



KPMG Private Equity Group

Due Diligence in Latin America

Presentation to LAVCA Third Annual LP/GP Roundtable

October 16, 2008

ADVISORY

Agenda

- **Regional characteristics present challenges**
- **Typical financial/tax deal concerns**
- **Success stories**
- **Concluding remarks**

Regional characteristics...

- **Emerging market challenges and opportunities**
 - **Infrastructure and investment needs**
 - **Limited regulatory oversight and public markets**
 - **Limited publicly available information**
 - **Statutory labor protection**
 - **Entrepreneurial culture (large number of family-owned companies), lack of PE understanding**
 - **Distribution of wealth**
 - **Enforceability of contracts**

...lead to deal concerns

- Business environment and cultural differences
 - Aggressive tax positions
 - Value perception gap
 - Off-book transactions
 - Related party transactions
 - Lower level of sophistication outside upper management
 - Are there viable exit options?
- } – What is the real picture?

Common due diligence findings

Financial due diligence should plan to address...

- **Quality of financial information**
- **Identification and quantification of unrecorded liabilities**
- **Personal and non-operating expenses on books**
- **Target's usage of judgmental reserves and allowances**
- **Maintenance and Capex history and needs**
- **Normalized working capital analysis**
- **Impacts on quality of earnings and asset valuation**



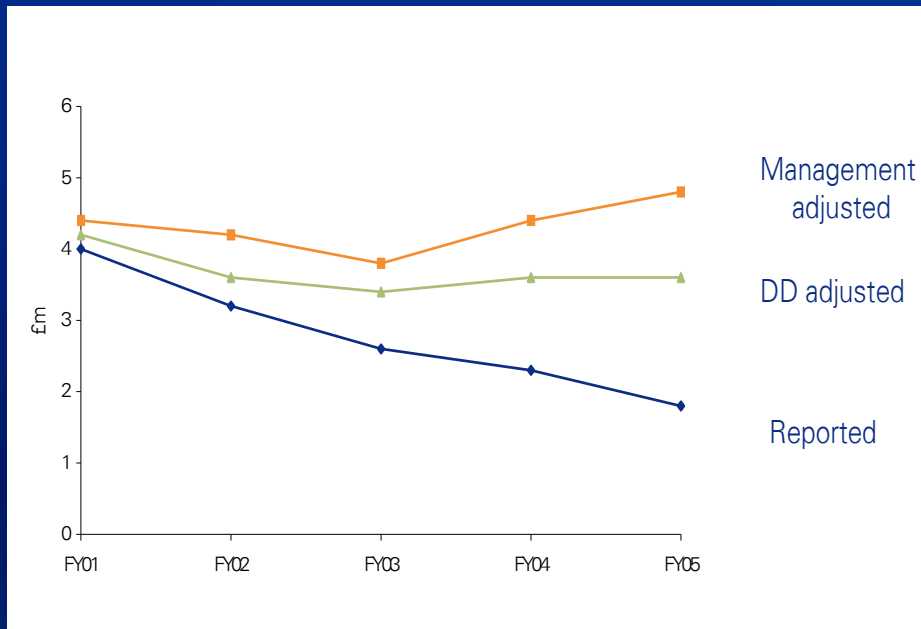
Common due diligence findings, cont.

Tax and labor due diligence should plan to...

- **Identify aggressive tax positions taken**
- **Understand manager-owner compensation schemes and implications thereof**
- **Assess quality of tax compliance (form-over-substance);**
- **Consider all applicable taxes (i.e., income, VAT, asset tax, social security etc.)**
- **Consider funding status of post-retirement benefits**
- **Summarize and quantify tax and labor contingencies**
- **Impact of due diligence findings on structuring alternatives (i.e. exit options, dividend capabilities, etc.)**

A few war stories (EBITDA #1)...

Project Retail



- Target increased prompt payments to vendors
- COGS adjusted to reflect discounts as a reduction on purchases
- Considerations given on deal –
 - > Working capital
 - Impact on on-going vendor policies
 - Classification COGS vs. financial item



A few war stories (EBITDA #2) ...

Project Pool

- Management had adjusted EBITDA for “excess compensation” to shareholders
- Inquiry of shareholders revealed that funds were used for facilitation payments and other expenses paid in cash
- EBITDA add-backs were reversed to account for business expenses paid directly by shareholders

In your discussions with banks for LBO financing

It is important to consider the timing and ability to incorporate EBITDA adjustments into BOOK EBITDA to avoid non-compliance with covenants

A few war stories (Net debt) ...

Project T-Bone

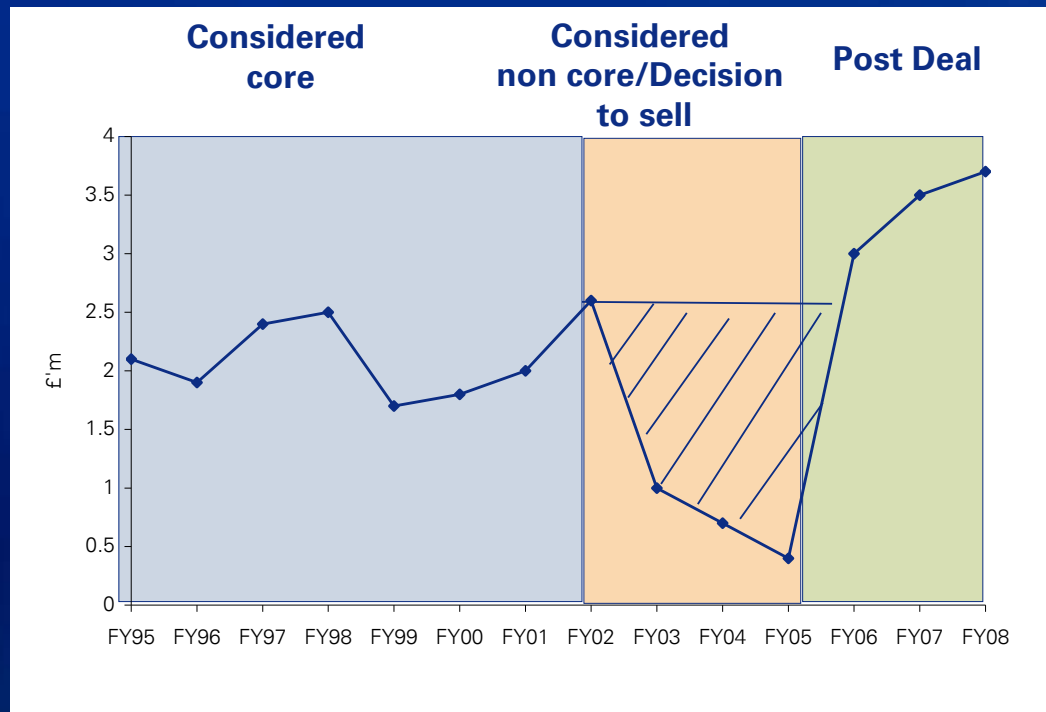
- Transaction negotiated on a debt-free/cash-free basis
- Target's deferred tax liability included \$95 million of taxable inventories which would reverse out in the next 7 years
- Buyer able to negotiate to classify as debt the NPV of taxable inventories for about \$20 million

For the purpose of debt free cash free price adjustment mechanism, seek definition of:

- Debt as wide as possible
- Cash as narrow as possible

A few war stories (CAPEX) ...

Project Rabbit



- Analysis of SG&A showed a significant increase of freight expenses.
- Target annually had acquired 90 trucks as compared to 12 in the most recent period
- Buyer able to negotiate \$11 million for unserved CAPEX

Concluding remarks

- **Phased approach – deal killers first**
- **Longer diligence cycles – different sense of urgency**
- **Quality analysis – normalization (EBITDA, cash flow and working capital requirements)**
- **Consideration of asset vs. stock deal**
- **Corporate governance and terms of shareholder agreement addressed earlier**
- **Family company issues**
- **Reliance on reps and warranties**
- **Clear exit strategies at entry**

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