Long Term Financial Planning

Planning and Forecasting

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Learning Objectives

By the end of this module, students will be able to:

- List the various documents contained in a financial plan
- Describe the sources of funds of the company
- Describe the uses of funds of the company
- Build a financial planning from detailed forecasts

1 Concepts

Financial planning

Definition

Financial planning formulates the way in which financial goals are to be achieved.
Ross, Westerfield, Jordan - Financial management and policy

Financial plan = 3-5 year financial forecasts

- Income statements
- Statements of cash flows (sources and uses of cash)
- Pro forma balance sheets

Basic elements of financial planning

Element	Financial policy involved
Needed investments	**Investment decision**
Future amount of borrowing	**Financing decision**
Necessary cash to pay dividends	**Dividend decision**
Liquidity & working capital needs	**Working capital management**

Financial planning: evolution

Financial planning is a loop process:

1. Build financial planning *before* new financing
2. Observe needs/surplus
3. Find financing/investment opportunities
4. Build/balance financial planning including new financing/opportunities
5. Wait - new information, events, realization... happen

6. Go to step 1

2 Financial planning before new financing

Sources of funds

- Net cash flow from operations
- Fixed assets sales (divestment)
- Debt increase (new loans)
- New equity capital raised

Net cash flow from operations

+	*Sales*
–	*Cash operating expenses*
–	Depreciation
=	EBIT
–	*Interest paid*
=	Earnings Before Tax (EBT)
–	*Taxes*
=	Net income

+	*Sales*
–	*Cash operating expenses*
–	*Interest paid*
–	*Taxes*
=	Net cash flow
	or,
+	Net income
+	Depreciation
=	Net cash flow

Fixed assets sales (divestment)

- Divestment : after tax cash flow from fixed assets sold
- Involves
  - Cash inflow (price) or zero if assets are worthless
  - Possible tax (capital gain) or tax savings (capital loss)

Uses of funds

- Investment
- Debt repayment
- Dividends payment
- Working capital requirement increase

Investment

All investments should be considered

- Renewal of tangible and non-tangible assets
- Growth investments
- Financial investments (acquiring other companies)

Debt repayment

- Repayment of old and new debt should be considered
- Warning : interest payments already taken in account (see cash flow)

Dividends payment

- Dividends paid to shareholders (DPS $\times$ # of shares)
- Warning : dividends are usually paid the year following the decision

Working capital requirement increase

- Increase in activity (sales) usually involves:
  - increase in inventories (use of funds)
  - increase in accounts receivable (use of funds)
  - increase in accounts payable (source of funds)
- $\Rightarrow$ Increase in net working capital

Balancing the statement of cash flows

- Reach internally decided level of end-of-year cash
- Theoretically, should be zero, but ...
- Identify new sources of funds needed:
  - How much?
  - When?
  - For how long?

New sources of funds

- Debt increase
- New equity capital

Debt increase

- Net proceeds from new loans or bonds issues
- All issuing costs should be deduced
- Involves
  - New interests payments
  - Repayment

New equity capital raised

- Net proceeds from new stocks issues (SEO)
- All issuing costs should be deduced
- May involve more dividend payments