Financial Planning [compiled from prassana chandra]



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Financial Planning Vision, mission, etc. guide a firms performance and financial planning Financial Forecasts (using trends) **Financial Projections (also includes** expansion/changes) So, one has to take care of industry-level factors, business-level factors, and firm-

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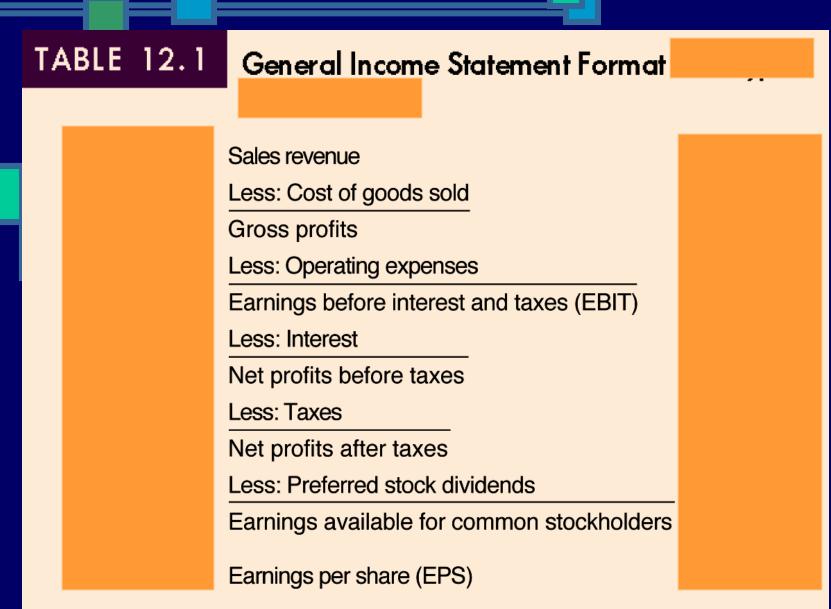
level factors

Usual Steps

Assumptions (usually economic in nature) Sales Forecast Qualitative Techniques (ITC) Time Series Projection Methods (Cement) Causal Models, Regressions (Alcoa) **Pro Forma Financial Statements** Percent of Sales Method Budgeted Method Combination Method Asset Requirements Financing Plan



Percent of Sales Method



KP Common Size Income Statement

	Regular (lakhs of Rs.)			Common-Size (%)		
	2001	2002	2003	2001	2002	2003
Net Sales	1,235	2,106	2,211	100.0	100.0	100.0
COGS	849	1,501	1,599	68.7	71.3	72.3
Gross Profit	386	605	612	31.3	28.7	27.7
Adm.	180	383	402	14.6	18.2	18.2
EBIT	206	222	210	16.7	10.5	9.5
Int Exp	20	51	59	1.6	2.4	2.7
EBT	186	171	151	15.1	8.1	6.8
EAT	112	103	91	9.1	4.9	4.1
Cash Div	50	50	50	4.0	2.4	2.3

What are we assuming here?



KP Common Size Balance Sheets

	Regular (lakhs of Rs)			Common-Size (%)		
Assets	2001	2002	2003	2001	2002	2003
Cash	148	100	90	12.10	4.89	4.15
AR	283	410	394	23.14	20.06	18.17
Inv	322	<mark>616</mark>	696	26.33	30.14	32.09
Other CA	10	14	15	0.82	0.68	0.69
Tot CA	763	1,140	1,195	62.39	55.77	55.09
Net FA	349	<mark>63</mark> 1	701	28.54	30.87	32.32
LT Inv	0	50	50	0.00	2.45	2.31
Other LT	111	223	223	9.08	10.91	10.28
Tot Assets	1,223	2,044	2,169	100.0	100.0	100.0

KP Common Size Balance Sheets

	Regular (lakhs of Rs)			Common-Size (%)		
Liab+Equity	2001	2002	2003	2001	2002	2003
Note Pay	290	295	290	23.71	14.43	13.37
Acct Pay	81	94	94	6.62	4.60	4.33
Accr Tax	13	16	16	1.06	0.78	0.74
Other Accr	15	100	100	1.23	4.89	4.61
Tot CL	399	505	500	32.62	24.71	23.05
LT Debt	150	453	530	12.26	22.16	24.44
Equity	674	1,086	1,139	55.11	53.13	52.51
Tot L+E	1,223	2,044	2,169	100.0	100.0	100.0

Combination method in Income statement

- How should we take the proportions last years or 2/3-years average?
- Percent-to-Sales Method can be used in items such as cost of goods sold, and selling expenses
- Budgeted Method can be used in items such as depreciation, general and administration expenses, and interest on debentures
- While items such as dividends and retained earnings will be based on managerial policy/decisions
- Use budgeted method for items having a structural change in the markets (example, managerial labour markets)

Combination method in a Balance Sheet statement

- Percent-to-Sales Method can be used in most asset-side items except 'investments' and 'miscellaneous expenses' [you can estimate them]. It can also be used for finding values in 'CL & P'
- Update the 'reserves and surplus' values using your P&L statement estimates
- Other values could be tentatively set as equal to previous levels (unless you have prior info)
- The difference in 'total assets' and 'total liabilities' will give an estimate of the amount of external funds required or surplus funds available

When assumptions are not there?

- There is a circularity problem in preparing pro forma statements
- We assumed that the ratios of assets and liabilities to sales remain constant over time

It means there is a linear relationship
Economies of scale (inventory)
Curvilinear ratios (inventory)
Lumpy assets (say, fixed assets)
Forecasting errors and excess assets
Computerized financial planning systems

