

TURNAROUND CORNER

The 13-Week Cash-Flow...

Keeping Your Eyes on the Road & Your Hands on the Wheel

BY LUKE D. SNYDER

Business founders and key management are often more positive about a situation than an objective third party. However, this optimism can very quickly cause — or exacerbate — a cash-flow crisis. Gavin/Solmonese director Luke Snyder says a well-crafted 13-week cash-flow model serves as a reality check for all stake holders and highlights a logical path forward.



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Entrepreneurs often demonstrate unbridled optimism with respect to future sales forecasts. It is understandable that business founders and key management are often more positive about a situation than an objective third party due to the blood, sweat and tears they invest in the business daily. However, this optimism can very quickly cause — or exacerbate — a cash-flow crisis that puts survival of the business at risk. A well-crafted 13-week cash-flow model (TWCF) serves as a reality check for all stakeholders and highlights a logical path forward.

The cash cycle in many businesses approximates 90 days (i.e., one calendar quarter or 13 weeks) which means an experienced turnaround consultant will appear to have a crystal ball when mapping out short-term cash-flows, because all the necessary data is available if one simply knows how to compile it. While every situation and industry is unique, the focus here is on a process that can be used in any situation, particularly one where there is no source of financing other than the cash generated by the business.

Why a TWCF?

Traditional accrual-basis financial statements are often unhelpful and can be misleading during a cash crisis. In a distressed organization where resources are likely constrained, time is better spent on developing an accurate cash-flow and liquidation analysis. The concept of a TWCF is very simple — map out all sources and uses of cash during the upcoming quarter. The execution is more complicated, as large customers and suppliers will need to be analyzed individually. A well-formulated TWCF will provide a road map for running the business, while also tracking key

balance sheet accounts to keep the lender informed of its collateral position on a weekly basis. A liquidation analysis, which should be prepared simultaneously, will allow all parties to get a feel for what a “plan B” might look like early in the process.

In a bankruptcy setting where no debtor-in-possession (DIP) financing is available, accurate TWCF reporting can allow the debtor to operate its business and accomplish planned objectives solely through careful use of cash collateral. This was the case in a recent bankruptcy situation involving FPD, LLC, a Maryland-based homebuilder. FPD and its affiliates spent more than a year in bankruptcy while executing an organized sale process and, ultimately, a structured dismissal of the Chapter 11 cases without the cushion of DIP financing. According to the debtor's lead counsel, Irving Walker, Esq., of Cole, Schotz, Meisel, Forman & Leonard: “Operating any business in Chapter 11 without an active credit facility to smooth over fluctuations in cash receipts and disbursement requirements is challenging enough. To accomplish this for a homebuilding business, which requires significant cash outlays to complete construction of a house before cash is received upon closing of a sale, is doubly challenging. Bringing in a skillful and respected financial advisor to prepare the cash-flow forecasts and to guide the debtors in cash management empowered the debtors to continue in business for 15 months and to successfully complete the Chapter 11 process. In addition, although we began the case fighting for the debtors’ lives in initial cash collateral litigation with the primary secured lenders, the financial advisor established credibility with the lenders who after the initial court fights reached agreements with the debtors on the use of cash collateral for the duration of the Chapter 11 cases.”

Getting Started

Begin by reviewing the current sales backlog and understanding the sales cycle (i.e. how long from when the order is placed to when cash payment is received). Lead times for purchasing and production as well as how customers pay their bills may seem like subtleties, but granular understanding of these nuances will prove critical to the accuracy of your model. Are there large customers whose sales can be easily forecasted on a weekly basis? In the case of a homebuilder, how many houses are under

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contract, and what are the anticipated settlement dates? Historical (same week in prior year) data may also help gauge seasonality in the business. Depending on the length of the sales cycle of the business, as much as 100% of the sales for the upcoming quarter may already be included in the backlog. The longer the sales cycle, the more accurate forecasting of near-term sales in the upcoming 13 weeks can be done.

It will be important to identify sales to large customers, as you will need to estimate when cash payments will be received. Some accounts may have longer payment terms (i.e., 60 days versus 30 days), and certain customers with the same terms will have different payment histories (early, late, once a week or once a month, etc.) which can have dramatic impact on the timing of cash receipts.

Sources of Cash

Once the current sales backlog has been converted into a sales forecast which groups customers with similar payment patterns, the next step is to forecast the largest source (and potentially only source) of cash — collection of accounts receivable. At this point, it is best to work closely with the collections department to map out when the current receivables for the largest accounts will be collected (based on its knowledge of the customers, not necessarily the payment terms). Typically, the 80/20 rule is applied here, and mapping a handful of customers will likely help establish a comfort level with the timing of the majority of expected cash receipts.

Before moving to the expense forecast, think about any other sources of cash that may be available to the business. For example, are loans available from ownership? Can excess or obsolete equipment or inventory be sold? Is there a life insurance policy with cash surrender value?

Uses of Cash

Next step is to forecast cash needs for the next 13 weeks. First, identify the recurring weekly or monthly cash expenses — such as salaried payroll, direct debits from bank for interest or fees — that do not run through accounts payable. Once these non-accounts payable expenses are plotted out on a weekly basis, focus will turn to the detailed accounts payable aging, which in the case of many distressed companies is already stretched well beyond payment terms when first preparing the TWCF.

When reviewing balances due to large suppliers, involve members of the management team with the best relationships with each of the suppliers. Discuss as a management team which suppliers are most critical, which could be easily replaced (and payment delayed) and which ones may be most receptive to setting up a payment plan on past due invoices. This exercise is extremely important, as maintaining supplier relationships will help the company avoid an involuntary bankruptcy and continue to meet customer demands.

Balance Sheet and Borrowing Base Considerations

Once you have plotted out all sources and uses of cash in the upcoming 13 weeks, you should calculate weekly snapshots of key balance sheet accounts (particularly accounts receivable, inventory and accounts payable). By calculating anticipated accounts receivable on a weekly basis, you will quickly see if the sales and collections forecasts developed are reasonable in comparison to recent borrowing base calculations. In cases with a secured lender watching over its collateral, this information feeds a borrowing base calculation that will keep the lender informed of its collateral position throughout, and give you the credibility to discuss potential upcoming issues with your management and lender.

What is the TWCF Telling Me?

Review your anticipated cash balance at each day's or week's end to see if it is positive throughout the upcoming 13 weeks. If it is positive, review the assumptions again, particularly the sales and accounts receivable collections forecasts and make sure the forecasts are *realistic*, not optimistic.

If cash is negative at any point during the forecast, the company and financial advisor will need to review options for potentially: Borrowing funds; accelerating receipts of cash (if the company is operating under a borrowing base, a real push should be made to collect ineligible receivables and liquidate ineligible inventory at this time); or eliminating or delaying expenses.

If none of these options are realistic and the negative cash position is sustained and not just an isolated timing issue, focus should turn to the liquidation analysis as it is possible that the company is worth more "dead" than "alive." After comparing the TWCF to a liquidation scenario, parties in interest may be willing to fund losses for a short time to allow for a sale of the company or its assets as a going concern; or they may determine that an immediate shutdown and liquidation will

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maximize recoveries. Seasonality in the nature of the business (e.g., a ski resort) needs to be considered at this time, as cash shortfalls in the near term (next 13 weeks) may be quickly rectified during peak times

Maintaining the TWCF

The TWCF should be updated on a weekly basis and all assumptions made should be clearly documented and can be refined as necessary. Be careful not to "override" the forecast of the week being updated; instead, document the actual results in a separate column so that comparisons of forecasts can be analyzed on a weekly, and more importantly a cumulative basis. It is important to reset key account balances (cash, line of credit, accounts receivable, outstanding checks) in the forecast to actual each week so that the go-forward forecast is not skewed by timing differences.

As the management team becomes more comfortable with the tool and its inputs, they will gain confidence in their ability to forecast future cash needs. This will allow the company to:

- More effectively negotiate with its lenders and explain upcoming borrowing needs;
- Regain confidence with its suppliers; and
- Potentially survive a bankruptcy or restructuring solely on the use of cash collateral

Conclusions

A well-developed TWCF, monitored on a weekly basis will provide all stakeholders visibility to the near term survival of a company that traditional accrual-based financials based on overly optimistic sales projections simply will not. This illustrates why a TWCF is the industry standard reporting tool in a distressed situation. Experienced turnaround consultants don't have crystal balls and we don't walk on water — instead, we know how to formulate cash-flow models and we know where the rocks are. That's how an experienced turnaround consultant can help navigate this process. [abfj](#)

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