Porter, White & Company

Forward-looking Financials for Companies in Distress

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Forward-looking financial statements are associated with many significant financial transactions. Credible financial projections are particularly important when a business encounters financial difficulty, and frequently become a necessary condition of forbearance by a creditor, or to obtain new or additional financing. Since the finance and accounting areas of middle market companies are usually overworked and understaffed at the time of maximum need for financial analysis, an outside consultant often assists with the projections and can add significant value to the process. Creditors often insist that the company retain an independent consultant to prepare projections and assist with developing and implementing a turnaround plan.

Porter, White & Company excels at the preparation of forward-looking financial statements, having prepared over the years hundreds of such statements across a broad range of businesses. In a number of cases, our work has made the difference between financial success and failure and we pride ourselves on doing financial analysis in difficult circumstances, including for companies in financial straits.

I. Overview of Key Forward-looking Statements

The basic tool requested by creditors of a company in financial distress is a projection of near term cash flow, usually for a period of 13 weeks. Work on this projection usually starts as soon as preliminary information is available, including recent audits, interim unaudited statements, aged receivables, and aged payables. As this work proceeds, a series of information requests will be prepared, with the most critical information listed in the initial request, and other items necessary for a more complete understanding of the company coming later.

Basic 13-week and 15-month statements of projected cash flow and loan availability for a hypothetical company operating with a line of credit secured by inventory and receivables are attached as Appendix A, tables A-1 and A-2.[1] The straightforward appearance of the statements obscures a large effort to consolidate financial statements of a company with several subsidiaries and affiliates. Many private middle market companies have one or more subsidiaries or affiliates, but do not prepare consolidated statements monthly or even quarterly. To the extent that the subsidiaries or affiliates generate or use cash or provide collateral for the loan facility, it is necessary to include their activity in statements of projected cash flow and loan availability.

Since cash is the first priority for a company under financial pressure, a 13-week statement of projected cash flow and loan availability brings greater transparency to the situation for the benefit of all parties. For lenders, it eases anxiety because it lessens uncertainty about the immediate future and provides a tracking tool to measure progress of the company's efforts. For managers and consultants, it provides a clear picture by which to understand the immediate situation and

[1] These are "direct" projections of cash flow, in a format that is not in accordance with generally accepted accounting principles, or "GAAP." We will explain the relative benefits of direct and indirect cash flow statements below.

identify opportunities to improve cash flow, including potential acceleration of collection of receivables and classification and cessation of non critical expenditures.[2] A 13-week and 15-month direct cash flow and loan availability projection is a powerful tool for evaluating plans, budgets, and cash needs under different scenarios, and for bringing focus to the management of working capital.

It is not possible to produce a useful projection of cash flow without considering the major elements that enter into the income statement and the balance sheet. Explicitly tying the statement of projected cash flow and loan availability to historical and projected income statements and balance sheets leads to greater accuracy and ensures that no cash flow goes unconsidered. Reviewing a cash flow statement without the benefit of the associated income statement and balance sheet is like driving an automobile with no peripheral vision: it is easy to get blindsided. For this reason, PW&Co typically prepares a package of projected statements as listed in the following table. Examples of these statements are included in Appendix A.

The Financial Projection Package

	Weeks	Months	Years	Found in Appendix Tables
1. Direct cash flow and loan availability	13	15		A-1, A-2
2. Income statement	13	15	3-5	A-3, A-6
3. Balance sheet	13	15	3-5	A-4, A-7
4. GAAP-compliant cash flow statement	13	15	3-5	A-5, A-8

The projections for the out years do not help much with assessing near term cash flow, but they are useful in making the case for additional investment in the company in order to achieve anticipated financial benefits. Of course, they can also reveal that the company is a lost cause. Not every rescue effort is successful.

Forward-looking financials come in various types and have different names, many of which are described in Appendix C: A Taxonomy of Forward-looking Financials.

II. Benefits of the Direct Cash Flow Projection

It is not uncommon for the cash flow contributions of specific products, services, and even entire departments to be unknown or misunderstood by key decision makers because of inadequate cash flow reporting that is not included in GAAP financial statements. PW&Co increases cash flow transparency beyond the limits of GAAP through two primary processes: (1) modeling cash flows directly and (2) breaking the projection out into activities that are understandable and predictable.

The preferred format for the statement of cash flow and loan availability (item 1 in the table above) varies from the indirect cash flow statement (item 4 above) as usually presented under GAAP. The weakness of GAAP as a tool for understanding cash flow can be traced to two cor-

[2] For suggestions on how to use cash flow forecasts see Hass, William J. and Pryor IV, Shepherd G., "12 Basic Principles for better Cash Flow Planning and Forecasting," 2006, http://board-resources.com/articles/Hass-Pryor-CashFlowPrinciples-reprint.pdf, accessed July 7, 2009.

nerstones of accrual accounting: the revenue recognition principle and the matching principle. The revenue recognition principle requires that revenue be recognized when earned, not when cash is actually received. Likewise, the matching principle mandates that expenses are recognized not when paid, but as they are "matched" to the revenues they helped to generate. Under GAAP, revenues may be recognized well in advance of the receipt of cash, and expenses may be incurred at a time very different from when cash is spent to pay for the incurred expense. In an indirect cash flow statement, these timing differences are "reconciled" to net income as changes in asset and liability accounts on the balance sheet. In contrast, a *direct* cash flow statement details cash receipts and disbursements by category as they occur. (See the comparison table on the next page.) Banks dealing with distressed situations often require a direct cash flow projection because it assists them in real time monitoring of payments by purpose and receipts by source.

A direct cash flow statement also has greater flexibility to break out activities related to products, services, or departments. Audited financial statements (though usually not internal statements) report aggregate numbers and are therefore less effective tools for identifying users and abusers of cash. In conjunction with management, we use the direct cash flow statement as an opportunity to break out activities that simply and sensibly highlight cash flow contributors, for example: cash receipts by factor, inventory payments by supplier, payroll by employee type, interest payments by loan facility. This process is effective in identifying areas that are abusers of cash and opportunities to improve cash flow. For the projected income statement, balance sheet, indirect cash flow statement, and statement of loan availability, we seek to match the company's customary formats so that management has the clearest picture possible of what current assumptions mean for their financial statements in the future.

See how the monthly cash flow statements in tables A-2 (direct, non-GAAP) and A-8 (indirect, GAAP-compliant) of Appendix A detail the same total cash flows, but are otherwise very different in ease of use. Comparative formats are displayed through the comparison table on the next page.

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Indirect Cash Flow Statement (GAAP)

Cash flow from operating activities:
- Net income

Adjustments to reconcile profit before tax with net cash flow from operations:
- Depreciation
- (Increase)/decrease in:
  - Accounts receivable
  - Inventory
- Increase/(decrease) in:
  - Accounts payable
  - Accrued income taxes
  - Other current liabilities

Total cash flow from operating activities

Cash flow from investing activities:
- (Increase)/decrease in:
  - Capital expenditures

Total cash flow from investing activities

Cash flow from financing activities:
- Term loan (Principal payments)
- Change in note payable - Bank

Total cash flow from financing activities

Net cash flow

Cash - Beginning of period

Cash - End of period

Direct Cash Flow Statement

<u>Cash Receipts</u>
- Cash Receipts - A/R

Total cash receipts

<u>Cash Disbursements</u>
- Supplier Payments
- Payroll & Fringes
- Manufacturing / SG&A / Utilities
- Capital Expenditures
- Interest Expense (Revolver)
- Interest Expense (Term loan)
- Debt Principal

Total cash disbursements

Net cash flow

Cumulative cash flow

The hypothetical XYZ Company, Inc. in Appendix A is a seasonal business with the height of its selling season in fall and winter and a build-up of inventory and receivables in late summer as it prepares for the selling season. In the fall of 2013 management may celebrate survival of its slow season (its period of tightest availability). Even in a bad economy the business can be expected to provide enough sales to keep it comfortably in compliance with bank covenants through the winter.

This short-term comfort masks the direction the business is heading, as well as significant risks to the company's survival. Because of the cumulative effects of sales missed or money wasted (underperformance relative to expectations in one month increases the revolver loan balance, an effect that is only reversed through subsequent outperformance), the management of XYZ may be blind to the risk of lower sales or the effect of maintaining excess capacity until it is too late.

Tables A-1 and A-2 project that the company will remain in compliance with its availability covenant, given current assumptions. But sensitivity analysis (not shown) reveals that the company could expect in September 2014 to be in default of its availability covenant with 10% lower sales (relative to projections) per month during 2014. If it maintained its labor cost structure at its October 2013 level rather than make an 11% cut in December, the model indicates the company could expect to reach default in September if sales per month were merely 2% lower than expected during 2014. The model clarifies and quantifies the need to trim costs and capacity in order to provide a cushion to survive if sales projections are too optimistic in a deteriorating economy.

III. Mitigating Challenges in Generating Credible Forward-looking Financials

A significant cause of delay and cost in the preparation of financial projections and other analyses is the lack of reliable information. In the case of a middle market company this can be due to poor information and financial systems, or it may be due to the fact that access to the information is obtainable only from an individual who is snowed under by other work. Aggressive but sympathetic pursuit of necessary information is usually required. Ability of the company to provide necessary information quickly is critical to completing credible projections at reasonable cost.

Time pressures are inherent in distressed situations. PW&Co works as rapidly and carefully as possible under the given time constraints to produce a set of dependable projections. In conjunction with management, we continually refine our projections over time by tracking errors and sources of errors and implementing corrections going forward.

Tying projections to historical results is important to the reduction of errors. Projections are not created out of whole cloth. To be realistic, they must be connected to past history while reflecting the evolving environment and the implementation of any turnaround plan. Projected statements are preferably presented alongside historical statements. Variances from long term trends should be explored and understood. Dramatic change is cause for suspicion. On the other hand, historical or projected financial statements revealing *no change* are also cause for suspicion.

Assumptions should be explicitly stated, analyzed in terms of historical results and the prevailing business environment, and highlighted for the users of the report. It is usually important to analyze the projections to determine the sensitivity of the projected results to changes in key assumptions and then to prepare a sensitivity analysis showing the results of alternate assumptions.[3] This is particularly true for projections over months or years rather than weeks.

It is necessary to be alert to the probability of error in the design or construction of the spreadsheet models used to generate projections. Research indicates that computer programmers expe-

[3] See PW&Co White Paper: "*Managing in Troubled Times: A Survival Guide for Middle-Market Companies in a Liquidity Crisis"* for more on common biases in management assumptions and the importance of scenario planning with a focus on revenues. The White Paper is available for download at http://www.pwco.com.

rience an error rate of approximately 3% (three errors per hundred lines of code) and spend 40% of their time checking for errors.[4] This being the case, preparers or users of projections should "run scared."

A requirement for weekly projections means that everything is material and unusual care is required. Changes in the company and changes in the market affect financial results in unanticipated ways and require frequent recalibration of models. Actual results will vary from projections and some variances will be material. Inevitably some variances will be the result of mistakes in information received, assumptions made, or calculations employed. Projections should improve in accuracy as time goes by. Expectations of creditors should be managed by explaining the uncertainty of the projections, introducing a measure of conservatism in the assumptions, or both. Lenders have a habit of treating projections as firm representations of what will occur in the future, rather than as "best estimates."

IV. Who Prepares Forward-looking Financials?

Large companies typically have a budgeting and planning function that produces projections for use of management. Smaller companies may do planning more informally and may have to outsource financial planning work when heavy lifting is required. When this happens the planners may be accountants, engineers, consultants or bankers.

Certified public accountants who are the regular auditors of a company may have a problem with independence if they engage in substantial planning work for an audit client. They will become particularly nervous about independence as the client approaches the zone of insolvency.

The engineering profession prepares technical reports on engineered projects, providing analyses and opinions on all aspects of projects, including the reasonableness of capital budgets and financial forecasts. However, it is unusual for an engineer to prepare projections for an operating business, other than one engaged in running a single project.

It is our observation that consultants and bankers do most of the financial projections for businesses in financial distress. This is probably because speed is essential and specific standards are beside the point. The goal is not the analysis, but to save the business, or, if this is not possible, to save as much value for the creditors and the owners as possible. Consultants and bankers are evaluated on the basis of their success in achieving these goals.

V. Conclusion

It is important to remember that financial models, even in their manifestation as financial statements, are not reality but characterizations of reality. At Porter, White & Company, we think of them as pictures drawn with numbers, pictures that capture important aspects of reality but by no means all of reality. In recent years, failure to understand the limitations of models (even finan-

[4] Swan, Jonathan, *Practical Financial Modeling,* 2nd Ed., Oxford: Elsevier, 2008, pp. xx-xxi.

cial statements) has led many prestigious financial institutions to disaster as they relied on inadequate or inappropriate financial models to inform them about the risk of their investments.

Modeling "seems to be one of just a few fundamental ways in which human beings understand the world."[5] Financial modeling is necessary in many contexts, including helping companies in financial distress deal with their challenges. Experience teaches, however, that it is best to approach the modeling task with both competence and humility.

James H. White, III
July 31, 2013

[5] Powell, Stephen G. and Baker, Kenneth R., *The Art of Modeling with Spreadsheets,* Hoboken: John Wiley & Sons, 2004, p. 1.

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Appendix A: Sample Financial Projection Package

Table A-1: 13-Week Direct Cash Flow & Loan Availability Projection (Non-GAAP)

Table A-2: 15-Month Direct Cash Flow & Loan Availability Projection (Non-GAAP)

Table A-3: 13-Week Projected Income Statement

Table A-4: 13-Week Projected Balance Sheet

Table A-5: 13-Week Projected Cash Flow Statement (GAAP-Compliant)

Table A-6: 15-Month Projected Income Statement

Table A-7: 15-Month Projected Balance Sheet

Table A-8: 15-Month Projected Cash Flow Statement (GAAP-Compliant)

Table A-1: 13-Week Direct Cash Flow & Loan Availability Projection (Non-GAAP)

XYZ Company, Inc.
Cash Flow & Loan Availability Projection (Consolidated)
(Weekly, $000s)

Week #:	1	2	3	4	5	6	7	8	9	10	11	12	13
Week ending:	10/9/13	10/16/13	10/23/13	10/30/13	11/6/13	11/13/13	11/20/13	11/27/13	12/4/13	12/11/13	12/18/13	12/25/13	1/1/14
Cash Flow Projection													
Cash Receipts													
Cash Receipts - A/R	1,552	2,329	2,018	1,087	1,552	2,639	1,863	2,484	1,500	1,750	2,250	2,500	2,000
Total cash receipts	1,552	2,329	2,018	1,087	1,552	2,639	1,863	2,484	1,500	1,750	2,250	2,500	2,000
Cash Disbursements													
Supplier Payments	820	729	1,267	1,072	605	288	794	1,897	1,642	500	1,410	1,191	196
Payroll & Fringes	-	435	-	691	-	435	-	691	-	317	-	317	364
Manufacturing / SG&A / Utilities	389	454	584	649	519	649	649	649	519	584	649	649	325
Capital Expenditures	-	-	24	-	-	-	-	10	-	-	-	44	22
Interest Expense (Revolver)	-	-	-	104	-	-	-	103	-	-	-	-	112
Interest Expense (Term loan)	-	-	-	7	-	-	-	6	-	-	-	-	8
Debt Principal	-	-	-	19	-	-	-	19	-	-	-	-	19
Total cash disbursements	1,209	1,619	1,875	2,542	1,124	1,372	1,443	3,375	2,161	1,402	2,059	2,202	1,045
Net cash flow	343	710	143	(1,455)	428	1,267	420	(892)	(661)	348	191	298	955
Cumulative cash flow	*343*	*1,053*	*1,196*	*(259)*	*169*	*1,436*	*1,856*	*964*	*303*	*651*	*842*	*1,141*	*2,096*
Loan Availability Projection													
Accounts receivable													
Beginning	15,524	15,472	14,893	15,125	16,538	16,986	16,847	17,484	17,500	18,000	18,500	18,750	18,750
Invoices	1,500	1,750	2,250	2,500	2,000	2,500	2,500	2,500	2,000	2,250	2,500	2,500	1,250
Collections	(1,552)	(2,329)	(2,018)	(1,087)	(1,552)	(2,639)	(1,863)	(2,484)	(1,500)	(1,750)	(2,250)	(2,500)	(2,000)
Ending	15,472	14,893	15,125	16,538	16,986	16,847	17,484	17,500	18,000	18,500	18,750	18,750	18,000
Ineligibles	(410)	(395)	(401)	(438)	(450)	(446)	(463)	(464)	(477)	(490)	(497)	(497)	(477)
Eligible A/R	15,062	14,498	14,724	16,100	16,536	16,400	17,021	17,036	17,523	18,010	18,253	18,253	17,523
A/R availability (85%)	12,802	12,324	12,515	13,685	14,055	13,940	14,467	14,481	14,895	15,308	15,515	15,515	14,895
Inventory													
Beginning	16,876	16,581	15,819	15,263	15,660	16,102	15,102	15,012	14,703	15,588	15,332	15,752	14,275
Inventory receipts	605	288	794	1,897	1,642	500	1,410	1,191	2,085	1,094	1,920	23	1,013
Inventory shipments	(900)	(1,050)	(1,350)	(1,500)	(1,200)	(1,500)	(1,500)	(1,500)	(1,200)	(1,350)	(1,500)	(1,500)	(750)
Ending	16,581	15,819	15,263	15,660	16,102	15,102	15,012	14,703	15,588	15,332	15,752	14,275	14,539
Ineligibles	(365)	(348)	(336)	(345)	(354)	(332)	(330)	(323)	(343)	(337)	(347)	(314)	(320)
Eligible inventory	16,216	15,471	14,927	15,315	15,747	14,770	14,682	14,380	15,245	14,995	15,406	13,961	14,219
Inventory availability (50%)	8,108	7,735	7,464	7,658	7,874	7,385	7,341	7,190	7,622	7,498	7,703	6,981	7,109
Total gross availability	20,911	20,059	19,979	21,342	21,929	21,325	21,808	21,671	22,517	22,806	23,218	22,496	22,004
Revolver													
Revolver balance, beginning	20,008	19,665	18,955	18,812	20,267	19,839	18,572	18,152	19,044	19,705	19,357	19,166	18,867
Net borrowing / (repayment)	(343)	(710)	(143)	1,455	(428)	(1,267)	(420)	892	661	(348)	(191)	(298)	(955)
Revolver balance, ending	19,665	18,955	18,812	20,267	19,839	18,572	18,152	19,044	19,705	19,357	19,166	18,867	17,912
Excess availability	1,246	1,104	1,167	1,075	2,090	2,754	3,656	2,627	2,812	3,449	4,052	3,628	4,092

Table A-2: 15-Month Direct Cash Flow & Loan Availability Projection (Non-GAAP)

XYZ Company, Inc.
Cash Flow & Loan Availability Projection (Consolidated)
(Monthly, $000s)

Month #:	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Month:	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14	Jun 14	Jul 14	Aug 14	Sep 14	Oct 14	Nov 14	Dec 14
Cash Flow Projection															
Cash Receipts															
Cash Receipts - A/R	6,986	8,538	10,000	12,750	10,750	11,250	11,500	5,750	5,000	5,000	9,000	16,500	9,500	10,500	16,250
Total cash receipts	6,986	8,538	10,000	12,750	10,750	11,250	11,500	5,750	5,000	5,000	9,000	16,500	9,500	10,500	16,250
Cash Disbursements															
Supplier Payments	3,888	3,584	4,940	6,136	5,861	6,000	5,400	5,100	7,650	6,000	9,450	6,900	3,600	5,500	6,400
Payroll & Fringes	1,126	1,126	998	998	998	998	998	998	998	998	998	998	998	998	998
Manufacturing / SG&A / Utilities	2,077	2,466	2,726	2,772	2,829	2,829	2,656	2,540	2,483	2,425	2,598	2,714	2,714	2,829	2,887
Capital Expenditures	24	10	66	20	24	64	80	24	16	20	24	28	24	24	24
Interest Expense (Revolver)	104	103	112	104	89	83	76	63	80	117	144	168	135	124	118
Interest Expense (Term loan)	7	6	8	6	6	6	6	6	6	6	6	5	5	5	5
Debt Principal	19	19	19	19	19	19	19	19	19	20	20	20	20	20	20
Total cash disbursements	7,245	7,315	8,869	10,055	9,827	10,000	9,236	8,751	11,253	9,585	13,239	10,834	7,497	9,501	10,453
Net cash flow	(259)	1,223	1,131	2,695	923	1,250	2,264	(3,001)	(6,253)	(4,585)	(4,239)	5,666	2,003	999	5,797
Cumulative cash flow	*(259)*	*964*	*2,096*	*4,790*	*5,713*	*6,963*	*9,227*	*6,226*	*(26)*	*(4,612)*	*(8,851)*	*(3,185)*	*(1,182)*	*(182)*	*5,615*
Loan Availability Projection															
Accounts receivable															
Beginning	15,524	16,538	17,500	18,000	16,250	17,000	17,250	15,750	19,000	22,500	25,500	26,000	20,000	21,000	22,000
Invoices	8,000	9,500	10,500	11,000	11,500	11,500	10,000	9,000	8,500	8,000	9,500	10,500	10,500	11,500	12,000
Collections	(6,986)	(8,538)	(10,000)	(12,750)	(10,750)	(11,250)	(11,500)	(5,750)	(5,000)	(5,000)	(9,000)	(16,500)	(9,500)	(10,500)	(16,250)
Ending	16,538	17,500	18,000	16,250	17,000	17,250	15,750	19,000	22,500	25,500	26,000	20,000	21,000	22,000	17,750
Ineligibles	(438)	(464)	(477)	(431)	(451)	(457)	(417)	(504)	(596)	(676)	(689)	(530)	(557)	(583)	(470)
Eligible A/R	16,100	17,036	17,523	15,819	16,550	16,793	15,333	18,497	21,904	24,824	25,311	19,470	20,444	21,417	17,280
A/R availability (85%)	13,685	14,481	14,895	13,446	14,067	14,274	13,033	15,722	18,618	21,101	21,514	16,550	17,377	18,204	14,688
Inventory															
Beginning	16,876	15,660	14,703	14,539	13,800	12,900	11,400	10,500	12,750	13,650	18,300	19,500	16,800	16,000	15,500
Inventory receipts	3,584	4,744	6,136	5,861	6,000	5,400	5,100	7,650	6,000	9,450	6,900	3,600	5,500	6,400	6,700
Inventory shipments	(4,800)	(5,700)	(6,300)	(6,600)	(6,900)	(6,900)	(6,000)	(5,400)	(5,100)	(4,800)	(5,700)	(6,300)	(6,300)	(6,900)	(7,200)
Ending	15,660	14,703	14,539	13,800	12,900	11,400	10,500	12,750	13,650	18,300	19,500	16,800	16,000	15,500	15,000
Ineligibles	(345)	(323)	(320)	(304)	(284)	(251)	(231)	(281)	(300)	(403)	(429)	(370)	(352)	(341)	(330)
Eligible inventory	15,315	14,380	14,219	13,496	12,616	11,149	10,269	12,470	13,350	17,897	19,071	16,430	15,648	15,159	14,670
Inventory availability (50%)	7,658	7,190	7,109	6,748	6,308	5,575	5,135	6,235	6,675	8,949	9,536	8,215	7,824	7,580	7,335
Total gross availability	21,342	21,671	22,004	20,195	20,375	19,849	18,167	21,957	25,293	30,049	31,050	24,765	25,201	25,784	22,023
Revolver															
Revolver balance, beginning	20,008	20,267	19,044	17,912	15,218	14,295	13,045	10,781	13,782	20,034	24,620	28,859	23,193	21,190	20,190
Net borrowing / (repayment)	259	(1,223)	(1,131)	(2,695)	(923)	(1,250)	(2,264)	3,001	6,253	4,585	4,239	(5,666)	(2,003)	(999)	(5,797)
Revolver balance, ending	20,267	19,044	17,912	15,218	14,295	13,045	10,781	13,782	20,034	24,620	28,859	23,193	21,190	20,190	14,393
Excess availability	1,075	2,627	4,092	4,977	6,080	6,803	7,386	8,175	5,259	5,430	2,191	1,572	4,011	5,594	7,630

Table A-3: 13-Week Projected Income Statement

XYZ Company, Inc.
Projected Income Statement
(Weekly, $000s)

Week #:	1	2	3	4	5	6	7	8	9	10	11	12	13
Week ending:	10/9/13	10/16/13	10/23/13	10/30/13	11/6/13	11/13/13	11/20/13	11/27/13	12/4/13	12/11/13	12/18/13	12/25/13	1/1/14
Net sales	1,500	1,750	2,250	2,500	2,000	2,500	2,500	2,500	2,000	2,250	2,500	2,500	1,250
Cost of sales													
Product costs	900	1,050	1,350	1,500	1,200	1,500	1,500	1,500	1,200	1,350	1,500	1,500	750
SPREAD	600	700	900	1,000	800	1,000	1,000	1,000	800	900	1,000	1,000	500
Other cost of sales													
Direct & Indirect Labor	170	170	170	170	170	170	170	170	124	124	124	124	124
Fringes	48	48	48	48	48	48	48	48	35	35	35	35	35
Freight	24	28	36	40	32	40	40	40	32	36	40	40	20
Packaging supplies	12	14	18	20	16	20	20	20	16	18	20	20	10
Total other cost of sales	254	260	272	278	266	278	278	278	207	213	219	219	189
GROSS PROFIT	346	440	628	722	534	722	722	722	593	687	781	781	311
Selling, general & administrative													
Salaries	50	50	50	50	50	50	50	50	32	32	32	32	32
Fringes	14	14	14	14	14	14	14	14	9	9	9	9	9
Depreciation	24	24	24	24	24	24	24	24	19	19	19	19	19
Utilities	39	46	59	65	52	65	65	65	52	59	65	65	33
Repair & maintenance	14	17	22	24	19	24	24	24	19	22	24	24	12
Other SG&A	300	350	450	500	400	500	500	500	400	450	500	500	250
Total SG&A	441	500	618	677	559	677	677	677	531	590	649	649	355
OPERATING PROFIT	(95)	(60)	10	45	(25)	45	45	45	62	97	132	132	(43)
Other income / (expense)													
Interest expense (Term loan)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Interest expense (Revolver)	(27)	(26)	(26)	(25)	(27)	(27)	(25)	(24)	(22)	(23)	(23)	(22)	(22)
PROFIT BEFORE TAX	(124)	(88)	(17)	18	(54)	17	19	19	38	72	108	108	(67)
Income tax	47	33	6	(7)	20	(6)	(7)	(7)	(14)	(28)	(41)	(41)	25
NET INCOME	(77)	(55)	(10)	11	(33)	10	12	12	24	45	67	67	(42)
EBITDA	(71)	(36)	34	69	(1)	69	69	69	81	116	151	151	(24)
Cumulative Net Income:	*(77)*	*(131)*	*(142)*	*(130)*	*(164)*	*(153)*	*(142)*	*(130)*	*(106)*	*(61)*	*6*	*73*	*31*
Cumulative EBITDA	*(71)*	*(107)*	*(73)*	*(3)*	*(4)*	*65*	*135*	*204*	*285*	*402*	*553*	*704*	*680*
Margin analysis													
Spread margin	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Gross margin	23.1%	25.2%	27.9%	28.9%	26.7%	28.9%	28.9%	28.9%	29.7%	30.5%	31.3%	31.3%	24.9%
Operating margin	-6.3%	-3.4%	0.5%	1.8%	-1.2%	1.8%	1.8%	1.8%	3.1%	4.3%	5.3%	5.3%	-3.5%
EBITDA margin	-4.7%	-2.1%	1.5%	2.8%	0.0%	2.8%	2.8%	2.8%	4.1%	5.2%	6.1%	6.1%	-1.9%
Net margin	-5.1%	-3.1%	-0.5%	0.5%	-1.7%	0.4%	0.5%	0.5%	1.2%	2.0%	2.7%	2.7%	-3.3%

Table A-4: 13-Week Projected Balance Sheet

XYZ Company, Inc.
Projected Balance Sheet
(Weekly, $000s)

Week #:	0	1	2	3	4	5	6	7	8	9	10	11	12	13
Week ending:	10/2/13	10/9/13	10/16/13	10/23/13	10/30/13	11/6/13	11/13/13	11/20/13	11/27/13	12/4/13	12/11/13	12/18/13	12/25/13	1/1/14
ASSETS														
Current assets														
Cash	46	46	46	46	46	46	46	46	46	46	46	46	46	46
Accounts receivable	15,524	15,472	14,893	15,125	16,538	16,986	16,847	17,484	17,500	18,000	18,500	18,750	18,750	18,000
Inventory	16,876	16,581	15,819	15,263	15,660	16,102	15,102	15,012	14,703	15,588	15,332	15,752	14,275	14,539
Total current assets	32,446	32,099	30,758	30,434	32,244	33,133	31,995	32,542	32,249	33,634	33,878	34,548	33,071	32,585
Construction in progress														
Fixed assets	36,462	36,462	36,462	36,486	36,486	36,486	36,486	36,486	36,496	36,496	36,496	36,496	36,540	36,562
Less: Acc. depreciation	(30,642)	(30,666)	(30,690)	(30,714)	(30,738)	(30,762)	(30,787)	(30,811)	(30,835)	(30,854)	(30,873)	(30,893)	(30,912)	(30,931)
Fixed assets, net	5,820	5,796	5,772	5,772	5,748	5,724	5,699	5,675	5,661	5,642	5,623	5,603	5,628	5,631
Other assets														
Goodwill	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543
Total other assets	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543
Total assets	40,809	40,437	39,072	38,748	40,534	41,400	40,237	40,760	40,453	41,819	42,044	42,695	41,242	40,759
LIABILITIES & EQUITY														
Current Liabilities														
Accounts payable	4,370	4,156	3,714	3,241	4,066	5,103	5,316	5,931	5,226	5,668	6,262	6,772	5,604	6,422
Note payable - Bank	20,008	19,665	18,955	18,812	20,267	19,839	18,572	18,152	19,044	19,705	19,357	19,166	18,867	17,912
Accrued income taxes	156	109	76	69	76	56	62	69	77	91	119	160	201	175
Other current liabilities	-	310	185	493	-	310	185	493	-	223	130	354	260	-
Total current liabilities	24,534	24,240	22,929	22,616	24,409	25,308	24,135	24,646	24,346	25,688	25,868	26,452	24,933	24,510
Other Liabilities														
Term loan	1,304	1,304	1,304	1,304	1,285	1,285	1,285	1,285	1,267	1,267	1,267	1,267	1,267	1,248
Total liabilities	25,838	25,544	24,233	23,920	25,694	26,593	25,420	25,931	25,613	26,954	27,135	27,719	26,199	25,757
Stockholder's Equity														
Capital stock	200	200	200	200	200	200	200	200	200	200	200	200	200	200
Additional paid-in capital	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112
Retained earnings	8,658	8,582	8,527	8,517	8,528	8,495	8,505	8,517	8,529	8,552	8,597	8,664	8,731	8,690
Total equity	14,970	14,893	14,839	14,828	14,840	14,806	14,817	14,828	14,840	14,864	14,909	14,976	15,043	15,001
Total liabilites & equity	40,809	40,437	39,072	38,748	40,534	41,400	40,237	40,760	40,453	41,818	42,044	42,695	41,242	40,759

Table A-5: 13-Week Projected Cash Flow Statement (GAAP-Compliant)

XYZ Company, Inc.
Projected Cash Flow Statement
(Weekly, $000s)

Week #:	1	2	3	4	5	6	7	8	9	10	11	12	13
Week ending:	10/9/13	10/16/13	10/23/13	10/30/13	11/6/13	11/13/13	11/20/13	11/27/13	12/4/13	12/11/13	12/18/13	12/25/13	1/1/14
Cash flow from operating activities:													
Net income	(77)	(55)	(10)	11	(33)	10	12	12	24	45	67	67	(42)
Adjustments to reconcile profit before tax with net cash flow from operations:													
Depreciation	24	24	24	24	24	24	24	24	19	19	19	19	19
(Increase)/decrease in:													
Accounts receivable	52	579	(232)	(1,413)	(448)	139	(637)	(16)	(500)	(500)	(250)	-	750
Inventory	295	762	556	(397)	(442)	1,000	90	309	(885)	256	(420)	1,477	(263)
Increase/(decrease) in:													
Accounts payable	(215)	(442)	(473)	825	1,037	213	616	(705)	443	594	510	(1,168)	817
Accrued income taxes	(47)	(33)	(6)	7	(20)	6	7	7	14	28	41	41	(25)
Other current liabilities	310	(125)	309	(493)	310	(125)	308	(493)	223	(93)	224	(94)	(260)
Net cash flow from operating activities	343	710	167	(1,436)	428	1,267	420	(863)	(661)	348	191	342	996
Cash flow from investing activities:													
(Increase)/decrease in:													
Capital expenditures	-	-	(24)	-	-	-	-	(10)	-	-	-	(44)	(22)
Net cash flow from investing activities	-	-	(24)	-	-	-	-	(10)	-	-	-	(44)	(22)
Cash flow from financing activities:													
Term loan (Principal payments)	-	-	-	(19)	-	-	-	(19)	-	-	-	-	(19)
Change in note payable - Bank	(343)	(710)	(143)	1,455	(428)	(1,267)	(420)	892	661	(348)	(191)	(298)	(955)
Net cash flow from financing activities	(343)	(710)	(143)	1,436	(428)	(1,267)	(420)	873	661	(348)	(191)	(298)	(974)
Net change in cash	(0)	0	0	0	0	-	(0)	(0)	-	0	0	-	-
Cash - Beginning of period	46	46	46	46	46	46	46	46	46	46	46	46	46
Cash - End of period	46	46	46	46	46	46	46	46	46	46	46	46	46

Table A-6: 15-Month Projected Income Statement

XYZ Company, Inc.
Projected Income Statement
(Monthly, $000s)

Month #:	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Week ending:	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14	Jun 14	Jul 14	Aug 14	Sep 14	Oct 14	Nov 14	Dec 14
Net sales	8,000	9,500	10,500	11,000	11,500	11,500	10,000	9,000	8,500	8,000	9,500	10,500	10,500	11,500	12,000
Cost of sales															
Product costs	4,800	5,700	6,300	6,600	6,900	6,900	6,000	5,400	5,100	4,800	5,700	6,300	6,300	6,900	7,200
SPREAD	3,200	3,800	4,200	4,400	4,600	4,600	4,000	3,600	3,400	3,200	3,800	4,200	4,200	4,600	4,800
Other cost of sales															
Direct & Indirect Labor	680	680	620	620	620	620	620	620	620	620	620	620	620	620	620
Fringes	190	190	174	174	174	174	174	174	174	174	174	174	174	174	174
Freight	128	152	168	176	184	184	160	144	136	128	152	168	168	184	192
Packaging supplies	64	76	84	88	92	92	80	72	68	64	76	84	84	92	96
Total other cost of sales	1,062	1,098	1,046	1,058	1,070	1,070	1,034	1,010	998	986	1,022	1,046	1,046	1,070	1,082
GROSS PROFIT	2,138	2,702	3,154	3,342	3,530	3,530	2,966	2,590	2,402	2,214	2,778	3,154	3,154	3,530	3,718
Selling, general & administrative															
Salaries	200	200	160	160	160	160	160	160	160	160	160	160	160	160	160
Fringes	56	56	45	45	45	45	45	45	45	45	45	45	45	45	45
Depreciation	96	97	96	96	96	97	98	98	98	98	98	99	99	99	99
Utilities	208	247	273	286	299	299	260	234	221	208	247	273	273	299	312
Repair & maintenance	77	91	101	106	110	110	96	86	82	77	91	101	101	110	115
Other SG&A	1,600	1,900	2,100	2,116	2,144	2,144	2,060	2,004	1,976	1,948	2,032	2,088	2,088	2,144	2,172
Total SG&A	2,237	2,591	2,775	2,809	2,855	2,855	2,718	2,627	2,581	2,536	2,673	2,765	2,765	2,857	2,903
OPERATING PROFIT	(99)	111	380	534	676	675	248	(37)	(179)	(321)	105	389	389	673	815
Other income / (expense)															
Interest expense (Term loan)	(7)	(6)	(8)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(5)	(5)	(5)	(5)
Interest expense (Revolver)	(104)	(103)	(112)	(104)	(89)	(83)	(76)	(63)	(80)	(117)	(144)	(168)	(135)	(124)	(118)
PROFIT BEFORE TAX	(210)	1	260	423	581	586	166	(105)	(265)	(444)	(44)	215	248	544	692
Income tax	80	(0)	(99)	(161)	(221)	(223)	(63)	40	101	169	17	(82)	(94)	(207)	(263)
NET INCOME	(130)	1	161	262	360	363	103	(65)	(164)	(275)	(27)	134	154	338	429
EBITDA	(3)	207	476	630	772	772	346	61	(81)	(223)	203	488	488	772	914
Cumulative Net Income:	*(130)*	*(130)*	*31*	*294*	*654*	*1,017*	*1,120*	*1,055*	*890*	*615*	*588*	*722*	*876*	*1,213*	*1,642*
Cumulative EBITDA	*(3)*	*204*	*680*	*1,310*	*2,082*	*2,854*	*3,200*	*3,261*	*3,180*	*2,957*	*3,160*	*3,648*	*4,136*	*4,908*	*5,823*
Margin analysis															
Spread margin	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Gross margin	26.7%	28.4%	30.0%	30.4%	30.7%	30.7%	29.7%	28.8%	28.3%	27.7%	29.2%	30.0%	30.0%	30.7%	31.0%
Operating margin	-1.2%	1.2%	3.6%	4.9%	5.9%	5.9%	2.5%	-0.4%	-2.1%	-4.0%	1.1%	3.7%	3.7%	5.9%	6.8%
EBITDA margin	0.0%	2.2%	4.5%	5.7%	6.7%	6.7%	3.5%	0.7%	-1.0%	-2.8%	2.1%	4.6%	4.6%	6.7%	7.6%
Net margin	-1.6%	0.0%	1.5%	2.4%	3.1%	3.2%	1.0%	-0.7%	-1.9%	-3.4%	-0.3%	1.3%	1.5%	2.9%	3.6%

Table A-7: 15-Month Projected Balance Sheet

XYZ Company, Inc.
Projected Balance Sheet
(Monthly, $000s)

Month #:	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Month:	Sep 13	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14	Jun 14	Jul 14	Aug 14	Sep 14	Oct 14	Nov 14	Dec 14
ASSETS																
Current assets																
Cash	46	46	46	46	46	46	46	46	46	46	46	46	46	46	46	46
Accounts receivable	15,524	16,538	17,500	18,000	16,250	17,000	17,250	15,750	19,000	22,500	25,500	26,000	20,000	21,000	22,000	17,750
Inventory	16,876	15,660	14,703	14,539	13,800	12,900	11,400	10,500	12,750	13,650	18,300	19,500	16,800	16,000	15,500	15,000
Total current assets	32,446	32,244	32,249	32,585	30,096	29,946	28,696	26,296	31,796	36,196	43,846	45,546	36,846	37,046	37,546	32,796
Construction in progress																
Fixed assets	36,462	36,486	36,496	36,562	36,582	36,606	36,670	36,750	36,774	36,790	36,810	36,834	36,862	36,886	36,910	36,934
Less: Acc. depreciation	(30,642)	(30,738)	(30,835)	(30,931)	(31,027)	(31,123)	(31,220)	(31,318)	(31,416)	(31,514)	(31,612)	(31,710)	(31,808)	(31,907)	(32,006)	(32,105)
Fixed assets, net	5,820	5,748	5,661	5,631	5,555	5,483	5,450	5,432	5,358	5,276	5,198	5,124	5,054	4,979	4,904	4,829
Other assets																
Goodwill	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543
Total other assets	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543	2,543
Total assets	40,809	40,534	40,453	40,759	38,194	37,971	36,688	34,271	39,697	44,015	51,587	53,213	44,442	44,568	44,993	40,168
LIABILITIES & EQUITY																
Current Liabilities																
A/P - Copper	4,370	4,066	5,226	6,422	6,147	6,286	5,686	5,386	7,936	6,286	9,736	7,186	3,886	5,786	6,686	6,986
Note payable - Bank	20,008	20,267	19,044	17,912	15,218	14,295	13,045	10,781	13,782	20,034	24,620	28,859	23,193	21,190	20,190	14,393
Accrued income taxes	156	76	77	175	336	557	779	842	802	702	533	516	598	693	900	1,163
Other current liabilities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total current liabilities	24,534	24,409	24,346	24,510	21,701	21,138	19,511	17,010	22,520	27,022	34,889	36,562	27,677	27,668	27,776	22,542
Other Liabilities																
Term loan	1,304	1,285	1,267	1,248	1,229	1,210	1,190	1,171	1,152	1,132	1,113	1,093	1,073	1,054	1,034	1,014
Total liabilities	25,838	25,694	25,613	25,757	22,930	22,347	20,701	18,181	23,672	28,155	36,002	37,655	28,751	28,722	28,810	23,555
Stockholder's Equity																
Capital stock	200	200	200	200	200	200	200	200	200	200	200	200	200	200	200	200
Additional paid-in capital	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112	6,112
Retained earnings	8,658	8,528	8,529	8,690	8,952	9,312	9,675	9,778	9,713	9,549	9,273	9,246	9,380	9,534	9,871	10,301
Total equity	14,970	14,840	14,840	15,001	15,264	15,624	15,987	16,090	16,025	15,860	15,585	15,558	15,692	15,846	16,183	16,612
Total liabilites & equity	40,809	40,534	40,453	40,759	38,194	37,971	36,688	34,271	39,697	44,015	51,587	53,213	44,442	44,568	44,993	40,168

Table A-8: 15-Month Projected Cash Flow Statement (GAAP-Compliant)

XYZ Company, Inc.
Projected Cash Flow Statement
(Monthly, $000s)

Month #:	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Month:	Oct 13	Nov 13	Dec 13	Jan 14	Feb 14	Mar 14	Apr 14	May 14	Jun 14	Jul 14	Aug 14	Sep 14	Oct 14	Nov 14	Dec 14
Cash flow from operating activities:															
Net income	(130)	1	161	262	360	363	103	(65)	(164)	(275)	(27)	134	154	338	429
Adjustments to reconcile profit before tax with net cash flow from operations:															
Depreciation	96	97	96	96	96	97	98	98	98	98	98	99	99	99	99
(Increase)/decrease in:															
Accounts receivable	(1,014)	(962)	(500)	1,750	(750)	(250)	1,500	(3,250)	(3,500)	(3,000)	(500)	6,000	(1,000)	(1,000)	4,250
Inventory	1,216	956	164	739	900	1,500	900	(2,250)	(900)	(4,650)	(1,200)	2,700	800	500	500
Increase/(decrease) in:															
Accounts payable	(305)	1,160	1,196	(274)	139	(600)	(300)	2,550	(1,650)	3,450	(2,550)	(3,300)	1,900	900	300
Accrued income taxes	(80)	0	99	161	221	223	63	(40)	(101)	(169)	(17)	82	94	207	263
Other current liabilities	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net cash flow from operating activities	(216)	1,252	1,216	2,734	966	1,333	2,364	(2,958)	(6,217)	(4,546)	(4,196)	5,714	2,047	1,043	5,841
Cash flow from investing activities:															
(Increase)/decrease in:															
Capital expenditures	(24)	(10)	(66)	(20)	(24)	(64)	(80)	(24)	(16)	(20)	(24)	(28)	(24)	(24)	(24)
Net cash flow from investing activities	(24)	(10)	(66)	(20)	(24)	(64)	(80)	(24)	(16)	(20)	(24)	(28)	(24)	(24)	(24)
Cash flow from financing activities:															
Term loan (Principal payments)	(19)	(19)	(19)	(19)	(19)	(19)	(19)	(19)	(19)	(20)	(20)	(20)	(20)	(20)	(20)
Change in note payable - Bank	259	(1,223)	(1,131)	(2,695)	(923)	(1,250)	(2,264)	3,001	6,253	4,585	4,239	(5,666)	(2,003)	(999)	(5,797)
Net cash flow from financing activities	240	(1,242)	(1,150)	(2,714)	(942)	(1,269)	(2,284)	2,982	6,233	4,566	4,220	(5,686)	(2,023)	(1,019)	(5,817)
Net change in cash	0	-	0	(0)	(0)	-	-	-	-	-	-	-	-	(0)	-
Cash - Beginning of period	46	46	46	46	46	46	46	46	46	46	46	46	46	46	46
Cash - End of period	46	46	46	46	46	46	46	46	46	46	46	46	46	46	46

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Appendix B: Sample Assumptions

The accompanying financial model projects financial statements for XYZ Company, Inc. for the months ending October 31, 2013 to December 31, 2014. The projections represent the company's best estimate of future events, and are included as Tables A-1 through A-8. Actual results will likely vary from those projected and variances may be material.

The actual balance sheet as of September 30, 2013 is included. Revenue and expense projections are based on the company's current expectations and are detailed below.

I. Key Revenue Assumptions

XYZ Company, Inc. is a seasonal business with the height of its selling season in fall and winter. Customers include "big-box" and "mom-and-pop" retailers (the majority of which are hardware or home-improvement stores), who then sell the company's products directly to the end user. XYZ has significant supplier relationships with several blue-chip companies including Home Depot, Lowe's and Wal-Mart. The company has been successful in limiting customer concentration for any single customer to no more than 15% of sales.

Projections incorporate a projected 20% drop in sales from the prior twelve months.

Sales growth comes from growth in same-store sales and growth in the customer base. The projections assume that the company maintains its current network of big-box and mom-and-pop retailers, but that no additional customers are added through 2014.

II. Key Expense Assumptions

Management has prepared projections for expense items based on historical results and the relationship of expenses to sales (for variable costs) or projected growth rates (for fixed costs). Variable costs tied to production are based on actual operating experience at the current facility; any adjustments are noted in the assumptions.

A. Cost of Sales

Product costs include materials and freight paid on delivery. Historically, spread margin at the company has averaged 43%. Because of planned sales and lower pricing as a result of the current economy, projection of spread margin is 40%, so that product costs are projected at 60% of sales.

Direct & indirect labor expense is derived from current hourly wage rates. Weighted-average wage rates for direct and indirect laborers are expected to equal $15.10. Labor expense is estimated as a component of (1) average hourly wage rate and (2) hours per period. Hours are calculated as normal production plus overtime work. There are currently 228 hourly employees who comprise direct & indirect labor. After planned labor cuts in November, the company expects to employ 182 employees.

Fringes - XYZ maintains full medical, dental and life insurance plans for all of its full-time employees. XYZ also matches employee 401(k) contributions up to specified levels, at the discretion of the Board of Directors, currently 3%. Fringe benefits for direct & indirect laborers are estimate to equal 28% of total direct and indirect labor wages.

Freight expense includes the expense that XYZ incurs in shipping its products to customers and is projected to equal 1.6% of sales.

Packaging supplies - Expense for packaging supplies includes expense for pallets, wrapping materials, and other supplied used in packaging the end product for delivery to customers. Packaging supplies expense varies with production, and is projected to equal 0.8% of sales.

B. Selling, General & Administrative Expenses (SG&A)

Salaries - SG&A salaries include salaries for fixed positions in company administration. SG&A Salaries are considered to be fixed during the next 15 months. The company is anticipating a decrease in salaried employees from 43 to 34 in November 2013.

Fringes for salaried positions include life insurance, health insurance, social security, employment taxes, and 401(k) contributions. Fringes are projected to equal 28% of SG&A salaries each period.

Depreciation - Depreciation is estimated using a combination of an existing schedule and a new schedule to account for the company's capital budget plan. Fixed assets acquired as part of the capital budget plan are depreciated straight-line assuming no residual value according to an estimated average 10-year useful life.

Utilities - There are four main components to utilities costs: (1) the costs to heat, cool, and otherwise operate the building - also known as building overhead, (2) costs that vary with production, and (3) water used in production. Utilities are estimated at 2.6% of sales.

Repair & maintenance - Expense for repair and maintenance is a function of the level of production and includes expense required to repair and maintain factory equipment. Repair and maintenance is projected to equal 1.0% of sales.

Other SG&A includes automobile expense, business insurance, dues and subscriptions, professional fees, and expenses for computers, training, safety programs, landscaping, licensing, meal/entertainment, office maintenance, office supplies, samples, telephone, and travel. Non-cash expenses include bad debt expense and an obsolete inventory allowance. Other SG&A costs contain a fixed component of $1.5 million per month to account for fixed components, including projected property taxes. The variable component is projected to equal 5.6% of sales.

C. Other Income & Expense

Interest expense on the working capital line is assumed at a 7.0% annual rate, paid monthly. Interest expense also includes 6.0% interest paid on existing long-term debt that matures in 2014.

Income tax expense is projected at 38% of profit before tax, and is accrued as a liability on the balance sheet.

III. Balance Sheet Assumptions

A. Assets

Accounts receivable - Management has provided a week-by-week budget of expected accounts receivable collections over the next three months (October-December 2013). Through 2014, a measure of days on hand (DOH) is used to project receivables accounts into the future. During the summer, XYZ makes “early” sales to dealers who are stocking up for the height of the season. These sales are made using longer, 3-5 month payment terms, causing the average “days on hand” of XYZ’s receivables to rise during the summer and fall.

The projected accounts receivable balance for 2014 is based on the historical average DOH during each month and detailed as Table B-1.

Table B-1: Projected Accounts Receivable Days on Hand

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
A/R DOH	45	45	45	45	60	75	90	90	60	60	60	45

Inventory - Management has provided a week-by-week budget of inventory receipts for the next three months (October-December 2013). The inventory balance is drawn down by projected sales/shipments. Through 2014, inventory is best projected using a forward-looking days on hand measure. For example, at the end of April we project that the factory will have enough inventory on hand to satisfy the next 60 days’ projected sales.

Management builds its inventory to a peak level in the late summer to prepare for the fall and winter, and maintains a lower level during the spring. Assumptions are detailed in Table B-2 below.

Table B- 2: Projected Inventory Forward-looking Days on Hand

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Fwd DOH	60	60	60	60	75	75	90	90	75	75	75	75

Fixed assets - Capital expenditures are based on a preexisting budget detailed as Table 3. Expenditures are highest in December 2013 and in March-April 2014 due to expected roof repairs and basement repairs and waterproofing.

Fixed assets acquired as part of the capital budget plan are depreciated straight-line assuming no residual value according to an estimated average 10-year useful life.

Table 3: Capital Expenditures Budget ($000s)

	2013			2014										
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
CapEx	24	10	66	20	24	64	80	24	16	20	24	28	24	24	24

B. Liabilities

Accounts payable - Expected payments to suppliers for the first four weeks are provided in a budget by management. Thereafter, payments are projected to be made on 30-day terms.

Working capital line (Note payable - Bank) - The borrowing base on the working capital line of credit is calculated to be 85% of the accounts receivable and 50% of the inventory balance. Interest paid on borrowings is at a 7.0% annual rate, paid monthly.

Other current liabilities include accrued interest and accrued payroll. Interest is accrued over the course of the month and paid at month's end. Direct & indirect labor (including fringes) is paid bi-monthly, while salaried positions are paid monthly. Therefore, the liability account is essentially debited in full at the end of each month. Other expenses, including freight, packaging supplies, utilities, repair and maintenance, and other SG&A is paid as expensed.

Term loan - The company borrowed $1.7 million in October 2011 in connection with an equipment purchase. The loan is being paid at 6.0% interest, amortized over seven years (through 2018).

C. Stockholder's Equity

Retained earnings is credited and debited according to the amount of net income in each period. No distributions to stockholders are expected or assumed through 2014.

Appendix C: A Taxonomy of Forward-looking Financials

Accounting literature distinguishes among different types of forward looking financial statements. While such distinctions are not usually drawn by consultants or bankers working on projections for companies in distress, they do help to put their work in perspective.

A Taxonomy of Forward-Looking Financial Statements

- Historical financial statements
- Subsidiary financial analyses
  - Aged receivables
  - Aged payables
  - Debt service schedules
  - Lease schedules
  - Other schedules
- Financial projections
- Financial forecasts
- Pro forma financial statements

Historical financial statements are mentioned, not because they are forward-looking, but because they are essential to interpretation of forward-looking statements. Annual audited and regular interim statements are necessary to provide context to the forward-looking statements. Subsidiary financial analyses are important building blocks supporting the forward-looking statements.

The AICPA *Guide for Prospective Financial Information* defines a ***Financial Forecast*** as

> Prospective financial statements that present, to the best of the responsible party's knowledge and belief, an entity's expected financial position, results of operations, and cash flows. A financial forecast is based on the responsible party's assumptions reflecting conditions it expects to exist and the course of action it expects to take.

A ***Financial Projection*** is defined as

> Prospective financial statements that present, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and cash flows. A financial projection is sometimes prepared to present one or more hypothetical courses of action for evaluation, as in response to a question that begins, for instance, "What would happen if …?"

Pro Forma Financial Statements are essentially historical statements and do not purport to be prospective financial statements. The objective of some "pro forma information" is to show what the significant effects on historical financial information might have been, had a consummated or proposed transaction (or event) occurred at an earlier date. Forward-looking financial statements prepared in connection with businesses in distress are usually projections rather than forecasts, as at least some of the assumptions are hypothetical rather than based on expectations.