

PROJECT FINANCE:

**Working Capital Assessment, &
Preparation of CMA Data**

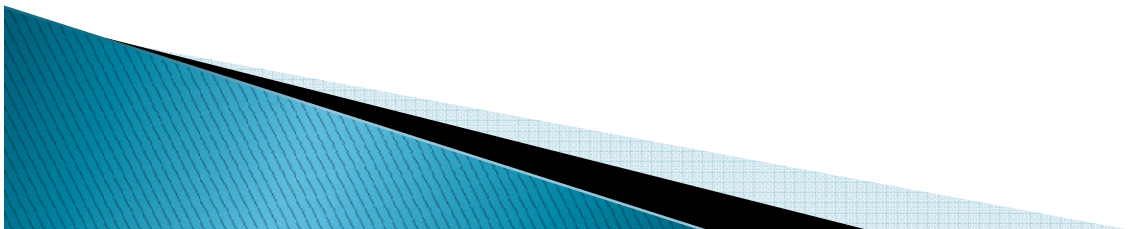
**NAGPUR BRANCH OF
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15FEB 2020

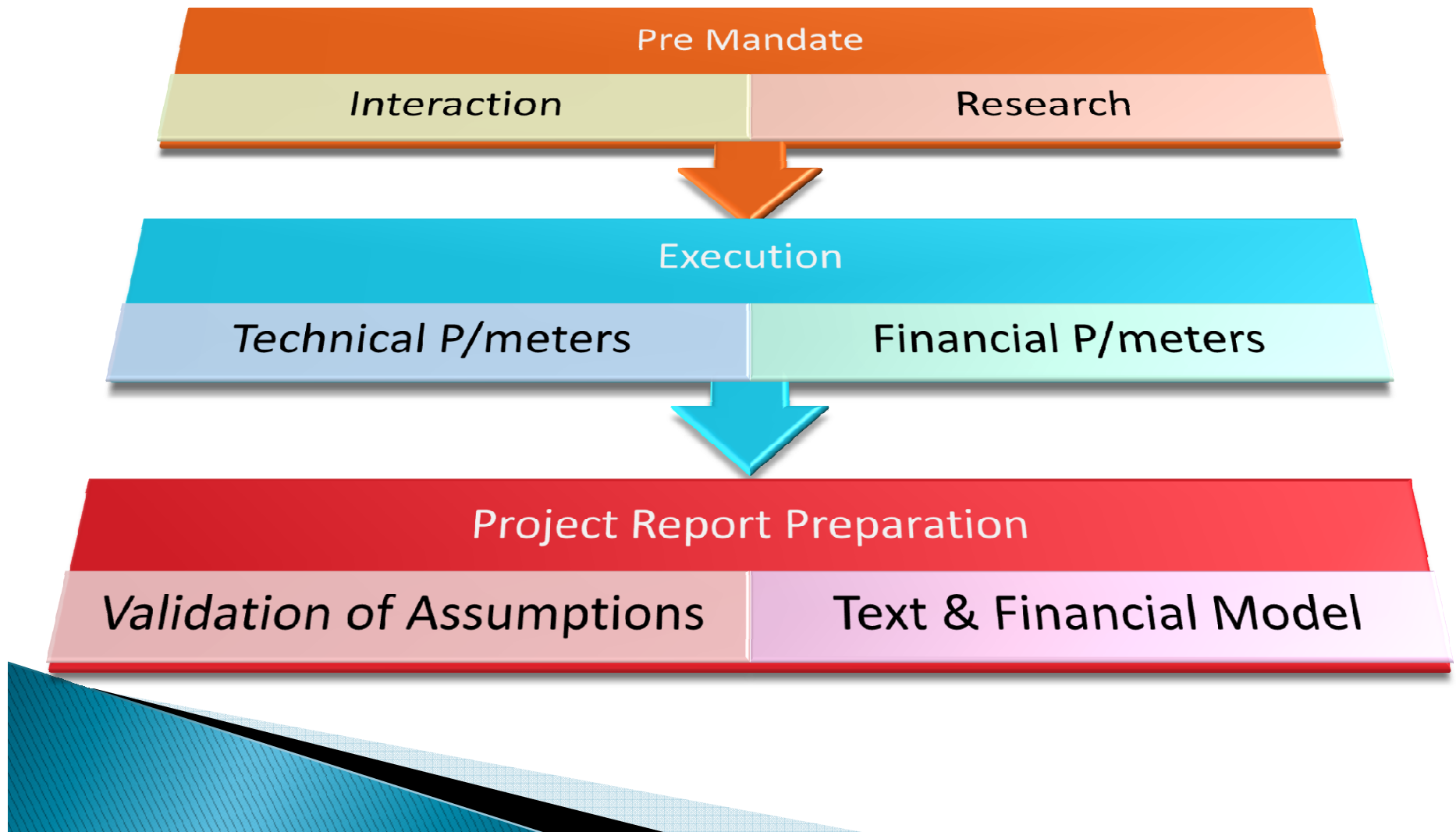
**CA Sagar Mitkary
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FLOW OF SESSION

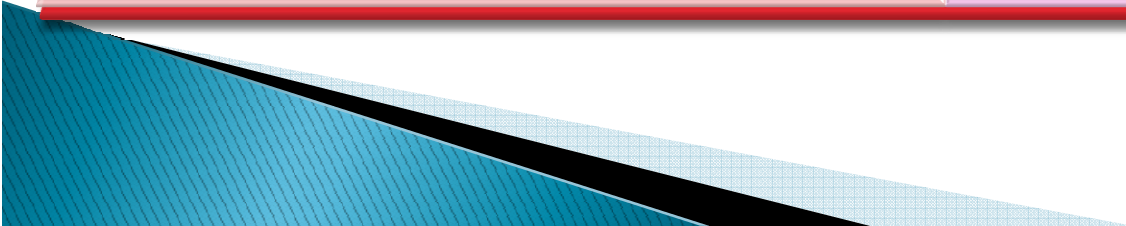
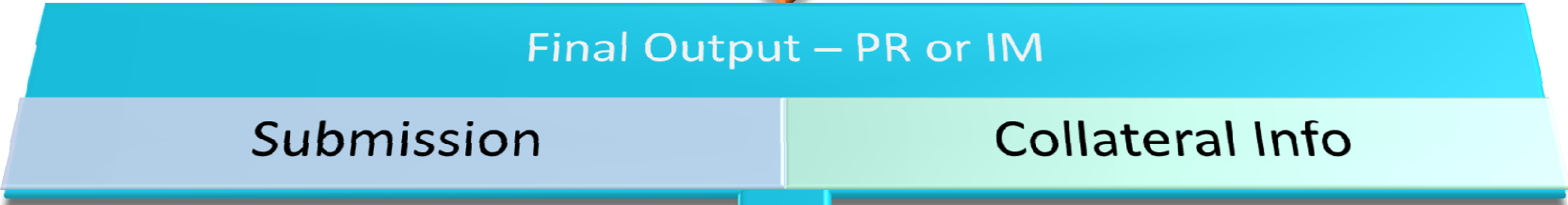
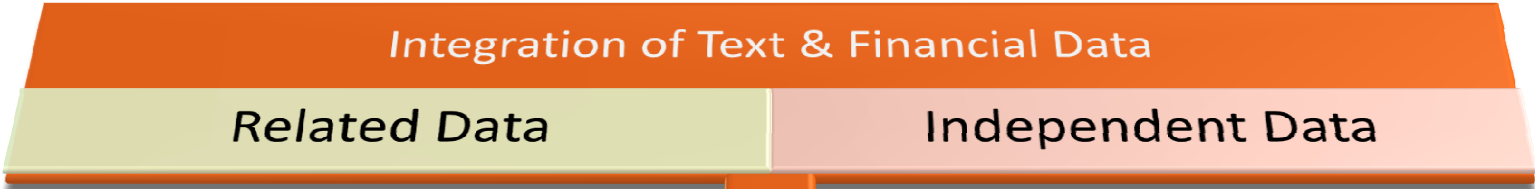
- ▶ THERE MAY BE SOME OVERLAP IN KNOWLEDGE SHARING
- ▶ FEW POINTS ARE EXPLAINED THROUGH EXCEL SHEET
- ▶ PREPARATION OF DPR, CMA DATA IS AN ART COMBINED WITH CORE DOMAIN KNOWLEDGE AND PROFESSIONAL TOUCH AND NOT A ONE DAY AFFAIR. ABSORB THE KNOWLEDGE THROUGH THIS ANGLE



LIFE CYCLE of PROJECT REPORT PREPARATION

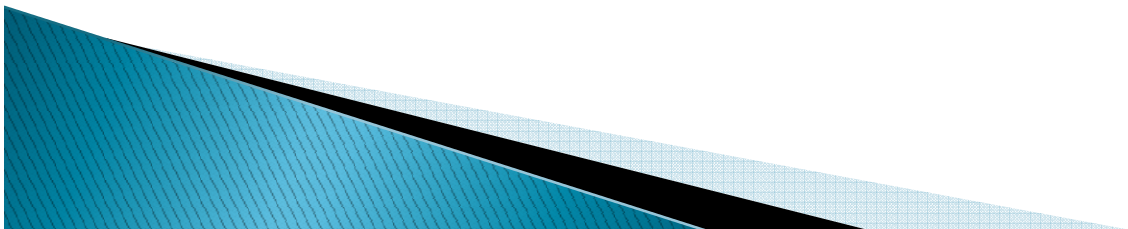


LIFE CYCLE of PROJECT REPORT PREPARATION



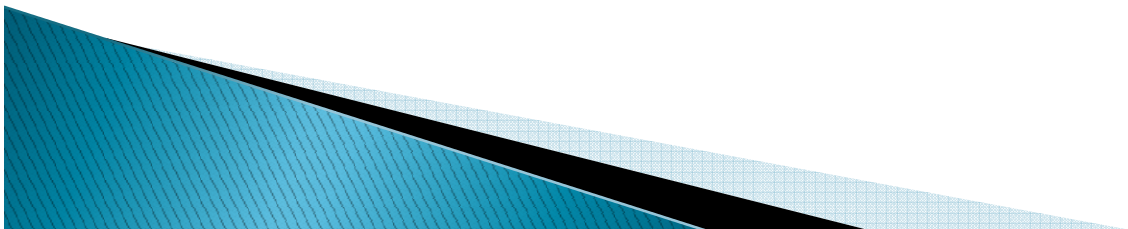
Why Projections are Important ?

- ▶ Going Concern
- ▶ Business Feasibility Studies required by Clients as well as all Stake Holders (Eg Ayurved; PP)
- ▶ Stakeholders like Banks rely on them for credit decisions
- ▶ Professional Responsibility
- ▶ Companies Act 2013, SEBI etc
- ▶ Internal & External Credit Ratings
- ▶ Whether Business is on the right track !!



Step – 1: Important Considerations in CMA/ Projections

- ▶ Past 2 year Actuals of P&L and Balance Sheet (Either prepared by you or from someone else. Treatment differs)
- ▶ Current Year Estimates (Quarterly performance, comparison)
- ▶ Next 2-3 years Projections (Based on Historicals and Present situation of market)
- ▶ Turnover, EBIDTA Projections
- ▶ PAT/ Retained Earnings Calculations
- ▶ Working Capital Requirement & Prima Facie Assessment



Important Considerations contd...

- ▶ Know the nature of business of the client – Seasonal, WC Intensive (Projections working to be accordingly, WC Intensive business depend on cost of input.)
- ▶ Note typical patterns to be incorporated in the CMA/ Projections Cost heads, Revenue items, Repay of existing loans, Unsec Loans, Fixed Assets, Non Current Assets, Current Assets, Equity.
- ▶ Find out existing and proposed limits (FB & NFB)
- ▶ Define project cost and means of finance with due care & client involvement
- ▶ Repayment Terms, Interest Cost, Finance, Processing Costs

Cost of Project & Means of Finance

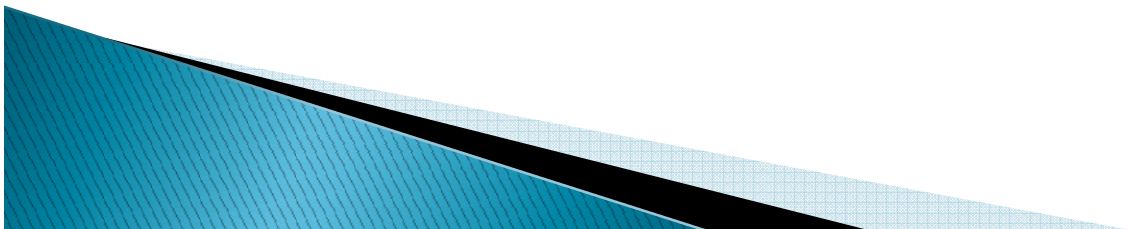
- ▶ Amt. of CAPEX to support quotations
- ▶ Interest during construction (IDC) to be included in project cost and simultaneously to be capitalized into fixed assets proportionately.
- ▶ Pre-operative expenses to be capitalized in fixed assets proportionately. Treatment in Projections as per Income Tax Act.
- ▶ Preliminary exp. to be written off in P&L
- ▶ Margin for working capital to be linked from assessment of working capital for the 1st year.
- ▶ TL should be 75% of hard cost (or as per industry)
- ▶ Remaining funds to be financed through own funds including capital, Unsec. Loans, subsidy, reserves and surplus of existing unit, if any
- ▶ Refer Sheet 2a, 2b

Next Step: Assumptions Sheet

- ▶ Separate sheet for all the assumptions
- ▶ Assumptions should be clearly defined
- ▶ It should be properly linked to the main sheet
- ▶ Main sheet should not include any bare numbers
- ▶ Assumptions to be verified by client or as per industry sources
- ▶ Following points to be included on a broad basis:
 - Working days
 - Installed capacity and capacity utilization
 - Prices of raw materials, chemicals, finished products, etc
 - Escalation clause
 - Level of holdings
 - Debt draw down
 - Revenue stream and production cost
 - EXAMPLE : Refer Sheet 2c

Turnover

- ▶ Valid basis/ reasoning for projecting too high TO
- ▶ As per order book position, if available.
- ▶ Thumb Rule may not always be correct !
- ▶ Finally, should be achievable as per client's production capacity/ Seasonal impacts/ Macro Factors
- ▶ Quantity X Rate = Sale Golden Rule
- ▶ Legitimate Quantity, Legitimate Rate

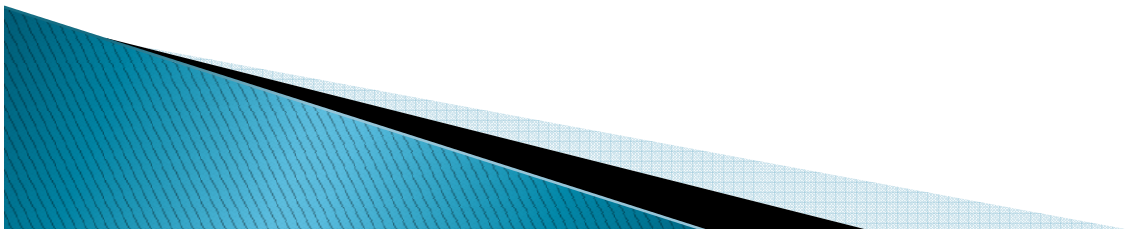


Production exp. (raw material consumes, labour exp.etc)

- ▶ % to sales should be more or less consistent
- ▶ Previous trends should be followed
- ▶ If projected at lower rate, valid reasoning should be there to support it

Interest cost

- ▶ Check sanction letter for pricing
- ▶ Check Base Rate
- ▶ Link it properly to the repayment schedules



Profit margins

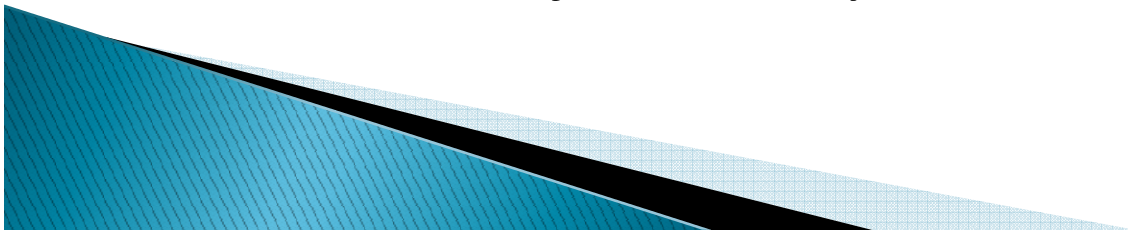
- ▶ Gross profit and net profit Consistency
- ▶ If gross profit for the immediate previous year is very less/ not consistent with historical, then historical trends may be followed while projecting with reasoning in explanations submitted to Bank
- ▶ In an attempt to increase net profit, other income should not increase absurdly unless there is valid justification
- ▶ Tax provision

Cash Credit

- ▶ If existing limits are renewed, then outstanding balance of the previous year (actual) should not be carried forward while projecting
- ▶ To be projected at renewed or enhanced limit

MPBF

- ▶ Level of holdings to be maintained
- ▶ If variations are to be brought then they should be maintained for further projections
- ▶ Cannot be increased or decreased at one's own free will
- ▶ Current assets not be projected at more than 90 days as they become non current thereafter (exceptions)
- ▶ Valid reasons for variations in level of holding
- ▶ Limits to be justified by both methods



Term loans

- ▶ Repayment schedule should be prepared with utmost care
- ▶ RoI, Moratorium, Monthly, Quarterly, Water-fall repayment, EMI/ Installment
- ▶ It should be properly linked to the CMA/ Projections sheet
- ▶ Outstanding balance at the year end should be bifurcated into current liability and long term liability
- ▶ Amt. to be repaid within the next year to be included in current liability
- ▶ The same should be deducted from the outstanding balance for the year

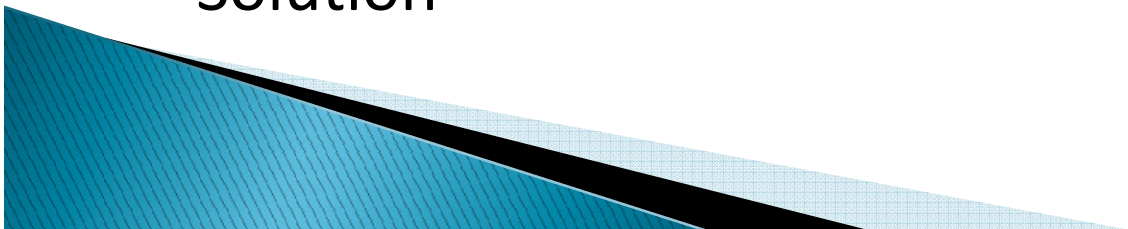
Unsecured loans

- ▶ Check whether it is from family members or outsiders
- ▶ Try to keep them constant till the currency of Term Loan requested.
- ▶ It should be treated as term liability (long term loan) and not to be included in current liability or as quasi capital
- ▶ Once increased while projecting, these cannot be withdrawn later
- ▶ Compliance with Companies Act 2013

Important Considerations contd...

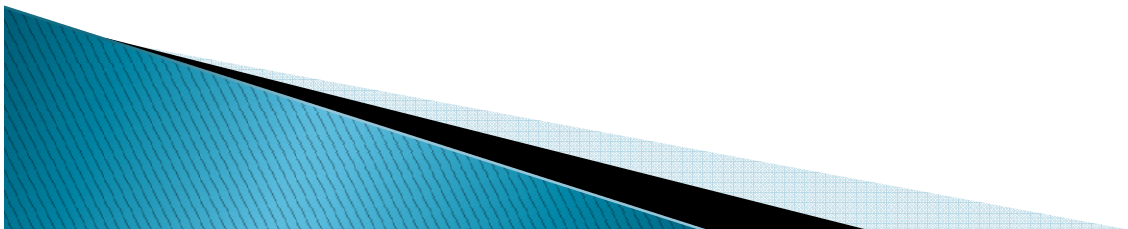
Net worth

- ▶ It mainly includes share capital/ partner's capital/ proprietor's capital, reserves and surplus, profits for the year, subsidy if already received and not to be repaid, share application money
- ▶ **NETWORTH-INTANGIBLE ASSETS=TNW**
- ▶ Quasi Equity – Treatment/ Justification/ Need/ Solution



Current assets

- ▶ While feeding the actuals, debtors for more than 6 months, deposits included in loans and advances, advances to family members to be considered as NON CURRENT assets
- ▶ Items like cash balance, other current assets should not be projected too high
- ▶ FD should be created for BG requirement at % of margin
- ▶ Level of holdings to be maintained
- ▶ Investment in shares/sister concerns to be shown in non current assets



Ratios

▶ Current ratio

At least 1.33 to justify MPBF

While calculating current ratio, cash credit/ working capital loan should be included in current liability

▶ Debt Equity

- Maximum depends on sector/ exposure
- Consider Unsecured as Term liability (P)
- In TOL/TNW, include all outside liabilities including current liabilities
- TL/TNW, should include only term loans

▶ DSCR

- Min. 1.50 for all the years and avg.
- PBT+ non cash exp.+ Interest on TL
(Principal amt+ interest for the same)

Non-cash expenses include dep., preliminary exp.w/off. Etc

▶ **Refer Sheet 3a**

Fund flow

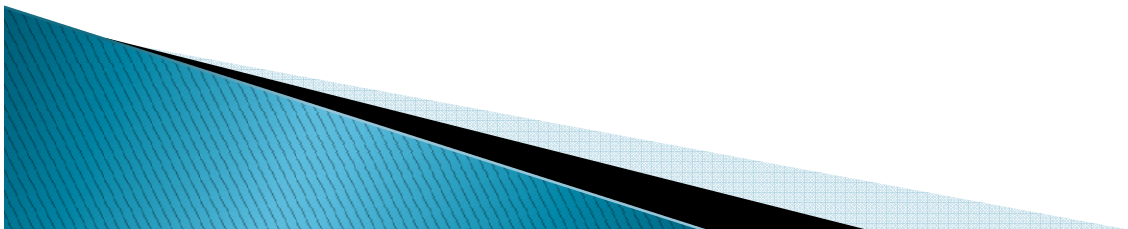
- ▶ Fund flow summary should draw the following conclusion
- ▶ *“ Long term funds should be used for long term applications and can be used for short term applications and short term funds should be utilized strictly for short term applications”*

▶ Other Minute Points

- Cash Accruals= PAT+dep.+other non-cash exp.
- Adjusted TNW= TNW – Investments in sister concerns
- Deferred tax liability to be included in reserves as part of Net worth
- Preliminary exp. To be written off
- Advance tax not to be projected unless and until it already appears in actuals
- Additional items apart from those already in audited balance sheet and P&L not be projected

Points other than that listed in CMA

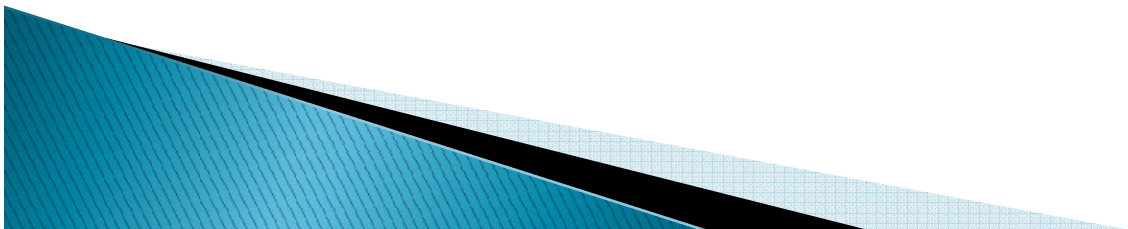
- ▶ Sensitivity analysis sheet
 - First prepare income sheet and calculate DSCR from it
 - Then, analyze the effect of changes in major components on DSCR
 - For example: Change in Selling prices, Change in cost of raw material prices, etc.
 - FUNDING PATTERN OF CURRENT ASSETS



KEY TAKEAWAYS

- ▶ TERM LOAN REPAYMENT – MORATORIUM, ROI, QUARTER/MONTHLY WATER-FALL REPAY
- ▶ Finance & Intt Charges
- ▶ Level of Holding mis-match
- ▶ Turnover % increase justification
- ▶ Profitability Spike
- ▶ DSCR 1.50
- ▶ IRR the tricky one!
- ▶ Repayment of Existing Liabilities to be accurate
- ▶ Unsecured Loans to be accurate Intt, Payment
- ▶ Equity – At par/ Premium

ANY QUESTIONS ?



THANKS !!

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