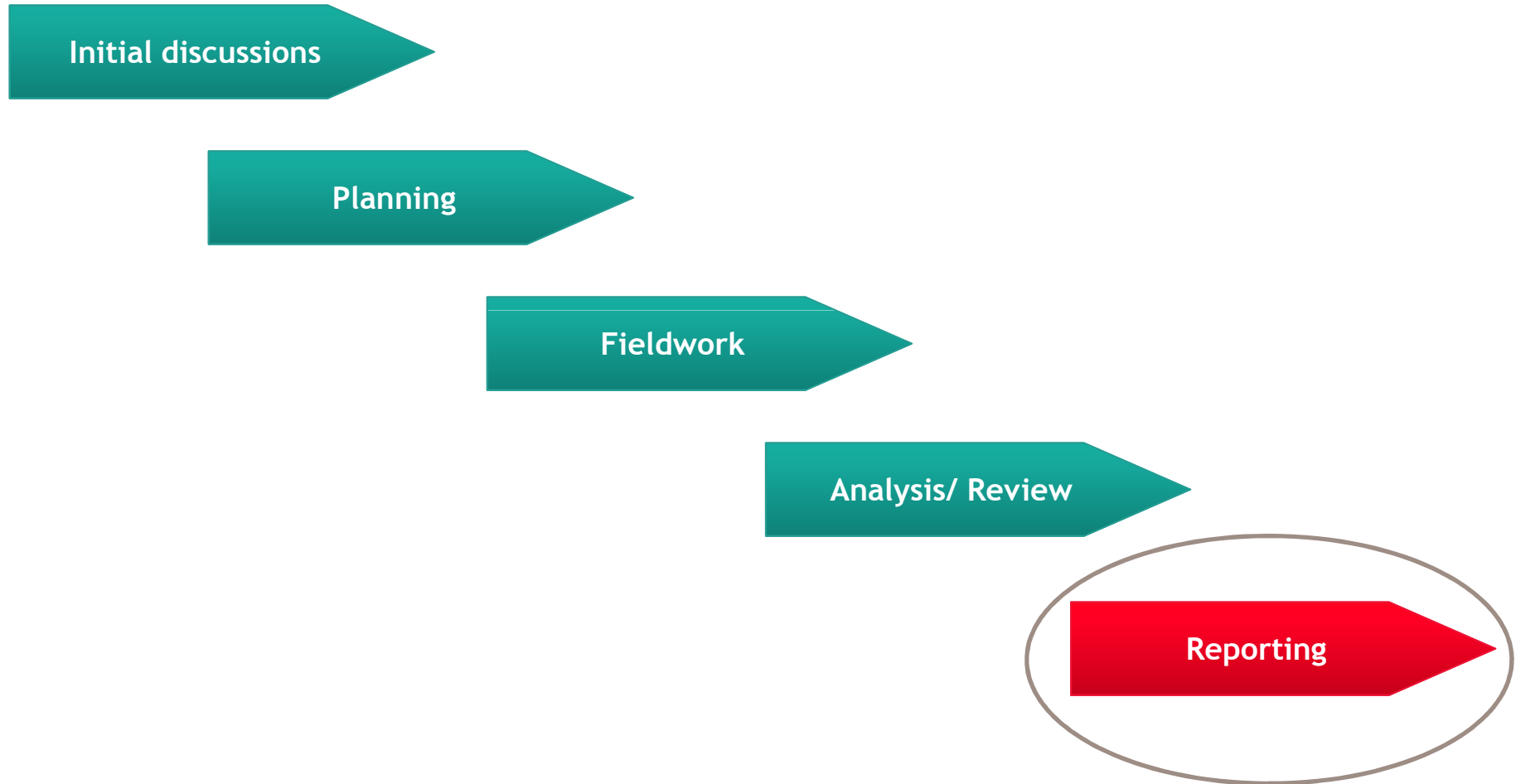


Presentation on Due Diligence Report

ICAI - 1 June 2013

Rajendra Chitale

DD Process



Definition

- Give a spoken or written account of something that one has observed, heard, done, or investigated.
- An account given of a particular matter, specially in the form of an official document, after thorough investigation or consideration
- Report is a self-explanatory statement of facts relating to a specific subject and serves the purpose of providing information for decision making and follow up actions.

Need of a Report



Systematic presentation of facts for decision making

Summary of our Observations

WHY?

Deliverable product

Client's expectation to meet agreed Scope of Work



Draft/Interim report during the Engagement

Final Report and Databook on completion and conclusion

Types of Report

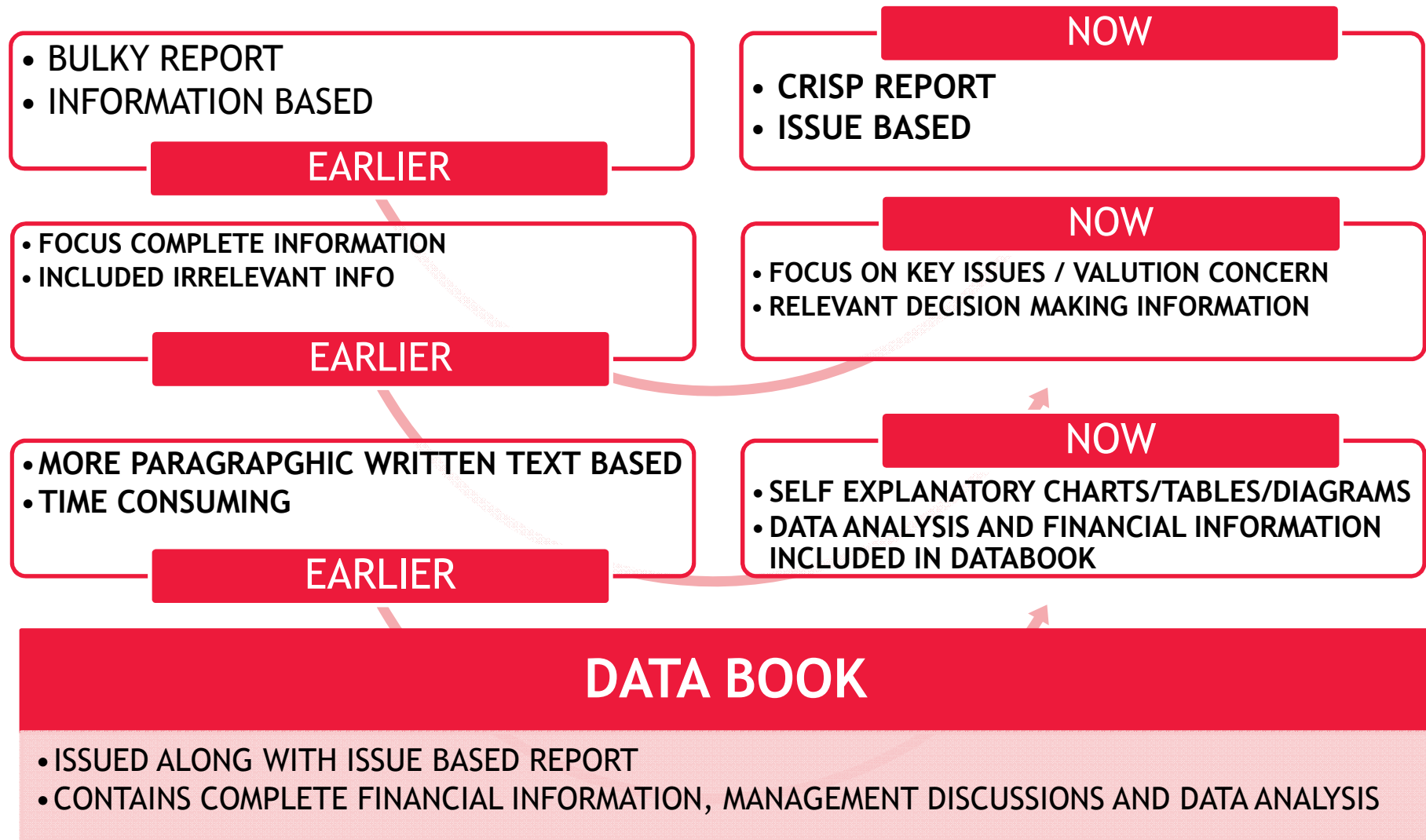
VERBAL

- Con Call
- Meeting with Client
- Formal/informal discussion

WRITTEN

- Preliminary issue / Draft / Interim Report in PDF
- Final Report
- Data book

Transition with Time



Report timing and frequency

Continuous

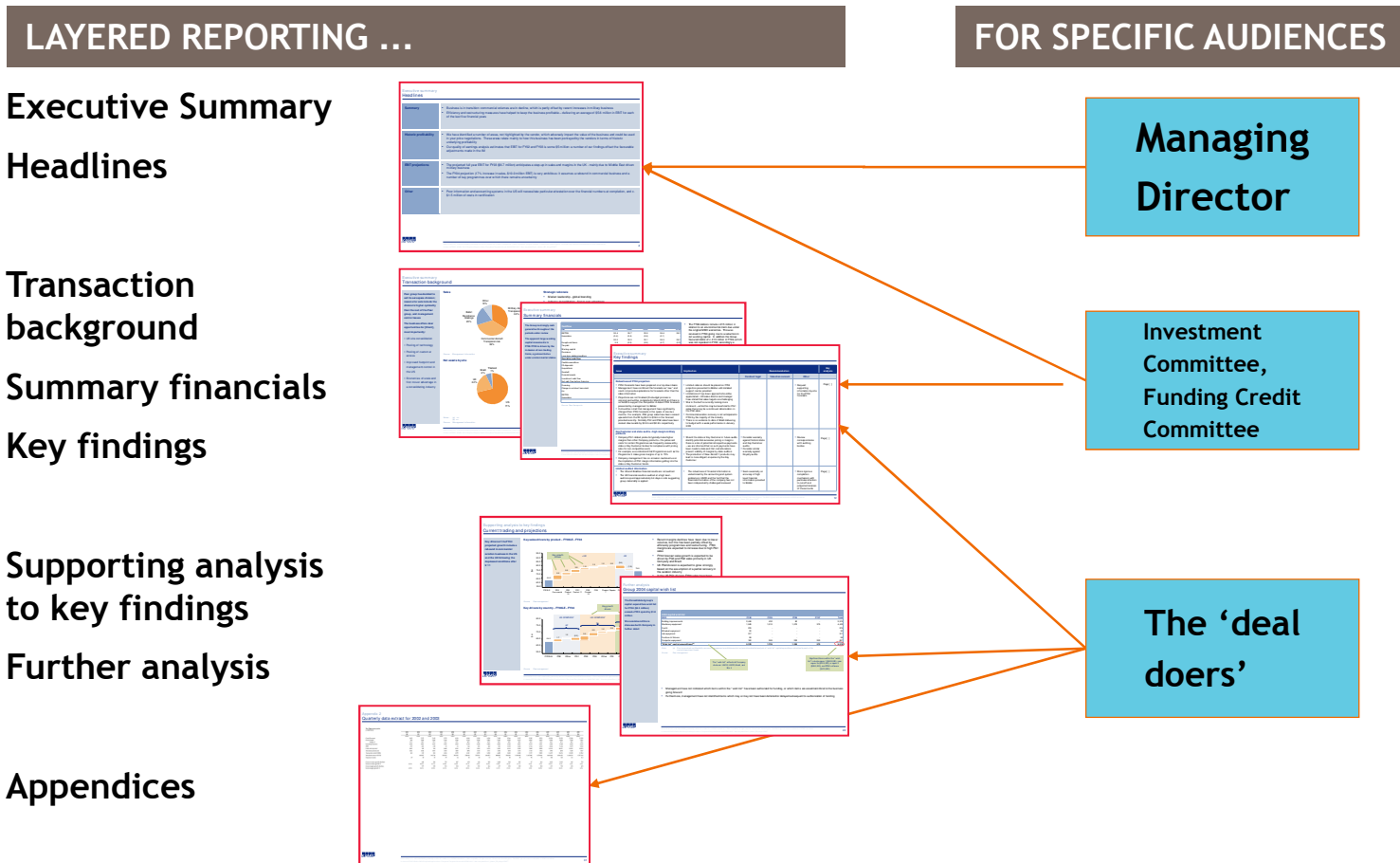
- On going discussions with client
- Meetings and informal chats

Periodic

- Preliminary Issue report
- Interim report
- Draft Report
- Final Report

Reporting

- Reports tailored to address key value drivers, decision making requirements as well as significant input to sale and purchase agreements
- Presented in a succinct story board style that co-funders will be comfortable with



Report Format and Structure (1/3)

Transmittal Letter

- Form the addressing the report to the client
- Includes reference to the underlying engagement mandate and Scope of Work
- Includes the period of execution and receipt of information
- Safeguarding from liability loss to Third Parties

Limitation of Liability

- Caveats for safeguarding our self from misuse of report by third party
- Limitation of reliance on report for decision making
- Cap of liability in case of loss due to reliance on report

Report Format and Structure (2/3)

Background

- An overview about the Target and the Transaction
- Timeline - Relevant Historical Events
- Background about the transaction
- Financial Snapshot
- Short note on the Target's business

Executive Summary

- List of Relevant Issues having an impact on final decision making / valuation
- Deal Maker / Deal Breaker issues
- Focusing need of Top/Senior Management
- Quick reference of Key important issues
- Presented in Tabular - ISSUE, OBSERVATION / RECOMMENDATION, REFERENCE TO DETAILED ANALYSIS (KEY FINDINGS)

Report Format and Structure (3/3)

Key Findings

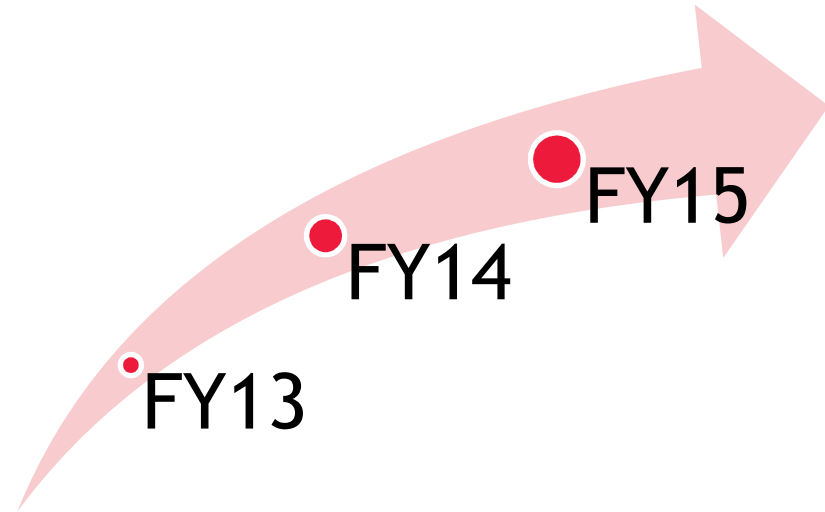
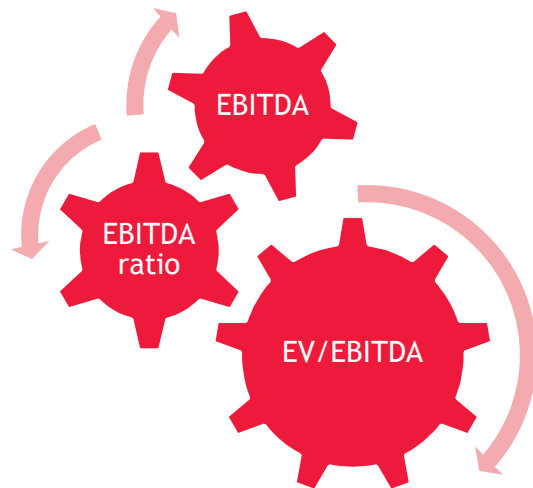
- Detailed explanation of Key Issues
- Includes Point by Point analysis and detailed information about the specific area
- Includes data analysis by use of Tables / Graphs / Diagrams, etc. specifically focusing on the ascertainment and quantification of issue
- Includes limitations and assumptions
- Includes our recommendation - internal audit, technical advise

Appendices

- Items relevant to support Key findings - Additional Information
- Scope of Work
- Limitations to Scope of Work
- Summary of arrangements
- Copy of scanned Vouchers
- Organization chart

Key issues

NORMALIZED / ADJUSTED EBITDA



KEY VALUATION TOOL

ASCERTAINMENT OF FUTURE
SUSTAINABLE INCOME FROM
OPERATIONS IN CURRENT BUSINESS
ENVIRONMENT

NORMALIZED / ADJUSTED EBITDA GIVES A FAIR IDEA OF SUSTAINABLE FUTURE EARNINGS FROM BUSINESS UNDER CURRENT OPERATIONAL SITUATION

Key Issues

NORMALIZED / ADJUSTED EBITDA

- DISREGARDS ALL ONE TIME / NON RECURRING INCOME AND EXPENSES
- DISREGARDS ALL NON SUSTAINABLE INCOME AND EXPENSES
- ACCOUNTS FOR ALL SUSTAINABLE AND ASSURED INCOME AND EXPENSES
- CONSIDERS QUANTIFIABLE AS WELL AS NON QUANTIFIABLE ITEMS
- OPERATIONS ORIENTED ADJUSTMENTS ONLY
- PRESENTED IN TABULAR FORM

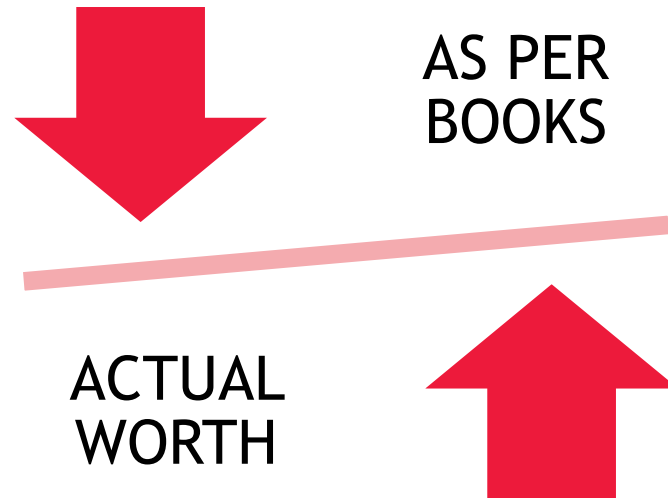
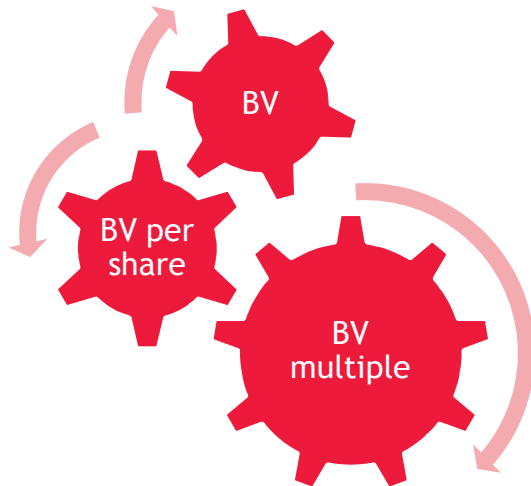
Key Issues

EXAMPLES OF NORMALIZATION / ADJUSTMENT TO EBITDA

- Bad or doubtful debtors/under provision of debtors
- Increment in salary of employees going forward
- Increase in rent expenses as per agreement
- Loss of a major regular/fix customer post balance sheet date
- One off costs which are not repetitive
- One off revenue - unique one time projects
- Loss of goods due to fire
- Resignation of key managerial personnel directly responsible for generating revenue

Key Issues

ADJUSTED NET WORTH



KEY VALUATION TOOL

ACTUAL NET WORTH OF BUSINESS MAY DIFFER FROM BOOK VALUE. ADJUSTED TO ASCERTAIN ACTUAL SHAREHOLDER VALUE

ADJUSTED NET WORTH FORMS THE BASIS OF PRESENT BOOK VALUE INVESTMENT OF EXISTING OWNER OF BUSINESS

Key Issues

ADJUSTED NET WORTH

- NET WORTH REPRESENT THE INTRINSIC BOOK VALUE OF THE ENTITY BASED ON ITS HISTORICAL PERFORMANCE TILL DATE
- ADJUSTMENT FOR UNDERVALUATION / OVERVALUATION OF ASSETS AND LIABILITIES
- ADJUSTMENT FOR UNRECORDED LIABILITIES
- ADJUSTMENT FOR MATERIALIZATION OF CONTINGENT LIABILITIES
- ADJUSTMENT FOR RESTRICTED ASSETS
- PRESENTED IN TABULAR FORM

Key Issues

EXAMPLES OF NORMALIZATION / ADJUSTMENT TO NET WORTH

- Under provision of debtors
- Materialization of off balance sheet liabilities (Eg. Legal claim materialized post balance sheet date)
- Cancellation of government grant
- Interest on Secured / Unsecured loan not accrued
- Undercharging of depreciation on fixed assets

Key Issues

OTHER BUSINESS ISSUES

CONCENTRATION OF REVENUES

- PRODUCT CONCENTRATION
- CUSTOMER DEPENDENCE
- REGIONAL CONCENTRATION

RESTRICTIONS ON OPERATION

- LICENSING
- GEOGRAPHICAL RESTRICTIONS
- TECHNICAL RESTRICTIONS (LIMITED CAPACITY)

Key Issues

OTHER BUSINESS ISSUES

ISSUES RELATED TO PURCHASES

- DEPENDENCE ON SUPPLIERS
- PRICE MOVEMENT OF INPUT MATERIALS
- IMPACT OF RELATED PARTY PURCHASES

MARGIN / CONTRIBUTION ANALYSIS

- ANALYSIS OF LOSS MAKING PRODUCTS
- ANALYSIS OF LOSS MAKING DIVISION
- ANALYSIS OF DIRECT COST ALLOCATION

Key Issues

OTHER BUSINESS ISSUES

ECO-POLITICAL ISSUES

- IMPACT OF FOREX FLUCTUATION
- CHANGES IN GOVERNMENT REGULATIONS & POLICIES
- IMPACT OF COMPETITION

HUMAN RESOURCE

- PARACHUTE PAYMENTS FOR TOP MANAGEMENT
- ATTRITION
- SKILLED LABOUR PROBLEMS

Key Issues

OTHER BUSINESS ISSUES

ISSUES ARISING FROM AGREEMENTS

- LONG TERM SUPPLY ARRANGEMENT
- TAG ALONG / DRAG ALONG RIGHTS / BUY BACK CLAUSE IN SHAREHOLDER AGREEMENT
- OWNERSHIP/ USE OF INTELLECTUAL PROPERTY

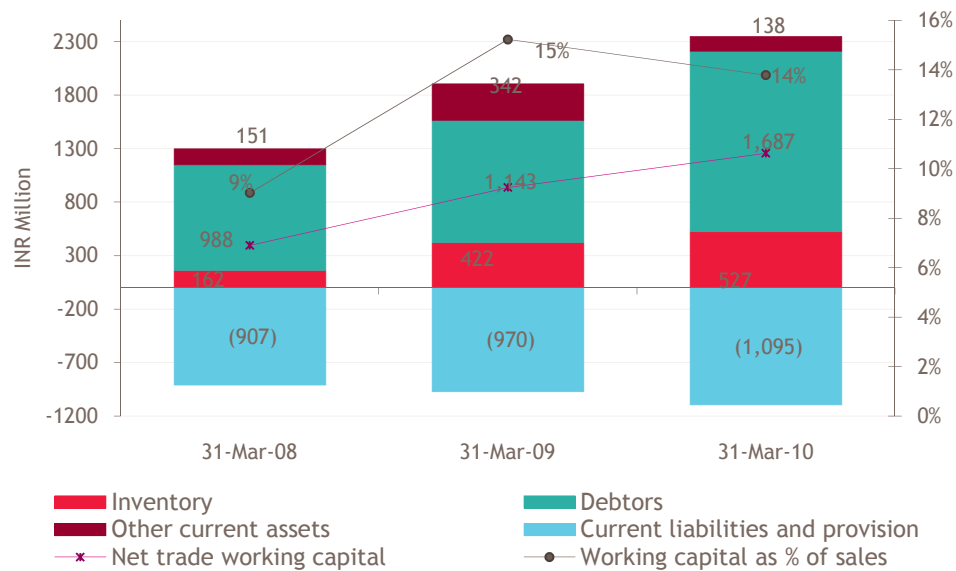
RELATED PARTY ISSUES

- LEVEL OF SUPPORT / DEPENDENCE ON RELATED PARTY / GROUP ENTITY
- ARMS LENGTH PRICING OF RELATED PARTY TRANSACTIONS
- FUTURE ARRANGEMENT AFTER TRANSACTION

Supplementary Analysis

WORKING CAPITAL ANALYSIS

- COMPOSITION OF WORKING CAPITAL
- ANALYSIS OF BLOCKAGE OF WORKING CAPITAL
- IDEA OF FUTURE INVESTMENT IN WORKING CAPITAL
- PRESENTED IN TABULAR OR GRAPHICAL CHART



Supplementary Analysis

REVENUE ANALYSIS

- ANALYZE MOVEMENT OF REVENUE YoY/QoQ
- ANALYZE CUSTOMER WISE COMPOSITION - ANALYZE TOP 10 CUSTOMERS
- ANALYZE PRODUCT WISE REVENUE - PIE DIAGRAM FOR PRODUCT SHARE
- HIGHLIGHT REGION WISE - STACKED BAR CHART TO ANALYZE MOVEMENT YoY
- PRICE VOLUME ANALYSIS FOR MOVEMENT OF REVENUE

Supplementary Analysis

COST ANALYSIS

- ANALYZE MOVEMENT IN PROCUREMENT COST YoY
- ANALYZE TOP 10 SUPPLIERS - PIE DIAGRAM TO REPRESENT SHARE
- ANALYZE KEY INPUT MATERIALS - TOP 10 INPUT MATERIALS

Supplementary Analysis

DEBTORS ANALYSIS

- ANALYZE DEBTORS AGEING TO ASCERTAIN POTENTIAL IRREVERABLE DEBTORS
- ANALYZE THE CREDIT PERIOD ALLOWED TO DEBTORS
- ANALYZE SEGMENT WISE DEBTORS TO ASCERTAIN THE BLOCKAGE OF WORKING CAPITAL\
- CHECK RECOVERY OF OLD DEBTORS POST BALANCE SHEET DATE

Supplementary Analysis

INVENTORY ANALYSIS

- ANALYZE MOVEMENT IN INVENTORY OF RM / WIP / FG
- ANALYZE VALUATION OF INVENTORY
- ASCERTAIN NON MOVING / SLOW MOVING / OBSOLETE INVENTORY
- ANALYZE BLOCKAGE OF WORKING CAPITAL IN INVENTORY
- ANALYZE ANY POTENTIAL WINDOW DRESSING

Supplementary Analysis

EMPLOYEE COST ANALYSIS

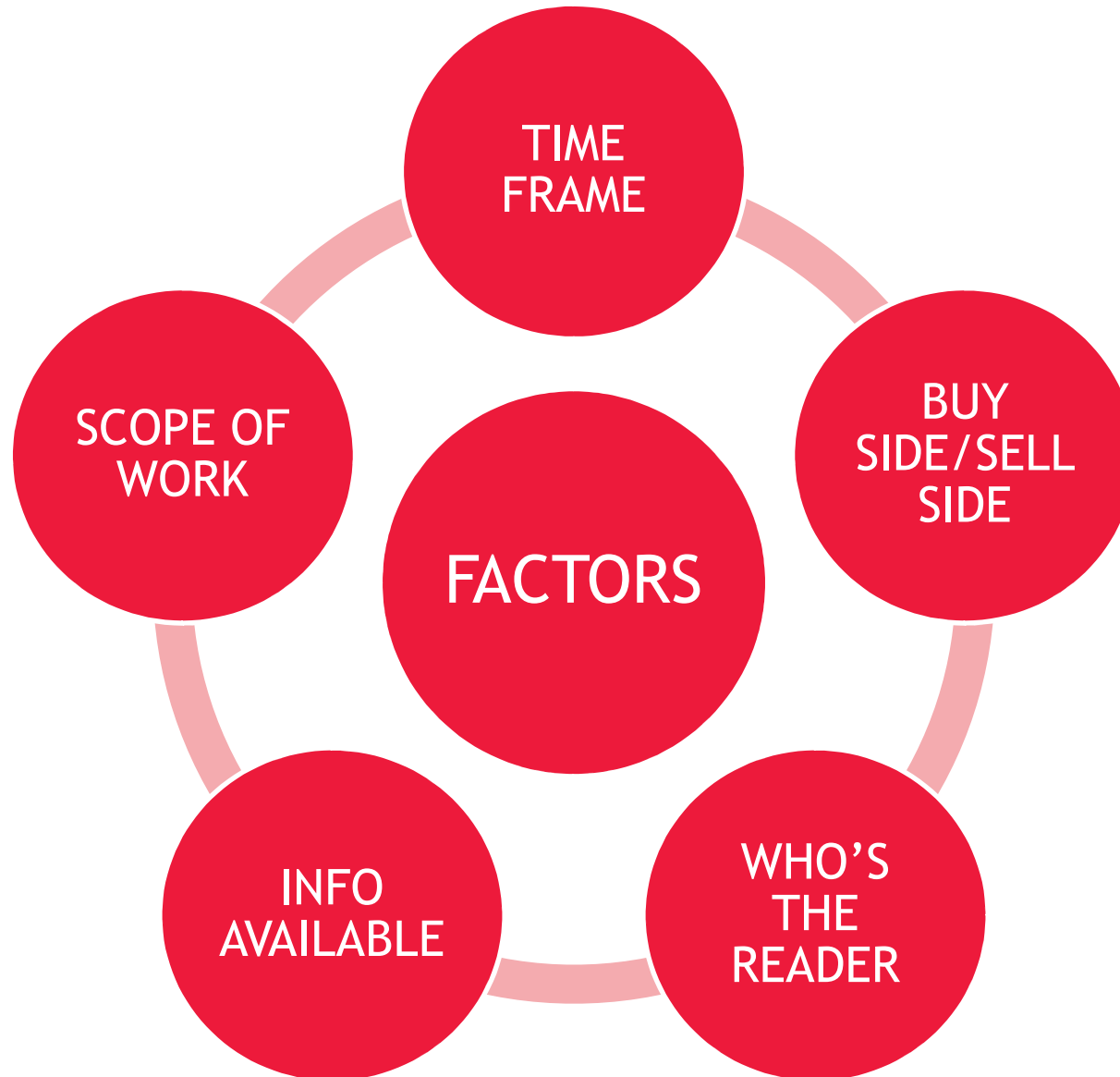
- ANALYZE DEPARTMENT MOVEMENT OF EMPLOYEES AND RELATIVE MOVEMENT IN COSTS YoY / QoQ
- UNDERSTAND IF THERE IS UNDERSTAFFING OR OVERSTAFFING
- ANALYZE IF THE COMPANY IS SUFFERING FROM HIGH ATTRITION

Key Issues

OTHER EXPENSES

- ANALYZE MOVEMENT OF OTHER / GENERAL / ADMIN EXPENSES YoY / QoQ AND HIGHLIGHT ANY SIGNIFICANT INCREASE
- ASCERTAIN ONE OFF EXPENSES
- ANALYZE ADEQUATE PROVISIONING OF OTHER EXPENSES
- ANALYZE DEPARTMENT WISE / LOCATION WISE / BRANCH WISE EXPENSES

Tips for Writing a good report



Tips for Writing a good report

- Understand the rationale of engagement from client's perspective
- Story boarding of relevant matter for thorough understanding
- Focus on the issue/matter of communication **TO THE POINT**
- Use of language / terminology that client is comfortable - Avoid Jargons
- Quantification of issues to the extent possible

Tips for Writing a good report

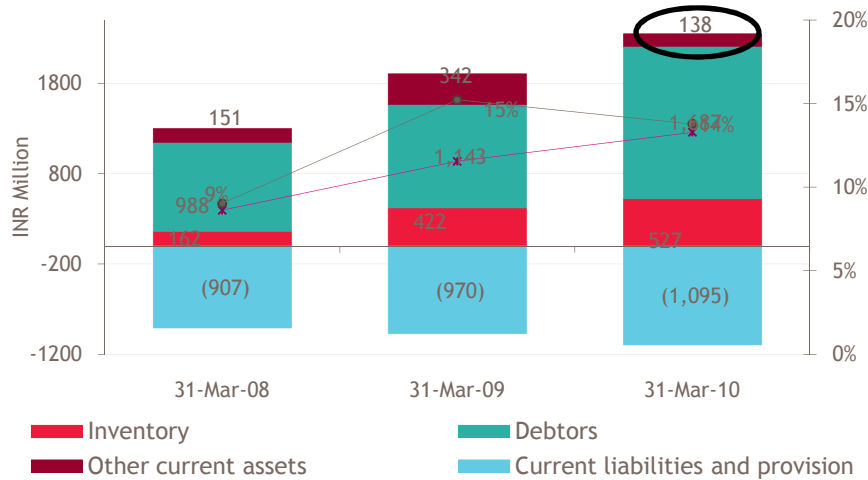
- Use of assumptions if required - mention the same
- Consistent format and nomenclature
- Unambiguous and clear text for easy understanding
- DO NOT ASSUME that the client knows; instead Client WANTS to know
- USE graphs / charts / tables - maximum 2 on a page

Tips for Writing a good report

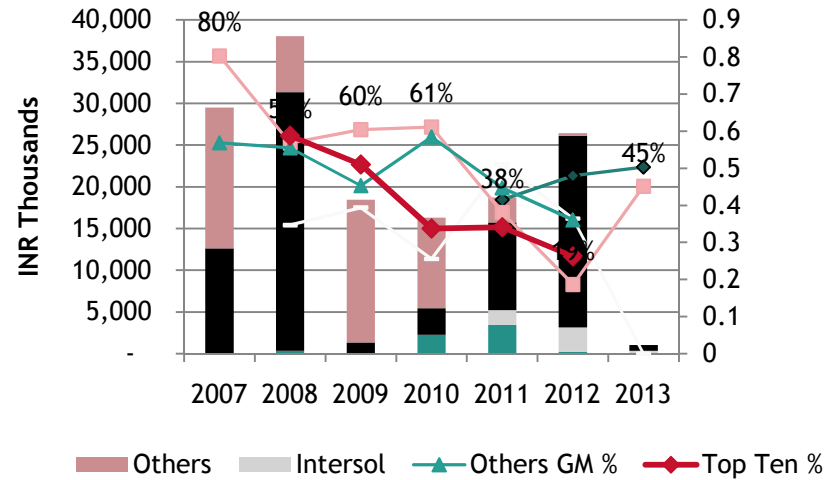
- DO NOT MIX too much information in a single graph - use one graph for one issue only
- USE highlighting techniques in graphs and tables. For eg. Circle over a particular number, highlighting a particular row
- Mention clear Headlines /Banner statement - for reader to know what is the issue related to. For eg.
- Undervaluation of contingent liabilities
- Conclusion / recommendation statement

Tips for Writing a good report examples

Highlighting Techniques



Avoid too much info on a graph



Reporting language of issues

ISSUE	BUY SIDE	SELL SIDE
Dependence on a single customer	Highlight the risk of losing the customer	Highlight assured revenue from the customer
Upward revaluation of fixed asset	Highlight abnormal upward revaluation and recommend an opinion from an asset valuer	Present how the upward revaluation represent a fair value by asset valuer report
Unsecured loans without arrangement or balance confirmation	Highlight risk on materializing liability, whether interest is accrued on same	Highlight whether interest is at preferential rate or payable only on demand.
Dependence on Group entity for Procurement of Raw Materials	Highlight the risk related to price and availability of Raw Material	Highlight assured long term supply under contract at arms length price

Reporting language of issues

ISSUE	BUY SIDE	SELL SIDE
Impact of Key Managerial Personnel	Highlight risk of loss of business due to discontinuance of service of Key Managerial Personnel	Highlight assurance of long term contract with key managerial personnel
Information not provided by management	Unable to comment as information not provided by management	Unable to comment as information not <i>readily available</i>
Internal control weakness	Recommend internal audit to ascertain the risk due to internal control weakness	Management in process of implementing internal control procedures

Questions??

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THANK YOU