Show Me the $: What Every Leader Needs to Know About Financial Acumen

Professor Joe Perfetti
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Joe Perfetti – Who Am I

• Serial Entrepreneur
  • Learning Communities, Intelliworks, Syllutions, Redhead and Percipient
• Atlanta Braves Fan
• Technology Junkie – I spent more $ on my home theatre system than most sane people spend on transportation
• Avid Traveler
• Haunted House Aficionado
• Dogs not Cats
• Spontaneous – my friends really like this…
Experience

Lecturer, Department of Finance, RH Smith School of Business since 2006
Equity Analysis: Undergrad, MS and Online MBA

Four consecutive teaching awards 2013-2016
Exec Ed: 80 days per year
Teaching at Wharton Exec Ed Since 2007
Teaching for Duke CE since 2008
Teaching for Heidrick & Struggles since 2014
Georgetown Law School 2014-2017
Online Learning:
Building Financial Acumen

Representative Custom Engagements:
Google (Alphabet), UnitedHealth Group, Comcast, CVS, Anheuser-Busch InBev, Aramark, KPMG, LyondellBasell, Santander, Citi, Bank of America Merrill Lynch, Morgan Stanley, Standard Chartered, RBS, Itau, Merck, AbbVie, Genentech, GSK, Lockheed Martin, Raytheon, PVH Corp, SAS, Medstar, Penn Medicine, Minsheng, China Merchants, Ping An, CSX, Ericsson and Nokia

Representative Open Programs:
Wharton EDP, SII, Nursing Leaders, Nursing Deans, Advanced Risk Management
Key Terms

Annualized Rate of Return on Investment
Return on Invested Capital (ROIC)

4%

Expected Rate of Return on Investment (annualized)
Based on the risk of the investment
Cost of Capital
Or
Weighted Average Cost of Capital (WACC)

6%

Internal Rate of Return (IRR)

Hurdle Rate
Four Cornerstones of Value Creation

- Companies create value by investing capital from investors to generate future cash flows at rates of return that exceed the cost of capital.
- Value is created by generating more cash flow rather than rearranging claims on the cash flows.
- A public company’s performance is driven by changes in expectations rather than just its actual performance.
- The value of a business will be determined by who is managing the business and the strategies that they choose to pursue.

Source: Value, Mckinsey
Buffet’s Rules

1. Find Good Industries

2. Find the Best Run Companies in the Industry

Industry Attractiveness vs. ROIC vs. WACC

Competitive Advantage vs. ROIC vs. WACC vs. Time
Industry Returns

EXHIBIT 4.5 Variation in ROIC within Industries, 1995-2013

EXHIBIT 4.6 Nonfinancial Companies: ROIC Decay Analysis

1. Scale limited to −10% to +10% for presentation purposes.
2. Health care equipment; suppliers.

1 At year 0, companies are grouped into one of five portfolios, based on ROIC.

Source: Composstat, McKinsey Corporate Performance Center analysis.
The Company: Building Advantage

Old Competitive Advantage: (Intel)
1. Select Markets / Products
2. Build Capabilities / Competencies

New Competitive Advantage (Amazon)
1. Build Capabilities / Competencies
2. Apply to vertical markets
The Disruption Engine

Competencies in Data (AWS) and logistics

Apply competencies to vertical markets

Here’s a look at the eight potential $1 trillion global categories Amazon is already in, according to D.A. Davidson.

1. Apparel
2. B2B E-Commerce
3. Consumer Internet of Things
4. Grocery
5. Pharmacy
6. Professional Services
7. Restaurants
8. Stores

Source: foxbusiness.com
Thinking About Risk
Which is better?

<table>
<thead>
<tr>
<th>In millions</th>
<th>Plan</th>
<th>Actual</th>
<th>Variance</th>
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<tbody>
<tr>
<td>Project A</td>
<td></td>
<td></td>
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<tr>
<td>New Orders</td>
<td>$500</td>
<td>$510</td>
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<tr>
<td>Sales</td>
<td>$300</td>
<td>$305</td>
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<tr>
<td>Profit</td>
<td>$(35)</td>
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<td>$5</td>
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<tr>
<td>Cashflow</td>
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<td>$(40)</td>
<td>$10</td>
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<tr>
<td>Project B</td>
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<td>New Orders</td>
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<td>Sales</td>
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<td>Profit</td>
<td>$100</td>
<td>$80</td>
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<tr>
<td>Cashflow</td>
<td>$100</td>
<td>$70</td>
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Investment Criteria

• The Market Opportunity
  ▪ The “Pain”
  ▪ How large / addressable is opportunity
  ▪ Competition

• The Product or Service
  ▪ Does it solve the problem / address customer need?
  ▪ Secret Sauce / Competitive Advantage / Patentable

• The Business Model
  ▪ How does the product or service make money / earn a return on investment?
  ▪ How and when will you pay the money back?
  ▪ Are the business risks fully understood?

• The Team
  ▪ Experience, expertise and understanding of the market
Basic Executive Summary (2-4 minutes)

- We are asking for $x to solve [insert problem here]
- Brief summary or anecdote on the problem and why it needs to be solved (pain)
- Benefits of solving the problem
  - Empathy to customer (internal or external)
  - Benefit to company
- Tie to company strategy / initiatives
- Summary of financial costs and benefits
  - Financial impact - How and when do I get my money back?
  - How much investment and what is it going to be used for
  - NPV / IRR / Breakeven
  - Sense of timing of the impacts
- Risks and alternatives
  - The uncertainties and how they can be addressed
  - Why is this better than other alternatives
## Opportunities

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<th>Scale: (H)igh (M)edium (L)ow</th>
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<tbody>
<tr>
<td>Market Size</td>
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<tr>
<td>Market Growth</td>
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<tr>
<td>Difficulty of Market Entrance</td>
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<tr>
<td>Market Attractiveness</td>
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<tr>
<td>(Potential ROIC)</td>
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<tr>
<td>Competitor Strengths</td>
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<tr>
<td>Uncertainty Level</td>
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<td>Capabilities</td>
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<table>
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