ASCENDANT CAPITAL ADVISORS

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Your business network, knowledge and intelligence partner.

CORPORATE FINANCE CONFERENCE

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FINANCIAL DUE DILIGENCE PRESENTATION

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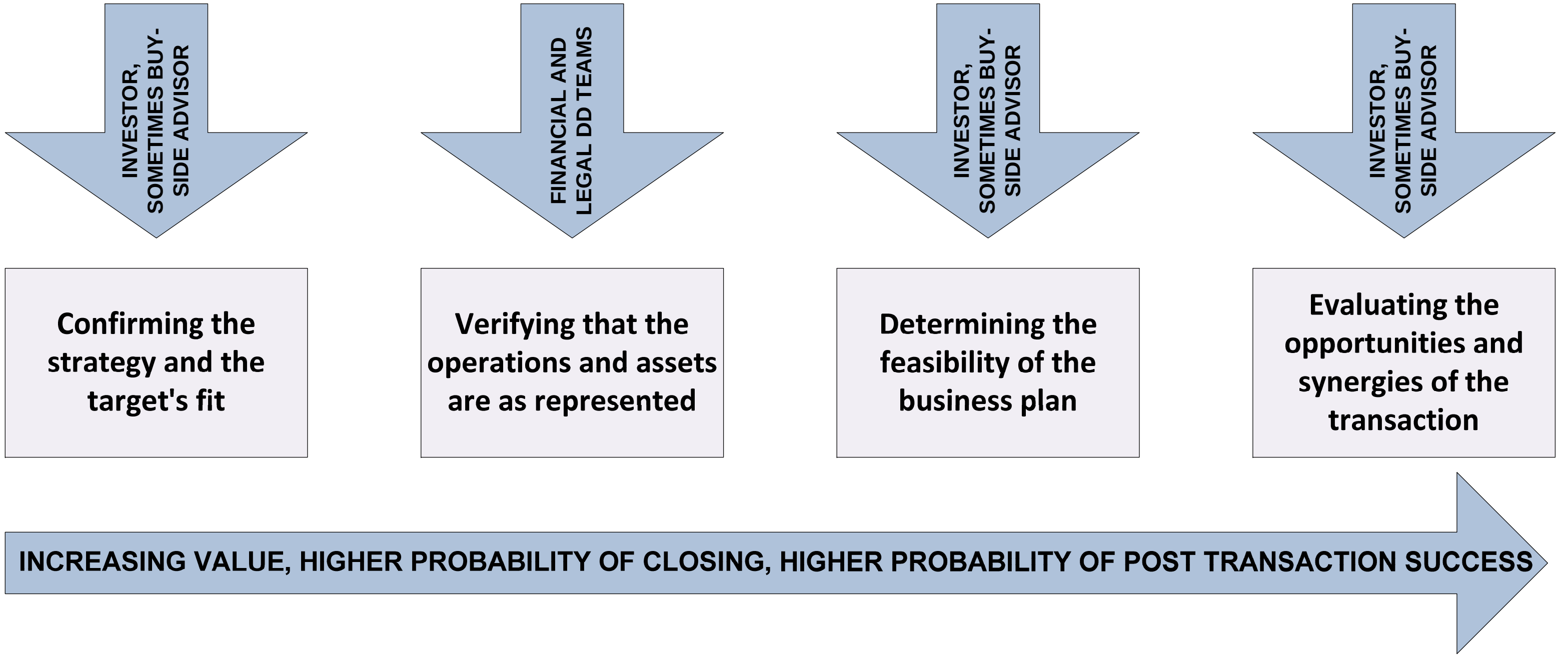
Ascendant Capital Advisors

Definitions of Due Diligence

- **Investopedia**
  - An investigation or audit of a potential investment. Due diligence serves to confirm all materials facts in regards to a sale.
  - Generally, due diligence refers to the care a reasonable person should take before entering a transaction.
- **Black's Law Dictionary**
  - The diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation.
- **Ascendant Definition**
  - Due diligence is the process by which an investor minimizes the risk of a transaction, and „due" refers to the amount of investigation that is necessary to reasonably reduce the level of risk (not to avoid risk altogether).
  - The Croatian term „dubinsko ispitivanje" seems to be wrong in that context. It is not necessarily a „deep" or extraordinary investigation, as much as an „appropriate" or „reasonable" investigation.

Overall Scope of Due Diligence

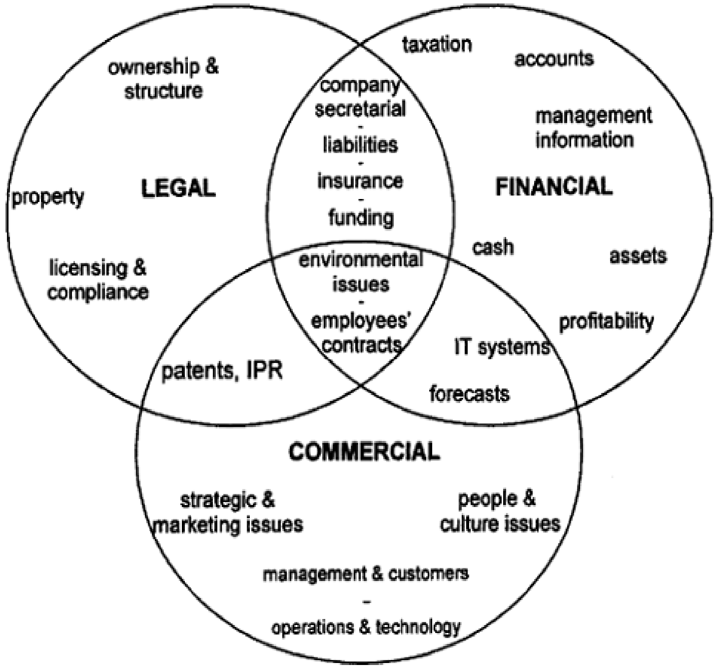
- Phillip Clements in his foreward to „The Art of M&A Due Diligence“, cites the four actions that are part of the due diligence process, the purpose of whic h to provide the investor a <u>“safety net” of value</u>:



- See *Lajoux and Elson*, “The Art of M&A Due Diligence”, McGraw Hill, 2000

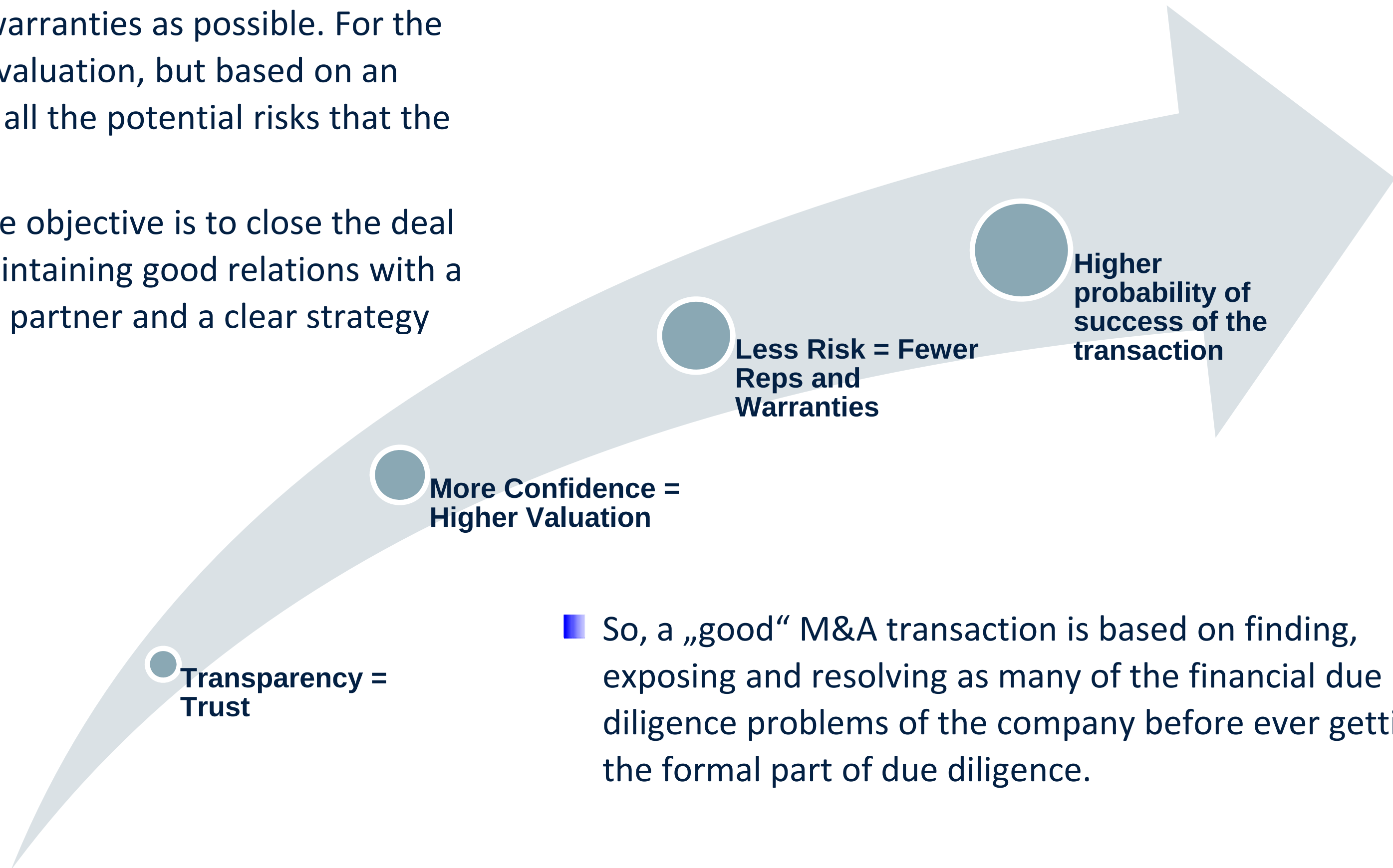
Extent of Due Diligence

- The second thing to say about the scope of due diligence is that it is sometimes difficult to draw boundaries between the different types of due diligence. The financial and due diligence by advisors does overlap with the commercial due diligence, but does not replace it. Furthermore, as shown, the scope could also include a deeper examination of :
  - Personnel issues
  - Operation activities
  - IP and Technology assets
  - Environmental issues
  - Health and Safety issues
  - Compliance issues
  - Cultural issues



The Basis of a “Good” Transaction

- The objective of an M&A process is to close a deal acceptable to both sides of the transaction. For the seller, this means a good valuation with as few reps and warranties as possible. For the buyer, also a fair valuation, but based on an understanding of all the potential risks that the he is assuming.
- For both sides, the objective is to close the deal without while maintaining good relations with a good trustworthy partner and a clear strategy for the future.



- So, a „good“ M&A transaction is based on finding, exposing and resolving as many of the financial due diligence problems of the company before ever getting to the formal part of due diligence.

The role of the M&A Advisor

- The M&A process starts with **a business and financial due diligence carried out by the M&A advisor**.
- The tangible result of this is a **financial model**, based on a **business plan**, agreed with management, and which, presented together with a description of the company, its products, market strategy and position, management capabilities, potential for growth, makes up the **Information Memorandum**.

Transaction Planning
- Identify the optimal transaction stucture
- Define the target market(s)
- Identify potential candidates and investors
- Perform internal business due diligence
- Develop transaction materials: teaser, info memorandum, confidentiality agreements, presentations, back-up materials, begin assembly of due-diligence documents

Approach to Investors
- Identify additonal targets through IMAP network
- Mainatin confidentiality and momentum
- Advise and coach management on presentation
- Maintain tight schedule and coordination between all parties

Selection process
- Assess levels of interest
- Answer additional questions and distribute additional information to all parties
- Organize and drive management meetings
- Guide investors to proper valuation levels

Negotiation process
- Agree preliminary Term Sheet(s)
- Decide on level of exclusivity
- Coordinate financial and legal due diligence
- Set deadlines and schedules
- Coordinate production and negotiation of transaction documentation

Closing and execution
- Coordinate execution of Conditions Precedent to avoid last minute surprises
- Closing and transfer of funds
- Develop post-transaction plan with client

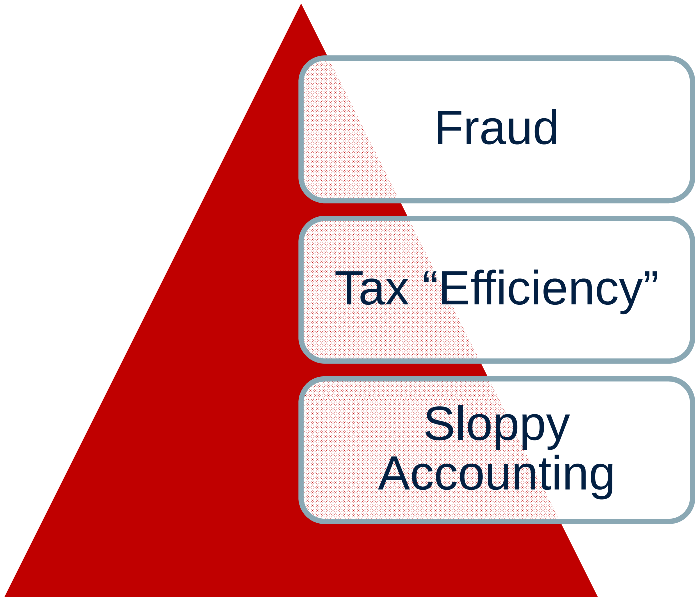
1 Month → **3 Months** → **6 Months+**

The “Pressure of the Process”

- This process is very “front-end” loaded = short time period
- Before signing an agreement, the M&A advisor cannot know what kind of problems lie within the company and its accounts. Once the agreement is signed, everyone is under pressure to keep to an agreed upon schedule i.e. keep the process going. The owner is usually now committed to the process, which we sold him, so he wants to see a result as soon as possible, (and he does not like paying the monthly retainer).
- For good companies that have all of their financial affairs in order this process is relatively straightforward, but even good companies have problems that left unresolved will be uncovered during due diligence, the effect of which will be to lower valuation.
- Types of issues to be resolved during the M&A preparation phase process
  - P&L and Balance Sheet Issues
  - Business Plan and Strategy Issues
  - Transaction Structure Issues
- If problems are found, the net result, can be
  - An extended assignment while we work through the problems = delay and expense
  - An acknowledgement, analysis and documentation of the problems resulting in a „pro-forma“ presentation of the accounts = preferred solution if possible
  - In extreme cases, a recommendation to abandon or re-structure the process = last resort

Types of P&L and Balance Sheet Issues

- The key financial due diligence issues mostly are related to -
  - **Over-reporting results**, the purpose of which is either to maintain bank lines of credit or to obtain an inflated valuation. The risk is that the company will have a lower valuation than at first expected and that there will be credibility issues between the partners.
  - **Under-reporting results** (this is much more common) in order to pay less tax. The risk is related to future tax liabilities and additional reps and warranties.
- These issues can be the result of sloppy accounting, tax "efficiency" or, in the worst case, fraud. In each case, the investor will evaluate and attempt to minimize his risk through transaction structuring and the extent of reps and warranties, or by stepping away from the transaction.



"We need to disguise these numbers. Take this down to accounts deceivable."

Top 11 P&L and Balance Sheet Issues

- 11. Over capitalization of salaries related to dubious „research projects“
- 10. Under or non-reporting of cash payments, compensation payments or payments in kind
- 9. Front-loading or early recognition of revenues
- 8. Extended depreciation periods
- 7. No write-off of obsolete inventory
- 6. No recognition of disputable receivables or payables
- 5. Related-party or „friendly“ transactions
- 4. Major personal expenses charged to the company
- 3. Abuse of travel expense allocations
- 2. Real estate and personal asset issues
- 1. Payment of bonuses via cash payments from dividends

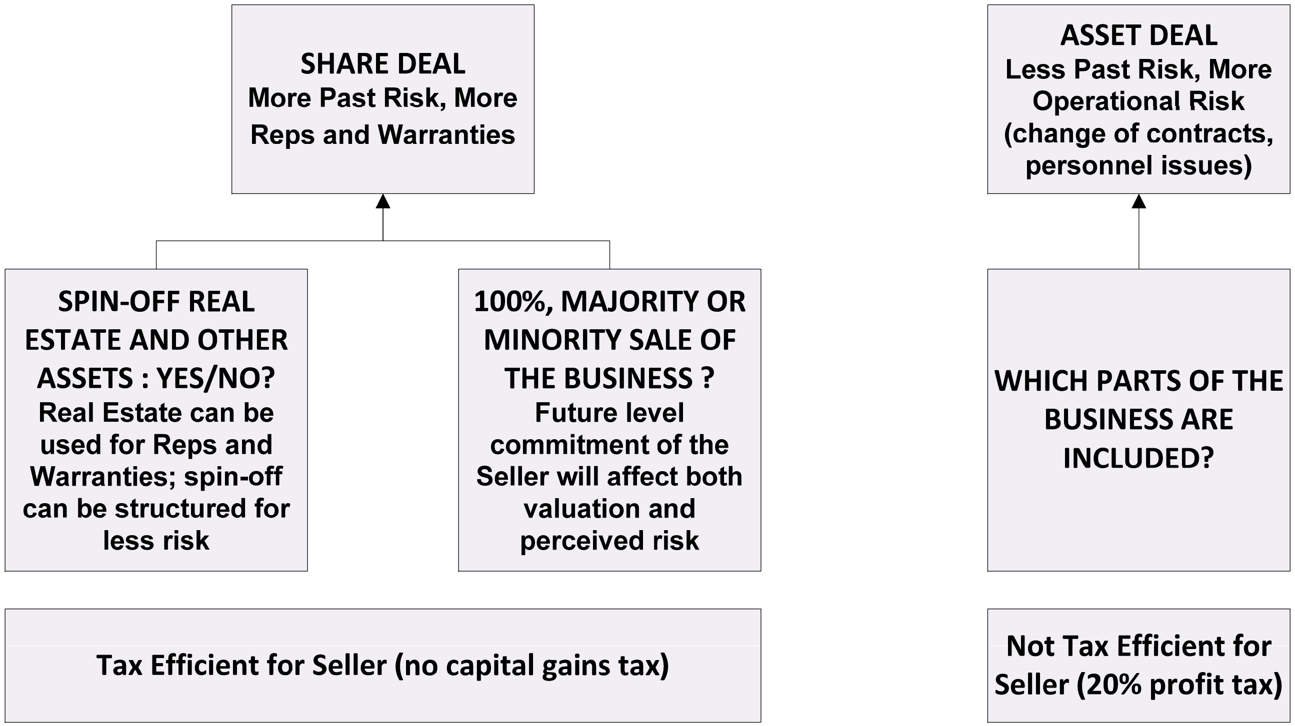
Business Plan and Strategy Issues

- Most private companies do not have a 3-5 year business plan. Even the best companies have at most a good 1 year business plan.
- The M&A advisor forces the management to take its views on future strategy and transform them into views on revenue growth, COGS, OPEX, investment requirements, loans and interest rates and inflation.
- This is a very subjective but necessary process in order to create the financial model.
- Most investors will make their own assumptions about the future business plan, but will use this as a starting point for the discussions.
- Operating Due Diligence should focus on the coherence and credibility of management's assumptions and the resulting financial due diligence should concentrate on those areas to which the business plan is most sensitive.

"Look what I found in the dumpster! A perfectly good business plan!"

Transaction Structure Issues

- Prior to Due Diligence, the projected transaction structure must be defined in a Term Sheet and the extent of detail in the Term Sheet will depend on the foreseen structure. The structure will define the risks of the transaction and thus the extent and basis of required due diligence.



Problems with the Due Diligence Process

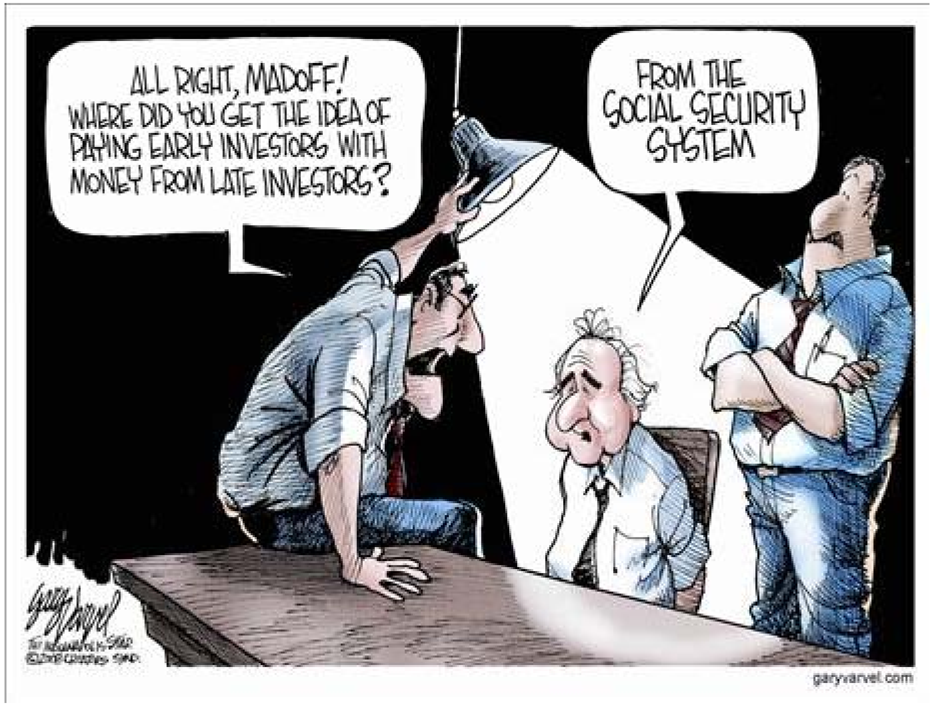
- **Secrecy**
  - Many companies, especially smaller companies, do not want their employees and customers to know that they are in a transaction process. Employees could begin looking for new jobs, customers could become concerned and start looking for alternative suppliers. One deal of ours was delayed more than a year because of leaks coming from the buyer's organization. Solutions, besides code names, blind teasers and off-site meetings, is to create a small team within the company responsible for providing information to the advisors. The obvious problem is that access to the company and management structure is limited, affecting the quality of information.
- **Disruption of operations**
  - A due diligence process has to be handled so that the operations of the company are not disrupted. Management time has to be rationed to the process. The advisors are compiling the information on an ongoing basis as required during the preparation stage. This is compiled either in an off-site physical or virtual data room.
- **Confidentiality**
  - Especially when competitors are potential bidders, which is often the case, a staged due diligence and negotiation process must be constructed so that as more information is revealed, the parties are more and more committed to close the deal. Some confidential documents relating to the company's strategy and business are held back until the buyer after signing of transaction documents.

Due Diligence is a Risky Process for Both Sides

- **Necessity of Reverse Due Diligence**
  - Even with confidentiality agreements in place, due diligence is a highly risky business. A competitor is playing a different role – that of a potential partner. Revealing even basic strategies could damage the business. So, due diligence should also be carried out by the seller on the buyer. This could include:
    - a) The acquirors history of acquisitions
    - b) An analysis of their balance sheet and ability to finance the deal, and operations
    - c) An analysis of the strategic fit and potential synergies
  - Even if 100% of the company is being sold, the owner wants to know that the company that he has built will be going into good hands, that will continue the company's traditions and take care of its employees and management. This is not always possible, but the more likely this is, the more likely the transaction will actually take place.
- **Necessity of a Step-By-Step Process**
  - Incremental information flows after defined milestones increase trust on both sides of the transaction.

Conclusions

- Due diligence is an extensive and on-going process and not a one shot deal by advisors.
- The earlier that problems are flagged and corrected, the easier the transaction process. Transparency leads to trust, better valuations, an easier due diligence process and a higher probability of success.
- The preparation phase by the M&A advisor is an essential step to provide transparency and structure to the process.
- The transaction structure must be clearly agreed to allow for appropriate due diligence.
- The burdens of the due diligence process on the seller must be minimized to eliminate potential future operational problems.
- Due diligence should be a two-way process to assure a post-transaction success.



Ascendant Capital Advisors - Snapshot

- Established November, 2003; Founding member of M&A CEE – Mergers and Acquisitions of Central and Eastern Europe
- Exclusive Croatian partner of IMAP, world's largest organization of M&A advisory firms
- 12 completed M&A transactions, with a total transaction value over €90 million
- Current backlog – 15 signed M&A sell-side and buy-side deals with a total projected transaction value of over €200 million
- Offices in Zagreb and Sarajevo, with associates in Belgrade and Ljubljana
- Services
  - Sell-side advisory
  - Buy-side advisory
  - Capital Raising
  - Valuation and financial analysis services

Ascendant completed M&A Transactions

This announcement appears as a matter of record only

Foto-Nekretnine d.o.o.

The owners of Foto-Nekretnine d.o.o. have sold a 70% ownership share to Xmedia AG, a subsidiary of Swiss media house Ringier AG.

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

The owners of Adriatic Media d.o.o. have sold a 75% ownership share to Centrum Holdings B.V. a subsidiary of Warburg Pincus

The undersigned acted as exclusive advisors to the sellers.

This announcement appears as a matter of record only

Logos d.o.o.

The owners of Logos d.o.o. have sold a 60% ownership share to Asseco East Europe Group

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

The owners of Lukaps d.o.o. have sold a 100% ownership share to ACG Worldwide

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

Vodatel d.o.o.

The owners of Vodatel d.o.o. have sold a 100% ownership share to Metronet telekomunikacije d.d.

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

DIETPHARM-FIDIFARM

The owners of Fidifarm d.o.o. and Dietpharm d.o.o. have sold a 100% ownership share to Atlantic grupa d.d.

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

Tau on-line d.o.o.

Kreativni poduhvati d.o.o.

The owners of Tau on-line d.o.o. have sold a 60% strategic ownership share and a minority share in its subsidiary Kreativni poduhvati d.o.o. to Northcliffe Media Ltd, a regional division of Daily Mail and General Trust plc.

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

Senso Mikro d.o.o.

The owners of Senso Mikro d.o.o. and HG Spot d.d. have concluded a merger transaction

The undersigned acted as exclusive advisor to Senso Mikro d.o.o.

This announcement appears as a matter of record only

Megaklik d.o.o.

The owners of Megaklik d.o.o. have sold a 80% ownership share to Shibsted SA and Styria International – Styria Medien AG.

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

The owners of ZU Ljekarne Dvoržak and Alpha Medical d.o.o. have sold a 49% ownership share to Lyf & heilsa Inc.

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

The owners of Oktal Pharma d.o.o. have sold a 49% ownership share to Andreae-Noris Zahn AG (Anzag).

The undersigned acted as exclusive advisor to the sellers.

This announcement appears as a matter of record only

EPM USLUGE d.o.o.

The owners of EPM usluge d.o.o. completed the Management Buy-Out of Elka kabeli d.o.o.

The undersigned acted as exclusive advisor to the buyers.

Ascendant Team

Thank you!

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