Scenarios

The All Seasons Coin Operated Car Wash

A law firm has hired you to assist with the purchase of a business.

The law firm's client is looking to purchase the All Seasons Car Wash. It is a small family-owned business. The lawyer is a bit skeptical of the seller. When asked why he was selling the company, he said, “Well, my kids are in college and are no longer around to help work the business, so I am going to sell the business and put the money toward tuition.” The seller produced a set of books that looks good, not great, but the bank deposits do not even follow the gross revenue from the Car Wash. The business seller agreed with the discrepancy and said, “Hey, it's a cash business, and sometimes I just take some WAM – Walking Around Money, everybody does it, and you will too.”

The asking price is USD 850,000, which includes the buildings, the land, and the business, as well as bits and pieces of miscellaneous equipment needed to run the business.

You are now charged with planning an investigation and asking questions.

Begin with asking questions. Create hypotheses of risk, and ask the questions that need to be asked to assess the risk. Also, consider hedges to the risk assumed.

Once this is done, set out a plan to access the informational resources you think you will need. Plan the research with the understanding that you have a small budget.

Why does the client want to buy the business? Motivation?

It is a small business, family owned, define small.

How does the family who owns the business live? How big is the family?

Why is the family selling the business?

The business is fully automated, and does not require any supervision, why would the kid be needed to help?

Where do the kids study?

Do an audit of the books and link the bank deposit to the way of life of the family (spending)

Do the machines have any mechanism to count the money incoming?

Place the value of purchase (USD850K) in comparison with the value of building, land, recorded business revenue.

The bits and pieces should be written off in this review.

What is the neighbourhood like?

Is the land based on or within developing area? (This could massively increase the value of the property.)

Is the land in risk area? (Crime, factories, environment, which could massively decrease the value of the property)

Have someone monitor the business randomly and specifically, during the day and night on weekdays and weekends.

Ask neighbouring businesses and preferably people who linger around like homeless people or mobile vendors on the frequency and popularity of the business.

Check with the city council for the status of the land including planning approval, planning proposal, surrounding development plans and zoning (rezoning), as well as any other note-worthy aspects.

Check the state of the business property, maintenance and operating cost.

Is there a connection between buyer and seller? (money laundering)

Corporate Gifting Policy

You have been asked to work with a large multinational company as an independent consultant. The company is involved in purchasing, restoring, and upgrading older HIND helicopters. The aircraft are multi-use but are easily armed. They are a favorite helicopter of smaller with border issues and insurgent issues as they are relatively cheap and easy to fly.

You have accepted the generous retainer and have begun work. As we all know, you are a brilliant and earnest group of consultants, not an Arthur Anderson Alum.

Comentado [VZ1]: Big 5:
KPMG
PwC (Price Waterhouse Coopers)
Deloitte
E & Y (Ernst and Young)
Arthur Anderson

One week later...

A scandal has rocked the company. It seems one of the former executives were both getting and receiving gifts that were, in fact, quite large. The amount is a bit of a mystery as these gifts always have a delta between retail, perceived, and purchased value – but we assure you they were quite large. The executive is protesting the broad brush of mischief he is being painted with, as he has said, that this, gifts and expensive meetings, is the normal course of doing business with the intended clients. The nature of building both trust between the company and the client for sale involves some time to be spent on expensive social obligations and some remembrance and thank you gifts. In his defense, in a public statement, he said, "I can't sell millions of dollars of equipment taking this type of client to cheap chain joint. I cannot sell what I have sold, dropping off Hallmark Cards with a nice piece of candy inside." The governments and companies' positions are ludicrous, and I will fight these accusations and any charges leveled – no plea, no deals.

Senior management, in response, has made a public statement that they will pursue ultimate integrity for the company. Further, they have announced a new "Zero Tolerance Policy" for any form of bribery or gifting outside of the policy guidelines. That each and every transaction will be fully vetted to ensure no undue influence will ever occur.

Guess what? You get to draft the new policy of gift getting and receiving. What are you going to consider? What are the questions to be asked and answered? What will you propose as guidelines, and what else might you suggest?

Reject the offer to draft the policy and refer them to a lawyer. The legal responsibility and liability are far too high for anyone but a lawyer to accept this task.

Why? How to define the boundaries? How to define the amounts? How to define the scope?

Why would the seller be bribed?

The issue here is not that the executive has been bribing government officials and other company executives, but that the executive has received favours ("bribes") to sell. This might indicate, that, for personal benefits, he may have put disadvantage onto the business rather (e.g. giving unreasonable discount or preferential treatment to the disadvantage of other clients and customers)

Did he buy crap for high price, did he equip with low quality for a high price, or did he sell high quality for low price?

Has the company suffered any lost through the business of this executive?

Did another company set up the executive in a scandal related to another business opportunity?

10 Billion Commodity Bonds

Two publicly traded funds have invested in 10 billion dollars of commodity bonds. The investors include a few prominent European corporate pension funds and a large US broker-dealer. The funds are both audited by one of the big accounting firms. The company offering the commodity bonds is also audited by one of the big accounting firms. The officers and directors are well known and are experienced persons with tons of information on LinkedIn.

The opportunity is simple; you can buy the bonds at a discount of 22%, and the bonds mature in two years. 11% per year fully collateralized investment is an excellent opportunity. The bonds are backed by over 10 billion dollars of diesel fuel to be delivered/sold. The diesel fuel is produced at the refineries of Bashkortostan, a republic within Russia. The bonds are traded on Cbonds.com, and you have a copy of the bonds with a safe-keeping receipt issued from the custodial bank holding the bonds, NatWest in London.

The documentation is excellent; the people are real people, the company offering the bonds and the funds are audited by big accounting firms, and you have copies of the disclosure on the bonds, a copy of the bond, and a safe keeping receipt from the custodial bank behind the two funds for the bonds that are for sale.

Comentado [VZ2]: Red flag: they trust anyone and they just invest, they do not do due diligence; not a competent client here

Comentado [VZ3]: Untrustworthy, they may make the books look good just to get the money

Comentado [VZ4]: untrustworthy

Comentado [VZ5]: facebook for executives and wanna be executives; only ideas provided, but no proof

Comentado [VZ6]: risk: traded commodity price fluctuates/price is volatile

Comentado [VZ7]: is a future trade, insecure, maybe you do not have it yet

Comentado [VZ8]: stay away from this investment because they do not even have the oil or fuel

Comentado [VZ9]: traded widely on the internet, which means unregulated

Comentado [VZ10]: they are only issuing a receipt that are holding a document which does not provide any guarantee on the document, nor on the deal related to the document nor on the parties involved in the deal

Your manager says, “Hey, this looks good.” She asks you to look into buying the bonds.

What do you do first?

What questions must be asked and answered, and do your best to put the questions in order – or bunch them if you think several are or could be done simultaneously.

Do they actually have the oil to produce the diesel fuel? How stable are economy, politics and country as such? What is the relationship between Russia and the country (Bashkortostan) as well as other countries. Where is the oil coming from?

This bond is based on a future deal, expected to happen, under the presumption that it will happen. However, there is no guarantee that it happens at all. The allocated risks are far too high, e.g. supply of material, the capacity to produce, political and economic stability, and most of all, the sales to whom, and at what price?

Documentations are excellent, yet only speculative, not really based on anything real. The people are real, and surely earning a lot of money, yet hardly holding any responsibility or liability, the audits of companies by big accounting firms are only related to current activities at that moment of audit and not to future activities, and therefore, does not guarantee anything, and it is good to know that the documents are kept safe by a great and reliable bank, yet that does not help anyone. The function and position of the bank in this case seems rather passive than active, and thereby, should not be valued too high.

With increasing inflation, on a high rate, bonds can have negative rate of return. There is possibility of default, as bonds depend on the ability of the issuer to repay the debt.

What is the intention for buying the bond? Periodic income or capital gain? Bond has fluctuating price. What is the probability of default risk? Risk effect of interest rate on bond? If holding until maturity, there is less risk by interest rate, but more by default. High coupon rate means high default risk.

There are 4 parties to be considered,

- **the issuer**

Who is the issuer? What is their reputation? What is their credibility? What is their financial status?

- **the seller**

Who is the seller? What is their motivation to sell? How much do they earn?

A seller generally has no liability. As a middle man, they earn commission on the sale and then are out of the picture, no matter what the outcome is

- **the buyer (the manager in this case)**

what is the motivation to buy? Where is the money coming from?

Money used to be "in excess", i.e. the money should be considered written off in case of default as worst case scenario. If the money is uses to buy is vital to the business operation and the business survival, then do not invest in bonds due to the high risk.

- **the shareholders or the stakeholders of the business**

Do they approve of the business transaction (which is the purchase of the bonds)? Are they willed to sacrifices the money for the potential gain?

Recommendation: not to go for this bond as the risk is too high.

Sale Side Due Diligence

Congratulations, you are the Chief Due Diligence Officer of a medical device company about to be bought out. Your CEO is a hard-charging woman with little regard for formalities – you know, a typical investor and entrepreneur. Nothing odd but defiantly not corporate. It is part of her grace, charm, and danger. It has been two years in the making. Every step and everything she has touched has turned to gold – indeed, the Midas Touch.

The company was one of the very first ever to get serious crowdfunding. Your CEO did her level best to get the company up on a crowdfunding platform, raised 6.3 million dollars, and fulfilled the expectations of everyone. The information about the offer has leaked out, no one is sure how, but it has leaked out. Your CEO, she has made no comment and suggested, "everyone just shut up." That was the quote she gave in the local Business Journal. Now even the crowd-funding platform is crowing about your future success.

The buyer is a known company. They are a NASDAQ-listed firm with a great reputation and an excellent and skilled acquisition team. They have been making many acquisitions.

You have a significant stock position; in short, you need not work a day in your long life with the money from the sale, even after taxes.

You have been charged with Sell-Side Due Diligence. That is what the CEO said as she left to return to the laboratory. In management parlance – the framework for your assignment is YOYO.

Comentado [VZ11]: your on your own

So what do you need to do? What are the questions to be asked and answered to complete the transaction?

Why do I have a significant stock position?

- **Establish a motive**

Why would we want to be selling?

Does it make sense to sell now? Or is the position better not to sell?

Do we have reason not to sell?

If we can or want to sell, how can we motivate a price increase?

- **Analyze financial:**

Are we solid in financials?

Are we attractive in terms of revenue? (consider the financial ratios)

How do we compare to other companies in terms of margins, inventory cycle, cash flow issues? How about the capital-to-sale ratio? How do we finance the business? And more (other ratios)

What is our financial status?

- **Ensuring business is sustainable**

Is our business sustainable?

What are the future prospects of the business?

How would it grow (SWOT, PESTEL)?

What kind of relationships do we have with sellers and buyers?

- **Ensuring Transparency**

Is our business formal or informal? How do we conduct business? Do we do barter trades?

Does it make sense to sell the business now after knowing it better? What would be the bottom, fair, top (acceptable and aspired) and what should be the negotiable asking price?

Should I buy the business myself? (since I hold enough stock and can use crowfunding)

New Medical Device to Treat Leishmaniasis

A new medical device designed to treat Leishmaniasis is being developed. If you are not familiar with Leishmaniasis – it is a skin infection that is spread by the bite of a sand fly. It is a parasitic intramacrophage that produces flesh-dissolving sores. There are about 20,000,000 new cases yearly, and over 1.5 billion people are exposed to this parasite. It's gross – do not look at the pictures on the internet unless you want to.

The medical device uses a specific wavelength of light to treat the sores. It seems the wavelength of light interrupts the proteins in the intramacrophage during reproduction. A side benefit is that the wavelength of light also helps prevent secondary infection of the necrotic tissue left behind as the disease slowly dissolves the body's cells.

Several studies have been done by groups in Taiwan and Africa demonstrating the effectiveness of the approach used by this medical device. Two papers on the topics were presented at a medical conference in Taiwan, one at the medical school in

Kampala, Uganda one at the Al-Nahrain University in Bagdad. Two additional papers were written taking information from the studies and were published in Science and one in the IEEE Journal. The results have been so consistent that the company has applied for and received a federal grant to further the device's development and commercialization.

Comentado [VZ12]: Iraq

The investment banker is looking to you to help them with the due diligence on the company. They are looking to raise $30,000,000 for the company in equity and debt to investors in the US and overseas.

Comentado [VZ13]: Selling equity like a stock, which is not public traded

You are now charged with planning an investigation and asking questions.

Begin with asking questions. Create hypotheses of risk, and ask the questions that need to be asked to assess the risk. Also, consider hedges to the risk assumed.

Once this is done, set out a plan to access the informational resources you think you will need. Plan the research.

Does it make sense to put this company public?
How can equity be justified with such a high price tag?
Are these studies credible?
What was the federal grant given for? Based on what?
Are patterns pending? How many people have the knowledge of the device details?
What is a potential outlook for the company? What could be a profit projection?
Are there investors or companies interested in this investment opportunities?
Who are the competitors?
How advanced is their research?
How financially independent are they?
Can this company be considered a humanitarian or philanthropic project for the benefit of all?
What’s the current value of the business? Who are the stakeholders?