FORECAST VIEW™

USER GUIDE

companywatch
financial analytics

CONTENTS

INTRODUCTION

The pressures facing UK companies are enormous. In recent years, businesses have faced external shocks due to COVID, Brexit, and now the War in Ukraine. In 2022, these are combining with long-term issues—the lowest business investment in the G7, a decade of poor productivity growth, and a large structural trade deficit—to present little prospect of a swift economic recovery. Companies are scrambling to fight multiple challenges, including ongoing supply chain and labour market disruption, squeezed margins in the wake of diminished consumer confidence, and an increasing urgency to meet sustainability targets. All this results in a difficult time for those of us who evaluate and manage risks.

At Company Watch, we have a proud record of supporting our customers through tough times. With **Forecast View™**, users can quickly test the resilience of companies under a wide range of customizable financial scenarios, immediately seeing the potential impact on the H-Score®. Inspired by our award-winning COVID Forecast, **Forecast View™** goes further in allowing users to alter revenue while fixing profit margins, to build in stock write-offs as well as bad debt, and to model the impact of action by a company's creditors. Finally, **Forecast View™** comes with a range of built-in scenarios out of the box, enabling users to begin modelling some of the most common situations facing companies with just the click of a button.

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Now more than ever, the risks facing our customers, suppliers and counterparties need to be considered on a company-by-company basis. The array of headwinds facing businesses is incredibly diverse, depending heavily on industry factors and, increasingly, on the markets which they cater for. There will be winners and losers: while many companies will be hit by a collapse in demand and margins, others will be buoyed by the lifting of COVID restrictions, perform well among consumers less exposed to economic pressures, or respond to adversity through innovation. The flexibility provided by the eight sliders permits users to model all of these scenarios, investigating how they might alter the prospects of the companies to which they are financially exposed.

In today's volatile economy, there is an urgent need for simple tooling which provides clarity in the face of uncertainty. By enabling rapid stress-testing of company financials even in a fast-changing business landscape, that is exactly what **Forecast View™** delivers.

WHAT DO THE SLIDERS DO?

Click the buttons to highlight the relevant sliders.

TURNOVER AND PROFITS 1

Use these sliders to set the percentage change in turnover, cost of sales and overheads, compared to the previous period.

By ticking the appropriate boxes, moving one slider automatically moves the other(s) to maintain the specified profit margin.

PAYING DIVIDENDS 2

This slider sets the portion of post-tax profits paid out to shareholders as dividends. By default, this is set to be the same as the previous period, up to 100%.

If the company is forecast to make a loss, this will automatically be fixed at 0%.

REVALUING FIXED ASSETS 3

Some fixed assets are revalued at the end of each period, such as investment property. Use this slider to increase or decrease the value of the fixed assets. This excludes intangible assets which are not relevant to the H-Score®.

WRITING-OFF DEBTORS AND/OR STOCK 4

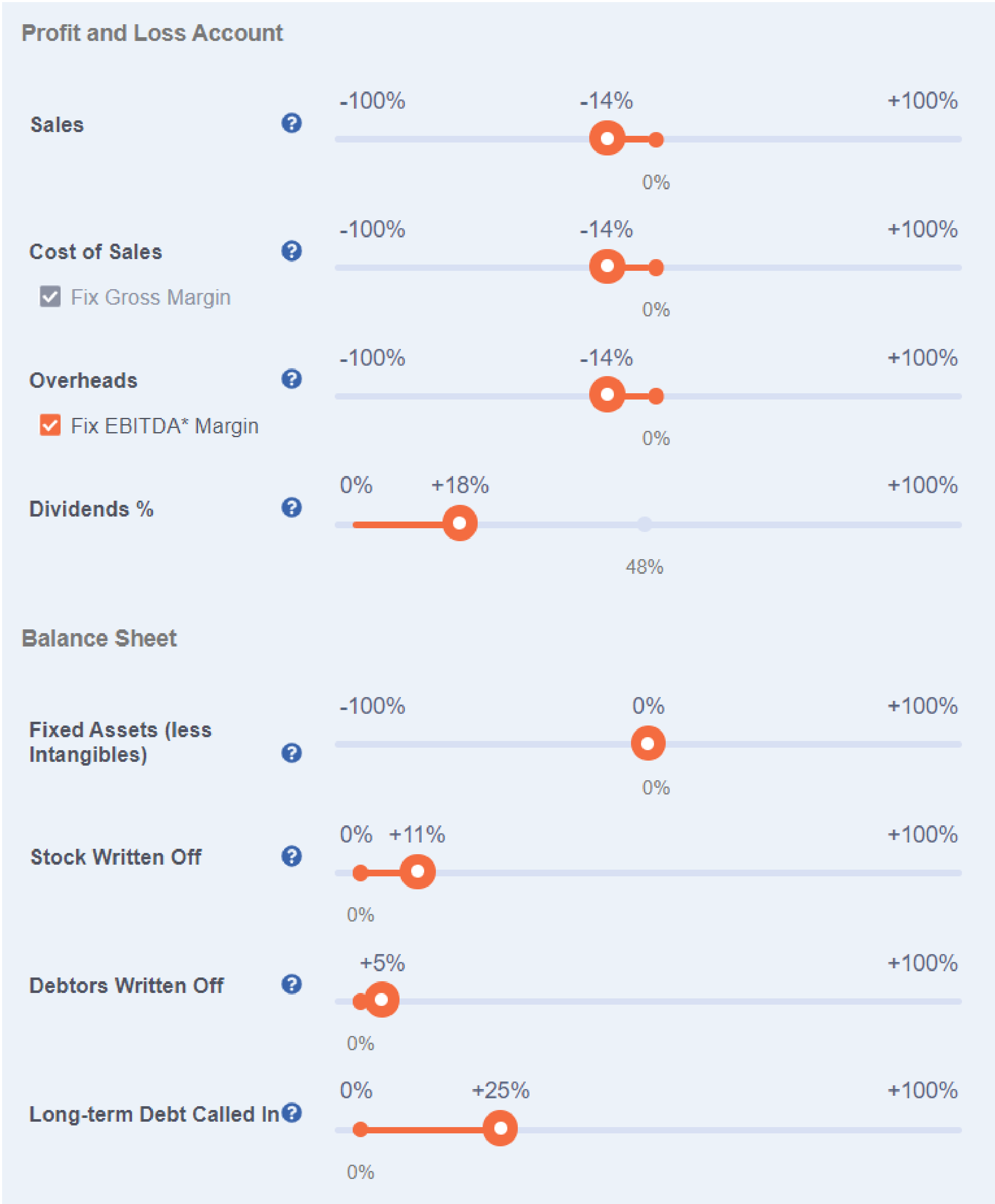
Use these sliders to write off a portion of the current assets.

Stock may need to be written off where it is obsolete or unlikely to be sold at its full value. Debtors may need to be written off where customers or other debtors are insolvent, and the debt is unlikely to be repaid.

REPAYING DEBT 5

Use this slider to repay a portion of the long-term debt, for example, where the debt has matured or the creditors have called in the debt due to a breach of covenants.

The debt is assumed to be repaid using cash or, where cash reserves are insufficient, by taking out short-term debt.



PRE-SET SCENARIOS

SIMPLE FORECAST

The simple forecast assumes that the profit and loss account remains the same as in the previous accounting period, and shows the change in the H-Score® which would result from an identical years' trading.

It can be used as a baseline forecast to understand the direction of travel of a company's financial health, before changes in economic conditions and company performance are factored in using the sliders.

PROFIT AND LOSS ACCOUNT	
Sales	0%
Cost of Sales	0%
Overheads	0%
Dividends %	PY%
BALANCE SHEET	
Fixed Assets (less Intangibles)	0%
Stock Written Off	0%
Debtors Written Off	0%
Long-term Debt Called in	0%

PY= Prior Year

MARGIN SQUEEZE

A margin squeeze arises when a company's costs increase, e.g. due to increasing commodity prices, but the company is unable to fully pass on costs to consumers due to regulation, high competition, or a reduction in consumer spending capacity. In times of economic difficulty, consumers are willing to trade down and buy cheaper goods and services, or to forego spending on non-essential items.

In this scenario, while revenue may increase slightly, it does not increase as much as cost of sales and overheads, reducing both the gross margin and EBITDA* margin.

**EBITDA excludes write off and revaluation items.*

PROFIT AND LOSS ACCOUNT	
Sales	+2%
Cost of Sales	+10%
Overheads	+10%
Dividends %	PY%
BALANCE SHEET	
Fixed Assets (less Intangibles)	0%
Stock Written Off	0%
Debtors Written Off	0%
Long-term Debt Called in	0%

DECREASED DEMAND

Many companies are seeing falling demand for their products, as consumers experience a fall in real wages or resume normal spending patterns following the lifting of pandemic restrictions.

In this scenario, revenue falls but the company is unable to immediately offset this by reducing costs. Cost of sales sees a lower decrease than revenue due to inflationary price increases and supply chain disruption, while many overhead costs, e.g. rent and utilities, remain fixed or increase slightly. Some stock is more difficult or impossible to sell, and needs writing off.

PROFIT AND LOSS ACCOUNT	
Sales	-10%
Cost of Sales	-5%
Overheads	0%
Dividends %	PY%
BALANCE SHEET	
Fixed Assets (less Intangibles)	0%
Stock Written Off	5%
Debtors Written Off	0%
Long-term Debt Called in	0%

PY= Prior Year

KEY CUSTOMER INSOLVENCY

Some companies rely on one or several key customers for a large portion of their revenue. If such a customer is insolvent and/or enters a bankruptcy procedure, any outstanding debt owed to the company may need to be written off, and the portion of the revenue due to that customer will be lost.

In this scenario, cost of sales is reduced in line with the fall in revenue, but achieving a corresponding reduction in overheads, e.g. by making staff redundant, is more difficult. The bad debt owed by the customer is written off, alongside some stock which cannot be sold elsewhere or must be discounted.

PROFIT AND LOSS ACCOUNT	
Sales	-15%
Cost of Sales	-15%
Overheads	-5%
Dividends %	PY%
BALANCE SHEET	
Fixed Assets (less Intangibles)	0%
Stock Written Off	10%
Debtors Written Off	30%
Long-term Debt Called in	0%

COVENANT BREACH

Debt covenants are restrictions that are imposed on a company by its lenders; for instance, that the company must achieve a certain level of profitability, does not take on additional debt, and restricts the dividends paid out to shareholders. If these covenants are breached, a lender may seek to renegotiate the terms of the debt agreement or demand a full immediate repayment of the loan.

This scenario mirrors the simple forecast in assuming that the profit and loss account remains the same as in the previous accounting period, but assumes a large portion of the company's long-term debt is called in by the lenders. Repayment of the debt is met through reducing cash, or taking on short-term debt in the event that cash would be negative. In this scenario, companies with a large degree of debt financing are likely to experience a large reduction in their forecasted H-Score®.

PROFIT AND LOSS ACCOUNT

Sales	0%
Cost of Sales	0%
Overheads	0%
Dividends %	PY%

BALANCE SHEET

Fixed Assets (less Intangibles)	0%
Stock Written Off	0%
Debtors Written Off	0%
Long-term Debt Called in	80%

PY= Prior Year

PENT-UP DEMAND

Some sectors, e.g. international travel or nightclubs, were almost entirely shut down by severe pandemic restrictions. Now that the restrictions are lifted, companies in these sectors may be experiencing a surge in demand for their products. While demand may be dampened somewhat by consumer concerns around the rising cost of living, some purchases, e.g. international holidays, may have been budgeted for far in advance.

In this scenario, although costs have increased due to increased commodity prices and labour shortages, demand is such that these costs can be passed on to consumers and the gross margin is maintained. Fixed costs, which the company could not fully reduce while restrictions were in place, do not increase as much, and the EBITDA* margin recovers towards pre-pandemic levels.

PROFIT AND LOSS ACCOUNT

Sales	+75%
Cost of Sales	+75%
Overheads	+50%
Dividends %	PY%

BALANCE SHEET

Fixed Assets (less Intangibles)	0%
Stock Written Off	0%
Debtors Written Off	0%
Long-term Debt Called in	0%

REVENUE GROWTH

Sectors where trading was less restricted during the pandemic, or where companies were able to adapt their business models during the second wave, e.g. takeaway food, may still experience an uptick in demand as workers return to city centres and health concerns of consumers diminish. Although costs are increasing due to inflation, for now demand is such that price increases can be passed on to consumers.

In this scenario, revenue sees a double-digit percentage increase while maintaining the gross margin. Overheads will likely not rise as quickly due to economies of scale, leading to an improvement in the EBITDA* margin.

**EBITDA excludes write off and revaluation items.*

PROFIT AND LOSS ACCOUNT

Sales	+15%
Cost of Sales	+15%
Overheads	+10%
Dividends %	PY%

BALANCE SHEET

Fixed Assets (less Intangibles)	0%
Stock Written Off	0%
Debtors Written Off	0%
Long-term Debt Called in	0%

PY= Prior Year

UPWARD ASSET REVALUATION

Uncertainty at the start of the pandemic led to a revaluation of certain fixed assets, e.g. commercial property was devalued heavily due to restrictions on in-store retail and working from home. With the lifting of restrictions and the return to the office, asset valuations have returned towards pre-pandemic levels and there is renewed demand for leasing, especially for prime offices.

In this scenario, the carrying value of the fixed assets, excluding intangibles, has increased as, e.g. the commercial real estate market recovers. The user may wish to tailor the scenario further to account for increases in rental revenue post-pandemic, and/or a squeeze in margins due to increased costs of construction and maintenance work.

PROFIT AND LOSS ACCOUNT

Sales	0%
Cost of Sales	0%
Overheads	0%
Dividends %	PY%

BALANCE SHEET

Fixed Assets (less Intangibles)	+10%
Stock Written Off	0%
Debtors Written Off	0%
Long-term Debt Called in	0%

METHODOLOGY

FORECAST PERIOD

The starting point for the forecast is the latest set of accounts filed at Companies House or, where appropriate, the latest interim or preliminary accounts filed at the London Stock Exchange. The period covered by these accounts is termed the reference period.

The period covered by the forecast is termed the forecast period, and depends on the reference period end date:

- Where the reference period end date is before 31 December 2021, the latest accounts are taken as representative of the year ending 31 December 2021. The forecast period is the entire year 2022.
- Where the reference period end date is between 1 January 2022 and 30 September 2022, a reduced forecast period is used, starting on the day following the reference period end and ending on 31 December 2022.
- Where the end of the reference period is after 30 September 2022, **Forecast View™** is not available.

PROFIT AND LOSS ACCOUNT

In general, individual items from the reference period profit and loss account are rolled forward on a pro-rata basis to obtain the forecast period profit and loss account. Adjustments are made to some of the values based on the positions of the forecast sliders, as described in this section. The items are then combined to calculate subtotals and the Retained profit, which is allocated to the balance sheet as described in the next section.

SALES AND COST OF SALES

The pro-rated values of these items are adjusted directly using the percentage changes set using the corresponding sliders.

OTHER OPERATING INCOME/COSTS

This item is usually a cost composed of many different charges. The depreciation and amortisation charges are removed to obtain the portion of this item due to overheads, and only this portion is adjusted using the percentage change set using the Overheads slider. Note that this portion is also displayed as Overheads in the Forecasted Financials. This treatment assumes that there were no other non-overhead items included in this item in the reference period.

Finally, charges due to the revaluation gain/loss, stock written off, and debtors written off are added to this item. These charges are determined by applying the percentages set by the appropriate sliders to the reference period balance sheet values, as described in the next section.

EXCEPTIONAL ITEMS AND TAX

Exceptional items are gains or losses that are unlikely to be repeated, and so even where there are exceptional items in the reference period, the value is set to zero inthe forecast period. While the tax charge could, in principle, be calculated from the Profit before tax and the headline rate of corporation tax, this can be complicated by differences in tax accounts and those filed at Companies House. The tax charge is simply rolled forward on a pro-rata basis.

DIVIDENDS

Dividends are calculated from the forecast Profit after tax using the percentage set by the Dividends % slider. The default position of the slider is calculated from the reference period data, bounded to be between 0 and 100%. If Profit after tax is negative, i.e. a loss, the forecast dividend is always zero.

BALANCE SHEET

FIXED ASSETS

The baseline assumption of the forecast is that the carrying value of the fixed assets is maintained during the forecast period, i.e. that routine depreciation and amortisation are offset by fixed asset additions paid for with cash. The carrying value of the fixed assets, excluding intangibles, is adjusted according to the value of the Fixed Asset Revaluation slider, and this gain/loss does not affect cash.

STOCK AND DEBTORS

Stock is determined by reducing the reference period value by the percentage set by the Stock Written off slider. Trade debtors and Other debtors are determined by reducing the reference period values by the percentage set by the Bad Debt Written off slider. Group balances remain unchanged.

CASH AND DEBT

Long-term debt is calculated by reducing the reference period value by the percentage set using the Long-term Debt Called In slider. This affects only the balance sheet, with the debt repaid in cash (if available) or by taking out short-term debt.

To forecast cash, the forecast Retained profit is first added to the reference period value, excluding those items allocated elsewhere on the balance sheet, i.e. fixed asset revaluations, stock written-off, and debtors written-off. The value of the long-term debt repaid is then subtracted to give the forecasted cash value. If the forecasted cash value would be less than zero, the cash value is set to zero and the negative balance is used to increase short-term debt.

EQUITY

The forecasted Shareholders' funds are calculated by adding Retained profit to the reference period value. No change is made to the minority interest.

OTHER ITEMS

Aside from the adjustments outlined above, the balance sheet items remain the same as those for the reference period.

EXCLUDED COMPANIES

Forecast View™ will not be available for companies where the latest filed set of accounts:

- are micro-entity accounts, or
- do not contain a full profit and loss account, or
- could not be used to calculate an H-Score®.

Forecast View™ will also not be available for dormant companies.

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