

# NEWS

## CORPORATE FINANCE INSIGHTS

Winter 2016

### Forecasts

Does your company prepare forecasts? I am not talking about budgets because they serve a different purpose. And I am not talking about sales forecasts because they focus on a limited part of the business. What I am talking about are honest-to-goodness forecasted financial statements – income statements, balance sheets and cash flows. Most small companies do not prepare them, and many mid-sized companies do not as well. But if you are not preparing forecasted financial statements you could be missing important information to help you manage your business.

#### Strategic Planning vs. Budgeting

Forecasted financial statements are central to the strategic planning process. When management teams are considering which way to take their business in the future, they need to know if their plans will generally increase the value of the company and if so, by how much. Managers prepare forecasted financial statements and then build valuation analyses to get an idea about how their plans affect the company's value.

Forecasts are quite different than budgets. Forecasts can cover several years in the future, while budgets generally only cover the upcoming year. Budgets are very detailed often including several pages of expense category detail. Forecasts are higher-level and are generally prepared in more of a summary format. In short, budgets are for near term management and control of the company, forecasts are for strategic planning.

#### Forecasts are Estimates

Always remember that forecasts are estimates and so are valuation techniques, so any work you do can't be said to be "The Answer."

But it can give you a set of assumptions to work with to form ideas about your plans and whether they tend to improve the value of your company or not. That is why scenario analysis is so important with forecasts. Since forecasts are built from assumptions, we need to see what happens with our forecasts and valuation analyses when we change our assumptions. We pay particular attention to assumptions that cause the greatest changes in the value of the company, which are known as sensitivity analyses.

Forecasts are quite different than budgets.

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"The usual stuff — a new virus from the Joker, spyware from the Penguin, malicious code from Cat Woman, another phishing scheme from the Riddler."



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Forecasts can be prepared top-down or bottom-up. Top-down forecasts are prepared at the highest level of management. While operating managers may be consulted, top management prepares the forecast and all of its assumptions. Bottom-up forecasts are prepared by operating managers for their specific business unit. Each operating unit's forecast gets handed up to the next level manager who consolidates the units and reconciles them to make sure there is no duplication or missing items. The process continues until it reaches the top level of management who consolidates all the operating forecasts into a corporate-wide forecast. Bottom-up forecasts are recommended, but you can see that they entail much more work throughout the organization.

More often than not, companies prepare forecasts only on an annual basis. And it can take several months for them to develop a forecast. But more and more companies are treating forecasting as an on-going activity. They are continually updating and refining their assumptions, and constantly seeking ways to quicken the process of preparing forecasts.

The knocks on forecasts are that they can be difficult to prepare, and that forecasted results are sometimes much different than actual results. But if you follow a disciplined process to prepare forecasts, your chances of having a useful analysis to help you manage your business are greatly improved. And forecasts are all about providing managers with information they can use in managing the business.

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**Corporate Value  
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- Preparing business valuations
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- Assisting with corporate performance measurements
- Assisting with the placement of debt financing
- Assisting creditors in corporate bankruptcies
- Assisting attorneys with the financial aspects of lawsuits