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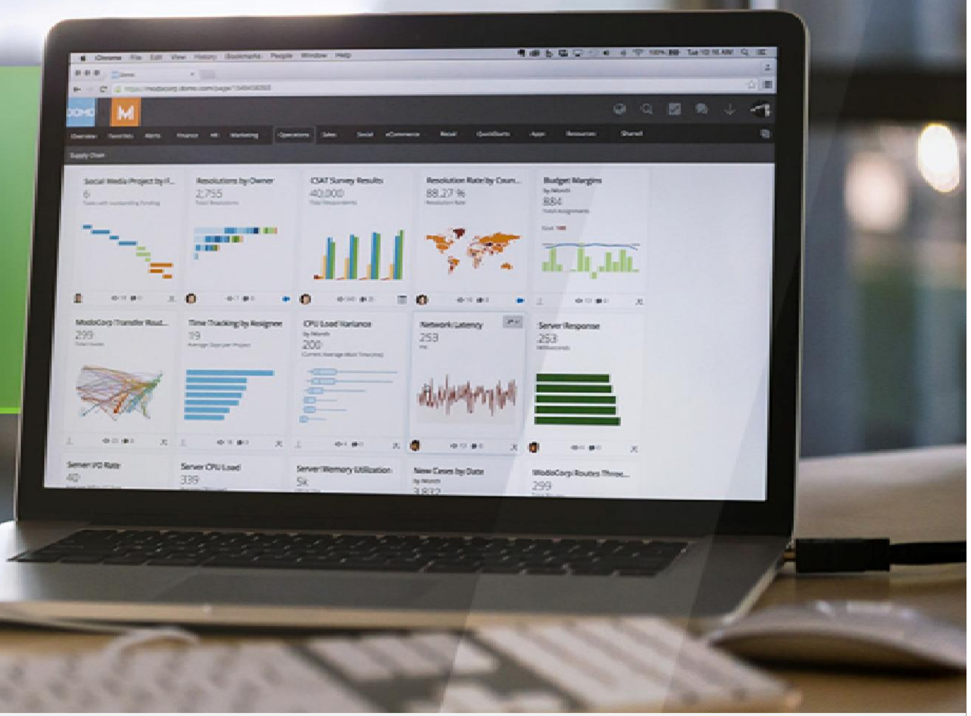
Financial Appraisal Techniques



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A Statutory Corporation Under Ministry of Agriculture & Farmers Welfare, Government of India

An ISO 9001:2015 Certified Organization

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Table of Contents

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SETTING THE CONTEXT

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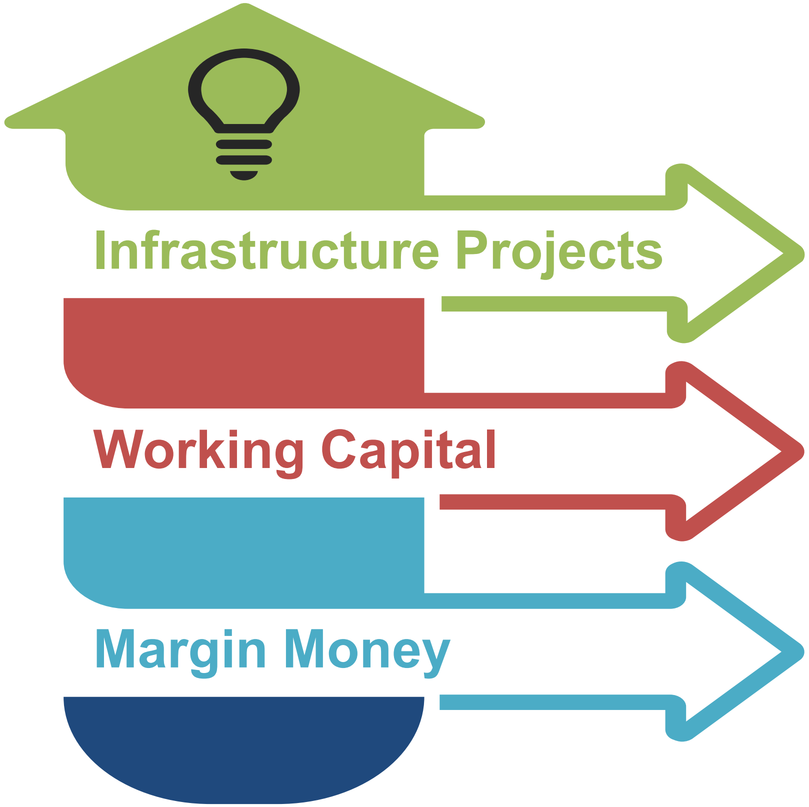
Types of Sanctions



Infrastructure Projects

Term Loan is typically given for setting up of a new project or modernization/expansion of existing capacity. Its tenure can range from 5 to 8 years

Working Capital

Funds required for day to day operations of a business entity is called the working capital. The time period for Working Capital(WC) loan for 30 days to 2 years

Margin Money

It is the amount/ contribution raised by an entity out of its own long term resources, towards a new/ existing venture, to meet part of the cost of the venture. The time period of Margin Money(MM) is for 3 – 5 years.

Key Aspects of Financial Appraisal

Financial Analysis of the Society

01

As-is assessment of society's financial statements i.e. Balance sheet and Profit and Loss Statement for last 3-5 years

Financial viability of the proposed project

02

Evaluating financial viability of the proposed project through Cost- Benefit Analysis and Sensitivity Analysis

Loan Security Cover

03

Nature and type of security should be sufficient to cover the loan in the event of any default

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As-Is Financial Analysis

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Balance Sheet Analysis

Net worth is the value the assets a person or corporation owns, minus the liabilities they owe i.e. (Total assets – Total external liabilities)

Net Working Capital =

Current Assets – Current Liability

Net Disposable Resources = Long term loans and deposits + Net Worth – Fixed Assets

Debt /Equity Ratio = Long term debt/Shareholder's equity. Higher D/E ratio suggests that organization has high financial risk

Note - In case of credit cooperatives/banks, sources and applications of funds should be seen along with parameters such as CRAR, recovery %, NPA etc.

	Summarized Balance Sheet For Last 3 Years			
1	Gross Block			
2	Less : Depreciation			
3	Net Block(1-2)			
4	Work in progress			
5	Investments			
	Total Fixed Assets (3+4+5)			
6	**Current Assets**			
	a) Cash & Bank Balance			
	b) Inventory			
	c) Loans, Advances & Prepaid Expenses			
	Total Current Assets (a to c)			
7	**Current Liabilities**			
	a) Working capital loan			
	b) Sundry creditors			
	c) Interest Payable			
	d) Cane payment/arrears			
	e) Other provisions and liabilities			
	Total Current Liabilities (a to e)			
8	Net working capital(6-7)			
9	Long & Medium term loans			
	a) Long term loans			
	b) Refundable deposits			
	Sub total			
10	Paid up share capital			
11	Convertible deposits			
12	Reserves (excluding Depreciation fund)			
13	Un-distributed Profits (+)/Accumulated Loss(-)			
14	Net worth without Revaluation Fund			

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Profit and Loss Analysis

Summarized P&L statements for 2 years of a sugar society

(₹ in lakh)

Sl. No.	Particulars	2017-18 (Audited)	2018-19 (Audited)
A. Summarized Profit & Loss Account for last 4 years			
1	Business Turnover	32911.02	36279.86
2	Profit before interest Depreciation & Tax	3492.31	3760.24
3	Interest	1604.07	1974.36
4	Cash profit (2-3)	1888.24	1785.88
5	Depreciation	1877.07	1757.69
6	Profit before Tax (4-5)	11.17	28.19
7	Income Tax	0.00	0.00
8	Net Profit (6-7)	11.17	28.19

Cash Profit = Net Profit + Depreciation
As depreciation is a non-cash expense, there is as such no outflow in terms of cash. Hence, it is added back to the net profit while working out the cash profit.

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Additional Details

01 Comments on as to whether the cooperative society has made necessary provisions for depreciation, interest payments and tax etc. Check the working capital arrangement

02 Details of outstanding term loans/ working capital loans- from the concerned lending agency as well as other agencies and repayment performance

03 Whether any re-schedulement one time settlements of loans made in the past

04 Whether any revaluation of assets has been made, if so, details there of - with supporting documents etc.

05 Audit position and classification for last 3 years and special comments if any, in the audit reports

06 Borrowings of the Cooperative should not exceed the limit as indicated in Bye-laws.

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Proposed Project Profitability

Financial Cost-Benefit Analysis

- The unit of analysis is the project, not the organization
- Evaluates and calculates the project's financial:
  - Revenues
  - Costs
  - Net benefits (excess of revenues over the costs)
  - Residual value (vale of project assets at the end of the project life)
- Evaluates and calculate the project's economic benefits and costs to the community:
  - Environmental benefits
  - Health effects
- Project revenues, costs and net benefits are determined on a *with-project* and *without project* basis.

Financial Cost-Benefit Analysis

1. Investment costs:
   - Capital costs: land, civil works, equipment, studies, Education programs, lab equipment & training, Institutional Development (consulting services, capacity building programs) etc.

2. Operation and maintenance costs: labor, electricity, raw materials, overheads, water charges, insurance, etc.

3. Residual values (of project assets at the end of the project life)

Financial Cost-Benefit Analysis

Financial Analysis

- Assumptions
- **Non discounted techniques**
  - Payback period
  - Rate of return
  - Debt service coverage ratio
  - Break-even point
- **Discounted techniques**
  - Net present value
  - Benefit Cost Ratio
  - Internal Rate of Return
- Sensitivity analysis

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Break Even Analysis

	(IN THIRD YEAR OF OPERATION) **(90% CU)**	At assumed sales realisation & raw material cost **(Rs. In Lakhs)**
A.	**REVENUE**	**1904.25**
B.	**COST OF PRODUCTION**	
	1. RAW MATERIAL	**1555.20**
	2. STORES & SPARES	**23.33**
	3. UTILITIES(Power)	**57.98**
	4. WAGES	**30.00**
	5. SELLING & DISTRIBUTION EXPENSES	**19.04**
	6. INTEREST ON WORKING CAPITAL	**30.65**
	TOTAL OF (B)	**1716.20**
C.	**CONTRIBUTION (A-B)**	**188.05**
D.	**FIXED EXPENSES**	
	1. SALARIES	**15.57**
	2. INTEREST ON TERM LOAN	**19.98**
	3. FACTORY & ADMN. OVERHEADS	**42.58**
	4. DEPRICIATION	**23.47**
	TOTAL OF (D)	**101.60**
	BREAK-EVEN POINT in %age = (D/C)*CU	**48.63**

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Sensitivity Analysis

- A technique for investigating the impact of changes in key project variables
- Identify key variables which influence project costs and benefits
- Investigate the consequences of likely adverse changes
- Manage risk

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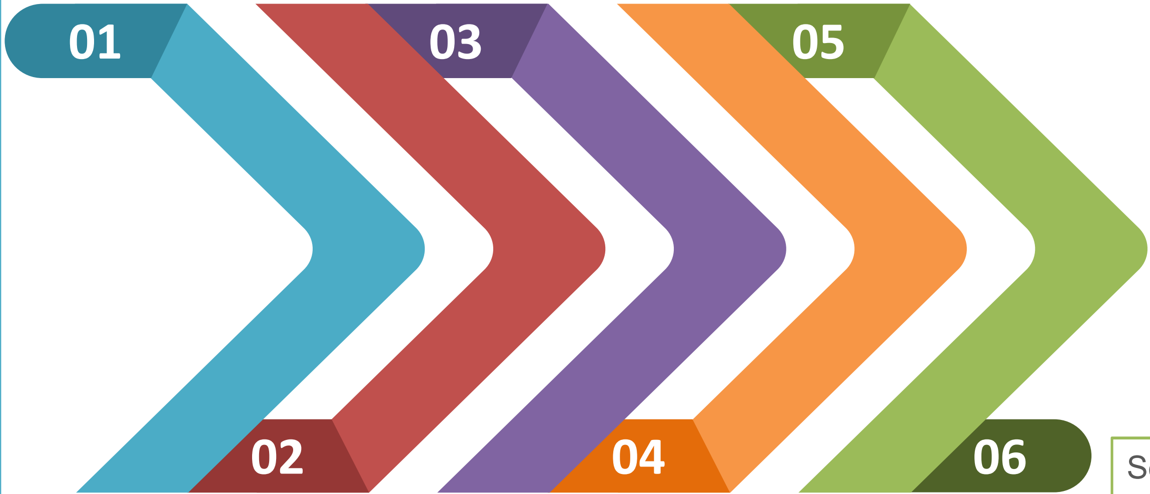
Working Capital Estimation

Assess working capital requirement based on the following factors –

- Projected business operations
- Peak level stock
- No. of cycles
- Funds for maintenance of required
- level of Inventory of Finished Goods,
- Raw-Material, Salary & Wages,
- Consumables Power & Fuel, Sundry
- Debtors etc.



Sale on credit or cash, in case of credit sale check the period of credit etc.

Present Working Capital facilities / limits and type of limit available from other Banks / Agencies

Own funds available with Borrower Co-operative

Funds required from the lending institution and period of loan

Security for loan offered and its availability

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Margin Money Estimation

A

First working capital requirement is to be assessed. Thereafter, based on industry/bank norms margin money requirement

B

Net Disposable Resources (NDR) - i.e. total long term funds - funds invested in long term assets

C

Margin Money assistance required would be shortfall in NDR i.e. (A) - (B).

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Loan Security Cover

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Security Cover (1/2)

GOVT. GUARANTEE

Check whether

-Govt. has agreed to give guarantee as per approved format
-Any prior conditions/ restrictions attached to the guarantee
-Past track record in honouring the Guarantees given to the concerned lending organization or others.
-Financial health of the State, etc.

BANK GUARANTEE

Check whether

-Nationalised/ Scheduled/ Commercial/ Cooperative/ State level

-Financial health of the ban

-Any restriclive clause in the guarante

-Duration of guarantee

GUARANTEE OF FEDERATIONS

Check whether

-Financial health of the guarantor,

-Past track record in honouring of guarantees, if any

-Whether its Board of Management is agreeable to provide the guarantee

FIXED DEPOSIT RECEIPTS

Check whether

-FDRs of scheduled / nationalised/ commercial banks wilh sound financial position only lo be considered

-Date of maturity of FDR should be beyond the loan period

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Security Cover (2/2)

MORTGAGE OF FIXED ASSETS

Check whether
-The assets are mortgaged to others
-examine the term loan liabilities from the balance sheets and security provided for existing loans.
-Book value of the assets
-Whether any revaluation of assets has been done, if so, by whom and when, whether the valuer is approved by Government / Govt. Bank approved
-Examine basis of valuation in the report, what is market value/realisable value/dislress value?
-Whether revaluation has been included in audited financial statement
-Whether adequate depreciation provision has been made in the previous years?
-Whether the cooperative society has clear title over lhe property, any clearances are requird from the State Government, existing charge holders or other agencies,
-whelher the cooperative society is prepared to meet cost of processing fee, legal documentation. Whether the cooperative society is in possession of title deeds and olher documents.
-In case lhe assets are already charged to other agencies, if they are willing to cede/share their charge in favour of the lending institution.
-Value of assets to be added in the project - take care not to include components such as margin money, interest during construction, contingency, etc.

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Funding Guidelines

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Funding Guidelines

- The society seeking assistance should have positive net-worth and its share capital should not have been eroded
- Audit of accounts should be complete upto previous year within 6 months of close of the financial year
- The cooperative seeking assistance should not have any major default in repayment of loans to the concerned bank or any other financial institution
- Debt: Equity ratio should be 65:35 to 70:30
- Security to the satisfaction of the lending institution:
  - Government Guarantee
  - Bank Guarantee
  - Mortgage of immovable assets. (1.5 times of the loan)
  - Pledge of FDRs (1.1 to 1.2 times of the loan)
  - Hypothecation of movable assets like stocks, book debt, etc. (1.25 to 1.5 times of the loan)
  - Personal guarantee of the Directors and collateral security

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Case Study

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Exercise

ABC Ltd. has submitted proposal for sanction of financial assistance for construction and expansion of storage godown / warehouse at a block cost of Rs.600.47 lakh (including Margin Money for raising working capital) through direct funding.

Project Financing –

Loan (51.18%)	Subsidy (18.82%)	From other source	Borrower's own share (30%)	Total Project Cost
Rs. in lakh	Rs. in lakh	Rs. in lakh	Rs. in lakh	Rs. in lakh
307.296	**113.034**	**-**	**180.14**	**600.47**

Loan period	Term Loan: 8 years with a moratorium of one year on repayment of principal. Margin Money: 5 years without moratorium on repayment of principal
Rate of Interest (Effective)	9.97% per annum
Proposed security details	The society has proposed to pledge FDR to the tune of 1.41 times of the proposed financial assistance to be sanctioned.

Exercise

<u>Assumptions-</u>

- •Total Storage Capacity – 11,643 MT
- •Capacity Utilization – 80% (1st Year), 85% (2nd Year), 90% (3rd Year), 95% (4th Year Onwards)
- •Year on Year increase in variable expenditure – 5%
- •Year on Year increase in insurance expenditure – 20%
- •Presently, society is using a rented godown for which society is paying rent at Rs. 175 per tonne per month

<u>Exercise –</u>

Prepare a project profitability statement and comment whether the project is profitable or not?

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Thank You