

# Business Planning for Managers

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Pierre was prompted to write this book because he could not find any book that deals with the practice of business planning and summarises everything that one needs to know. So he set out to write the book himself...

# Business Planning for Managers

How to use powerful techniques  
to write better business plans

With 100 illustrations

First Edition

Pierre A. Lurin

INVESTAURA Management Consultants

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# Table of Contents

Introduction	11
<b>Part One: Getting Started</b>	
Chapter One: Structuring a Business Plan	17
Chapter Two: Case Study of a UMTS Service Provider	33
Chapter Three: What Can We Learn from the dot.com Crash?	53
<b>Part Two: Financial Statements and Valuation</b>	
Chapter Four: Understanding Financial Statements	61
Chapter Five: Valuing Businesses	89
Chapter Six: Checklist of Common Pitfalls	139
<b>Part Three: Forecasting Revenues and Costs</b>	
Chapter Seven: Forecasting is an Art	145
Chapter Eight: Forecasting on the Supply Side	161
Chapter Nine: Forecasting Demand	173
<b>Part Four: Advanced Techniques</b>	
Chapter Ten: Knowing Your Competitors	223
Chapter Eleven: Value Chain and Business Model	239
Chapter Twelve: Scenario Planning	251
Chapter Thirteen: Valuing Business Opportunities as Real Options	263
Conclusion: Did MNOs Overpay for their UMTS Licence?	295
Annex: A note on Regression	305
Bibliography	311
Index	318

Part One

# Getting Started

## Chapter One

# Structuring a Business Plan

“Failing to plan is planning to fail”  
Chinese Proverb

In this chapter we start by looking into the typical structure of a business plan and then discuss its main components in further detail. The key aspects presented below should be covered one way or another in a business plan, at least at a high level. Depending on the audience and recipients of the plan, the time available for preparation and presentation, and other circumstances, you will have to decide in which area to put more emphasis. Preparing a business plan can be time consuming, but it does not have to end up as a long document: remember that quality is more important than quantity.

### *Overview of Chapter One*

1. Purpose of Business Plans .....	18
2. Typical Business Plan Structure .....	19
3. Detailed Review of the Business Plan Components .....	21
4. Focus on the Right Issues .....	29
5. Execution is Key .....	31

## Chapter Two

### Case Study of a UMTS Service Provider

“Money never starts an idea, it is the idea that starts the money”  
W. J. Cameron, the Ford Motor Company

In this chapter, we go through a case study to illustrate how a business plan can be prepared in practice. As UMTS has been a much debated topic in recent years, we take the perspective of a mobile network operator in late 1999 planning to bid for a UMTS licence in the following year. We take a narrative style to describe the course of events that might have happened at that time. The company Xiliom and the people referred to are imaginary, and any resemblance to actual companies and people would be purely coincidental.

#### *Overview of Chapter Two*

1. Setting the Scene .....	34
2. Strategic Options.....	35
3. Target Market and Market Forecast.....	38
4. Mobile Data Applications.....	41
5. Traffic Forecast .....	42
6. Network Infrastructure .....	43
7. IT Platform .....	44
8. Cost of Content.....	44
9. Cost Model.....	45
10. Financial Results.....	46
11. Scenarios.....	50



Part Two

# Financial Statements and Valuation

## Chapter Four

### Understanding Financial Statements

“If you owe the bank \$100 that’s your problem. If you owe the bank \$100 million, that’s the bank’s problem”

J.P. Getty, American business executive

If one component of a business plan attracts more attention than any other, this is certainly the financial plan. The financial plan is a forecast of the business financial statements and includes a minimum of a profit and loss account and a cashflow statement, over multiple years. Before we can generate a financial forecast we need to develop a good understanding of one year’s financial statements.

In this chapter we therefore perform a deep dive into financial statements and review what their rationale is, how they are structured, and how cashflows, profits and balance sheets are calculated. If you keep with us until the end of this chapter, you will acquire a good understanding of financial statements on the journey. This knowledge will prove invaluable later on when preparing a financial plan – or evaluating an investment proposal as a decision maker. In Chapter Five, we will then show how you can estimate the business value from the financial plan. Finally, in Chapter Six, we will close Part Two with a list of common pitfalls relating to financial forecasting.

#### *Overview of Chapter Four*

1. The Rationale behind Financial Statements.....	62
2. The Statement of Cashflow.....	66
3. The Profit and Loss Account.....	69
4. The Balance Sheet.....	72
5. Key Ratios .....	77
6. Generating a Financial Statement Forecast .....	86

## Chapter Five

### Valuing Businesses

“When it is a question of money, everyone is of the same religion”

Voltaire, French Enlightenment writer

In the previous chapter, we have discussed how to generate cashflow and profit forecasts for a business opportunity. In this chapter we will learn how to derive an estimate of the business value from these forecasts. For a new business, valuation is an important exercise telling us whether it is worth undertaking the project or not, and if it is, how much value the project will be creating for those who are funding it (shareholders, debt holders) on top of what they typically expect considering the risk involved (dividends, capital gains, interests). Valuation can also help us prioritise projects when funding is limited.

After reading this chapter you will be able to value all sorts of companies and businesses. However, beware that a valuation will never be precise, it will only be as good or as bad as the quality of the assumptions it is based on and the correct application of valuation methods. Valuation involves substantial judgment on how the future is likely to unfold and as to whether the managers can influence this future. Therefore, valuation will always be relative to the party undertaking the valuation.

We will start by reviewing the meaning of value and valuation. We will then turn to the allegedly simpler valuation methods based on Sales and EBITDA multiples, and explain their limitation. Asset-based methods are not discussed as they play a marginal role in high tech as innovation and price decreases are high and existing assets depreciate quickly. We will then review the Net Present Value (NPV) method and the Economic Value Added (EVA<sup>®</sup>) approach, and explain their equivalence. Both methods provide better valuation as they capture the growth and profitability of the business explicitly rather than implicitly: a good valuation should be primarily bottom-

up, based on deep understanding of the business dynamics. Finally, we will discuss the estimation of the cost of capital.

*Overview of Chapter Five*

1. A Holistic View on Value and Valuation .....	91
2. ‘Multiples’ Valuation based on Key P&L Figures .....	98
3. The Net Present Value (NPV) .....	104
4. The Economic Value Added (EVA®) .....	112
5. The NPV Terminal value, or the Multiples Method Revisited .....	116
6. Estimating the Weighted Average Cost of Capital (WACC).....	120
7. Estimating the Cost of Debt .....	123
8. Estimating the Cost of Equity.....	127
9. Don’t Use the Internal Rate of Return (IRR) .....	134

Part Three

# Forecasting Revenues and Costs

### Forecasting is an Art

“Prediction is very difficult, especially if it is about the future”

Nils Bohr, Nobel laureate in Physics

With this chapter, we turn to the difficult issue of forecasting. Understanding customer needs, translating these into products and generating accurate forecasts of market demand are real challenges that keep legions of market researchers, marketing experts and consultants busy. This is especially true in very innovative businesses where there is limited or no historical data available and no experience to relate to. On the supply side, uncertainties can also be large, especially the availability of new technologies, their costs evolution and their respective benefits. However, the challenges on the supply side are not as great as on the demand side, and reasonably accurate forecasts can be derived following careful analysis.

In this introductory chapter, we start by reviewing the issue of forecasting from a holistic perspective and discuss the alternative methods that are used by practitioners. In the next chapters we will show how numerical forecasts for supply and demand can be generated for your business plan.

#### *Overview of Chapter Seven*

1. We Are Still in the Stone Age .....	146
2. Two Types of Uncertainty.....	147
3. Using Rules of Thumb .....	148
4. Modelling.....	149
5. End-User Surveys .....	156
6. Pilot Project .....	158
7. Commercial Launch .....	159

### Forecasting on the Supply Side

“640kbytes should be enough for anybody”

Bill Gates, Microsoft, 1981

Earlier in this book, we have discussed valuation techniques that should become routine over time with regular and rigorous practice. Unlike valuation, forecasting cashflows for new businesses will always require considerable experience and personal judgment. In this chapter, we look at the supply side and how technology characteristics and costs can be forecast in practice.

#### *Overview of Chapter Eight*

1. Forecasting Technology Capacity Evolution.....	162
2. Forecasting Technology Costs (CAPEX) .....	166
3. Forecasting Operating Costs (OPEX).....	170

## Chapter Nine

### Forecasting Demand

“There is no reason anyone would want a computer in their home”

Ken Olsen, Chairman and President, DEC, 1977

Demand forecasting is a mixture of art and science. Substantial experience pays off, but a share of luck will always remain. It is also a wide topic, and unsurprisingly, there is a large divide between the theory, often complex and difficult to implement, and the level of simplicity required in business practice. The deeper you dig into the forecasting instruments available, the more sophisticated they become, while often adding only marginal improvement to the forecasting quality.

In this chapter we provide a summary of the demand forecasting know-how that any business planner should have in his toolbox. If you are lucky enough to have access to people with strong forecasting skills in your organisation, for instance from your marketing department, then the best approach will be to refer to those experts when faced with a forecasting issue. Unfortunately, when you do not have access to expert opinion, you will have to rely on yourself, and this is where this chapter will prove helpful.

#### *Overview of Chapter Nine*

1. The Diffusion of Innovations in Markets.....	174
2. Main Parameters Characterising an S-curve .....	182
3. Review of Various S-curve Models .....	184
4. Forecasts Must Have Predictive Power.....	196
5. More Complex Models .....	199
6. Monte Carlo Simulation.....	212
7. Lessons Learned from Demand Forecasting .....	219



Part Four

# Advanced Techniques

### Knowing Your Competitors

“When you are ignorant of the enemy but know yourself, your chances of winning or losing are equal. Know the enemy and know yourself, and in a hundred battles, you will never be defeated”

Sun Tzu, *The Art of War*, c. 400 BC

Traditionally, competition analysis involves collecting competitor data from a variety of sources, filtering the relevant from the irrelevant, structuring results into reports and newsletters, and drawing implication for a company’s competitive strategy. If you do not know your competitors, you are running your business in blind mode. This could be fatal as you do not know what your relative strengths and weaknesses are, and can not articulate why customers should do business with you rather than with someone else. So you need to look into what your competitors have to offer, how they position themselves in terms of image and price, and where they believe that their competitive advantage lies. In addition, you need to find out what your competitors are currently preparing and where their next move could be. This knowledge is invaluable as it helps you compete by differentiating your own offering.

In Part Three we have talked extensively about forecasting demand. To derive a revenue base line from the target market, you need to provide answers to the following questions: “How much of that demand can my business win?”, “What is a realistic market share?”.

Estimating future market share is probably one of the most complex forecasting exercises, as market shares are constantly fought for and can rapidly decrease or increase, especially in industries that have not reached maturity yet. But why worry about market share at all? A high market share is particularly important in capital or R&D intensive businesses, where scale matters and can make the difference between a profit or a loss-making company. The initial costs of setting up a new mobile network or developing

the next PC operating system are immense, but the marginal cost of transporting an additional Mbyte of data or distributing software licences over the Internet is close to zero.

Competition analysis is a wide area. Rather than trying to be comprehensive, the objective of this chapter is to provide an introduction to the topic and present a number of techniques for analysing industry structure and forecasting market share. We will follow an eight-step approach.

### *Overview of Chapter Ten*

1. What's the Overall Battleground Like? .....	225
2. Who are Your Current Competitors? .....	226
3. What do You Need Know about Your Current Competitors? .....	227
4. Where are Your Future Competitors Likely to Come From? .....	229
5. What are Your Core Competencies, Comparative Advantage, USP?.....	230
6. Where and How do You Want to Compete in the Future? .....	232
7. What is Your Realistic Market Share? .....	234
8. How to Beat the Competition? .....	237

## Chapter Eleven

### Value Chain and Business Model

“Our real problem is not our strength today, it is rather the vital necessity of action today to ensure our strength tomorrow”  
Dwight D. Eisenhower, American President

The only constant in life is change. Analysing an industry and deconstructing its value chain is an effective way to identify the main players and the roles that they fulfil. This in turn will help define the business areas where you want to compete, as well as alternative business opportunities and business models. It sharpens your positioning and triggers tough but important questions: why do my business activities start here, and why do they stop there? It also helps you anticipate and prepare for major industry transformation.

#### *Overview of Chapter Eleven*

1. Introduction.....	240
2. Value Chains are Not Static .....	242
3. Examples of Value Chains.....	244
4. Selecting Your Position in the Value Chain and Business Model.....	247
5. Impact on the Business Plan.....	249

## Chapter Twelve

### Scenario Planning

“Uncertainty and mystery are energies of life. Don’t let them scare you unduly, for they keep boredom at bay and spark creativity”

R.I. Fitzhenry, Vice President, Harper & Row

Sometimes, the environment in which a company operates is so uncertain that it seems that anything could happen. This is in particular the case when new technologies and industries are emerging: the product is unclear, the applications and the end-user demand are unclear, the business model is unclear, and the competition is unclear. In this situation a scenario planning exercise is particularly useful to identify the main scenarios that might unfold and clarify how the future could look like. Scenario planning allows you to generate a first set of forecasts, identify the key signposts that distinguish one scenario versus another, and understand whether the company’s current strategy and product roadmap are robust across multiple scenarios.

The good news about scenario planning is that there is no rocket science behind it: it is mostly straightforward and can be great fun. Ideally, it should be undertaken over a period of 4-6 weeks by a small group of people bringing various backgrounds and sufficiently diverse opinions to the table. In scenario planning you should be bold and think outside the beaten track to develop multiple pictures of the future world. These must be clearly different from one another to be valuable, but at the same time remain realistic. The forecasting horizon will typically be two or more product life cycles, and ranges between 4 and 30 years.

Following a review of the scenario planning methodology, we will go through a case study looking at Mobile TV with Digital Video Broadcast Handheld (DVB-H) as a major enabling technology. The DVB-H standard has been retained in Europe in 2004 to provide mobile TV type of services.

We would like to thank Gigaset Communications GmbH for its permission to reuse this material which was originally developed in the year 2004 as it was still part of Siemens AG. Note that the material is illustrative only and does not necessarily represent the current opinion of Gigaset Communications GmbH or Siemens AG.

*Overview of Chapter Twelve*

1. Methodology .....	253
2. Case Study: Scenario Planning for Mobile TV .....	254
3. Conclusion.....	261

## Chapter Thirteen

# Valuing Business Opportunities as Real Options

“A wise man turns chance into good fortune”

Proverb

Methodologies used by practitioners in the financial industry evolve very slowly. Today the standard approach for valuing business opportunities is based on Multiples as well as the Net Present Value (NPV) and its operational equivalent the Economic Value Added (EVA<sup>®</sup>). However, this has not always been the case: it took 30 years for the NPV method to be widely accepted and used in business. Until the 1980s, other techniques were predominant and included P/E ratios, the use of the internal rate of return and pay-back period as selection criteria, on the basis that the shorter the pay-back period the better the project.

Today, practitioners start recognising the limitations of the NPV method for valuing businesses. In this chapter, we present a complementary technique that enhances the traditional NPV approach with the valuation of options that are embedded in the business opportunity, for instance the option to delay the decision to invest or the option to expand the project. Unlike financial options like *call* and *put* on shares, options in business ventures are said to be *real* because the underlying assets are real business assets as opposed to financial securities. The Real Options framework has been available since the early 1990s. Although not always easy to put into practice, valuations using Real Options bring new insights into the business opportunity and have been used successfully in a number of industries, for instance in mining and pharmaceutical. We expect that Real Options valuation will find more and more acceptance and become a standard tool in the next decade.

In this chapter, we start with a review of the NPV limitations. We will then discuss financial options and how they are valued using the Black-Scholes model. We then establish an analogy between an investment opportunity and a call option. A numerical example shows how to estimate the volatility of

return sigma, one of the key parameters for option valuation. We then expand the framework to remove a number of limitations. Finally we discuss where and when it makes sense to apply Real Options and conclude on a number of industries where option valuation is currently widespread.

A note of caution before we start: the primary objective when valuing Real Options is to gain new insights as a business manager into a project opportunity, not to produce precise results. Therefore, making meaningful assumptions to simplify and solve Real Options problems is all right and always better than being precisely wrong. Results should always be understood as estimates: Real Options valuations, like NPVs, are based on models that approximate a complex reality.

### *Overview of Chapter Thirteen*

1. Limitations of NPV Valuation .....	265
2. An Introduction to Financial Options .....	268
3. Valuing a Financial Option .....	269
4. Analogy between a Real Option and a Financial Option .....	271
5. Case Study: Valuing the Option to Invest in WiMax .....	272
6. How do You Estimate the Volatility Sigma? .....	275
7. Positioning the Project in the Option Space.....	278
8. Expanding the Framework: the Binomial Model.....	282
9. Recapitulation of the Real Options Methodology .....	289
10. When is it Worth Using Real Options Valuation? .....	289
11. Applications of Real Options .....	290



# Conclusion

## Did MNOs Overpay for Their UMTS Licence?

“May you look back on the past with as much pleasure as you look forward to the future”

Paul Dickson, writer

Ten years after the auctioning of UMTS licences in Europe (from April 2000 to September 2001), a tantalising issue remains: did MNOs overpay for their licence? This is not a vain question when you consider that the average UMTS licence reached the horrendous price of £4.5bn in the UK and €8.4bn in Germany, with 5 and 6 licences awarded respectively. In Germany, the total licence costs were equivalent to €620 per head of population and 2.5% of the country GDP in that year! Also, the delays in network build-up, the initial lack of handsets, the late launches of commercial services in 2004 rather than 2002, and finally the rather lukewarm enthusiasm from end-users so far show that the short- and medium-term business opportunities from UMTS services were largely overestimated at the time.

But let us remain fair and not forget that the telecom industry looked quite different in the year 2000, and operators, facing strong subscriber growth in most countries (+60% on average in Europe, and in some countries up to +100% in 2000), had good reasons to be optimistic. Hindsight is always an exact science and it is all too easy to see things clearly in retrospect.

Methodologically, we therefore have to be careful to differentiate between an ex-ante view based on the market beliefs at the time of the auction, and an ex-post analysis taking today's perspective. So we first have to restate the original question: did MNOs overpay for their UMTS licence *based on what they knew at the time?*

# Bibliography

This short bibliography provides a diverse collection of business books, university text books, research papers and Internet links. The references are grouped according to the chapter that they (mostly) relate to. If you have limited time for further reading, start with the reference at the top of each list.

## Chapter One: Structuring a Business Plan

- [1.1] *Business Plans for Dummies*, Paul Tiffany and Steven D. Peterson, Wiley Publishing, 2<sup>nd</sup> Edition, 2005
- [1.2] [http://www.score.org/template\\_gallery.html](http://www.score.org/template_gallery.html), Business Plan for a Start-Up Business, The Score organization,
- [1.3] *The definitive business plan*, Richard Stutely, Financial Times Prentice Hall, 2<sup>nd</sup> Edition, 2002
- [1.4] *Planen, Gründen, Wachsen*, McKinsey&Company and Redline Wirtschaftsverlag, 4<sup>th</sup> Edition, 2007 (in German)
- [1.5] *Praxisratgeber Existenzgründung*, Sandra Bonnemeier, dtv, 2005 (in German)
- [1.6] *Entrepreneurship*, Mirosław Malek and Peter K. Ibach, dpunkt.verlag, 1<sup>st</sup> Edition, 2004 (in German)

[1.1] is an excellent book that is full of practical examples and is very enjoyable to read. [1.2] is a great template that asks all the right questions and can be used as guideline when writing a business plan in Microsoft Word. [1.3] is a more numerical book that looks how business plans can be prepared in practice in the Microsoft Excel<sup>®</sup> spreadsheet software. [1.4] is addressed at start-ups and would-be entrepreneurs, while [1.5] looks into the practicalities of setting up a new business. [1.6] is a very good book covering all the important issues relating to entrepreneurship.

# Index

## A

Accruals 64, 67  
Acid test 82  
Adjusted R<sup>2</sup> 307  
ADSL 34, 163, 273  
Amortisation 70, 75, 76, 78, 79  
Applications 41, 44, 154, 158, 169  
ARPU 38, 46, 48, 51, 140, 153, 155, 201, 212, 216  
Autocorrelation 133, 309  
Autoregression 309

## B

Balance Sheet 65, 72, 76, 83  
Bass 187, 193, 214  
Battery 163, 254  
Benchmarking 45, 77, 139, 150, 151, 176, 230  
Beta 128, 131, 132  
Biased 92, 101, 131, 156, 199, 204, 265, 309, 310  
Binomial tree 283  
Black-Scholes 269, 274, 275, 278, 282  
Brands 75

## C

Call option 125, 126, 267, 268, 269, 271  
CAPEX 45, 48, 63, 86, 107, 166  
Capital Employed 76, 78, 80  
Capital turnover 80, 81, 108, 118  
CAPM 128  
Cash in excess 83, 104  
Cash ratio 82  
Cashflow 27, 63, 66, 67, 68, 92, 104, 135, 216, 217, 271, 273, 276  
CATV 44, 203, 204, 258  
Characteristic duration 180, 185, 188, 189, 190  
Coefficient of imitation 185, 188, 189, 192  
Coefficient of innovation 187, 188, 189  
Competition 24, 56, 140, 223  
Competitive strategy 225

Consolidation 235, 242  
Content 41, 44, 46, 48, 51, 216, 244, 258  
Costs 45, 141, 166, 170, 232  
Critical mass 175, 179, 180, 188, 189, 244, 248  
Cross-checks 46, 108, 139, 153  
Cross-impact 207, 208, 209, 210  
Current assets 70, 72, 73, 81, 82  
Current cost 73, 123  
Current ratios 81, 82

## D

Debt 72, 73, 81, 83, 84, 85, 120, 123, 132  
Debt cover ratio 84  
Debt-to-equity ratio 83  
Depreciation 62, 64, 70, 71, 78, 103  
Differentiation 25, 232, 233  
Diffusion speed 180  
Dividends 65, 67, 69, 118, 120, 130, 282  
Driver tree 81  
DVB-H 163, 251, 254

## E

Early adopters 175, 179, 186, 187  
Early majority 175, 179, 182, 198  
EBIT margin 49, 78, 81, 98, 99, 102, 107, 116, 119, 171, 302  
EBIT multiple 99, 101, 103, 117  
EBITDA margin 78, 98, 302, 303  
EBITDA multiple 99, 101, 103  
Elasticity 153, 200  
Equity 72, 120, 127, 132, 275  
EVA 100, 112  
Experience curve 167  
Exponential 186, 193  
Extended logistic 191, 193  
Externalities 179, 189

## F

Fibre 162, 167  
FIFO 74  
Fisher-Pry 184, 193, 205  
Forecast 38, 42, 61, 86, 92, 106, 145, 161, 173, 236, 238, 260, 305

Fragmentation 235, 242  
 Free Cashflow 48, 68, 104, 105, 110, 115,  
 120, 142, 218

## G

GAAP 62, 70, 74, 76, 79  
 Gearing 83, 84, 102, 121, 132, 133  
 Gompertz 190, 193, 197  
 Goodwill 62, 70, 75, 76, 79, 113  
 GSM 34, 35, 36, 37, 40, 49, 148, 197,  
 210, 211, 299, 303

## H

Handset 167, 168, 195, 210, 215, 216,  
 229, 247, 255, 260  
 HHI 236  
 Historical Cost 73, 123

## I

IFRS 70, 74, 75, 76, 79  
 i-mode 151  
 Industry analysis 225  
 Inflation 73, 74, 88, 109, 117, 122, 123,  
 130, 141  
 Innovators 175, 186, 193  
 Intangibles 70, 75  
 Interest cover ratio 84  
 Inventories 72, 73, 74, 80, 82, 107  
 Invested Capital 78, 79, 80, 113, 114  
 IRR 134

## K

Key drivers 30, 38, 256  
 Key ratios 77, 86  
 KSIM 207

## L

Laggards 176  
 Late majority 175, 178, 182, 191  
 Learnings 54, 139, 219  
 Least-Squares Estimation 306  
 Lessons learned 139, 219  
 Leverage 80, 83, 101, 103, 121, 122, 132  
 Licence 52, 229, 245, 272, 274, 287, 288,  
 295, 296, 297, 298, 299, 303  
 LIFO 74  
 Linear model 306

Liquid ratio 82  
 Liquidity metrics 81  
 Liquidity ratio 81  
 Logistic 183, 184, 188, 192, 193, 194,  
 197, 201, 203, 205, 219  
 Loss 68  
 Lotka-Volterra 202

## M

M&A 76, 95, 237, 242  
 Market share 140, 179, 203, 205, 223,  
 234, 301, 302, 303  
 Marketing 20, 23, 45, 170, 178, 181, 182,  
 187, 190, 233  
 Memory 166  
 Mobile content 244, 258  
 Mobile data 41, 154  
 Mobile TV 168, 178, 214, 216, 254  
 Monte Carlo simulation 212, 276  
 Moore's law 162, 169  
 Multicollinearity 308  
 Multiples 98, 117, 263

## N

Network externalities 179  
 New Economy 53, 56, 291  
 Non-linear model 306  
 NOPAT 79, 98, 107, 108, 118  
 NPV 54, 104, 218, 263, 265, 272, 273,  
 278, 285, 288

## O

Operations 26, 67  
 OPEX 45, 48, 63, 70, 80, 141, 170

## P

P/E 56, 102, 263  
 Performance ratios 85  
 Perpetuity 107, 109, 113, 116, 117, 118  
 Price elasticity 153, 200  
 Profit and Loss 64, 69  
 Profitability metrics 78  
 Put option 267, 268

## Q

Questionnaire 156  
 Quick ratio 82

## R

$R^2$  152, 196, 206, 307  
 Radio capacity 45, 163, 167  
 Real Options 263  
 Regression 128, 131, 150, 151, 152, 186,  
 187, 191, 193, 194, 196, 199, 200, 204,  
 205, 305  
 Residuals 152, 188, 201, 205, 308, 309  
 Risk premium 56, 128, 129  
 Risk-free rate 123, 128, 129, 130, 217,  
 269, 279  
 Risks 28, 92, 120, 249, 278  
 ROA 80  
 ROE 79, 80  
 ROI 80  
 ROIC 79, 80, 81, 98, 99, 102, 107, 109,  
 113, 114, 115, 116, 117, 118

## S

Sales channel 25, 141, 168, 170, 176, 227,  
 234  
 Sales multiple 99, 101, 116, 117  
 Satellite 203, 204  
 Scenarios 20, 30, 38, 50, 52, 251, 257, 300  
 S-curve 174, 182, 184, 193, 195, 196, 198,  
 200, 278  
 Segmentation 23, 39  
 SG&A 28  
 Simultaneous equation 310  
 SMS 50, 146  
 Stability metrics 83  
 Subscribers 39, 40, 148, 151, 201, 214,  
 215, 216, 302  
 Sunk costs 55, 141

## T

Tariff 47, 50, 51, 153  
 Tax 62, 68, 71, 72, 79, 103, 110, 120, 132,  
 142  
 Terminal Value 106, 107, 113, 116, 119,  
 134, 142  
 Times burden covered 84  
 Times interest earned 84  
 Traffic 42, 47, 200, 201  
 t-test 306, 308

## U

UMTS 33, 43, 167, 209, 210, 254, 258,  
 272, 295  
 Unbiased 127, 199, 306, 308, 309  
 USP 19, 25, 230, 231, 233, 237

## V

Valuation 49, 52, 56, 73, 74, 75, 76, 82,  
 89, 142, 263, 299  
 VAT 69  
 Volatility 269, 275, 284, 291

## W

WACC 50, 79, 105, 110, 118, 120, 133,  
 142, 217  
 Weblux 191, 193, 197  
 WiMax 209, 210, 272, 279, 284  
 WLAN 209, 241, 248  
 Working capital 73, 82, 107, 108, 115,  
 142, 249