




2020 Deloitte Power & Utilities Conference

Knowledge to thrive

December 2, 2020



Cash flow:
Managing
liquidity in
uncertain
economic
times

Agenda

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Polling question #1

Which executive manages cash and liquidity within your organization?

- CAO
- CFO
- Treasurer
- Other
- No one formally owns it
- Don't know/not applicable

Cash Flow Culture

Liquidity typically only gets the attention when there is very little left

Prioritizing liquidity means changing the culture throughout the organization – balance sheets and income statements are distorted; cash flow is reality.

Cash enables business operations

- Cash is required to fund the business:
 - Inventory, Raw Materials and Production
 - Employees & Contractors
 - Supplies
 - Facilities (Rent, Utilities, etc.)
 - Taxes and Other Governmental Fees
 - Debt – Principal and Interest
- With solvency being a critical part of the business, it is important to understand where to source and conserve cash:
 - Running the business
 - Balance sheet / working capital
 - Financing
 - New borrowings / investments (e.g., PIPEs)
 - Drawing-down on current facilities
 - Selling Assets

...but is rarely thoroughly understood

- Cash is often viewed and siloed into ‘Treasury’.
- Management and stakeholder emphasis is typically on the Profit and Loss (P&L).
- The Statement of Cash Flows is derived from the P&L and Balance Sheet (B/S) – it is rarely viewed as a standalone measure of performance.
- A healthy P&L is assumed to translate into healthy cash flow and a healthy cash balance.
- Even though Treasury may own cash functions, those who actually affect liquidity are rarely ‘brought to the table’ to establish accountability.

Examples of this include:

- Sales (measured on conversion, not collections)
- Supply Chain (measured on efficiency)
- Procurement (measured on metrics that may not relate to cash savings)

...until it puts the entire business at risk.

- In cases where companies can remain in business, they often fall victim to:
 - Expensive financing with high costs
 - Tactical rather than strategic management
 - Reputational damage due to strained relationships with suppliers and / or customers
 - Distressed asset sales
 - Renegotiation of covenants in debt agreements, often at significant cost to the business
- In cases where companies cannot find enough liquidity, the ending may be ugly:
 - Bankruptcy – a Chapter 11 reorganization if lucky, but often results in a sale (via a 363) or creditors taking over the equity
 - Liquidation by creditors

Companies place heavy emphasis on the P&L and rarely discuss cash. It is akin to driving a car and focusing on the speedometer without understanding how much gas is in the tank.

Creating a cash culture through active cash management

Active cash management provides a platform and approach to manage short term liquidity, and to drive both tactical and strategic cash focused improvements

Operational Benefits

- Provides 'ground truth' visibility into the operations of a business
 - Allows decisions to be made based on 'what is happening' versus 'what the plan says'
- Enables executive teams (in particular, the CEO and CFO) to act quickly and exercise control in a crisis
 - Improves ability of company to absorb shock
- Facilitates an end to end understanding of where and how the business generates and expends cash
 - Unlocks data-supported operational and working capital focused improvements
- Frees up capital that can be re-deployed within company to growth / higher value initiatives

Financial Benefits

- Improved near and medium term financial and operational decision making through effective cash forecasting
 - Impacts near term operational, borrowing and investment decisions
 - Provides improved visibility into the sources and uses of cash (along with associated costs/benefits/trade-offs)
- Increase available cash and improve capital efficiency
 - Limit need for more expensive debt e.g. factoring, revolver
 - Accelerate reduction of debt and interest burden and/or free up capital for re-investment
- Actively monitor and manage (cash) covenants, helping maintain financial and operational flexibility
- Improve crisis management
 - Identify and understand levers to release working capital, preserve operating cash

In a stressed or crisis situation, there are few choices – cash quickly becomes a critical determining factor in meetings, decisions and actions

Roadmap to a cash driven culture

These challenges can be addressed by engaging and supporting management teams, embracing the cultural change, and building 4 inter-dependent key capabilities

Roadmap to a cash performing business

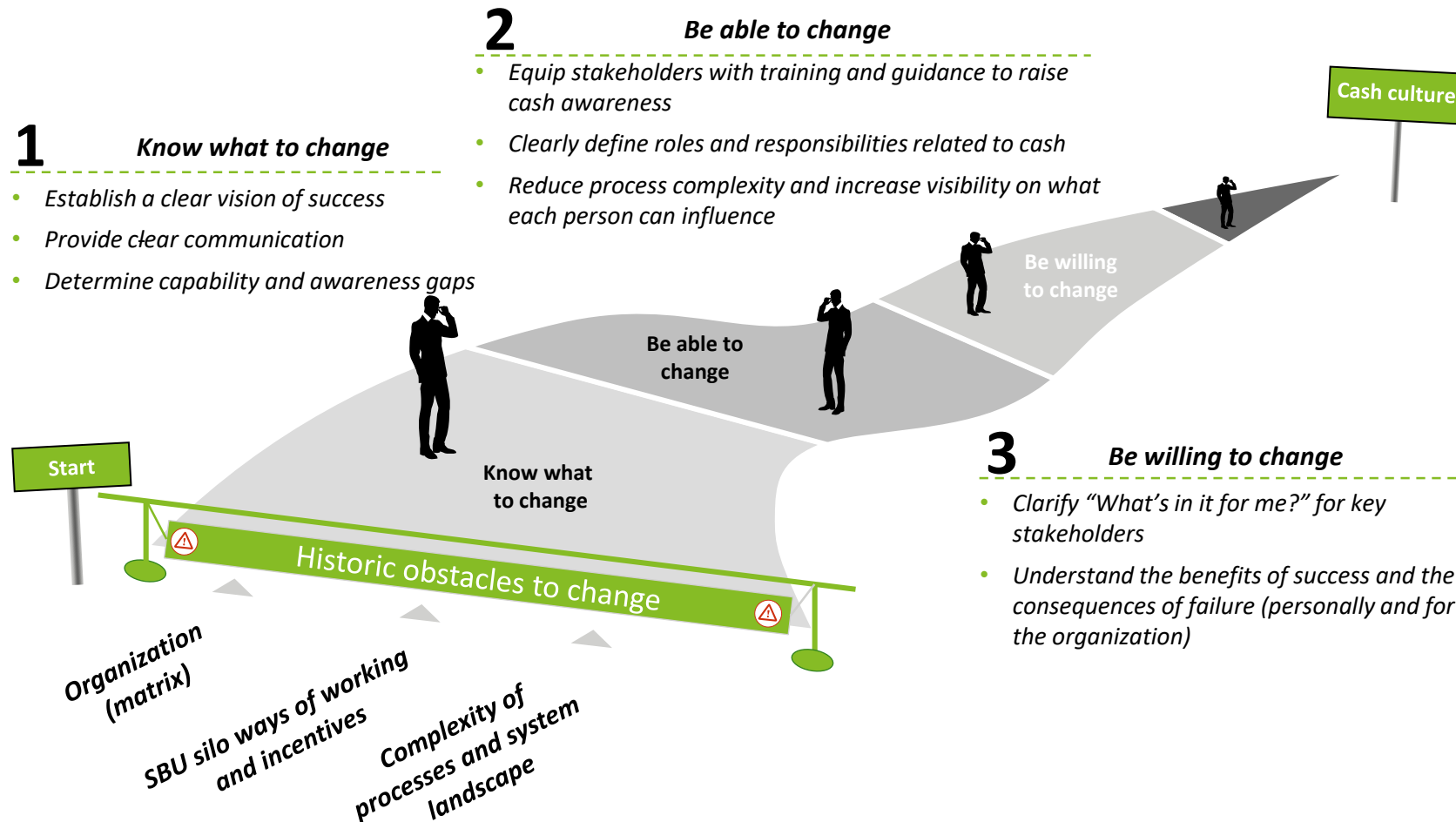


The four inter-dependent capabilities needed



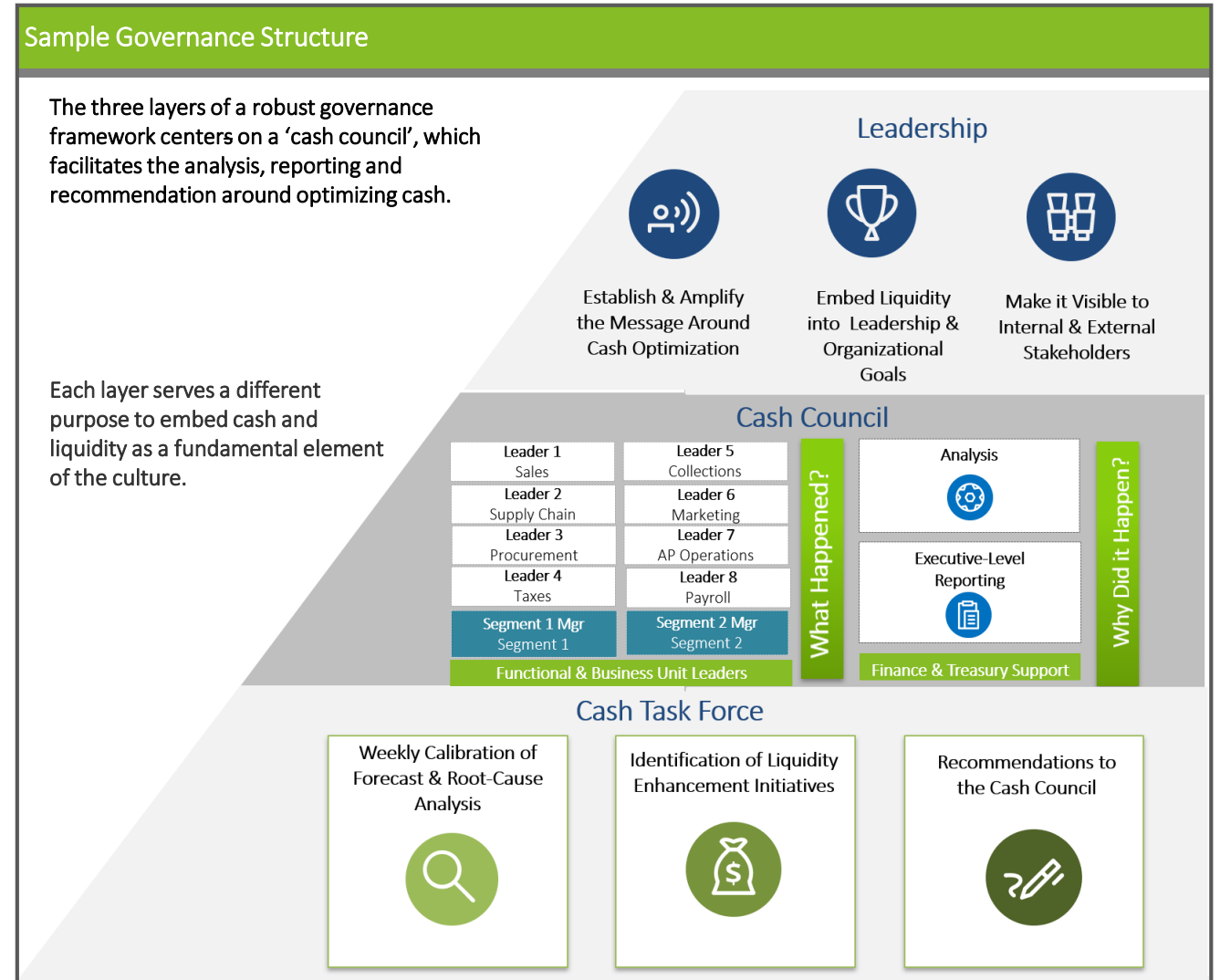
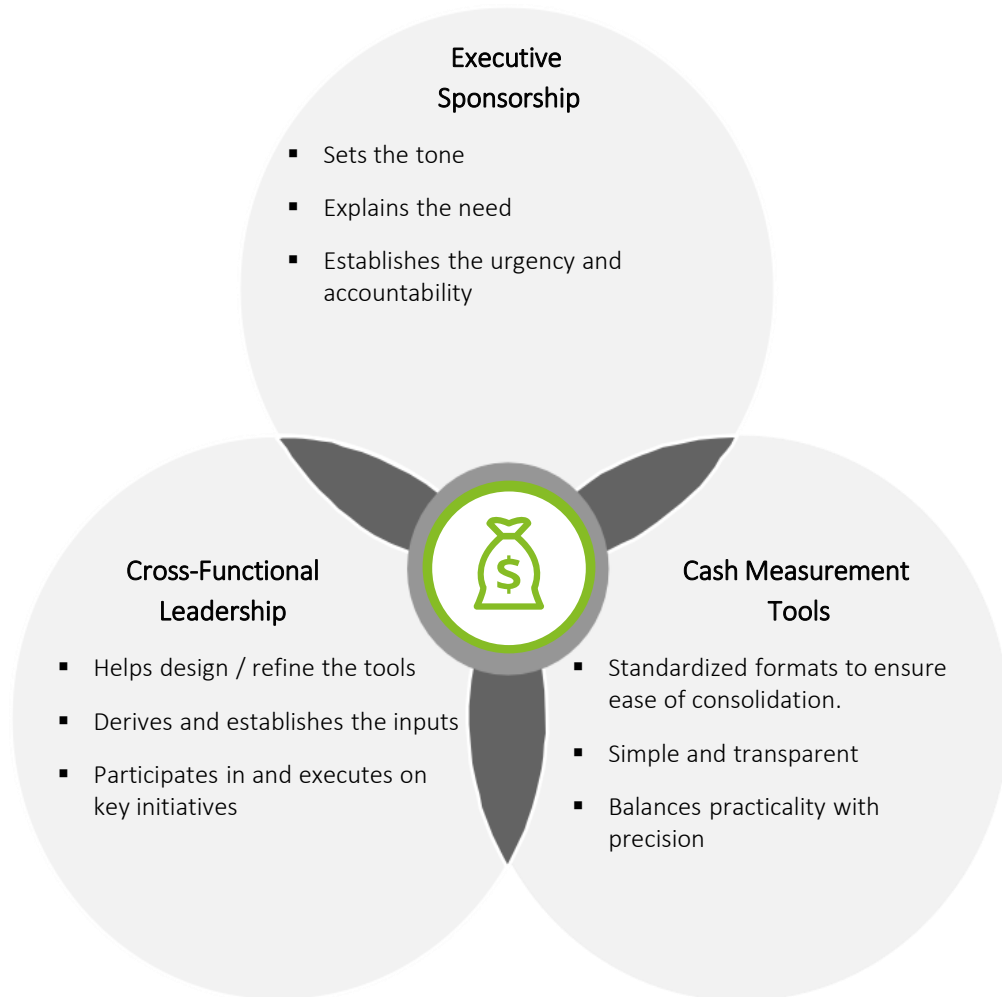
Roadmap to a cash driven culture

Having set the targets, primary obstacles to change must be overcome on the road to building a sustainable cash culture



Pillars of a cash culture

Instilling a cash culture into an organization is predicated on executive sponsorship, cross-functional leadership involvement in the process, and an understanding of how cash measurement tools translate into cash management initiatives.



Key Learnings – Advising companies on transitioning to a ‘cash culture’

Below are pervasive themes observed in working with companies as they transition to a cash culture

Executive Sponsorship



Executive sponsorship is not a one-time mandate. To make a cash culture sustainable, executive sponsorship and prioritization should be heard early and often. Cash cultures should not be a temporary ‘crisis mode’ mentality - they should be a core consideration of how decisions are made. In order for that to happen, executive sponsorship should be consistently reinforced in the form of accountability.

Balancing Act



Understanding that functional leaders at companies are often incentivized at the detriment of cash is important to understand and put into context. For example, sales teams push for longer terms for key customers to drive higher volumes, which increases Days Sales Outstanding (DSO) – having a model that can quantify the cash impact of stretching terms is invaluable in helping companies understand the impact of using levers like longer customer terms on liquidity. A cash culture does not mean all decisions are made based on cash impact; it means cash impact is taken into consideration in all major decisions.

Transparent Model



A cash flow model cannot be built in a vacuum – those providing information should understand how it is being used, how it gets ‘ingested’ by the model and what assumptions are used to convert operational data to cash flow. Organizational leaders cannot be expected to be held accountable if they do not sign-off on both what data and assumptions are being used. This is a critical piece that is often overlooked – best practice is to walk leaders through the actual model to show how their information translates into a cash flow item.

Frequent Calibration



Encourage frequent calibration of the model and its assumptions using a weekly variance analysis, look for patterns in variances, both in prevalence and magnitude – the business environment is always evolving, and the model should evolve with it. A model is merely a hypothesis and the variance analysis either validates it or does not, but you should keep looking for ways to ‘tweak’ key assumptions to improve the precision.

Standardize Templates



The more entities and components of a cash flow model, the more important it is to standardize templates that roll-up into a consolidated model. Time should be focused on understanding variances in the budget-to-actual analysis, not on compiling data. Having automated system pulls and other like-mechanics will embolden the insights and strengthen the ability to improve your forecast.

Standardized Schedule



Standardizing a weekly schedule can be extremely useful in making sure the cash flow model and analyses becomes a part of everybody’s regular business flow. Example would be: Weekly variance analysis (with explanations) for the prior week’s budget v. actual forecast is due by EOD Tuesday for the prior week enables liquidity analysis to be built into everybody’s normal workflow.

Cash Flow Forecasting

Polling question #2

When thinking about your organization's liquidity forecasting during COVID-19, how would you describe it?

- Forecasting was our top challenge
- Forecasting was among our top challenges
- Forecasting was not a top challenge
- Don't know/not applicable

The basics of a direct cash flow model

The primary differences between a 'Cash Flow Model' and a 'Consolidated Statement of Cash Flows' (i.e., 10-Q and 10-K)

At its core, a Cash Flow Model is a forward-looking tool, whereas the Statement of Cash Flows is a recap of what's already happened. Unlike a Consolidated Statement of Cash Flows, a cash flow model is on a pure 'Sources' and 'Uses' basis; it is not a reconciliation of accrual-based accounting (i.e., Net Income). The goal is *not* to reproduce a Statement of Cash Flows in a different format; the goal is to understand cash flow in shorter increments (weekly *not* quarterly) which inherently creates better visibility into cash conversion and predictability on both a short- and long-term basis.

Putting in place an effective short-term cash forecast requires planning and execution, however, once implemented it is a very effective tool to drive cash management and operational decision making.

Sources

- Sales projections
 - Sales channels
 - Customer profiles
- Non-operating receipts

Uses

- Inventory purchases
- Sales, General and Admin (SG&A)
 - Commissions and incentives
 - Payroll and benefits
 - Marketing and advertising
 - Utilities
 - Rent
 - Outside services
 - Research and development
 - Other general and administrative
- Non-operating uses
 - Income taxes
 - Interest on debt
 - Dividend payments
 - Share repurchases
 - Debt paydowns
 - CapEx

Levers / Assumptions

- Sales and Purchasing Cycles
- Cash Conversion Cycle – Roll-forward schedules for:
 - Accounts Receivable
 - Inventory
 - Accounts Payable

Borrowing Base: Available Financing

Cash management and forecasting tool

The Benefits



Immediate savings and cash generation

- Detect and remediate deficiencies in operating cash generation
- Identify areas of excess cash spend and implement controls to conserve / redeploy cash
- Identify cash generation opportunities and deliver upside in the short-term



Accessing incremental cash benefits

- Drive cash benefits from working capital management improvement
- Implement improvements and efficiencies within processes and controls
- Improvement of a hedging program to manage transaction risk



Planning for future funding requirements

- Early identification of funding requirements in the short, medium and long-term
- Ability to more actively exploit market opportunities (operations and financing)
- Manage seasonality of revenues with appropriate sources of finance



Improved reporting and stakeholder management

- Tailored reporting for both internal and external stakeholders
- Both an analysis and understanding of cash position and movements in working capital
- Creation of a cash culture, ownership and accountability throughout the business



Better decision making

- Make informed decisions, utilizing all the data available
- Make quick decisions with enhanced visibility over cash requirements
- Make impactful decisions that use resources most efficiently

Our Approach

Developing a weekly direct cash forecasting model requires financial and operational leadership input to empower a tool that can be measured on a weekly basis and promotes transparency and accountability through shared ownership.

1

Developing a weekly direct cash flow forecasting tool

Identify the key stakeholders (operational and financial) that should own the forecast.

Interview owners of key liquidity flows to understand key drivers and assumptions.

Test and challenge the underlying assumptions

Calibrate the forecast based on budget v. actuals variances

Reconcile the forecast to the business plan

Integrate and align cash flow with business plan

2

Building the reporting and governance to enable the tool

Assess reporting for fit-for-purpose for internal and external stakeholders

Review adequacy of analysis and insights

Evaluate the cash governance structure and reporting process

Establish a cash management framework

Review the delegated authorities and key controls

Instill a cash culture

Fundamentals – Model methodology

Structure

Well-organized, intuitive, user-friendly framework that is easy to understand by multiple users



Transparency and Accuracy

Transparent and logical in its calculation approach and an accurate and realistic reflection of the input data and assumptions



Flexibility and Insight

Flexibility to accommodate large “what-if” hypothesis swings and the ability to harness the model outputs to extract insight to facilitate informed decisions

Standardization and Controls

Designed to incorporate leading modeling practices, separating inputs, calculation and output data and incorporating self-check mechanisms for robustness



Documentation

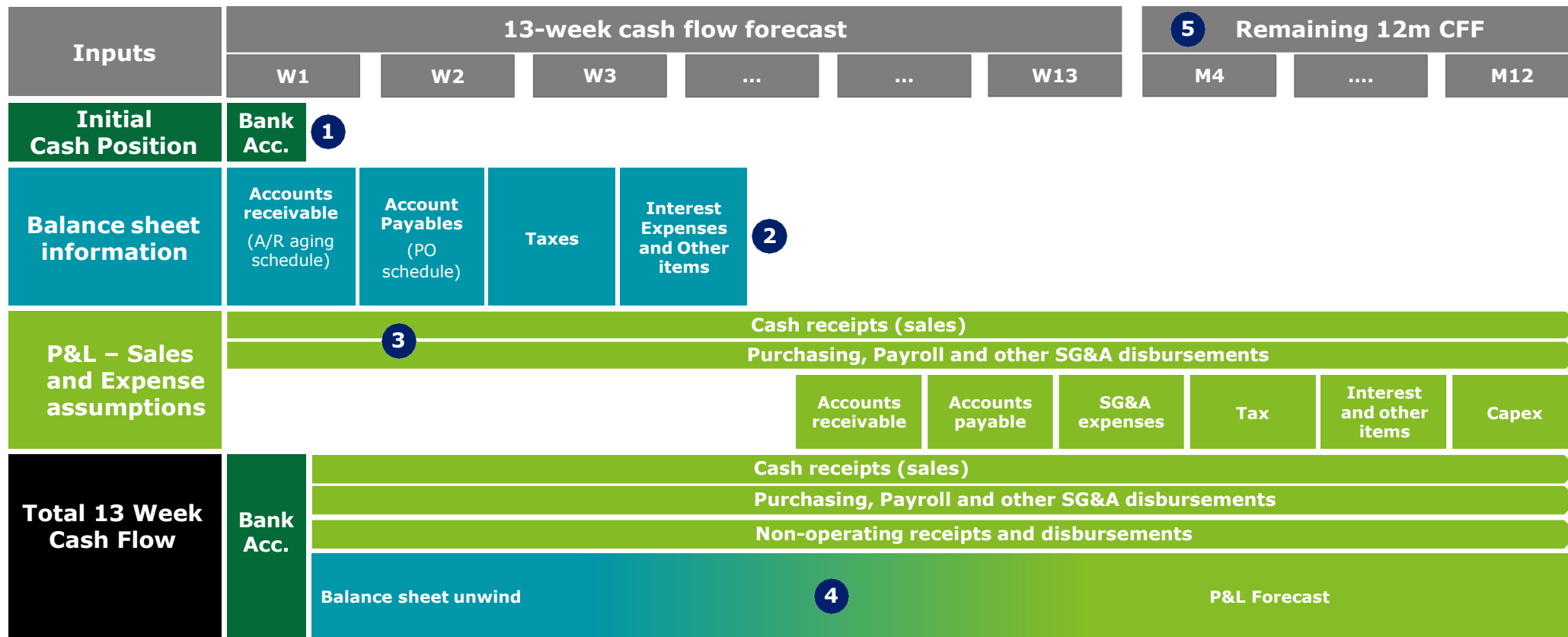
Supported by a detailed book of assumptions / user manual, in written form, that will document the underlying assumptions used, the associated rationale and the requisite source data



“The model should be a tool – a model that is so overburdened with complexity without a methodical layout becomes nothing more than...a fancy model”

13-week cash flow model – Methodology and key components

The cash flow forecast should be anchored in the latest cash position with the balance sheet driving near-term disbursements and receipts, and projections driving the forecast the further out it goes.



Cash flow forecasting methodology

- 1) Based on the structure of the business, the forecast can be developed at multiple levels and aggregated or developed in-aggregate – this is based on practicality, types of systems / data sets, and other factors, including management preference. Actual opening bank balances should be the starting point for each 13-week cash flow forecast.
- 2) The current balance sheet positions should then be unwound to reflect the expected cash flows in the near term (A/P for disbursements and A/R for receipts).
- 3) The cash flows for intra-month cash flows (sales, payroll, rent and other SG&A costs etc.) can be estimated per the latest forecasts.
- 4) The forecast migrates from unwinding the balance sheet (e.g., collecting receipts for past sales and disbursing payments for past purchases) to more heavily reliant on business unit forecasts based on sales / collections and purchasing / disbursement cycles.
- 5) The forecast is often analyzed in 13-week periods (full fiscal quarter), but often extended continuously for perpetual analysis and calibration of the model.

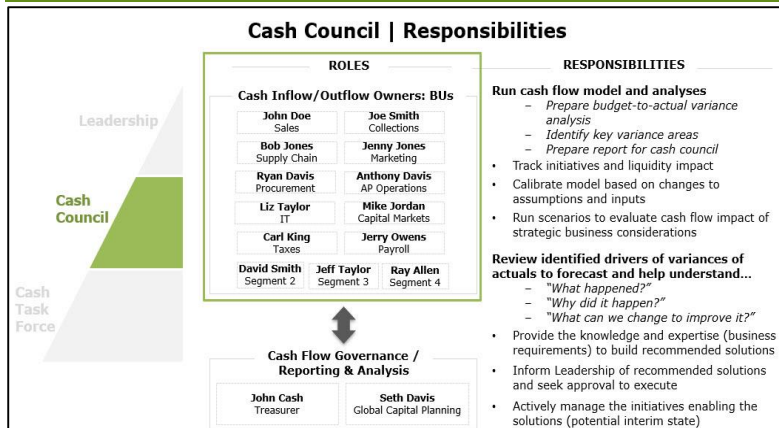
13-week cash flow model – Reporting and analysis

Develop simple yet effective processes and cash/KPI reporting dashboards, leveraging existing system capabilities to provide cash insights that drive action.

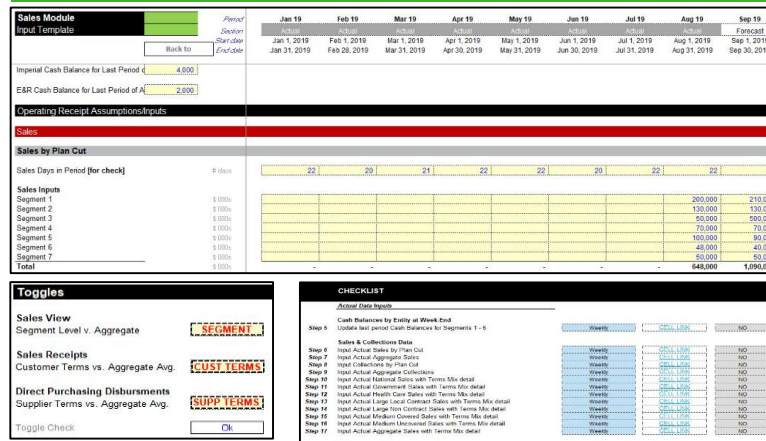
Cash Flow Mechanics, Reporting and Analysis

Develop simple yet effective processes and cash/KPI reporting dashboards, leveraging existing system capabilities to provide cash insights that drive action.

Simple and effective processes and governance



Standardized templates and user interface



Tailored dashboards and analysis



- **Evaluate existing processes** to retain what works and address what doesn't
- Assess and **leverage existing system capabilities** re: cash flow forecasting
- **Develop governance model** to establish roles and responsibilities, assign ownership to accountability, and establish a framework for consistent evaluation and analysis.
- **Tailored templates** developed in collaboration with operating units to ensure fit for purpose and ability for aggregation
- **Toggles to seamlessly switch cash flow forecast view** based on different inputs and assumptions
- **Pre-population of central assumptions / automated feeds** (e.g. payroll, interest, tax)
- **In-model step-by-step user guide** with hyperlinks to update model for actuals, inputs, assumptions
- **Automated dashboards focused on driving insights** to identify and action improvement areas
- **Ability to sensitize forecasts in real time** to reflect impact of risks / opportunities / changes to business ops
- Ability to see key **Cash Conversion Cycle** metrics on a trailing basis based on actuals with comparison to targets.
- Management reporting for **central cash oversight**

Output – The 13-week cash flow model output

The 13-week cash flow model is a ‘staple’ for lenders and other stakeholder groups in heavily distressed situations. The reasons why they are popular in distress is because they are simple (sources and uses), transparent (eliminates noise of accounting), and drive accountability – all characteristics that can benefit healthy companies as well.

We just finished building a 13-week cash flow model for a \$10 billion MRO distributor, who is very healthy, but wanted better insight into how to influence their cash flow, assist with its global capital planning and drive accountability using a ‘cash culture’ throughout the company.

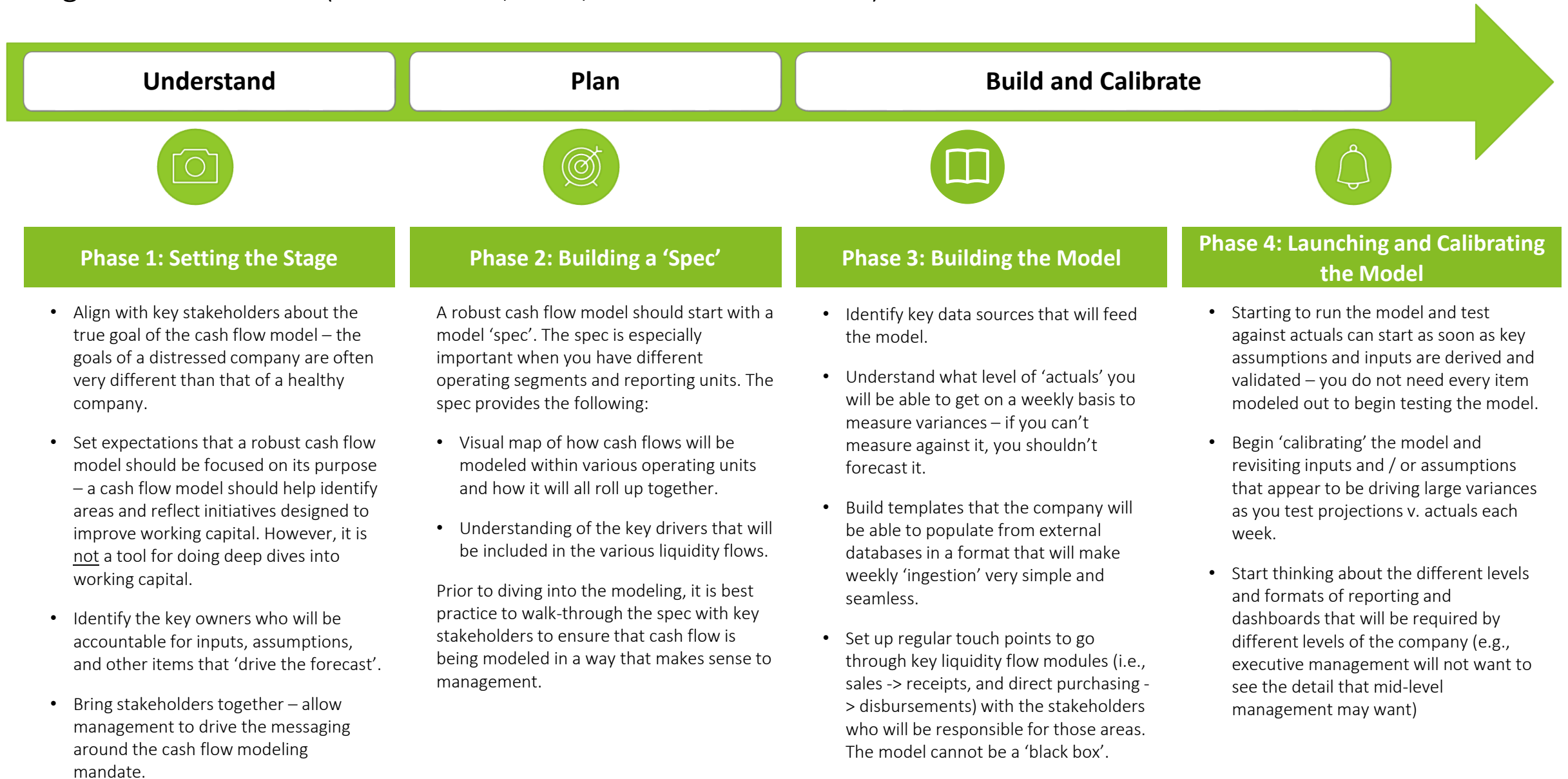
	Wk:10 Q3 '19	Wk:11 Q3 '19	Wk:12 Q3 '19	Wk:13 Q3 '19	Wk:1 Q4 '19	Wk:2 Q4 '19	Wk:3 Q4 '19	Wk:4 Q4 '19	Wk:5 Q4 '19	Wk:6 Q4 '19	Wk:7 Q4 '19	Wk:8 Q4 '19	Wk:9 Q4 '19
	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10	Week 11	Week 12	Week 13
	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast	Forecast
	09/07/2019	09/14/2019	09/21/2019	09/28/2019	10/05/2019	10/12/2019	10/19/2019	10/26/2019	11/02/2019	11/09/2019	11/16/2019	11/23/2019	11/30/2019
	09/13/2019	09/20/2019	09/27/2019	10/04/2019	10/11/2019	10/18/2019	10/25/2019	11/01/2019	11/08/2019	11/15/2019	11/22/2019	11/29/2019	12/06/2019
Company X US Cash Flows:													
Operating Receipts:													
Total Sales Receipts	166,935	171,656	168,905	171,135	171,819	174,281	140,493	177,398	177,087	177,087	170,374	167,262	168,695
Minority Suppliers	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Receipts	166,935	171,656	168,905	171,135	171,819	174,281	140,493	177,398	177,087	177,087	170,374	167,262	168,695
Operating Disbursements:													
Total Direct Purchasing ¹⁾	(97,662)	(84,028)	(80,255)	(86,256)	(87,563)	(87,563)	(83,749)	(84,997)	(80,767)	(80,767)	(80,767)	(90,663)	(80,767)
Indirect Spend													
Freight - Transact	(6,684)	(6,684)	(6,684)	(6,747)	(6,686)	(6,688)	(6,688)	(6,646)	(6,481)	(6,481)	(6,481)	(5,722)	(6,481)
Freight - AP	(4,267)	(4,267)	(4,267)	(4,240)	(4,200)	(4,200)	(4,195)	(4,160)	(4,026)	(4,026)	(4,025)	(3,371)	(4,021)
SG&A ²⁾	(13,234)	(13,234)	(13,234)	(28,510)	(11,707)	(11,707)	(11,707)	(21,784)	(9,712)	(9,712)	(9,712)	(9,708)	(22,721)
Customer Rebates & Incentives	(1,769)	(1,769)	(1,769)	(1,899)	(1,881)	(1,881)	(1,881)	(1,829)	(2,387)	(2,387)	(2,387)	(1,900)	(2,387)
Employee Payroll, Taxes & Benefits ³⁾	(33,375)	(1,115)	(34,040)	(1,622)	(39,787)	(1,869)	(40,380)	(1,670)	(39,099)	(694)	(36,910)	(641)	(38,888)
Total Indirect Spend	(59,829)	(27,369)	(80,294)	(42,817)	(84,042)	(26,144)	(84,651)	(36,089)	(81,706)	(23,600)	(81,516)	(21,551)	(74,498)
Taxes													
Income Tax	(10,000)	(66,000)	-	-	-	(8)	-	-	-	-	-	-	-
Other Taxes ⁴⁾	(5,306)	(5,306)	(5,306)	(5,565)	(4,203)	(4,203)	(4,203)	(5,522)	(4,802)	(4,802)	(4,802)	(4,178)	(7,190)
Total Taxes	(15,306)	(71,306)	(5,306)	(5,565)	(4,203)	(4,211)	(4,203)	(5,522)	(4,802)	(4,802)	(4,802)	(4,178)	(7,190)
Debt Interest	-	-	-	(135)	-	-	-	-	-	(15,900)	-	-	-
Unclassified ⁵⁾	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)
Total Operating Disbursements	(184,597)	(194,702)	(166,855)	(146,772)	(167,828)	(129,938)	(164,602)	(138,608)	(166,275)	(146,069)	(166,065)	(128,391)	(183,456)
Operating Cash Flow	(17,661)	(23,046)	2,050	24,362	3,992	44,344	(24,109)	36,791	8,812	31,018	2,289	38,872	(14,760)
Investing Activities:													
Capital Expenditures	-	-	-	-	-	-	-	-	-	-	-	-	-
Asset Sales	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Investing Activities	-	-	-	-	-	-	-	-	-	-	-	-	-
Free Cash Flow	(17,661)	(23,046)	2,050	24,362	3,992	44,344	(24,109)	36,791	8,812	31,018	2,289	38,872	(14,760)

Polling question #3

How confident are you in your organization's ability to manage cash and liquidity?

- Highly confident
- Somewhat confident
- Not confident
- Don't know/not applicable

High-level overview (Understand, Plan, Build and Calibrate)



Polling question #4

Is your organization updating its cash flow and liquidity management plans?

- Yes, daily
- Yes, weekly
- Yes, biweekly
- Yes, monthly
- No
- Don't know/not applicable

Typical pain points in developing a direct cash flow model

Why is this hard to do?



Management consensus on key inputs and level of precision required.



Identifying whether variances are timing issues or issues with the underlying assumptions.



Linking cash flow model with established reporting (e.g., GAAP Financials).



Building a tool with a balance of desired precision with 'agile functionality'. A tool that cannot be updated is just a spreadsheet.



Data mapping to source files and establishment of standardized templates.



Building a cadence of 'repeatable consistency'. Consistent improvement through weekly variance analysis.

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