Developing an Operational Cash Forecast

Presenters:
Mike Leo – Health Care Service Corporation
John Covey – PricewaterhouseCoopers
Agenda

- Health Care Service Corporation
- Cash Forecasting Drivers and Benefits
- Cash Forecast Development
- HCSC’s Cash Forecasting Process
- Lessons Learned
Health Care Service Corporation (HCSC)

The nation’s fourth largest health insurance company

• The nation’s largest mutual health insurer
• Serving approximately 13.5 million members in five states
• HCSC provides insurance through Blue Cross and Blue Shield of Illinois, New Mexico, Oklahoma, Texas and Montana
Health Care Service Corporation

Financial strength is a cornerstone of HCSC’s business

• HCSC stands by its members with strong financial ratings
  – A+ from A.M. Best Company
  – AA- from S&P
  – A1 from Moody’s

• Historically a “net investor”

• Cash balance targets are prudently developed to cover all known outflows
HCSC’s Drivers for Cash Forecasting

HCSC had a number of drivers for implementing a formal cash forecasting program:

• A formal program will allow HCSC to better manage working capital
• Provide visibility for a new liquidity structure
• Materially increase investment performance through longer term investment vehicles
Benefits of Cash Forecasting

Companies that have a robust cash forecast process realize value in many ways

- Supports cash culture with accountability for results
- “Early warning” for liquidity problems/opportunities
- Optimize short-term investing / borrowing decisions
- Analysis of actual vs. expected cash flows
- Increase insight into the company’s cash drivers
- Increase confidence in external reporting
Key Success Factors

- Methodology
- Information Availability
- Culture
- Systems
- Training
- Clear Objectives
- Harmonized Forecasts
- Accurate Information

Effective Cash Forecasting

Key Stakeholder Identification
Cash Forecasting Development Approach

An organized approach to information discovery and program development increases chances of success

Assess

Design

Construct

Implement

Operate & Review
The Assess phase confirmed HCSC’s business needs and analyzed the cash flows and availability of information.

**Work Performed**

- Articulate cash forecasting objectives
- Assess current state cash forecasting activities
- Identify cash flows and drivers
- Identify cash flow line items
  - Analyze bank BAI cash flow data
- Assess magnitude and volatility of cash flows
  - Identify key cash flows for trending
  - Perform trending analysis
- Document key requirements for forecast design
- Assess technology options
The Design phase outlined the processes and data flows, while Construct included system configuration and a pilot run.

**Work Performed**

- Define input data requirements
- Design and develop cash forecasting processes
- Design management reports
- Develop schedule for cash forecast meetings
- Work with functional departments to prepare for data submissions
- Establish basic cash forecast functionality within the treasury management system
- Execute a pilot run of the cash forecasting program
The Implement phase consisted of full roll out, while the Operate and Review phase achieved go live.

**Work Performed**

- Refine cash forecast processes
- Roll out full implementation within TMS
- Build an analysis tool in Excel to augment TMS capabilities
- Build management reports and dashboards
- Develop cash forecasting policy
- Document desk procedures
- Schedule cash forecast meetings
- Train Treasury Operations team
- Go live
- Assess new process/tools and adjust as necessary
HCSC’s Cash Forecasting Process

HCSC leverages historical and predictive data, tempered with human judgment

- Leverage historical cash flow data
- Capture current functional department inputs
- Applies refinements via on-going management review and approval

1. Upload Historical
2. Review Trends & Weightings
3. Assess & Apply Other Information
4. Review Draft Forecast Results
5. Upload Model & Produce Reports
6. Ongoing Review of Actual vs. Forecast

Day 1
Day 2

Not Acceptable
Acceptable
Lessons Learned

• Assessment Phase is critical
  – Articulate objectives within Treasury and beyond
  – Identify and categorize cash flows
  – Evaluate technology solution

• Cash forecasting is much more than technology
  – Good information from the business is key
  – Robust process needed to ensure consistency
  – Systems/tools do not replace human judgment

• Establishing a forecast is just the beginning
  – Use outputs to support business decisions
  – Continuously improve the process
Presenters

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# Key Design Factors

<table>
<thead>
<tr>
<th>Factors</th>
<th>Description (examples)</th>
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<tbody>
<tr>
<td>Objectives</td>
<td>• Provide visibility into short term cash and working capital needs</td>
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<tr>
<td></td>
<td>• Report to external stakeholders on available liquidity with confidence</td>
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<tr>
<td>Forecast method</td>
<td>• Receipts and disbursements method</td>
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<tr>
<td>Spread/scope of cash flows to be forecast</td>
<td>• Business Units/Legal Entities: Corporate, Subsidiary 1, Subsidiary 2</td>
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<td>• Regions/Countries: North America, EMEA</td>
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<td></td>
<td>• Cash Flow Types: All cash inflows and outflows, including operating, non-operating, financial, investment, and intercompany cash flows</td>
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<td>Time horizon and period intervals to be used</td>
<td>• Time Horizon: 13 weeks</td>
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<tr>
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<td>• Intervals: Daily; Weekly; Monthly</td>
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<tr>
<td>Variance Analysis</td>
<td>• Forecast vs. Actual and Forecast vs. Forecast to be performed daily</td>
</tr>
<tr>
<td></td>
<td>• Variance analysis interval – daily, weekly, monthly</td>
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<tr>
<td></td>
<td>• Threshold amount requiring analysis based on line item</td>
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<tr>
<td>Primary areas requiring trending / analysis</td>
<td>• Revenues</td>
</tr>
<tr>
<td></td>
<td>• Accounts Payable</td>
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<tr>
<td></td>
<td>• Intercompany Trade Receipts/Payments</td>
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<tr>
<td>Primary line items</td>
<td>• <em>Operating cash in- and outflows</em>: Receivables &amp; collections, Intercompany payables and receivables, Payroll</td>
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<td>• <em>Non-Operating cash in- and outflows</em>: Tax, CAPEX, Restructuring charges, Other (Pension, etc.)</td>
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<td>• <em>Financial in- and outflows</em>: Intercompany funding, Asset Sales, Debt (principal, interest, fees)</td>
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<tr>
<td></td>
<td>• <em>Investing in- and outflows</em>: Short and Long Term Investments</td>
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