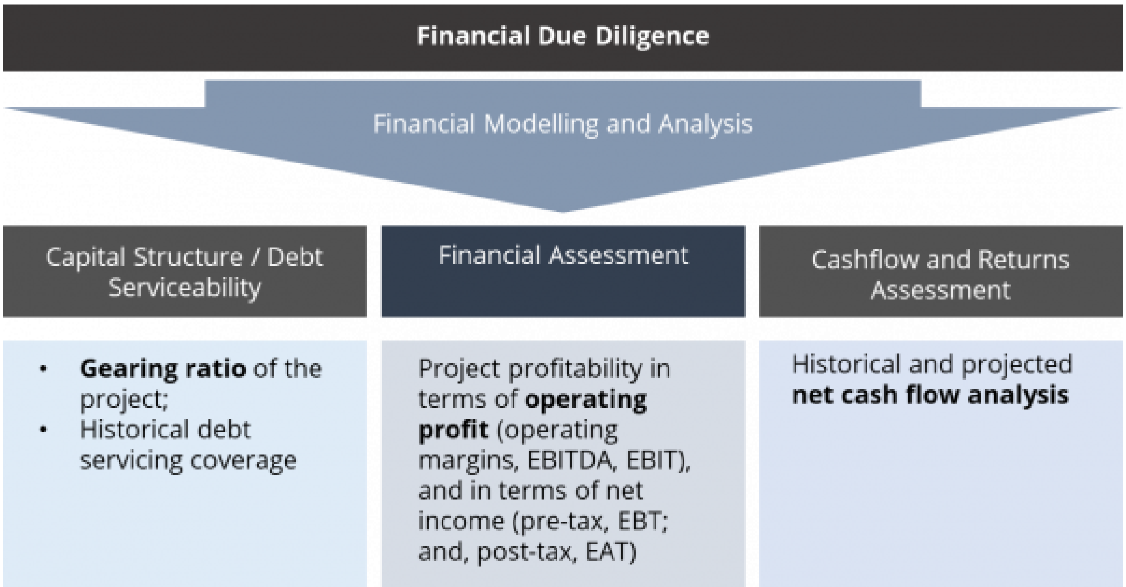
Financial Due Diligence in Asset Recycling

Full Description

The financial due diligence should cover the analysis of the asset's historical and projected financial performance. This will provide the Relevant Authority with an indication of the capital structure and debt serviceability, the asset's profitability, and projected cashflow and returns.

Figure 3: Financial Due Diligence Coverage



The following assessments should be undertaken as part of the financial due diligence:

Assess and ensure the quality of financial information is complete and current.

Financial information should include:

- Financial feasibility study for the development of the asset (if any).
- Financial statements of the entity responsible for development and operations of the asset.
- Financial model developed to assess financial performance of the asset.
- Internal audit reports and list of audit adjustments to assess potential issues; and
- Relevant financial forecasts.

Review existing capital and the financing structures

Consider the following:

- Financing facility; including details of any senior and subordinated debt terms.
- Capital structure; including shareholding structure, preference shares and shareholder loans.
- Assess adequacy of historical cashflow generated from the asset to service debt facilities.
- Review off-balance sheet liabilities (if any) including operating leases, loan guarantees, swaps, hedges, etc
- Review historical financial ratios including:
  - Debt to equity ratio = total liabilities / shareholder's equity.
  - Interest coverage ratio = EBIT / interest expenses.

    - Debt service coverage ratio = net operating income / total debt service.

Financial performance

Assessment of the financial statements including:

- Income Statement (Profit and Loss Statement).
- Balance Sheet.
- Cash Flow Statement and cash requirements.

Key ratios to assess would include:

- Gross margin = gross profit / net sales.
- EBITDA margin = EBITDA / net sales.
- Net margin = net income / net sales.
- Return on assets = net income / total assets.
- Return on equity = net income / shareholder's equity.

As indicated above, a financial model should be developed by the Relevant Authority to ensure that the asset will be able to provide the private sector investor with an acceptable level of return; taking into account the upfront fee to be paid by the private sector to secure the concession (or lease) as well as operating and debt servicing costs.

Related Content
Guidelines for Implementing Asset Recycling Transactions (Download PDF version) - Now Available!
Additional Resources
Due Diligence Checklist for Legal and Institutional Enabling Environment for PPP
PPP Reference Guide
Page Specific Disclaimer

The Guidelines have not been prepared with any specific transaction in mind and are meant to serve only as general guidance. It is therefore critical that the Guidelines be reviewed and adapted for specific transactions To find more, visit the Guidelines to Implementing Asset Recycling Transactions Section Overview and Content Outline, or Download the Full Report.