Understanding Financial Information for Bankruptcy Lawyers – 13-Week Cash Flow Projections

What Are TWCF Projections?

One of the most important areas for any business and its management team to deeply understand – as well as manage, forecast and track – is liquidity and the ability to meet obligations as they come due. Lack of liquidity is often the root cause behind why a business becomes distressed. Liquid assets are defined as cash and other assets that are easily converted to cash such as stocks, bonds, and other short-term investments. Businesses employ many tools to monitor and manage their liquidity, including short- and long-term cash flow forecasting, borrowing base calculations and other assessments of funding facilities, and various liquidity ratios and metrics such as days cash on hand, days sales outstanding ("DSO"), days payables outstanding ("DPO"), and days inventory on hand, among others. For a distressed company in particular, cash is king. One of the most commonly used and helpful tools to forecast and track liquidity is the development of 13-week cash flow ("TWCF") projections. A powerful cash management tool, TWCF projections, are utilized by management teams at both healthy and distressed companies to help manage and anticipate short-term liquidity needs.

TWCF projections are a method to forecast all sources and uses of cash over a 13-week period. The 13-week time horizon is short enough to allow management to project cash flows in detail with a reasonable amount of accuracy, while also long enough to provide insight into any upcoming potential liquidity concerns and allow time to take mitigating actions as needed. The use of weekly projections avoids intra-month timing variances and "surprises" (for example, a payroll disbursement that occurs every two weeks on a Friday (i.e., twice a month) might occasionally occur three times in a given calendar month due to timing). The structure of TWCF projections mirrors that of a checkbook, outlining all cash inflows and outflows by significant line item, with a reconciliation between beginning and ending cash balances for each weekly period. Borrowing availability calculations can also be included if the business relies on a revolving credit facility to supplement liquidity. Line items, or inflow/outflow categories, are developed based on the nature of the business with major categories shown as single line items, and other smaller items lumped together in an "other" category. It is important, however, to make sure that the "other" category does not become the repository for too many items; otherwise it makes tracking cash flow movement less accurate and can limit the usefulness of the TWCF projections.

13-Week Cash Flow Projections Example

Description	Week1	Week2	Week3	Week4	Week5	Week6	Week7	Week8	Week9	Week10	Week11	Week12	Week13	Total
Customer A	$25	$30	$40	$20	$50	$30	$30	$25	$20	$45	$30	$20	$45	$410
Customer B	250	-	-	200	-	-	250	-	-	200	-	-	200	1,100
Royalties	50	-	-	40	-	-	50	-	-	40	-	-	40	220
All other	5	-	10	-	5	-	10	-	5	-	10	-	5	50
Total Cash Receipts	**330**	**30**	**50**	**260**	**55**	**30**	**340**	**25**	**25**	**285**	**40**	**20**	**290**	**1,780**
Inventory Purchases	60	70	40	50	60	40	40	70	60	40	50	30	70	680
Payroll & benefits	10	-	10	-	30	-	10	-	10	-	30	-	10	110
Rent	15	15	15	15	15	15	15	15	15	15	15	15	15	195
Utilities	20	-	-	-	20	-	-	-	20	-	-	-	20	80
Taxes	30	-	-	-	30	-	-	-	30	-	-	-	30	120
Interests	10	-	-	-	10	-	-	-	10	-	-	-	10	40
All other	-	-	5	-	10	-	-	5	-	-	5	-	10	35
Total Cash Disbursements	**145**	**85**	**70**	**65**	**175**	**55**	**65**	**90**	**145**	**55**	**100**	**45**	**165**	**1,260**
Net Cash flow (A)	**185**	**(55)**	**(20)**	**195**	**(120)**	**(25)**	**275**	**(65)**	**(120)**	**230**	**(60)**	**(25)**	**125**	**520**
Beginning Cash (B)	500	685	630	610	805	685	660	935	870	750	980	920	895	500
Ending Cash (A + B)	**685**	**630**	**610**	**805**	**685**	**660**	**935**	**870**	**750**	**980**	**920**	**895**	**1,020**	**1,020**

To maximize its effectiveness, once the weekly forecast is prepared, management should then prepare weekly variance analyses comparing actual performance against the forecast, and analyzing and documenting reasons for variances in both magnitude and timing. This process will start to build a pool of data to assist management in more accurately predicting inflows and outflows (and managing cash) going forward.

The TWCF projections should be treated as a "living" document, i.e., they should be regularly updated to reflect new actual information. Weekly actuals are incorporated as historicals and the weekly projections are extended to maintain a 13-week forecast. This structure is typically referred to as a "rolling" 13-week forecast.

How Are TWCF Projections Different from Other Financial Reporting?

TWCF projections differ from other kinds of cash flow reporting in three distinct areas:

1) **Cash vs. Accrual Basis** – TWCF projections are prepared on a cash basis only. No account is taken of accruals, prepayments, or non-cash items such as depreciation and amortization seen in audited financial statements, which are frequently not indicative of the true liquidity picture. Further, many liquidity and solvency ratios are not performed on a cash basis and therefore are not reflective of the true cash position of a business, which is critical during periods of low liquidity. The weekly structure of TWCF projections highlights specific peak cash needs and provides greater visibility into the company's cash position on a more "real-time" basis.

2) **Disaggregation, or Specificity, of Reporting –** The structure of TWCF projections allows for more specificity with respect to certain line items. Indeed, for the TWCF projections to be effective, they should be as specific as possible. For example, expenses

may be classified as "administration" expenses on the income statement, but the corresponding cash disbursements may be broken down into narrower categories as appropriate (e.g., payroll and benefits, professional fees, equipment and supplies, licenses and permits, travel and lodging, etc.). Further, management frequently finds it beneficial to prepare separate TWCF projections for each major segment or business unit within the company. This format allows for even greater visibility into the underlying business, helps to identify the "core" business operations, and enables management to evaluate and monitor the cash impact of different scenarios on the business segments.

3) **Specificity of Timing –** The weekly format of the TWCF projections provides significant visibility into the nature and timing of cash receipts and disbursements. Along with highlighting specific peak cash needs, the timing of inflows and outflows signals if an amount is recurring or extraordinary. Weekly and monthly trending also becomes more apparent, which helps management identify anomalies, opportunities for negotiation, and/or the need for more stringent cash management (e.g., "stretching" of payables, pursuing collections more aggressively, etc.).

How Are TWCF Projections Developed?

<u>Stabilized Business</u>

For a business with stabilized operations, when no significant changes in performance are anticipated, then the TWCF projections are less difficult to prepare and the use of historical data is often heavily relied upon. Typically, management will look at historical cash receipts and disbursements, paying attention to quantity and timing trends (including whether an activity is recurring vs. nonrecurring), and then use these trends to develop the projections. Regular inflows and outflows will be estimated using averages or run rates. Timing of activity is estimated based on historical patterns. Adjustments can then be made to individual line items or activities to reflect specific facts and circumstances. For example, the projection may need to be adjusted to reflect seasonality, changes to payment or contract terms, or other factors that may cause variations from historical trends.

Historical activity can be captured in several ways. Accounts receivable agings, accounts payable agings, and check registers are frequently helpful in capturing historical activity in such a way as can be easily quantified and analyzed. It is important to ensure that all historical cash transactions are recorded, including cash, checks, wires, lockbox receipts, automated clearing house ("ACH") payments, direct deposits, and other electronic transactions. Historical information should always be reconciled back to the bank statements to ensure that all activity is captured.

<u>Business Transition</u>

When a business is not operating in a steady state, then a more detailed approach to the TWCF projections needs to be adopted. Such instability can be caused by a number of factors including significant changes in operations or performance, either through expansion or contraction, or when seasonality is a significant factor. In these scenarios, a more detailed approach to developing TWCF projections will involve the development of individual assumptions for the

key drivers behind each cash flow category, which in turn drives the resulting projections. (For example, payroll and benefits disbursements may be driven by individual assumptions for head count, pay rate changes, etc.).

This approach may also utilize similar methodology to the historical approach, as analyzing key historical trends is frequently insightful in developing specific assumptions for key drivers. Also, not every cash flow line item may require detailed key driver assumptions, particularly if projected activity is expected to remain consistent with historical trends (and therefore a "run rate" may suffice) or the activity is dictated by known contractual terms.

There is no "one-size-fits-all" approach to developing detailed TWCF projections, as the key driver assumptions and overall methodology are highly dependent upon the nature of the underlying business. The table below lists sample cash flow categories and the potential key drivers associated with each. Please note that this is not a comprehensive list by any means, but rather, it is meant to illustrate the kinds (and variety) of key drivers that one might encounter in practice.

Illustration: Sample Key Drivers by Cash Flow Category

Category	Potential Key Drivers or Determinants
Cash Receipts	
Customer receipts	DSO, revenue growth, market penetration, price increases or discounts, backlog, production or shipping volumes, contractual or stipulated rates, capacity utilization, customer retention, customer mix, etc.
Royalties	Contractual royalty rates, number of franchisees, sales growth
Tax refunds	Tax rates, projected income or losses
Equity contributions	Key performance indicators, contractual stipulations
Cash Disbursements	
Inventory purchases	Revenue growth, raw material pricing, production or shipping volumes, gross margins, contractual or stipulated rates, mandatory purchase minimums, backlog, product mix, freight and shipping costs, days inventory on hand or inventory turnover, etc.
Payroll & benefits	Headcount, pay rate or benefit changes, tax rates
Rent	Contractual or stipulated amounts, sales
Utilities	Usage, rate changes, seasonal trends
Taxes	Tax rates, projected income or losses
Interest	Interest rates, projected debt balances

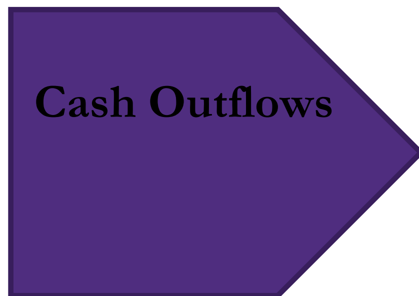
What Kinds of Insights Can Be Gleaned from TWCF Projections?

In addition to gaining visibility into how timing of inflows and outflows might impact cash balances, TWCF projections provide valuable insights into the health and performance of the underlying business. Actual performance against the TWCF projections allows management to

understand the short-term impact of strategic initiatives and operating procedures on cash flows. It further gives management the opportunity to create a dialogue among department leaders and other accountable parties about what initiatives should be introduced, how they should be implemented, and what modifications to existing initiatives might be necessary.

Examples of Key Questions/Learnings from TWCF Projections

- Who are our key customers?
- Are customers failing to pay according to terms?
- Are higher than expected discounts being provided?
- Is there deterioration in the customer base?
- Are competitive/pricing/position factors more influential than projected?



- Are vendors accelerating payments (reduced terms, COD, deposits)?
- Are material or supplier costs increasing?
- Is a system of addressing vendor payments necessary/functioning?
- Is inventory being managed in the most cost-effective manner?
- Which outflows can be negotiated, deferred, or converted?

TWCF projections are a powerful forecasting and management tool, and can be applied to virtually any business regardless of its size, performance or complexity.

Bibliography

Turnaround Management Association. (2010). *Thirteen Week Cash Flow Workshop.* Chicago: Turnaround Management Association, Chicago-Midwest Chapter.