Succeed with Financial Forecasting

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Questions

How to ask a question during today's webinar?

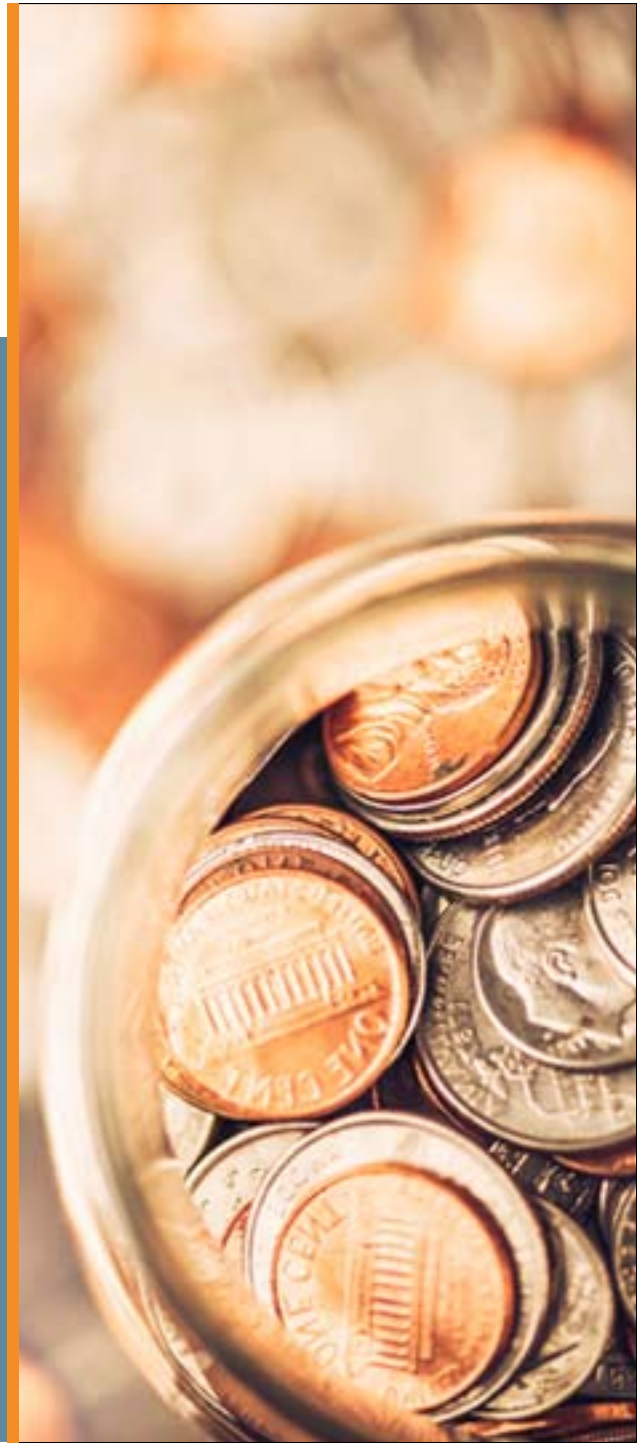
- Use the "Chat" or "Question" feature on the GoToWebinar panel
- You can also email Deidra Wiley at dlwiley@cshco.com
- Questions will be addressed at the end of the webinar

Objectives for Today

- What's involved in creating a financial forecast and why it's important
- How a financial forecast should be done
- When a bank needs the results of your financial forecast, what items trigger a red flag, and details a bank looks for if you're interested in acquiring or financing capital

Agenda

- What story does a financial forecast tell?
- When should a business prepare a financial forecast?
- Who should prepare a financial forecast?
- Why should a business prepare a financial forecast?
- How should a financial forecast be prepared?
- Review of a sample financial forecast
- Q&A – What is a bank looking for?



What Story does a Financial Forecast Tell?

- A financial forecast for a business tells the company's financial story to its stakeholders both internally and externally
- Provides the expectation of operations based on the opportunities available for the upcoming period and an illustration of the projected health of the organization for the upcoming period
- Provides what financial drivers are most important and indicative of success for the organization

What Story does a Financial Forecast Tell? (cont.)

- Indicates what economic and financial resources are needed in order to deliver the expected results
- Indicates whether funds are available to meet existing operating and capital requirements or if there is a need for incremental infusion
- Indicates whether or not the organization in compliance with established financial covenants if applicable
- Provides the mechanics and story to either maintain or obtain financing needed to operate the business

When should forecasts be prepared?

- Financial forecasts should be prepared at least annually based on a business' fiscal year
- Financial forecasts should always be done when circumstances or assumptions change for a business
- We believe that the best practice is to reforecast projections at least quarterly based on the actual performance and/or changes in the business' assumptions and operations

Who should prepare a forecast?

- Should be prepared by any business regardless of size
- Should be prepared at locational, divisional, and/or product level, if applicable
- Should be prepared by an individual that has the experience and expertise to do so
  - We estimate that 99% of small businesses do not have the expertise and skills to evaluate their current operations, forecast for the future, and communicate their story

Why should forecasts be prepared?

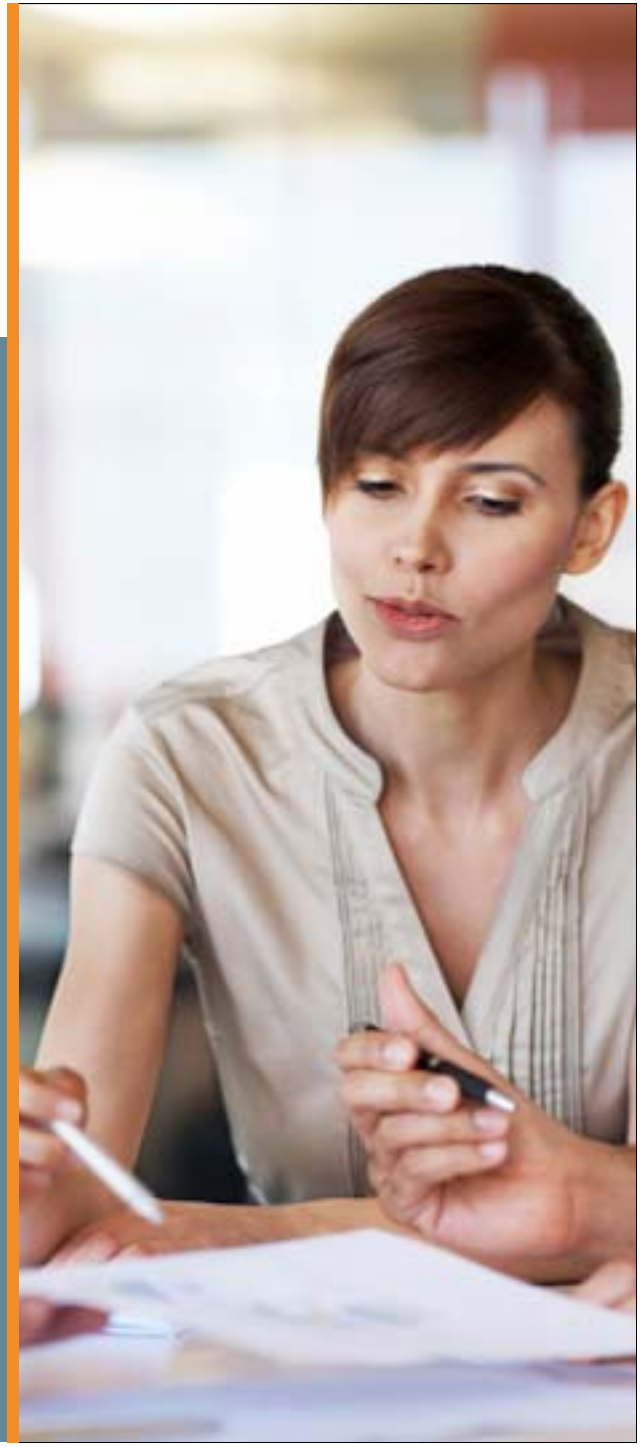
- Provides information to access performance and opportunities
- Provides information to be proactive in its decision making
- Allows for the ability to properly plan for periods of growth, decline, and/or investment
- Communicates the goal target and relevant drivers of the business to unify the activities and management of the organization, both internally and externally

Why should forecasts be prepared? (cont.)

- Indicates whether or not existing financial and economic resources are sufficient to support the planned operations
- May be required to secure/maintain a debt facility with a financial institution
- Provides a benchmark that can be used to measure actual performance against to determine if there are any changes in expectations

How should forecasts be prepared?

- Collectively prepared by management
- Should be realistic and conservative to be achievable and provide meaningful projections
- Must be defendable by assumptions and historical company performance
- Ideally should be prepared with a mentality of “beat and exceed”



How should forecasts be prepared? (cont.)

- Should be prepared on a monthly basis
- Should possess integrated financials, including the Balance Sheet, Income Statement, and Cash Flows to illustrate the impact that Operations has on the Balance Sheet and resulting Cash Flows
- Too many businesses make the mistake of forecasting only off their income statement

How should forecasts be prepared? (cont.)

- Financial forecasted numbers are driven by planned operations and assumptions that can be communicated and supported
  - Revenue – flat, growth, decline
  - Gross margin % – consistent, improvement, decline
  - Personnel additions/reductions required to deliver planned operations
  - Operating expenses as a % of revenue
  - Profitability as a % of revenue
  - EBITDA presentation

How should forecasts be prepared? (cont.)

- Need to incorporate assumptions relating to balance sheet turns, debt, capital, and equity which all have an impact on available cash
  - Accounts receivable turnover
  - Accounts payable turnover
  - Inventory turnover
  - Debt principal payments
  - Capital investments in equipment
  - Equity infusions and distributions

Review of a financial forecast

	ABC Company							
	CONSOLIDATED INCOME STATEMENT							
	FOR THE YEAR ENDING 2012							
Projected Revenue Growth								
BUDGET PROJECTIONS	MONTH							
	Month	Month	Month	Month	Month	Month	Month	Month
BUDGET	Ending	Ending	Ending	Ending	Ending	Ending	Ending	Ending
	1/31/12	2/29/12	3/31/12	4/30/12	5/31/12	6/30/12	7/31/12	8/31/12
	Projected	Projected	Projected	Projected	Projected	Projected	Projected	Projected
Sales								
Sales-Wedding	$58,899	$54,455	$158,536	$161,085	$329,781	$423,613	$326,311	$276,852
Sales-Non Wedding	$184,500	$221,990	$261,630	$224,126	$226,602	$125,024	$68,621	$101,145
Sales Adjustments	($113)	($506)	$0	$0	$0	$0	$0	$0
Service Charges	$47,318	$54,618	$86,826	$81,513	$117,765	$114,026	$82,422	$80,396
Special Events	$0	$0	$0	$0	$0	$0	$0	$0
	$0	$0	$0	$0	$0	$0	$0	$0
Net Sales	**$290,604**	**$330,557**	**$506,992**	**$466,724**	**$674,148**	**$662,663**	**$477,354**	**$458,393**
Percentage by Month	**4.67%**	**5.31%**	**8.14%**	**7.50%**	**10.83%**	**10.64%**	**7.67%**	**7.36%**
Cost of Goods Sold								
Food-in House	$39,100	$45,961	$68,207	$60,401	$86,080	$74,280	$57,516	$58,759
Food - Cake	$0	$0	$0	$0	$0	$0	$0	$0
Beverage-in House	$19,682	$21,596	$33,618	$21,877	$33,274	$39,943	$35,955	$32,759
Kitchen Hourly Labor	$5,988	$6,881	$11,308	$11,245	$16,266	$14,439	$11,006	$10,462
Front Hourly Labor	$20,177	$25,741	$40,511	$38,472	$52,386	$53,963	$40,702	$37,980
Kitchen Salary Labor	$26,973	$24,469	$27,032	$26,157	$26,967	$26,096	$26,966	$27,094
Front Salary Labor	$14,540	$13,757	$18,015	$17,345	$19,146	$17,507	$19,765	$19,595
Cakes Labor	$0	$0	$0	$0	$0	$0	$0	$0
Special	$3,274	$2,567	$5,382	$4,779	$13,204	$3,312	$896	$2,297
Audio Visual Expense	$3,200	$1,740	$4,719	$939	$2,167	$7,882	$54	$531
Ice Expense	$525	$500	$2,000	$850	$1,460	$825	$700	$1,025

Q&A – What is a bank looking for?

Q: When does a bank request pro-forma financial statements, projections, or budgets?

- When, in your discussions, it is determined that the next 12-24 months of your company's performance will have a material change from your past performance.

Q&A – What is a bank looking for? (cont.)

Q: What types of events typically trigger a performance deviation?

- Acquisitions
- A new product line offering
- Significant new client win or any significant sales growth
- Significant changes to payment terms with clients or suppliers impacting cash flow
- Start-up companies

Q&A – What is a bank looking for? (cont.)

Q: What types of information might a bank request?

- Income statement projections for a 12-24 month period, presented with monthly breakouts
- Pro-forma balance sheets documenting changes to working capital accounts, debt levels and cash position
- Projected statement of cash flows documenting the impacted sufficiency of cash flow to undertake the anticipated change

Q&A – What is a bank looking for? (cont.)

Q: Why does a bank want to see this information?

- The first question a bank wants to answer is: Can the company generate enough cash flow to service the debt on hand plus the additional debt needed to finance the significant event (acquisition, sales growth, etc.)?
- The bank wants to determine what this change will do to the leverage of the company, and it helps them establish meaningful covenants given the pro-forma information provided
- To determine the cash demands and working capital needs of the company so they can establish the appropriate debt levels as outlined by the company's needs as documented by the projections

Q&A – What is a bank looking for? (cont.)

Q: What are some of the key attributes of the forecasting that a bank will focus on?

- Sales impact – growth of the top line
- Margin impact - how will this new initiative impact margins and the resulting pull through to the bottom line?
- The bank will focus on the anticipated net changes to A/R, A/P, inventory, and equipment levels to determine the appropriate borrowing levels and structure

Q&A – What is a bank looking for? (cont.)

Q: What are some of the common pitfalls or red flags a bank sometimes encounters?

- Unobtainable results – never forecast a result that cannot be met.
- Banks typically establish covenants based upon the forecasts, so provide something between the most-likely case and worst-case scenario.
- Over achieve. Meet and exceed the expectation you set with your forecasts.

Q&A – What is a bank looking for? (cont.)

Q: What are some of the common pitfalls or red flags a bank sometimes encounters? **(cont.)**

- Insufficient understanding of the impact of sales growth
  - Growth in sales typically cause a growth in A/R, inventory, equipment needed to produce increased sales levels, and sometimes changes to plant and facilities
  - Each of these items are a use of cash, not a source of cash
  - Many business owners think that more sales = more profit which = more cash
  - What they fail to plan for in the near term is the cash demands they will experience as they ramp up to a new level of business

Q&A – What is a bank looking for? (cont.)

Q: What are some of the common pitfalls or red flags a bank sometimes encounters? **(cont.)**

- Using the right financing structure to support your new undertaking
  - Permanent changes to any asset needs permanent funding
  - Most business owners immediately think Line of Credit for most of their needs
  - Remember – tie your repayment to your flow of cash
    - If you are going to convert an asset to cash in the near term, think Line of Credit
    - If you plan to repay debt from an increased profit level over a period of years, think term loan
    - Permanent increases to A/R, inventory, equipment, plant or human resources should be supported by a permanent loan rather than an annually renewed line of credit

Questions?

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