Understanding financial forecasts in the context of business rescue

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Why are financial forecasts necessary?

- Basis upon which dividends will be paid
- Provides transparency into the process
- Allows for affected persons to assess likelihood of success
- Important to gauge solvency – requirement for substantial completion

What does the Companies Act require?

- s150(2)(c)(iv) on the basis that the plan is adopted, prepare:
  - projected balance sheet
  - projected statement of income and expenses for the ensuing three years

- A balance sheet for three years?

- What about a cash flow statement?

What does the Companies Act require?

- s150(3)(a) & (b):
  - Notice of material assumptions
  - May include alternative projections taking into account varying assumptions and contingencies
- Financial forecasts are best estimates – inherent uncertainty
- Must reflect what is included in the plan
- Must be for three years from exit of the business rescue

Level of detail of financial forecasts

- Chapter 6 provides no guidance in this regard
- Professional judgment required – what do affected persons require in order for an informed decision on the plan
- “Substantial compliance” is required!

A basic understanding of financial statements

- Balance sheet
- Income Statement
- Cash flow statement

Balance sheet

- Financial position of an entity
- Important for solvency
- Breakdown of the key assets & liabilities / owned / leased / valuation

Income statement

- Reflection of the financial performance (profitability) of an entity
- Insight into the financial health of a business
- Detail of key revenue streams, material expenditure items, non-cash items (eg depreciation / bad debt write-offs)

Cash flow statement

- Cash flows from
  - Operations
  - Investment activities
  - Financing activities

- Liquidity position is vital

Critical components

- Consider your audience and financial sophistication
- Key components:
  - Easy to read & understand
  - Granularity of information
  - Assumptions & sensitivities (what are the key risks?)
  - Timeframe of projections
  - Best-practice

Stakeholders

- Financial creditors (secured & unsecured)
- Unsecured trade creditors
- Employees
- Shareholders
- SARS