Effective cash forecasting within reach: Techniques and best practices

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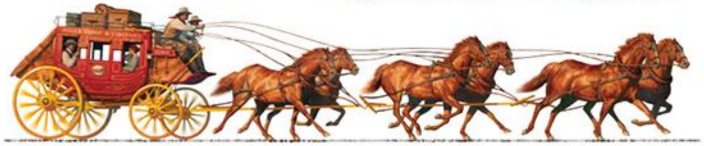
March 12th, 2014

Together we'll go far



Agenda

- Introduction
- Cash forecasting overview
- Best practices
- Techniques
- Discussion with Guitar Center, Inc.
- Recap
- Q&A

30%

of companies expect to rely more on cash forecasting over the next six months

Source: Treasury Strategies, Inc., Corporate Survey, September 2013

Audience polling question

How accurate do you expect a cash forecast to be relative to actual cash balances and flows?

A. +/- 2%
B. +/- 5%
C. +/- 10%
D. +/- 15%

Effective cash forecasting

What is cash forecasting?

The modeling of a company's or entity's future financial liquidity over a specific time frame

Why forecast?

It supports key treasury activities:

- Funding operations
- Short-term investment and borrowing
- Cash concentration/ balance transfer scheduling
- Nondiscretionary payment planning
  - P&I repayments (debt)
  - Taxes (payroll)

Cash forecasting objectives

- Managing currency exposure
- Financial control
- Capital budgeting
- Liquidity management
- Lower interest expense
- Higher interest earnings

Cash forecasting benefits

- Maximize value of cash assets
  - Greater investment income
  - Minimize borrowing costs
- Avoid unanticipated emergency borrowing or premature investment liquidation situations
- Support decision making across financial functions
  - Budgeting
  - Timing of capital expenditures
- Improve financial risk management effectiveness
- Provide liquidity early-warning mechanism

Ask the right questions

Can we meet the requirements of our creditors and shareholders?

Do we have adequate liquidity?

Do we have adequate working capital?

Can we support our business plan?

Effective cash forecasting

New mind-set required	Must address treasury mission-critical decisions
Forecasts that support any financial projections need to be refined to support liquidity decision making. This includes daily, monthly or quarterly projections.	How much cash is needed to fund today’s and tomorrow’s activities? How much liquidity is needed for the business to operate? When do we need to repatriate cash from foreign operations and from where?

What can affect forecasting reliability?

Availability of data

Data quality

Data quality decay over time

Timeliness of reporting

Cost of preparation

Precision

Interpretation of results

Best practices

Sources of data

Bank transactions and balances
(bank portals)

Repetitive payments
(various sources: tax, payroll, insurance, accounting, finance)

Sales forecast
(sales department)

Accounts receivable system
(ERP & A/R department)

Accounts payable system
(ERP & A/P department)

Investment & debt maturities
(ERP & treasury)

Interest flows
(ERP & treasury)

FX & derivative settlements
(ERP & treasury)

Capital expenditures
(business planning)

Cash forecast

Best practices

1. Data collection

Combine systems data with human information to develop streams of information with higher predictive volume

2. Methodology

Use a method that can forecast trends specific to **your** business

3. Variance analysis & analytics

Measure inaccuracy and identify causes

4. Execution

Change data collection and methodology based on V-A

5. Reporting

Design reports that support decision making

6. Timelines

Perform all of the above in a consistent, timely manner

Variance analysis

Refines and leads to greater accuracy of the cash forecasting process:

Variance analysis responsibility

Review and reconcile material variances on a timely and regular basis

Applying materiality thresholds

Variances can be measured as a certain dollar amount or as a percent of deviation from an acceptable cash flow parameter

Statistical techniques to measure the magnitude of cash flow variances:

- Squared error
- Absolute deviation

Forecasting techniques

Financial statement method

1. **Project** financial statement items
   - Ratios and other metrics
   - Budget information
   - Known components
2. **Incorporate** capital structure changes into projection
3. **Remove** noncash items such as depreciation, amortization, and accruals

Financial statement method

Pros

- **Simple** process
- **Actual-to-forecast** comparison easy
- **Significant knowledge** regarding balance sheet line items
- **Historical data** abundant

Cons

- **Daily forecasting** not feasible
- **Book cash** is forecast output

Receipt and disbursement method

Create a **schedule** of known inflows and outflows:

Capital flows	Operating flows
• Capital expenditures • Bond maturities and interest payments • Stock issuance • Dividend payments • Other	• Collections • Disbursements

Receipt and disbursement method

Evaluate any **inconsistent** flows to identify:

Trends

- No trend
- Rising trend
- Falling trend

Seasonality

- Patterns within a quarter
- Patterns within a month
- Day-of-the-week cycle

Receipt and disbursement method

Pros

- **Supports liquidity management**
- **Daily forecasts** are possible
- **Bank cash** is forecast output

Cons

- **Detailed historical data** requirement is large
- **Significant knowledge** of cash flows required
- **Complex** methodology
- **Time-consuming** process
  - Initial development and ongoing production
  - Review and fine-tuning

Recap

- Why cash forecasting is important
  - Objectives and benefits
- Best practices
  - Ask the right questions
- Forecasting techniques
  - Financial statement method
  - Receipt and disbursement method

Q&A