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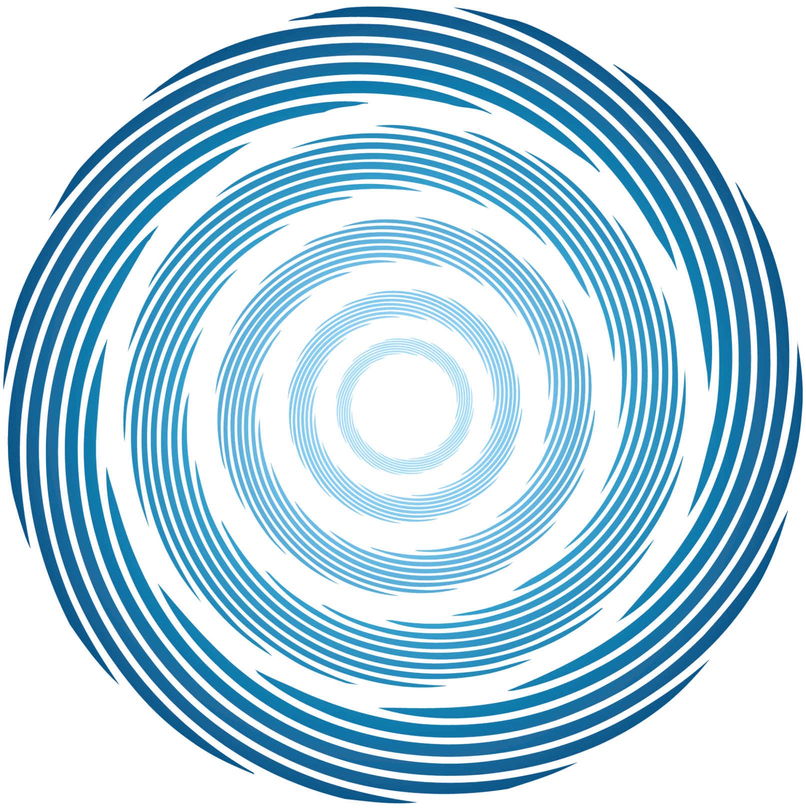

Navigating the Due Diligence process

You know what they say about failing to plan…

Whether your business has received an unsolicited approach from a potential purchaser, your company or division is the subject of a parent company's divestment programme or if you are a shareholder looking to exit a business, due diligence is likely to emerge as a key step as the transaction proceeds from its infancy through to completion. Regardless of whether the diligence team has been engaged by the company itself (vendor due diligence) or by the potential acquirer (acquisition or buy-side due diligence), there are a number of key considerations that can impact on the diligence process and ultimately on the successful execution of the transaction.

Underestimating the time demands of the transaction process

Do not underestimate the time required of the finance team and senior personnel to engage with diligence teams, especially if the proposed transaction is not known amongst the wider organisation. In addition to information requests, diligence teams will require access to key management for Q&A sessions throughout the process and it can be difficult to balance the demands of diligence teams and advisors while maintaining a focus on the day to day running of the company. If you are not sufficiently resourced to deal with these demands, slippage to the transaction timetable can result.

Failure to carry out a readiness review

Carrying out a readiness review is a critical step as a company prepares for diligence. While the temptation exists to jump straight in and provide information immediately to a diligence team, carefully considering the information requested can save time and effort in the longer term. In particular, consider:

1. What financial information you produce and how it links/ reconciles to audited information. This is likely to be a key exercise undertaken by the diligence team and having a clear understanding of the material audit adjustments in advance can provide comfort on the robustness of the financial information.

2. Does the financial information you prepare match the transaction perimeter? If it is intended that not all divisions within the company will be sold/ acquired, are you capable of providing financial information for the business being sold? While P&L information is often available by division, divisional cashflows and balance sheets are less frequently available (in particular in smaller entities) and it can be a difficult and cumbersome exercise to extract these.

3. Is your financial information internally consistent? Taking time to ensure supporting schedules provided to diligence teams reconcile to headline financials prevents the reliability of the information you produce being questioned.

4. Have you considered the tax implications of the proposed transaction and the requirement/opportunity to carry out any pre-sale restructuring?

Lack of awareness of the impact of diligence findings on deal metrics

Allied to carrying out a readiness review is considering how the deal metrics can be affected by information that is introduced during the diligence process.

In a typical debt free/ cash free transaction structure, the diligence team will use the analysis performed and discussions held with management to provide their client with information to inform pricing negotiations in the areas of:

1. Quality of earnings/ maintainable profits (often termed normalised EBITDA);
2. Working capital and a normalised level of working capital; and
3. Net debt and other potential debt like items.

Having considered in advance the existence of any one off/ unusual costs or revenues, reviewing your balance sheet for debt like items and considering your working capital profile and any normalising items, "price chipping" by the buyer at a later stage of the transaction can be minimised.

In summary, by taking time at the beginning of a transaction to assess how you will practically manage the diligence process as well as considering the quality and robustness of your financial information, you can help minimise the potential for timetable slippage and value leakage during the process.

Deloitte Financial Advisory

Deloitte Financial Advisory have extensive experience in assisting companies prepare for sale and navigate the due diligence process. By applying our deep and broad transaction experience, we can help you plan a more efficient diligence process which presents a robust view of your business to ultimately realise a successful transaction that maximises value to shareholders.

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