

Financial Modelling for Exports

A Best Practice financial model is robust and dynamic and offers greater clarity and control over tough decisions regarding potential export markets and their impact on your business.

Spreadsheets are a way of life in business and in many cases the primary basis for all significant future decisions. Each day business owners face a myriad of questions, such as:

- ▶ What are the costs and benefits of expanding into a new country or geographic region?
- ▶ What impacts will a devaluation/appreciation in the exchange rate have on my SAUD cash flow?
- ▶ What will be the impact on working capital (and cash) if I need to stockpile products due to transport

risk or debtor/creditor terms changing?

- ▶ What is my exposure to items such as demand risk, commodity price risk, interest rate risk, inflation (or hyper-inflation) risk, political/sovereign risk and currency risk?

In the current economic climate, it is essential that businesses incorporate a robust and dynamic Best Practice model into their arsenal of analysis tools. This will in turn enhance your decision making capabilities.

THE PROBLEM

Accounting systems found in most businesses are generally focused on

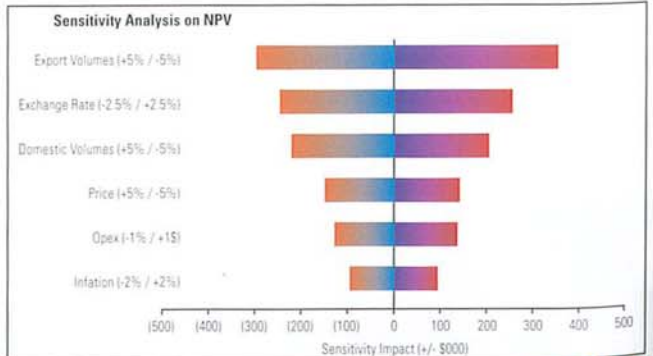
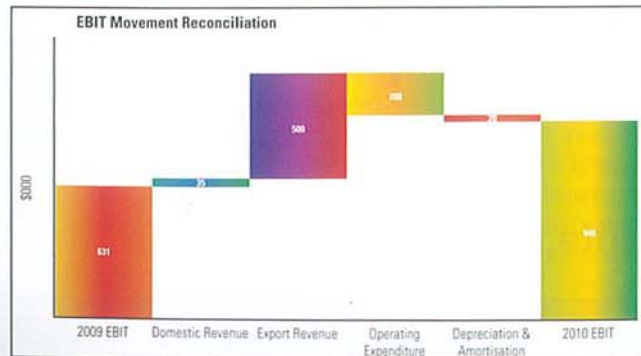
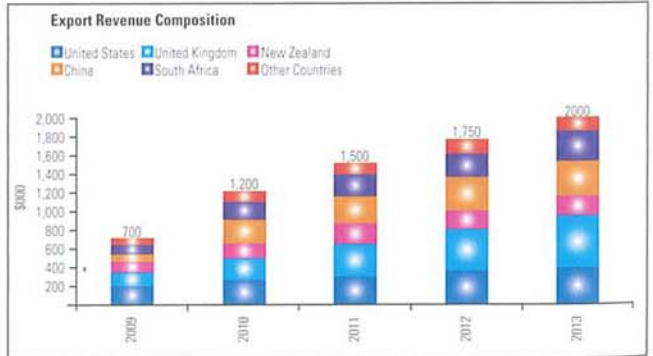
historical performance and as such, are unable to answer the aforementioned forward looking questions. Although businesses can purchase off-the-shelf forecasting packages, they are generally not tailored to your business, are inflexible and time consuming in terms of undertaking analysis.

In order to generate meaningful and relevant outputs, forecasting products require the programmer to develop operational logic in line with the decision-making process of the business in question, hence construction of any meaningful forecasts requires software with a large degree of flexibility. To this

Company ABC Example Dashboard

Income Statement (\$000s)					
Profit and Loss Statement	2009	2010	2011	2012	2013
Domestic Revenue	1,500	1,525	1,571	1,607	1,643
Export Revenue	700	1,200	1,500	1,750	2,000
Total Revenue	2,200	2,725	3,071	3,357	3,643
Operating Expenditure	(1,300)	(1,500)	(1,650)	(1,750)	(1,900)
EBITDA	900	1,225	1,421	1,607	1,743
Depreciation and Amortisation	(259)	(258)	(310)	(331)	(358)
EBIT	631	966	1,111	1,276	1,387

Ratios	
Total Revenue Growth	24.3% / 12.3% / 9.3% / 8.5%
Total Domestic Revenue Growth	2.3% / 2.3% / 2.3% / 2.3%
Total Export Revenue Growth	71.4% / 25.0% / 16.7% / 14.2%
Total Opex Growth	15.4% / 10.0% / 6.1% / 6.6%
EBITDA Growth	37.2% / 15.0% / 13.1% / 6.6%
EBITDA Margin	43.9% / 45.2% / 46.2% / 47.9%



extent, spreadsheet models are ideal.

It is widely known however, that spreadsheets are far from foolproof and that errors frequently occur. In fact, over the years a number of embarrassing spreadsheet development oversights have been discovered in large corporations with far-reaching consequences. What's more, surveys of spreadsheet developers consistently show that spreadsheet creation is informal, and that few organisations have comprehensive spreadsheet development policies or systems in place.

THE SOLUTION – SPREADSHEET MODELLING STANDARDS

In the past decade, a set of Best Practice Spreadsheet Modelling Standards have been created to promote the development of Best Practice spreadsheet models. Best Practice spreadsheet models are consistent, robust, flexible and transparent in turn improving levels of clarity and control whilst reducing the likelihood of errors.

Adopting principles-based financial modelling standards creates a central point of reference for the construction of any financial model. Any model builder who follows such standards should be able to produce a financial model that has the following characteristics (amongst others):

- ▶ The formatting of the model is consistent;
- ▶ The model is documented and includes a user guide and diagrams illustrating the model's logic flows and interdependencies;
- ▶ The model's formulae are consistently applied and robust;
- ▶ Users can identify assumptions (entry points) and can intuitively manipulate assumptions to evaluate outputs; and
- ▶ The model's outputs are dynamic, automatically updating with changes in assumptions.

The Best Practice Spreadsheet Modelling Standards ("Standards") were developed by BPM Financial Modelling.

BPM is also the founding member of the Spreadsheet Standards Review Board, a body established to maintain and develop the Standards. The Standards can be downloaded for free from www.ssrp.org.

The benefits of adopting the Standards are:

- ▶ Improved quality and transparency.
- ▶ Decrease development time and cost.
- ▶ Minimisation of error risk.
- ▶ Facilitation of efficient sharing of model development methodologies.
- ▶ Prevention of model redundancy.
- ▶ Alignment of the needs of model developers and model users.

A financial model that is robust, systematic and flexible allows a business to quickly make important decisions, whilst understanding the impacts on financial statements, including profits and cash flows, of key risk factors.

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FINANCIAL MODELLING FOR EXPORTS: A CASE STUDY

In September 2006, an Australian-based company "XYZ Ltd" decided to begin exporting Product Alpha to the United States, after undertaking research into Alpha's potential in overseas markets. In order to fund this new export market, XYZ borrowed AUD 750,000 for three years at 8% p.a. to expand capacity and produce additional stock. At the time of making the decision, the exchange rate was USD 0.75/AUD, expected sales were USD 750,000 p.a. and expected cost of goods sold were AUD 500,000 p.a. (including transport costs). With a standard principal and interest loan, net cash flow was forecast to be AUD 208,975 per annum for the first three years.

However, by February 2008 the Australian Dollar had appreciated against the US Dollar and was trading at USD 0.94/AUD. This caused the net cash flow to decrease to AUD 6,847, only barely covering the required payments on XYZ's additional borrowings. Changes in other assumptions, such as fuel/transport costs, may have further eroded the positive cash flow.

A dynamic financial model would have allowed XYZ to analyse the potential impacts of movements in the exchange rate on the profitability of the new export market and helped XYZ to make decisions around risk appetite and potential risk mitigation strategies, such as foreign exchange futures or forward contracts.

