

Breakout Session

**A Financial Framework
to Meet the Changing Economic Environment**



2023 CLUBS NSW CONFERENCE & AGM

Financial Frameworks

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PKF Digital







What is happening
right now?

What happened?



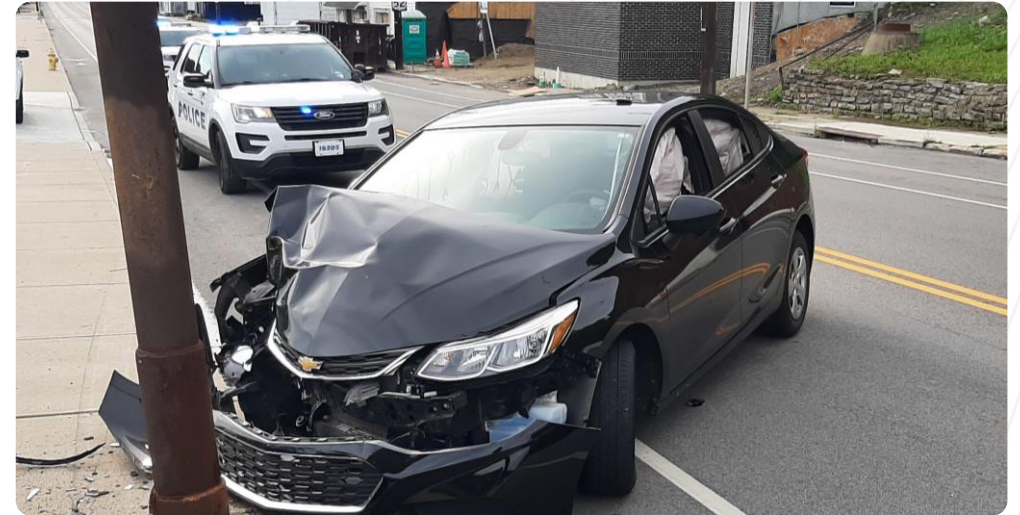
What is coming?



Where am I going?



Planning for the unexpected





And the future

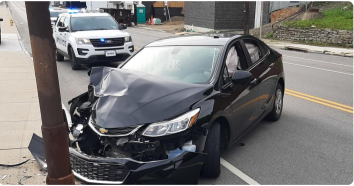
Key components of your Financial Framework



Economic environment
Future view



Data from your systems
P&L, Balance Sheet, Cash Flow



Identifying risks
Mitigation of risks



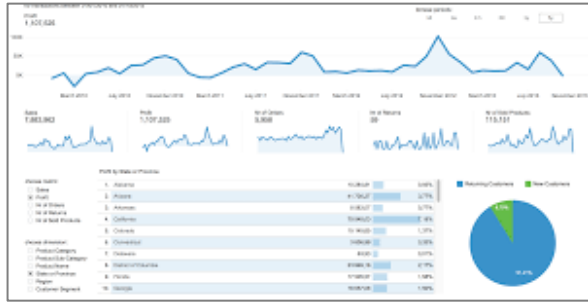
Representation of data
Adjusting immediate direction



Emerging Technology
The role of AI



Planning
Foreseeing & changing plans



Your Ideal Dashboard



Planning your Journey

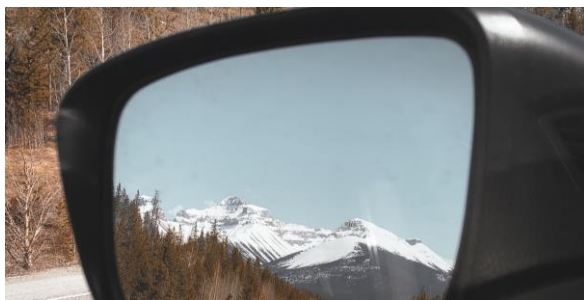


Economic Environment



Emerging Technology

Key Performance Indicators (KPIs)

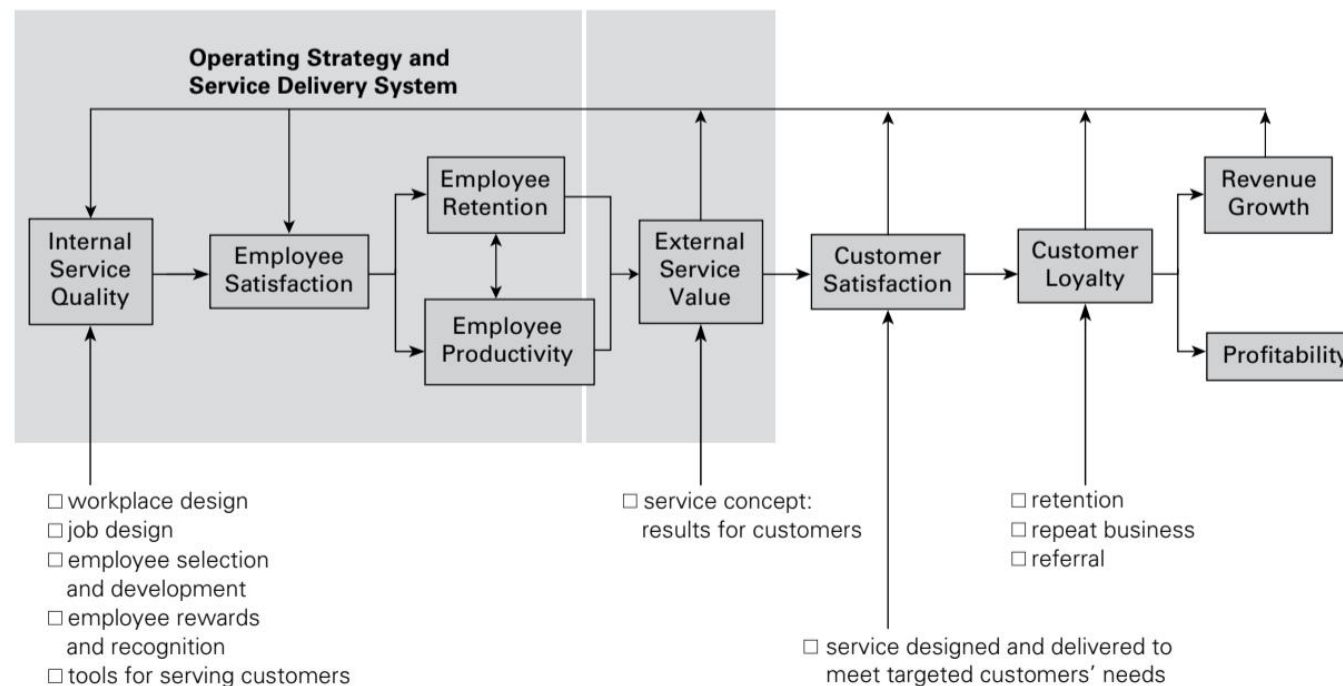


Trailing



Leading

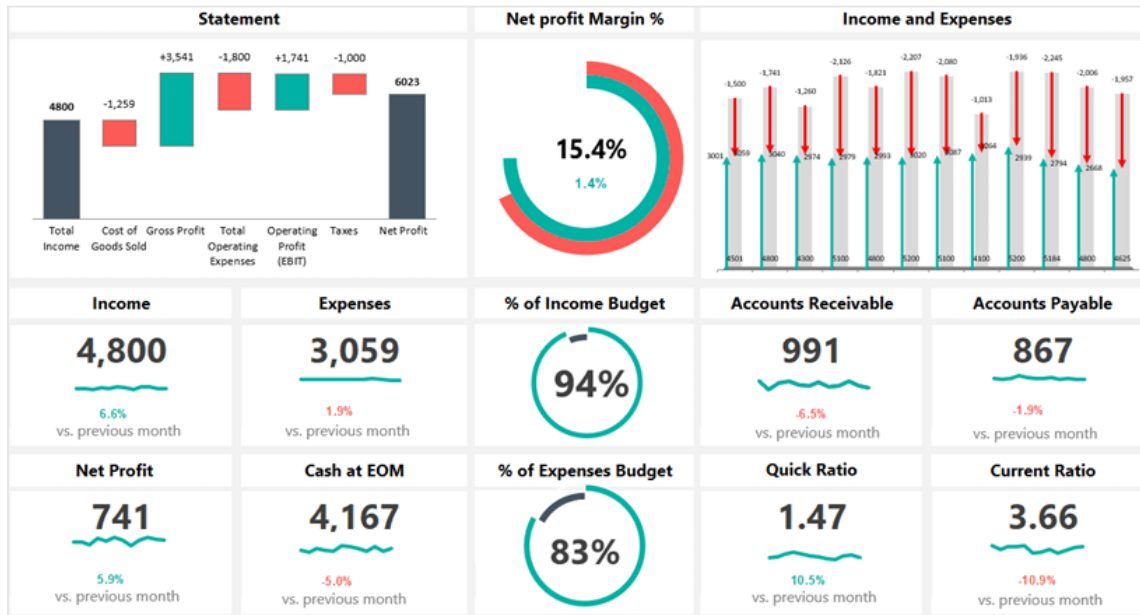
Service Profit Chain



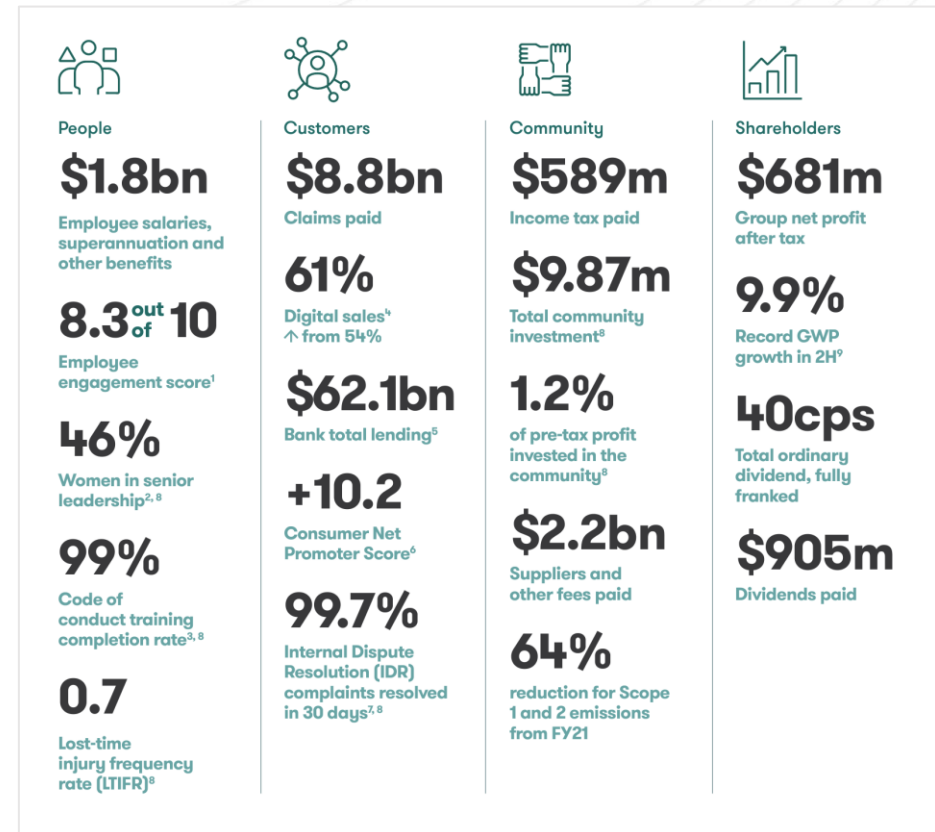


Your ideal dashboard

Trailing



Leading & Trailing





Leading KPIs are the drivers of the business

Create a plan based on these drivers

Be able to take opportunities when they occur

Be able to quickly see different scenarios

Planning your journey

1. Baseline Scenario Modelling
2. One-off Event Scenario Planning
3. Strategic Scenario Modelling
4. Planning a Change in Operations



PESTLE analysis is an important tool that executives can rely on to organize factors within the general environment and to identify how these factors influence industries and the firms within them.

PESTEL reflects the names of the six segments of the general environment: (1) political, (2) economic, (3) social, (4) technological, (5) legal, and (6) environmental.

Cyber Security

ISO 27001 Audit requirement

Information security management practices

What would the effect be on your financial framework?



▶ ASIC's Longo lays out new obligations for businesses ▶ Hacked companies face difficult balancing act on sharing information

Ignorance no excuse for boards in tougher cyber threat regime

Nick Bonyhady

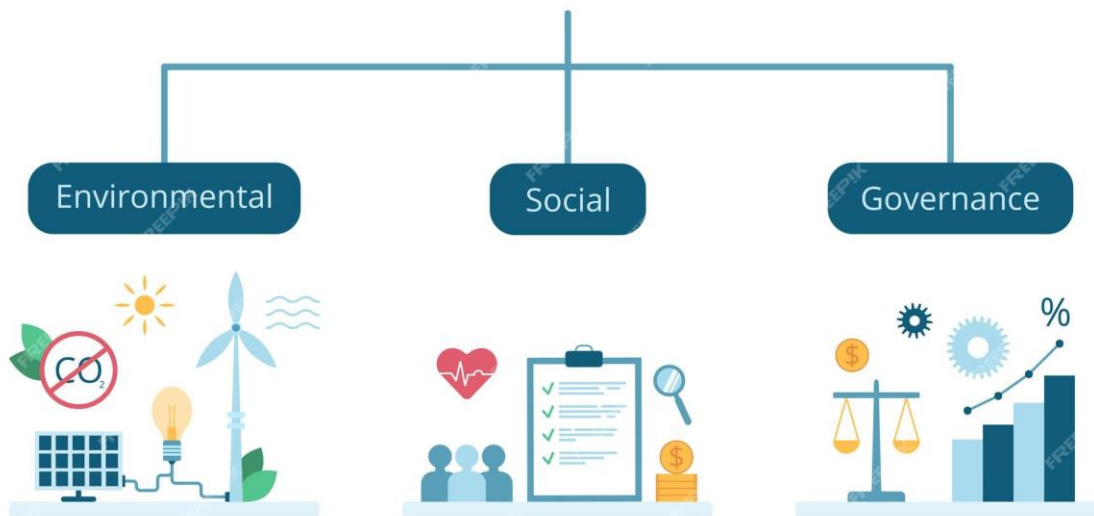
Company directors will not be able to plead ignorance to cyber threats, with government and regulators spelling out tougher minimum standards for protecting sensitive information and the need to stress test safeguards against real-world threats.

ASIC chairman Joe Longo and the federal government's cybersecurity strategy review chairman Andy Penn outlined the ramped up obligations on business leaders at The Australian Financial Review Cyber Summit in Sydney yesterday.



Boards should know what data they hold, have an inventory of their IT systems and a plan to upgrade their systems, he told the Summit. And they should have a response plan to manage the fallout of a breach and repair their systems if they are hacked.

ESG





WHAT IS ARTIFICIAL INTELLIGENCE?

Machine Learning

Using sample data to train computer programs to recognize patterns based on algorithms.



Neural Networks

Computer systems designed to imitate the neurons in a brain.



Natural Language Processing

The ability to understand speech, as well as understand and analyze documents.



Robotics

Machines that can assist people without actual human involvement.





Natural Language Processing

SCENARIO:

- A product line is about to disappear
- This product is a significant revenue (35%)
- The latest financial year is a loss
- We feel like the business is failing
- But there is a new product we can start but will it produce enough growth soon enough?
- What are the options?
- How can we survive?

Fed into the AI Model:

- Last 3 years of financial data (FY21, FY22, FY23)

Balance sheet

Profit & Loss

Emerging Technology



can you summarise the full profit and loss and balance sheet provided



Absolutely. Here's a summarized version of both the Profit & Loss and the Balance Sheet data provided in a markdown format:



Profit & Loss Summary

Description	FY21	FY22	FY23
Total Revenues	\$5,013k	\$5,528k	\$6,367k
Total Costs	-\$2,650k	-\$2,789k	-\$3,041k
Gross Margin	\$2,363k	\$2,739k	\$3,326k
Total Expenses	-\$1,987k	-\$2,400k	-\$3,600k
Operating Profit	\$376k	\$339k	-\$274k

Balance Sheet Summary

Description	FY21	FY22	FY23
Total Current Assets	\$780k	\$750k	\$847k
Total Non-Current Assets	\$803k	\$686k	\$492k
Total Assets	\$1,583k	\$1,436k	\$1,339k
Total Current Liabilities	\$113k	\$154k	\$288k
Total Non-Current Liabilities	\$232k	\$191k	\$188k
Total Liabilities	\$345k	\$345k	\$476k
Equity (Retained Earnings)	\$1,238k	\$1,091k	\$863k

This provides a condensed view of the Profit & Loss and Balance Sheet for the three financial years you provided



can you provide a detailed P&L for FY21-FY23



Certainly! Here's a detailed Profit & Loss (P&L) statement for FY21 to FY23 in markdown format based on the information you've provided earlier:



Detailed Profit & Loss Statement

Description	FY21	FY22	FY23
Revenues			
Product A	\$1,200k	\$1,500k	\$2,200k
Product B	\$1,750k	\$1,850k	\$1,980k
Product C	\$200k	\$230k	\$950k
Product D	\$1,200k	\$1,000k	\$850k
Service X	\$76k	\$198k	\$255k
Service Y	\$500k	\$652k	\$110k
Service Z	\$87k	\$98k	\$22k
Total Revenues	\$5,013k	\$5,528k	\$6,367k
Costs			
Salaries	-\$2,000k	-\$2,099k	-\$2,321k
Other cost of sales	-\$650k	-\$690k	-\$720k
Total Cost of Sales	-\$2,650k	-\$2,789k	-\$3,041k
Gross Margin	\$2,363k	\$2,739k	\$3,326k
Expenses			
Fixed Costs	-\$1,200k	-\$1,250k	-\$1,850k
Marketing	-\$220k	-\$250k	-\$550k
Other expenses	-\$567k	-\$900k	-\$1,200k
Total Expenses	-\$1,987k	-\$2,400k	-\$3,600k
Operating Profit	\$376k	\$339k	-\$274k

This table offers a detailed breakdown of revenues, costs, and expenses resulting in the operating profit for FY21, FY22, and FY23.

Equity Injection?

what was the scenario i asked you to model

You asked to model a scenario in which:

1. **Product A** is withdrawn from sales starting in **FY24**.
2. A new product, **Product L**, is introduced in **FY24** with:
 - Initial revenue of **\$1,000,000** in FY24.
 - An annual increase of **10%** in its revenue for subsequent years.

You then sought projections on revenues, operating profits, net assets, and the equity injections needed to keep the company solvent and/or to maintain its FY23 equity level across FY24, FY25, and FY26.

Equity Summary (FY24 - FY26)

Metrics	FY24	FY25	FY26
Starting Equity	\$863k	\$389k	\$-216.4k
Operating Profit	\$-474k	\$-605.4k	\$-759.94k
End of Year Equity	\$389k	\$-216.4k	\$-976.34k

From the above table, it's evident that without any equity injection or significant positive change in revenue or cost structure, the company will be insolvent by the end of FY25 and the situation will worsen by FY26.

Debt raising?



how much debt would this business be able to raise

From the provided data for FY23:

- **Equity:** \$863k
- **Total Liabilities:** \$476k

Typically, a healthy debt-to-equity ratio for many industries ranges from 1:1 to 2:1. Given this range, and the current equity of \$863k and liabilities of \$476k, there's potential room to increase debt. However, the exact amount will depend on the factors mentioned above, especially the company's ability to service the debt.



given the debt to equity ration of 1:1.2 is exact for this business in this industry



Alright, if the optimal debt-to-equity ratio for this business in its specific industry is 1:1.2, we can determine the maximum debt level the company can sustain.

So, based on the desired debt-to-equity ratio of 1:1.2, the business could theoretically raise an additional \$243.17k in debt. However, the actual ability to raise this debt will also depend on factors like the company's current financial health, creditworthiness, and the prevailing economic conditions.



will this amount of debt make a difference to the business surviving



To determine whether an additional debt of \$243.17k will significantly impact the business's chances of survival, we need to factor this into the financial projections we previously discussed for FY24, FY25, and FY26.

Let's reevaluate the net assets (equity) position considering this new debt:

- FY24:**
 - Starting Equity: \$863k (from FY23)
 - Debt Injection: +\$243.17k
 - Operating Loss: -\$1,706.1k (as previously projected)
 - End of FY24 Equity: $\$863k + \$243.17k - \$1,706.1k = \$400.07k$
- FY25:**
 - Starting Equity: \$400.07k (from FY24)
 - Operating Loss: -\$606.1k
 - End of FY25 Equity: $\$400.07k - \$606.1k = -\$206.03k$
- FY26:**
 - Starting Equity: -\$206.03k (from FY25)
 - Operating Profit: +\$603.9k
 - End of FY26 Equity: $-\$206.03k + \$603.9k = \$397.87k$

With the additional debt of \$243.17k:

- The business still becomes insolvent by the end of FY25, but the insolvency position is less severe than before.
- By FY26, thanks to the operating profit, the business comes back to a positive equity position.

Conclusion:

The additional debt of \$243.17k provides a cushion and delays the point of insolvency to the end of FY25. The company then returns to solvency by the end of FY26 due to the projected positive operating profit. While the additional debt helps, it's still essential for the company to continue its efforts in optimizing operations, cutting unnecessary costs, and driving revenues to ensure long-term sustainability. The business still operates on thin margins, so continuous monitoring and strategic decisions are crucial.



lets raise debt of \$243.17K and add it to the balance sheet at the end of FY24.



Alright. By raising a debt of \$243.17k at the end of FY24, we will increase the company's liabilities but also increase its available cash, which affects the equity.



The adjusted equity at the end of FY24 will be:

End of Year Equity = Starting Equity + Operating Profit + Debt Raised

Using this, let's create the adjusted equity summary for FY24 through FY26:

Adjusted Equity Summary (FY24 - FY26) with Debt Injection

Metrics	FY24	FY25	FY26
Starting Equity	\$863k	\$632.17k	\$26.77k
Operating Profit	-\$474k	-\$605.4k	-\$759.94k
Debt Raised (end of FY24)	\$243.17k	\$0	\$0
End of Year Equity	\$632.17k	\$26.77k	-\$733.17k

With the debt injection of \$243.17k at the end of FY24, the equity position improves, postponing insolvency. However, by the end of FY26, the company is still in a negative equity position, indicating challenges with solvency unless other changes are made.



if we can get product L to increase year on year by 50% what difference will this make



Alright. Let's consider the scenario where Product L increases year on year by 50% starting from its FY24 revenue.



Product L's Revenue:

- FY24: \$1,000k (as given)
- FY25: \$1,500k (50% increase from FY24)
- FY26: \$2,250k (50% increase from FY25)

With this new revenue projection for Product L, let's adjust the P&L and then examine the equity position.

Adjusted Summary P&L (FY24 - FY26)

Metrics	FY24	FY25	FY26
Revenues	\$5,167k	\$5,667k	\$6,417k
Total Expenses	\$(5,641k)	\$(5,873.1k)	\$(6,128.41k)
Operating Profit	-\$-474k	-\$-206.1k	\$288.59k

Now, let's adjust the equity summary:

Adjusted Equity Summary (FY24 - FY26) with Debt Injection and 50% Growth in Product L

Metrics	FY24	FY25	FY26
Starting Equity	\$863k	\$632.17k	\$426.06k
Operating Profit	-\$-474k	-\$-206.1k	\$288.59k
Debt Raised (end of FY24)	\$243.17k	\$0	\$0
End of Year Equity	\$632.17k	\$426.06k	\$714.65k

With a 50% YoY growth in Product L's revenues, the company's financial health improves notably by FY26. The company moves from a declining equity position to an increased equity by the end of FY26, suggesting a positive trajectory for solvency and potentially long-term sustainability.

The solution is

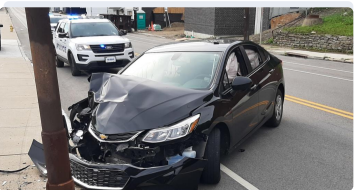
- Raise debt of \$245K
- Increase sales in FY25 of Product L by 50% or more

Conclusions

Financial Framework – next steps



Do you have leading indicators that provide warning signs?



Have you Identified risks in the future economic environment through PESTLE analysis?



What level of planning complexity do you need?



Can your existing accounting systems be more effective?



Should you use dashboards to show overall performance?



Monitor and look for where new technology can provide productivity improvements

Thank you

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