SPOTLIGHT ON...

Due Diligence:

Reviewing and Reporting Company Commercial Advantage

Contact:
Carlton Strategy Advisors Limited
Carlton Mews
London SW20 8AG

Email: david.mcclelland@carlton-advisors.co.uk
Tel: +44 (0) 208 947 5108
Web: www.carlton-advisors.co.uk

David McClelland, Carlton Strategy Advisors Ltd

Private equity investors, bank debt lenders and corporate acquisitions teams all face the challenge of assessing where true value rests in third party companies of potential interest to them. Opinions on approach may vary, but ultimately one has to be able to link trading performance to rudimentary industry norms and sector yardsticks. Due diligence carried out by the transaction services consultant advisor, sets out to fulfil this role.

Acting on behalf of a client, private equity house, bank or trade buyer, the independent reporting consultant will parachute into the target company with a remit to seek to understand the real rationale and logic of the target-co's management when it takes the company's business direction down a chosen route to market. Due diligence is therefore an assessment carried out by the consultant advisor of the wisdom, benefit and risk involved when a company's trading is aligned by its management team to specific markets, inclusive the product/customer mix in competition to alternative suppliers as possible market rivals.

Of course, one person's risk is another's opportunity. The trick for the CDD reporting advisor is to see the transaction through the eyes of the client, remaining aware about what in the deal will make the client 'comfortable or nervous'. It is therefore the advisor's ability to read the key issues most likely to have a material influence on the outcome of the transaction after presenting the necessary supporting evidence that makes due diligence effective.

Such 'opinion' at the end of the day is often subjective and like all advisory services, due diligence can be done well or badly. Part of the 'art' is in knowing when to stop 'rowing the boat ashore'; substantiating and setting down 'opinion' in what is usually a restricted timeframe, governed by the length of any period of transaction exclusivity agreed between the participating parties, namely: an equity sponsor, a management buyout team and business vendor, for example.

It comes down to the level of granularity contained in the analysis, charged by the consultant on a time and materials basis. High level or limited scope due diligence may be enough when examining a few, relatively straight forward, specific issues about the trading activities of the target-co. However, a more comprehensive and detailed project scope may be necessary given greater complexity across the business due to, for example, the number of separate business units contained in the company group organisation and therefore the sources of its revenue streams across different sales territories, and the like.

The business variables most often examined by the process of due diligence, particularly commercial due diligence, can include:

- The experience and accuracy of the management team when setting and meeting key business objectives;
- The revenues gap that has to be bridged between the business's historic or actual performance to date and that which is forecast in the light of any assumptions about the economy, demand and pricing;
- The size, structure and rate of growth of the addressable marketplace, including relationships with dependent customers or competitors, for example.

Due diligence needs to be able to articulate what can go right as well as wrong within the target-co's business proposition. It should therefore consider the manner by which customer value is either created or destroyed and how the business offering is differentiated in terms of possible core competences. Only when questions such these are laid bare can assumptions be drawn about patterns of sustainable earnings in the business and of the prospects that can be levereged by the MBO team together with its equity sponsor and banking partner.

Whatever depth of analysis is deployed, due diligence reporting should not be couched in ambiguous terms - equity investors, corporate and commercial bank lenders and company management alike require early and clear opinion devoid of 'unexpected surprises'.

About David McClelland

David McClelland is a Director at Carlton Strategy Advisors Ltd.

CSA is a commercial due diligence and business strategy consultancy, with clients across the Private Equity, Bank and Corporate sectors.

C S A Carlton Strategy Advisors
Commercial | Market | Advisory