	6,635
Accrued expenses	2,708	(1,375)	4,558
Deferred revenue	2,302	2,164	4,806
Deferred rent	102	138	48
Net cash (used in) provided by operating activities	<u>\$ (22,706)</u>	<u>\$ 4,847</u>	<u>\$ 40,114</u>
<b>EBITDA #2</b>	<u>\$ (27,682)</u>	<u>\$ (699)</u>	<u>\$ 34,386</u>
<b>Cash from Operations</b>	<u>\$ (22,706)</u>	<u>\$ 4,847</u>	<u>\$ 40,114</u>

Change in WC  
\$4782



## Calculating Cash Flow Dynamics

### Days Sales in Receivables

AR Balance *	<u>\$ 27,000</u>	0.177	360	<b>63.6</b>
Sales	<u>\$ 152,806</u>			

### Days Costs in Payables

AP Balance *	<u>\$ 13,715</u>	0.208	360	<b>75.0</b>
Cost of goods	\$ 78,136			
Opex	\$ 86,342			
Less: payroll/rent	<u>\$ (98,687)</u>			
	<u>\$ 65,791</u>			

# Understanding your Unique Cash Flow

## YOU MUST UNDERSTAND

- Days Sales
  - How long does it take a receivable to turn to cash
- Payables
  - What is average days payable
  - What must you pay currently, 30 days, what gets stretched
- To what extent does your business have “deferrals”

## Managing Float – (the Holes of Cash Inflow)

### Invoicing Float

- Time goods / services are delivered to time invoiced
  - Particular issue with professional services firm

### Mail Float

- Time it takes for invoice to get to customer
- Time it takes for “check to be in the mail.”

### Customer Processing Float

- Time it takes for customer to receive, code, approve and pay invoice

### Company Processing Float

- Time it takes to get the check from the mail, posted and to the bank

### Bank Processing Float

- Time it takes from deposit to available funds
- Time it takes from available funds to a cleared check