

The Source

Your Resource for Modeling and Planning Expertise

ISSUE NO.6 | SECOND QUARTER 2011

Welcome.

As summer approaches, it seems the construction season is in full force here in Chicago with new buildings and skyscrapers emerging out of the concrete all around us. In fact, Blue Stone is expanding as well. While we are not building a looming skyscraper, I am pleased to announce the opening of our Toronto office. Led by Tassos Siatras, the new office is serving such clients as Barrick Gold Corporation, Four Seasons Hotel and Resorts and Saskatchewan Telecommunications. In addition to Toronto, Blue Stone is also serving the Silicon Valley area with a presence in San Francisco.

Of course with any opportunity such as opening a new office there is a certain amount of risk involved. In this edition of The Source, Jesper Johansen's article helps us understand how the Probabilistic Analysis capabilities of Crystal Ball can be used to manage uncertainty and deal with risk. As an addition to your HSF and Excel spreadsheets, Crystal Ball is a valuable tool for your financial modeling. This quarter we are working with Oracle to finalize our plans to co-host a webinar showcasing Crystal Ball's capabilities. Additionally, we are offering our well-received Crystal Ball training class in June. For more ad-hoc HSF training, Brad Malis has contributed an article on Advanced Tax Modeling, which is also a topic in our featured case study, Energy Future Holdings. Brad's article shows us how Advanced Tax Modeling skills are applicable beyond the Energy and Utilities industries.

In the upcoming months are looking forward to connecting with our colleagues in the healthcare and higher education fields at the Healthcare Finance Management Association (HFMA) annual conference in June and at our second visit to the National Association of College and University Business Officers (NACUBO) conference in July. After completing successful HSF implementations at Cincinnati State Technical and Community College and the University of Missouri, we were invited this spring to give a presentation with the University of Missouri on the benefits of HSF for improving planning and communication with the school at the Higher Education User Group conference in Denver.

BLUESTONE
INTERNATIONAL

EVENTS AND CONFERENCES

Jun 15 2011
Houston, TX - HSF User
Group

Jun 26 - Jun 29 2011
Orlando, FL - Healthcare
Financial Management
Association Conference

Jul 09 - Jul 12 2011
Tampa, FL - NACUBO
Annual Meeting

Jul 20 - Jul 21
Seattle, WA - OAUG
Connection Point

For information about
upcoming events
contact [Greg Szpalik](mailto:Greg.Szpalik@bluestoneinternational.com)
gspalik@bluestoneinternational.com

Finally, I'd like to share some feedback we recently heard on the value we provide our clients:

"The Blue Stone Team delivered according to a methodology that was exactly what they talked about during the sales process." Another client offered: "When you implement these types of systems, the consultants always say they are business or finance types, but you quickly find out they mainly just know the technology well – I felt like I was dealing with investment bankers with the Blue Stone Team. I did not have to explain finance concepts to them."

I believe those comments sum up the Blue Stone offering. Our work with our clients is a partnership. Our continued growth is a result of our focus on the building of relationships through trust and proven expertise.

Regards,
Jay Laabs
Managing Director, Blue Stone International

What's New at Strategic Finance Central?

The User Community's Resource for HSF's 11.1.2.2 Launch

- Register to be selected for Oracle's Beta Testing
- Exclusive - View Oracle Development's HSF Roadmap
- Sneak previews of SmartView Integration- Coming Soon

Sign up for your secure login and access to our updated blog, FAQ's, webinars and more.

www.strategicfinancecentral.com



Want to connect with colleagues, share a comment or ask a question?

Join the conversation at
www.strategicfinancecentral.com

Strategic Finance Central is the Online Hub of the HSF User Community

Advanced Tax Modeling in HSF

By Brad Malis, Director, Blue Stone International

In previous articles, we discussed how you can model taxes in HSF while focusing on current and deferred provision. In this article, we will expand our discussion of taxes to other areas including net operating loss (NOL), alternative minimum tax (AMT) and alternative minimum tax net operating loss (AMTNOL), and tax sharing agreements.

Background

When we introduced current and deferred provision, we covered the concepts of temporary and permanent differences. These are reasons why taxable income differs from book income. Companies pay cash taxes on taxable income. Starting with taxable income, we are assuming that you can model book-tax differences and calculate taxable income. Taxable income is not always positive. When it is negative, you have incurred an NOL. Tax law gives benefits for NOLs. In the US, losses generally can be carried back two years and forward 20.

Additionally, there are two different ways of calculating tax. We normally work with regular tax, for which the US statutory rate is 35%. The other way is AMT. AMT has its own rate, which is 20%. It also has its own adjustments from regular taxable income. Finally, it has its own version of NOL, called AMTNOL.

Because of NOLs and other considerations, companies can find themselves in regular tax some years and AMT other years. Let's look at cash taxes that considers both regular tax and AMT.

Regular Taxable Income, with NOL

This example illustrates the effects of NOL carryforwards. In it, the company has losses in previous years and is now profitable. Because of NOLs, it will not pay taxes immediately on becoming profitable.

	Account Names	2010	2011	2012	2013	2014	2015
335.00.045	Taxable Income Before State Tax Deduction	0.00	164,464.27	135,055.93	89,818.05	92,038.31	123,704.63
335.00.050	State Tax Deduction	0.00	6,578.57	5,402.24	3,592.72	3,681.53	4,948.19
335.00.055	Taxable Income Before NOL	0.00	171,042.84	140,458.17	93,410.77	95,719.85	128,652.82
335.00.060	NOL Balance	405,674.00	234,631.16	94,172.99	762.22	0.00	0.00
335.00.065	NOL Utilization	0.00	171,042.84	140,458.17	93,410.77	762.22	0.00
335.00.075	Taxable Income	0.00	0.00	0.00	0.00	94,957.63	128,652.82
335.00.080	Federal Income Tax (Regular)	0.00	0.00	0.00	0.00	33,235.17	45,028.49

The company has an NOL from prior years that is carried into 2011. It has taxable income for the next several years. Because of the NOL, it doesn't have to pay regular tax until 2014.

AMT, with AMTNOL

There are two separate concepts we want to illustrate here. The first is the calculation of AMT. It is effectively a parallel construct to regular tax. It has its own income base, adjustments, NOL, and tax rate.

	Account Names	2010	2011	2012	2013	2014	2015
335.00.055	Taxable Income Before NOL	0.00	171,042.84	140,458.17	93,410.77	95,719.85	128,652.82
335.00.085	AMT Adjustments	0.00	10,756.00	13,457.00	21,365.00	7,341.00	13,419.00
335.00.095	Tax Preference Items	0.00	0.00	0.00	0.00	0.00	0.00
335.00.110	AMTI before AMT NOL Deduction	0.00	181,798.84	153,915.17	114,775.77	103,060.85	142,071.82
335.00.115	AMT NOL Balance	175,980.00	12,361.05	0.00	0.00	0.00	0.00
335.00.120	AMT NOL (limited to 90% of AMTI)	0.00	163,618.95	12,361.05	0.00	0.00	0.00
335.00.135	AMTI	0.00	18,179.88	141,554.12	114,775.77	103,060.85	142,071.82
335.00.150	Tentative Minimum Tax	0.00	3,635.98	28,310.82	22,955.15	20,612.17	28,414.36

As with regular tax, the company had losses in prior years and is returning to profitability. Some items that are deductible for regular tax are not deductible for AMT, so we have to add them back. AMT has its own NOL calculation, but with AMT, you can only offset 90% of income. The AMT tax rate is 20%. In this case, the AMTNOL is used in 2012 but because AMTNOL can only offset 90% of income, there is tax in all periods.

There are additional concepts within AMT that can be modeled in HSF but are beyond the scope of this article.

Calculation of Federal Cash Taxes

As you can see, in some years, regular tax is higher than tentative minimum tax, and other years, tentative minimum tax is higher. Which tax actually gets paid? Effectively, it is the higher of the two, although companies get credit for AMT paid in previous years when they have to pay regular tax.

	Account Names	2010	2011	2012	2013	2014	2015
335.00.150	Tentative Minimum Tax	0.00	3,635.98	28,310.82	22,955.15	20,612.17	28,414.36
335.00.155	Regular Tax Liability	0.00	0.00	0.00	0.00	33,235.17	45,028.49
335.00.160	Excess of Tentative Minimum Tax Over Regular Tax	0.00	3,635.98	28,310.82	22,955.15	0.00	0.00
335.00.180	AMT Credit Balance	0.00	3,635.98	31,946.80	54,901.96	42,278.96	25,664.83
335.00.165	Minimum Tax Credit Utilization	0.00	0.00	0.00	0.00	-12,623.00	-16,614.12
335.00.170	Federal Taxes	0.00	3,635.98	28,310.82	22,955.15	20,612.17	28,414.36

To arrive at federal cash taxes, we compare AMT and regular tax. In the first three years, the company pays AMT because the NOL causes regular tax to be 0. In years four and five, regular tax is higher. However, due to the AMT credit, the company is effectively paying AMT in years four and five. In the next year or two, it is likely that the AMT credit would run out, and the company will be paying regular tax.

Tax Sharing

Companies generally calculate taxes at a consolidated level. They net NOLs against consolidated taxable income and apply a tax rate against taxable income net of NOL. There are, however, situations where companies make the same calculations at a single entity level. They do this because their ownership structure is such that they don't file a consolidated tax return. Or they have performance metrics that require them to calculate taxes for individual entities.

To manage this process, companies will often sign tax sharing agreements. In these cases, companies will track their tax attributes at both a single entity and consolidated level. If one company has to pay another company's taxes, they create intercompany loans. This generally occurs because only one entity pays the taxing authorities, and if that entity makes a payment on behalf of another entity, it is an intercompany loan.

Additionally, companies will manage their tax attributes (NOL) at a consolidated level and allocate them to the individual entities. In some cases, one of the entities will use up all of its attributes while the other entities have not. Part of the tax sharing agreement will mean that each entity will lose a proportionate share of its attributes.

The calculations in HSF are basically the same as described above. The difference is that when you need to pass data from one HSF entity to another, you use Assumptions Change Manager (ACM) to do so.

Why Model Taxes in HSF

Taxes are a significant expense for most companies. While companies typically have tax departments to calculate book-tax differences and other concepts, there is a significant benefit to modeling taxes in HSF. When you do scenario analysis, you will likely generate a new forecast for income. With these calculations in HSF, each scenario can generate its own result for cash taxes, giving you a more accurate and timely cash flow statement. Without these calculations in HSF, you will have to ask the tax department for a tax number each time you generate a new income forecast. This will cause delays in the process, making it harder to generate results on a timely basis. HSF provides opportunities for improved accuracy and efficiencies within the tax process.

Click for enhanced versions of the graphics or to learn more about using HSF for advanced tax modeling please contact Brad Malis at bmalis@bluestoneinternational.com.

Brad Malis joined Blue Stone International in 2006 and is a Director with the firm. He primarily focuses on technology issues and modeling best practices. Prior to working at Blue Stone, Brad was in charge of product management and product development for HSF at Hyperion. Brad also has extensive experience with Arthur Andersen building tax software and working in the tax practice.

Why Choose a Blue Stone Training Class?

"The HSF course provided great insight to our future user group and greatly enhanced the interaction we had in the design and build of our application."

**Paul Dague, Strategic Planning Consultant,
El Paso Corporation**

**Introduction to HSF - June 20th – June 22nd
Advanced HSF - June 23rd- June 24th
M & A Modeling in HSF - June 27th- June 28th
Crystal Ball for HSF - June 30th – July 1st**

**To reserve your seat or to request more information
email Greg Szpalik at gszpalik@bluestoneinternational.com**

When Do I Use Probabilistic Analysis For Financial Modeling?

By Jesper Johansen, Senior Associate, Blue Stone International

Risk is more than a strategic board game. For Finance professionals, dealing with risk is an important component of managing uncertainty. How do we quantify the risk in the financial metrics we track to run our businesses and make financial and operational decisions?

"It is better to be approximately right than precisely wrong" – Warren Buffet

The answer is probabilistic analysis. Probabilistic analysis is analyzing the ranges of outcomes as opposed to single-point-estimates. Moving beyond just the theoretical, you can take your financial models to the next level by incorporating probabilistic analysis using Oracle's Crystal Ball.

Crystal Ball is an Excel add-on that allows you to account for uncertainty in your model inputs by assigning a range of values as opposed to a hard coded value. Crystal Ball works both in conjunction with your HSF models and your Excel models.

The base case in your financial model might be the best estimate as to what the future will look like; but ultimately you know that the future is

See the Opportunities with Crystal Ball

Choosing Crystal Ball for your HSF models gives you access to better analytic tools, the ability to optimize processes and portfolios and also allows you to quantify planning risks and rewards. Each time you perform a simulation with Crystal Ball you can gain a richer understanding of the inherent risks. Mitigating risk and understanding uncertainty combined with the ability to frame financial decisions can give you a significant competitive advantage.

Register to learn more about Crystal Ball Capabilities at our Training Session: June 30th - July 1st.

Jesper Johansen joined Blue Stone International as a Senior Associate in 2010. His primary focus is on probabilistic analysis and Blue Stone's Crystal Ball practice.

With 13 years of experience as a consultant and analyst he has worked for J.P. Morgan Stanley, Sungard Data Systems, and Oracle. During his time at Oracle, he spent three years as a Senior Consultant involved with Crystal Ball pre-sales, consulting and training.

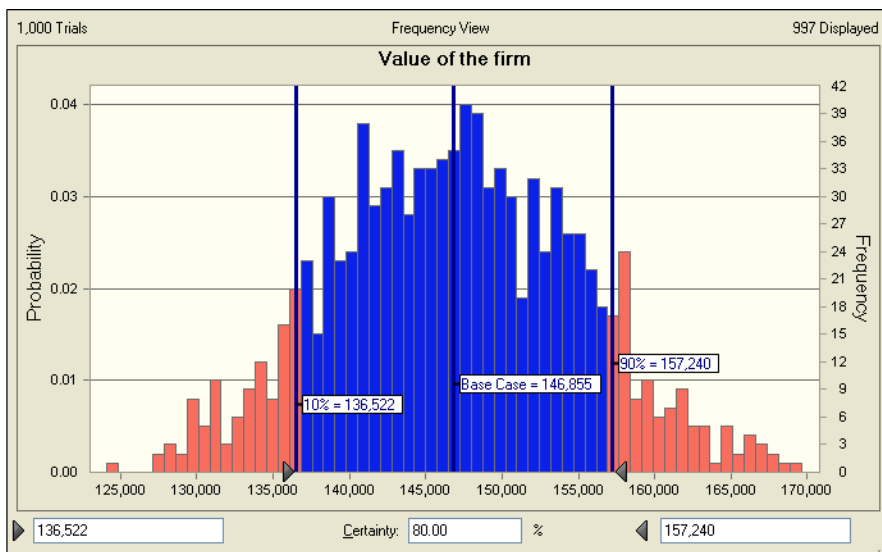
going to be different from your base case. But how different and what are the implications?

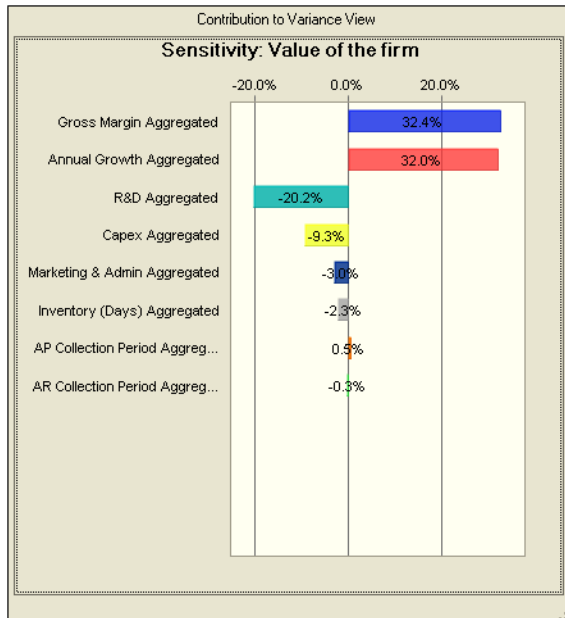
By assigning distributions or ranges around your model inputs, Crystal Ball will simulate your key performance indicators and give you a range of outcomes as opposed to a single-point-estimate. These ranges will quantify the aggregated impact of flexing multiple assumptions. This will allow you to quantify the risk in the outputs and assess the probability of falling below or exceeding certain thresholds.

By applying Crystal Ball to your existing Excel models there are several ways to benefit by the insight provided by the probabilistic analysis, for example:

M&A and Discounted Cash Flow models:

You can account for uncertainty in underlying model assumptions to quantify uncertainty in key performance metrics like NPV and IRR. By doing this you will gain more confidence in the valuation metrics and understand the ranges around the metrics and what is driving the uncertainty in the metrics (as illustrated on the charts.)





Commodity Pricing models and Sales Forecasting models:

When you perform time series analysis on historical data using Crystal Ball, you can create a forecast with trend and seasonality while accounting for uncertainty. Commodity pricing and sales forecasts are often key drivers in financial models and emphasis should be placed on creating these forecasts. Crystal Ball will help you take the guessing out of the forecasting process.

Valuation of Stock Based Compensation:

Valuation of non-cash based compensation requires Monte Carlo simulation (FAS 123). Using Crystal Ball you can create flexibility around package specific terms such as complex vesting schedules and establish the value of the stock based compensation and probability of vesting as required by FAS 123.

R&D models:

R&D models are often very complex due to the number of uncertain input variables including “What is the probability of success?” “How long will the process take?” “How much will the project cost?” and “What will the revenue impact be?”

Crystal Ball can help you account for these uncertainties and improve your understanding of the likelihood of success and financial impact which will ultimately give you insight on the return on investment, time to market and other important considerations.

These are just a few examples of the many uses of probabilistic analysis. Crystal Ball’s mastery of probabilistic analysis can help you become more comfortable making decisions based on your financial models and improve your understanding of the implications of the underlying model assumptions.

At Blue Stone International our consulting services, implementation abilities, and training offerings can be utilized to help you apply Crystal Ball to your HSF and Excel models. Don't leave your next analysis project to chance, find out more about Crystal Ball by contacting Jesper Johansen, jjohansen@bluestoneinternational.com.



INDUSTRY SPOTLIGHT

HSF and Energy & Utilities

Many companies make significant investments in their transactional processes to ensure organizational consistency and controls, however; some finance functions are still relying on unwieldy and inefficient tools to understand the financial impact of major strategic initiatives. Spending too much time gathering, reconciling and updating data from other finance functions and validating the financial integrity of disparate scenarios, your finance team should be able to focus on testing alternative strategies, building contingency plans and understanding the potential impact on long-term performance.

Blue Stone's expertise in Energy & Utilities is utilized to create HSF solutions designed to meet the demands of the industry including:

- Integrated Rate Case Strategy: forecast and sensitize OPEX, rate base, capital structure and required rate of return to optimize rate case timing and request
- Revenue Planning and Flexing: create dynamic what-if analysis around customer mix and tariffs to better understand revenue streams



Coming to a Conference Near You...

The Blue Stone Team will be sharing HSF demos and handing out prizes.

**HFMA June 26-29 Booth# 1814
NACUBO July 9-11 Booth# 507**

**Plan a visit by contacting Greg Szpalik
gszpalik@bluestoneinternational.com**

Energized By The Prospect of Improving a Utility's Forecasting and Planning Needs, Blue Stone International Leverages Industry Expertise to Create a Unique Solution.

Client Success Story

THE SITUATION

Energy Future Holdings Corp. (EFH) is a Dallas-based energy holding company with a portfolio of competitive and regulated subsidiaries including TXU Energy, Luminant and Oncor. These businesses serve the high-growth Texas electricity market, which is one of world's largest and among the nation's most successful competitive markets. The privately owned company is partially owned by KKR private equity company.

EFH turned to Blue Stone to identify ways to streamline their long-range planning processes and improve their forecasting and scenario building capabilities. As a highly levered company, with a complex capital structure, EFH needed a solution that would enhance the Corporate Planning team's ability to deliver timely analysis and reporting to management for making critical funding decisions that would comply with debt covenants.

THE CHALLENGE

In order to meet the demands of the highly competitive utility industry, EFH's Corporate Planning team needed to provide their management team with additional insights and forecasts to help them quickly make strategic decisions based on commodity price assumptions and analyze scenarios around effectively managing their balance sheet through debt refinancing.

Prior to the project, EFH's long-range planning processes were reliant on an unwieldy Excel-based environment that failed to meet the team's requirements. The system was composed of disparate, inconsistent processes of gathering information from numerous sources and was highly dependent on manual input. The model ran on an Excel macro that quickly became a "black box" over the years and eliminated the transparency behind the calculations. The team also lacked the integration between the various planning departments, particularly the tax, treasury, and corporate planning groups. As a result, EFH sought a more accurate and integrated forecasting solution that would allow them to conduct scenario analysis more quickly and seamlessly.

Industry:
Utility

Needs:
Long-Range Planning
Tax Planning

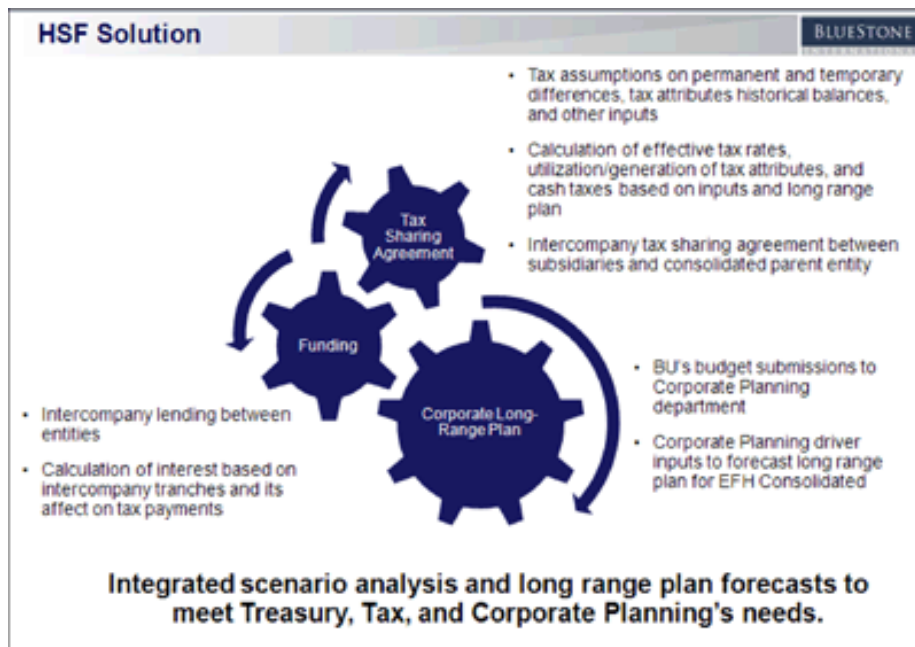
Product Solution:
Hyperion Planning
Hyperion Strategic Finance
Essbase

"With the improved streamlining of our FP&A process, we can now quickly and efficiently provide reports for major meetings. Our board and executive team has the analysis and reports they need to readily take decisive action on important issues."

Grant Carter, Director of FP&A

THE SOLUTION

Blue Stone International's consulting expertise allowed the team to take on an expanded role beyond the project's initial scope of work. Blue Stone designed a unique tool to address the company's intricate tax and funding logic, which calculated the cash impacts according to tax sharing agreement (TSA) and ensured that the company's balance sheet and cash flow was sufficient to meet its highly scrutinized covenants and other business needs. With a combination of HSF's out-of-the box treasury functionality and tax depreciation scheduler as well as customized TSA and funding logic built by Blue Stone, the team can access the cash tax impact on its funding routine simultaneously.



By building the logic in one system, HSF addressed the inherent circular logic of tax and debt/interest expense. While the initial scope entailed only building the model to meet Corporate Planning's requirements, the project broadened to include the needs of the Tax department. How much cash taxes does Oncor, EFH's regulated entity, have to pay based on the TSA? How will the cash taxes affect EFH's intercompany debt tranches? With the customized HSF model, EFH can spend time analyzing data to determine the answers for both of those questions versus managing and transferring data through various Excel models between the Tax and Corporate Planning teams.

THE RESULTS

With the transparency offered by HSF, the new solution offers integration between Corporate Planning, Treasury, Tax, and Business Development. The Corporate planning group has the ability to calculate the tax and funding outputs concurrently and within one system, which now allows the group to be less dependent upon the tax group for

information. By creating model standardization and clarity, the newly integrated P&L, Balance Sheet and Cash Flow offer improved insight and functionality. The new system also provides scenario analysis for ad hoc assumptions flexing around commodity prices and operational strategy, while offering the team more efficient real-time output generation and consolidation.

About Blue Stone International

Blue Stone International, LLC is a strategy and financial consulting firm offering a unique balance of financial, industry and technical expertise, to enhance the way our clients manage their financial processes. Our teams develop financial models and streamline processes for CFO-related activities, such as strategic planning, mergers and acquisitions, divestitures, corporate valuation and treasury management. We leverage the unique balance of our financial and technical skills to provide practical business solutions and processes to support the underlying initiatives that drive these modeling activities. As the leading Oracle Certified Advantage Partner for Hyperion Strategic Finance, Blue Stone International is trusted for more than 75% of all implementations of Hyperion Strategic Finance. Blue Stone International's specialized financial and strategic consulting services are globally recognized and valued for the results we help our clients achieve.