Case Study/Certain Aspects on preparing an Excel Model to submit with Project Report
For
ICAI – Nashik Branch

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LIFE CYCLE of PROJECT REPORT PREPARATION

Pre Mandate

Interaction	Research

Execution

Technical P/meters	Financial P/meters

Project Report Preparation

Validation of Assumptions	Text & Financial Model

LIFE CYCLE of PROJECT REPORT PREPARATION

Integration of Text & Financial Data

- Related Data
- Independent Data

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Final Output – PR or IM

- Submission
- Collateral Info

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Processing & Sanctioning

- Queries
- Post Sanction Compliances

Why Projections are Important ?

"Get ready! The next wave of legislation is rolling in."

- Going Concern
- Business Feasibility Studies required by Clients as well as all Stake Holders
- Stakeholders like Banks etc rely on them for credit decisions
- Professional Responsibility
- Sec. 36 of Companies Act 2013
- Internal & External Credit Ratings
- Whether Business is on the right track !!

Important Considerations in CMA preparation

- Past 2 year Actuals of P&L and Balance Sheet
- Current Year Estimates
- Next 2-3 years Projections
- Turnover, EBIDTA Projections
- PAT/ Retained Earnings Calculations
- Working Capital Assessment

Eg a) Trader b) Distributor c) Construction Co d) Term Loan Structuring Eg.

Commerce Professor asks the Student:

What is the most Important source of Finance for Starting Business?

Student: “Father in Law”.

Important Considerations

- Know the nature of business of the client – Seasonal, WC Intensive
- 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
- Define project cost and means of finance with due care & client involvement
- Repayment Terms, Interest Cost, Finance, Processing Costs

Assumptions

"... and then I told my wife the expense ratio in our household is not within the norm of our peer group."

- 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 utilisation
  - Prices of raw materials, chemicals, finished products, etc
  - Escalation clause
  - Level of holdings
  - Debt draw down
  - Revenue stream and production cost

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 Consistancy
- 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 of Sec 73-76 Companies Act 2013 (Deposits)
- Compliance of 185-186-188 Companies Act 2013 (Loans to Directors)

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 from 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

- <u>Current ratio</u>

  Atleast 1.33 to justify MPBF

  While calculating current ratio, cash credit/ working capital loan should be included in current liability
- <u>Debt Equity</u>
  - Maximum depends on sector/ exposure
  - Consider Unsecured as Term liability
  - In TOL/TNW, include all outside liabilities including current liabilities
  - TL/TNW, should include only term loans
- <u>DSCR</u>
  - Min. 1.50 for all the years and avg.
  - <u>PBT+ non cash exp.+ Interest on TL</u>

    (Principal amt+ interest for the same)

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

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 over 5 years
  - 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

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.
- 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 [3]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

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

THANKS !

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