White Paper 2025-05

How to Conduct Due Diligence Project Reviews: Project Assessment in Incomplete Information Context

We are sometimes called in to value capital projects as part of a due diligence, particularly in the context of merger & acquisitions. Valuation of such segments of the business requires specific approaches and skills that are quite different from the usual due diligence appraisal approaches and require a specialist in the field of capital projects. In this White Paper, we examine how to conduct such due diligence in the context of partial information.

Why the valuation of projects is essential in most due diligence

For most companies, capital projects will have a major influence on the medium to long term value of the business.

- For owners, the performance of large capital expenditure projects will have a substantial long-term impact on future profitability of the business.. The portfolio of such projects and the ability to deliver them successfully will also often dictate the future competitiveness of the company in terms of capacity, capability, productivity, operating expenses and amortisation. Also, on the short to medium term, irrespective of the forecast profit & loss statements, the cash outlays required for the capital projects will have a substantial impact on the company cash flow situation,
- For contractors, contracted projects (and submitted bids) are usually a large part of their business. The forecast margin at completion is an essential part of the future short to medium term cash flow estimate and thus of the company value based on a multiple of EBITDA. Many contractors also have capital projects on their own to develop internal assets, and this may also be an important area for due diligence (example: specialised ships for offshore construction).

There have been many examples in the past of transactions where the buyer overpaid to acquire a business to finally find a dire project situation that has actually destroyed value on the medium term (and sometimes, even put the buyer in a very difficult financial situation). Guarantees provided by the seller during the transaction generally have a ceiling that is quite limited compared to the major consequences of a project turning sour. Generally, the mere fact that a transaction is contemplated may be an indicator that the forecast of some current projects is not as good as reported. Alternatively, the prospect of a transaction may lead:

- a contractor to inflate the order book by committing to excessively low priced projects or with poor terms and conditions,
- an owner to launch a portfolio of underestimated the cost and duration and overestimate the performance of capital projects showing inflated future benefits in the business plan and an inflated net present value.

Why the valuation of projects is a difficult endeavour, particularly in the context of limited information

The valuation of projects relies mostly on the quality of the project forecast (or, for projects in bidding or development phase, on the quality of the estimate). It is thus an indirect indicator that cannot be directly measured through usual financial analysis of (past) accounting statements. Evaluating a project cost and schedule estimate or forecast, and operating expenses for capital expenditure projects, requires a deeper understanding of the underlying business or contracts, and a good understanding of challenges of capital projects, and thus the intervention of specialists with ample experience in the matter. While it is already a challenging endeavour during project reviews where all data and project personnel are accessible, it is even more difficult in the context of a due diligence where data is limited and access to project personnel often impossible or heavily restricted.

Independent evaluation of the health of capital projects is even more difficult during a due diligence because of the limited documentation and lack of access to the project team.

In addition to producing an alternate estimate or forecast, an important outcome is also to evaluate the associated level of risk so that sensitivities can be taken into account in the financial models of the acquirer, and adequate provisions can be derived that will influence the proposed valuation.

The importance of an overall review of project management capability and track record

Past performance does not always reflect current or future performance, in particular if the company being acquired tried to increase value by boosting its order book taking risky or low price projects.

Nevertheless, there is great value in evaluating the competency and maturity of the project management framework that is deployed within the target organisation.

- Past experience and track record vs current portfolio - unchanged or increase in size and complexity?

© Project Value Delivery, 2025

- Past performance on similar projects and actual delivery capability
- Current and projected project governance and support organisation
- Current project management system and tools
- Project organisation charts and experience of key people
- What is included in the deal? (will all these great processes, support organisation and people come along?)

It will also be important to assess the realism of the current project portfolio.

- For owners, duration and timing of different project definition stages
- For contractors, margins and contingency levels of won projects at bid submission
- Ramp up of personnel on the different projects
- Capacity to deliver the portfolio as planned (may significantly affect the cash flow and NPV if critical projects in the portfolio are delayed for realism/capacity)

For most companies, capital projects will have a major influence on the medium to long term value of the business

What key information is required to assess specific project estimates or forecast?

To produce an alternate estimate or forecast, and an evaluation of the related uncertainty and risk, as direct information will generally be limited, indirect methods will need to be used. We generally use a 3-step method. If any one of those steps fails, then it means that there is a high suspicion that the estimate or forecast will be off the mark, and it is quite unnecessary to pursue the review to the next step.

Step 1: project definition maturity

It is widely known that project maturity is the major driver of project success and reliability of estimates. Therefore, the first priority will be to evaluate the current maturity of the project definition, including in particular:

- Full scope coverage (in particular for an owner, all owner own scope),
- Technical maturity of solutions (Actual piloting of innovative processes, field proven assets and methods, etc)
- (For owners) realism of the expected benefits in the business plan,
- Permitting,
- Status and coverage of geotechnical investigations,
- Proper understanding of specific logistics issues for the project site and condition,
- Constructability, operability and maintainability reviews,
- Preparedness of the future operator,
- Current status of quotes and contracting,
- Composition, profiles and preparedness of the project team.

Those elements can be deducted from available documentation from project governance review milestones, project execution plan, available contracts with contractors (or draft contracts under negotiation), invitation to tender documents, etc. Those can generally be made available without major issues during a due diligence.

Step 2: quality of the current status of the project

From periodic project performance reports (which may be more difficult to obtain, but should be accessible) we can then assess the accuracy of the current assessment of project status (actual cost spent, actual effort and physical progress), making sure that the full project scope is effectively covered and followed. This check will ensure that the current condition is accurately reported, which will demonstrate if the project is under control.

Comparison with pictures from the site will prove useful to challenge progress, and if possible, intelligence from the main suppliers and contractors.

Analysis of the cash flow of the project, if available, will provide a useful indicator of the adequacy of the project status reports. This can be done from current accounting reports. A review of the accounts would also allow an assessment of the quality of the performance reports, especially if the booked amounts exceed the reported actual costs.

A difficult aspect is to evaluate the condition of contractual relationships involved in the project, as envisaged contractual claims may not always be reported or known. It will require some intelligence gathering to evaluate the actual health of the current contractual relationships, and whether some difficulties may need to be anticipated from key suppliers or contractors.

Step 3: quality of the estimate / forecast

Only if the two previous steps are successful is it useful to assess the quality of the forecast (supposing that the current condition of the project is adequately reported in step 2). It will generally be difficult to obtain the underlying documentation for the reported project cost and schedule forecast. This exercise will thus be mostly based on benchmarks and judgment taking into account the current condition of the project. Still, some useful indirect indicators are useful:

- Actual consumption of contingency,
- Any delay on major convergence points in the schedule, which will cause snowballing impact on other (sub)contractors,
- Any hint to difficulties to be expected during commissioning and ramp-up,

We Empower Organizations to be Reliably Successful in Executing Large, Complex projects.

Discover more on
www.ProjectValueDelivery.com

© Project Value Delivery, 2025

- Visible increase of time and expenditure for key activities in the current condition, that need to be extrapolated to the full project,
- Comparison to available industry benchmarks

It is also worth referring back to the general uncertainty levels associated with the estimate class (based on project maturity) to provide a rough evaluation of the potential sensitivities associated with the estimate at completion. Depending on the level of definition defined in step 1 this will provide a useful guidance as to potential expected deviations from the nominal estimate or forecast, and thus sensitivities that need to be accounted for in the business plan. They may lead to a provision for risk to be included as part of the negotiations.

Summary

Independent evaluation of the health of capital projects is even more difficult during a due diligence because of the limited documentation and lack of access to the project team. Still, it is possible to infer independently the project health and forecast, and the associated risk, by measuring indirect indicators which are known to be closely related to project success: overall project management maturity, specific project maturity and accuracy of the current project condition. From there, it is possible to independently assess a project estimate / forecast and conclude about the quality of the numbers used in the business plan.

In addition to an expected estimate or forecast, it is important to always take into account the high variability of capital project outcomes, and thus evaluate the related uncertainty, which will be highly dependent on project maturity. This will provide useful inputs for the transaction business plan sensitivities and may lead to a provision for risk to be included as part of the negotiations.

Read the Industrial Projects Practical Owner Guide

Available on all e-bookstores such as Amazon.com, amazon.co.uk and on Kindle