

FINANCIAL DUE DILIGENCE (FDD)



What to look out for when conducting FDD?



HISTORICAL ANALYSIS

Understand and evaluate :

- **Accounting policies** and **management practices**.
- Is the **financial data presented suitable/reliable** for our analysis.
- The key drivers of **revenue**.
- Components of **key costs** and **margins**.
- How the business **manages** its **assets** and **liabilities**.
- **Trends** or **anomalies** in the financial performance and position.



QUALITY OF EARNINGS

Assess:

- How **sustainable, predictable** and **reliable** are earnings.
- If **normalisation** adjustments for any **non-recurring, discontinued, exceptional, discretionary items, non-operational** are needed.
- Whether **pro forma** adjustments to reflect **anticipated changes after the transaction** or **full year effects of actions** taken part way through the historical period.



CASH FLOW

Understand and evaluate :

- The **key drivers of “free” cash flow**. How **earnings convert to cash**.
- Any **one-off/ non-recurring cash flow**.
- Large **movements in working capital**.
- **Capital expenditure** – categorisation of maintenance vs expansionary and timing of the expenditure.



WORKING CAPITAL

Analyse:

- How **inventories, receivables, payables and other short-term items** affect **cash flows** and **liquidity** of the business.
- The underlying **net working capital** required to run the business on a **normal basis**.
- If there are **significant seasonal fluctuations**.



DEBT AND LIABILITIES

Identify and determine:

- All debt and liabilities and evaluate prevalent **terms, conditions, and covenants**.
- How the above affects the **solvency** and **leverage** of the business.
- **Net debt (or net cash)** of the target company, which affects the enterprise value of the business.
- **Capital commitments** that are off-balance sheet.



FORECASTS

Review and analyse:

- **Assumptions, drivers** and **sensitivities** of forecasts.
- How they compare to **historical performance** and **industry benchmarks**.
- Any **potential synergies** such as **revenue growth, cost savings** or **capital efficiency** from business combination.