



# A GUIDE TO THE DUE DILIGENCE PROCESS



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# A DUE DILIGENCE SERVICE ON BEHALF OF PRIVATE INVESTORS

## WHAT IS DUE DILIGENCE?

Due diligence, often known by the acronym 'DD', is an investigation into the affairs of a company prior to its investment, acquisition, disposal, refinancing, restructure, public listing or other similar transaction.

When after reaching an initial agreement of cooperation with the target (in addition to the signing of a confidentiality agreement, and after a letter of intent has been issued, the investing party is permitted through mutual agreement to conduct an investigation into the operational situation of the target firm.

Due diligence ordinarily incorporates investigative measures directed against all relevant matters pertaining to an investment

The aim of due diligence is to enhance the understanding of key information underpinning a corporate transaction, allowing all parties to make informed investment decisions.

There are no hard and fast rules of what the due diligence process involves, and each engagement will be individual to the specific transaction.

Due diligence is a bridge that must be crossed in nearly all transactions, without it, the risk of problems or failure along the journey are undoubtedly increased.



## WHAT DOES OUR DUE DILIGENCE PROCESS COVER?

*The scope of a due diligence engagement depends on the needs and the nature of the transaction, although it is ultimately down to the perceived risk associated with the target.*

Due diligence typically falls in to the following broad categories:

### *Financial due diligence*

A review of historic and current data (trading results, balance sheet and cash flows) for the entire entity or possibly on specific projects, a review of forecast performance and potential funding requirements. Assessment of the impact, if any, on the value of the target business, and any tax issues arising.

### *Commercial due diligence*

Could encompass a review of various commercial factors including but not limited to; market conditions, sector specific legislation, competitor analysis, product or service assessment or any other commercial aspects that an investor wishes to investigate.

### *Operational due diligence*

Consideration of non-financial matters of a target business, which may include assessment of systems and processes, review of the incumbent management team, staffing levels and other HR activities, or insurance arrangements and risk assessment.

### *Legal due diligence*

Investigation of any legal risk associated with the rights and obligations of the target entity. Issues may typically involve property ownership, intellectual property and employment issues.

***Throughout this document, we will expand upon some of the important facets of the due diligence process.***

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# GENERAL OVERVIEW OF THE INSIDE KNOWLEDGE

## ABOUT US

The Inside Knowledge is an autonomous firm of Global consultants who specialise in providing a bespoke service advising predominantly high net worth individuals on their businesses and personal wealth dealings.

We work in close partnership with our clients to deliver palpable results regardless of geography, complexity or controversy.

We have a long and proven track record of delivering personal support and excellence in the most complex of situations to both individuals and across a range of business sectors.

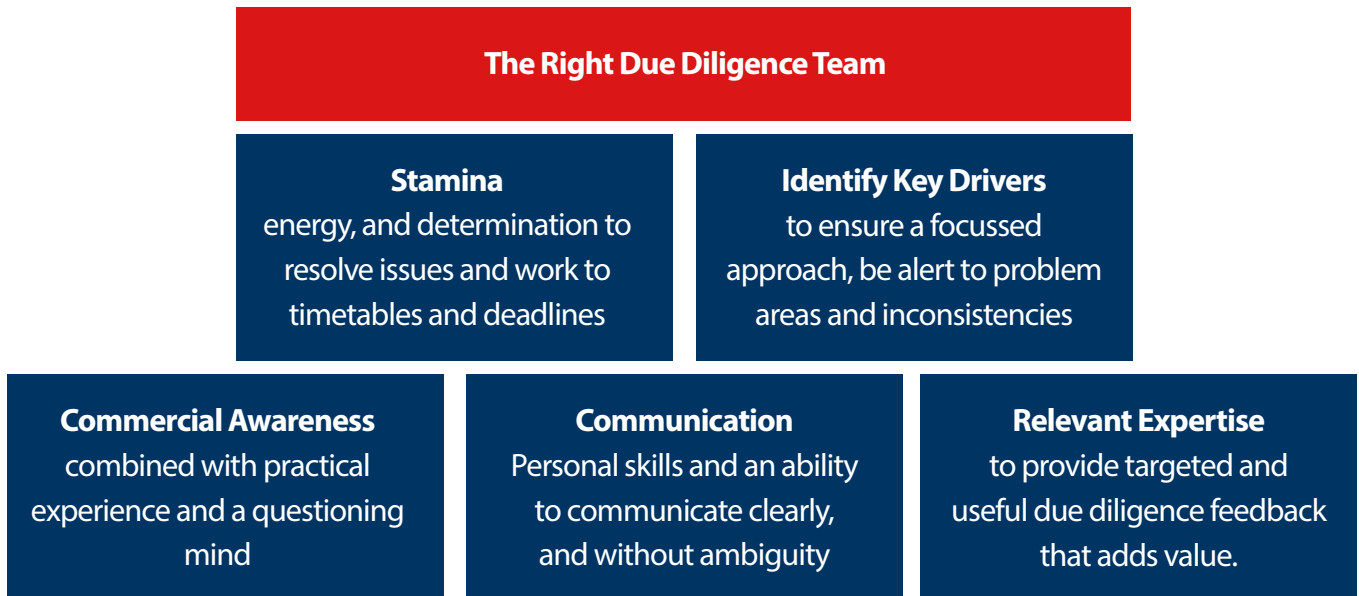
Our steadfast conviction and energy for results is what makes us stand out. We care for our clients' and their businesses, we share their ambitions and align our goals to complement their objectives. Our clients know we're in this together.

***We are proud to be recognised as different.***

# GETTING THE RIGHT DUE DILIGENCE TEAM

For an effective and efficient due diligence assignment it is important to engage a team with the relevant skills.

Key skills forming the foundation of expert team:



At The Inside Knowledge, we can draw from a vastly experienced team, who have undertaken assignments across a wide range of sectors. We pride ourselves on building the right team for each transaction in order to deliver a tailored solution for each of our clients.

# 1. PURPOSE AND INITIAL CONSIDERATIONS FOR THE INVESTOR

## 1.1. PURPOSE OF DUE DILIGENCE

The starting point for any investor in any share or asset purchase transaction is *maxim caveat emptor* (let the buyer beware). Since the investment recipient is under no duty to disclose to the investor any defects in, and liabilities of the target, the investor will always need to conduct its own investigations. It will therefore instruct advisers such as ourselves to conduct due diligence (whether commercial, legal, tax, financial or otherwise) and prepare due diligence reports to highlight any material issues arising from this review exercise.

From our perspective, the main purpose of legal and commercial due diligence is risk management. With the information obtained about the target as a result of due diligence investigations, the investor can make an informed decision as to whether to enter into the proposed transaction and equally, it will identify early on whether there are any potential deal breakers that in most cases because of being highlighted at the beginning can be overcome.

### **Purpose of disclosure**

**Some of the areas that will be covered if appropriate to the process will be to:**

- carry out a proper valuation of the target;
- be provided with comfort that we have a full picture of the material assets and liabilities of the investment target;
- establish areas of risk, including how the target addresses those risks, and negotiate with the investment recipient as to where liability for any known risks should fall, ideally, from the investor's perspective, by requiring the investment recipient to provide indemnities in respect of any identified risks;
- structure and document the transaction correctly and determine if any consents are required (as conditions to completion) in order to effect the transaction;
- agree a realistic timetable with the investment recipient to complete the transaction;

## 1.2. WHEN WILL DUE DILIGENCE COMMENCE

Due diligence will normally be carried out after the parties have signed heads of terms, put confidentiality provisions in place and clear the invoices for us to commence the process, of which the costs are normally borne equally between both parties. The due diligence process will then run concurrently with the negotiation of the principal investment documentation. The majority of the due diligence will be conducted during the early stages of the transaction so as to ensure that the parties can negotiate appropriate warranty and/or indemnity cover in the investment agreement, and also to ensure the investment recipient's disclosures against such warranties.

## 2. TYPES OF DUE DILIGENCE TO BE CONDUCTED

Considering the information that has been made available to us, we plan to conduct the following revisions of the investment target:

- **legal due diligence:** which involves an assessment of the target's legal rights and obligations and any effect that the proposed transaction may have on those rights and obligations;
- **commercial/business due diligence:** which involves an assessment of the market in which the target operates, its competitors in that market, and any possible opportunities and risks;
- **financial due diligence:** which aims to assess the financial risks and opportunities of the deal and involves an assessment of the accuracy of the target's past audited accounts, recent management accounts, budgets, projections and forecasts, and whether the values attributed to the target's assets in the accounts are correct;
- **due diligence on the financial standing of the investment recipient:** which is relevant if the investor is to enforce a warranty and/or indemnity claim, together with an assessment of whether a guarantor of the investment recipient's obligations will be required, e.g. from a parent company;
- **tax due diligence:** which assesses the existence and extent of any tax liabilities and any disputes with local or international tax authorities, so as to deal with the negotiation and tax warranties or tax covenants, usually this will be carved out of legal due diligence and carried out by specialist tax advisers appointed by us;
- **actuarial due diligence:** involving an assessment of the target's pensions scheme liabilities, if applicable;
- **technical due diligence:** that will include a revision of all technical aspects of the project, equipment reliability, product demand, feedstock supply, and team qualification;
- **environmental due diligence:** which aims to assess any potential liabilities flowing from environmental damage caused by the target's business (where the nature of the target's business makes this a concern), and which will involve: a 'desktop survey' reviewing documentation, such as geological surveys, site visits, or a full survey.

In particular, you can assume that other areas of revision that will concentrate our attention are the following:

- a. Revision of the business plan and finance model;
- b. Management team interviews;
- c. Technical revision, estimated high-level questions;
- d. Overview of the manufacturing/service provision technology and market conditions;

To express an opinion on the regulatory environment and risk of any legislation change, including health and safety, and environmental, compatibility.



## 3. ADVISERS

### 3.1. THE DUE DILIGENCE TEAM

The due diligence team will be selected on the basis of specialist sector knowledge appropriate to the target's business, jurisdiction, and the proposed transaction.

This team will usually consist of:

- **The Inside Knowledge team**, who will assess the commercial and business risks arising from the transaction and to whom all advisers must therefore report.
- **The lawyers**, who will co-ordinate the legal due diligence process on behalf of the investor with more senior members of the team who will take responsibility for drafting the due diligence report and liaising with the investor, but much of the investigative work will be delegated to our corporate lawyers, with specialist knowledge in matters such as property law, employment law, IP law and pensions law, as appropriate;
- **The accountants and financial experts**, who will advise on the financial due diligence and tax matters, which may impact on the financial assumptions within the investors opinion and valuation of the target;
- **Other appropriate specialist advisers**, such as surveyors or environmental auditors, pensions advisers and Tax advisors who we would foresee as being local specialists from one of the Big Four which will be attracted to this process.

### 3.2. DUE DILIGENCE REPORTS

Each adviser engaged in the due diligence process, will report their key findings (especially any key issues or problems), as they are discovered, and also then prepare a sector due diligence report to highlight material issues arising from their review exercise.

The purpose of the due diligence report is to:

- give the investor sufficient information about the target and to summarise that the information is in a concise and comprehensive manner;
- highlight areas of potential risk for the investor that may need further protection in terms of specific warranties and indemnities and/or an adjustment to the equity investment model;
- act as a checklist of legal matters for the investor to consider and to identify what needs to be done before completion (e.g. obtaining third party contractual consents) on or after completion.

The scope of the legal due diligence report will depend on the nature and complexity of the transaction and of the target's business and assets, and may range from a high-level report outlining key issues to an in-depth audit of the target.

The summary due diligence report will usually include an executive brief, setting out the key findings. This will be the only part of the report that will be presented to the investor which will include and overview of the technical and financial reports as well as a list of recommendations and conclusions.

## 4. CONDUCTING DUE DILIGENCE: ENQUIRIES, DATA ROOMS AND SEARCHES

### 4.1. DUE DILIGENCE QUESTIONNAIRES

We will on instruction submit a due diligence questionnaire to the investment recipient, which is intended to elicit all relevant material information about the target investment.

The questionnaire is usually based on a detailed pro forma, but will be tailored to the specific transaction and sector. The investment recipient's lawyers will usually co-ordinate the responses to the questionnaire, with specialist lawyers/advisers (e.g. employment, property etc.) dealing with responses relevant to their area. The investment recipient's lawyers/advisers will then index the documents supplied and give us access to those documents. Although it is also common practice that in a lot of cases the directors and senior management may compile and present this information to us.

### 4.2. SECURE DATA ROOM

All information shall be made available via a secure data room which will be created by us with access rights for the investment recipient and their advisors to have preview and upload rights.

It is our general practice to use a 'virtual' data room, however, we reserve the right to request a physical data room, if this is the case, it will usually be set up at the offices of the investment recipient or its lawyers, financial advisers or accountants. Access to the data room will usually be for a limited duration and may be concentrated to a small number of persons at any one time.

The data room will contain all information relating to the target investment.

We will prepare a set of data room rules that, in addition to addressing the issue of confidentiality, will normally govern the support and administration of the data room, who may visit, the conditions for visiting, copying restrictions and the procedure for additional queries relating to the information contained therein.

### 4.3. DISCUSSIONS WITH TARGET/INVESTMENT RECIPIENT MANAGEMENT

Throughout the due diligence process ongoing discussions with the management of the target and/or the investment recipient will continue, as this is useful for us in properly getting to understand the information being presented and the targets investment practices and objectives on behalf of the investor, as management are always best placed to provide this information on the target's business and prospects we also will be conducting management interviews, as we see this as an integral part of our due diligence process.

### 4.4. SEARCHES OF PUBLIC REGISTERS AND RECORDS

In addition to reviewing information made available by the investment recipient, we will conduct searches of public registers. Public records may, however, not be fully up to date and this will form part of our crosschecking conformation throughout the due diligence enquiries.

External searches include, but are not limited to:

- Investigations where the target, investment recipient or the investment recipient's guarantor is a company;
- Companies registrar records, Bankruptcy and Court records;
- where the guarantor or the target owner is an individual, a search of the Individual Insolvency Register for current and recent bankruptcies, current individual voluntary arrangements, debt relief orders and current bankruptcy restrictions orders and undertakings;
- the registers of trade marks, patents and registered designs maintained by Intellectual Property Offices;
- land registrar searches;
- Commercial information providers such as Dun & Bradstreet;
- the target's websites, and general searches of the target through internet search and any other legitimate searches and information requests.

## 5. REVIEW OF INFORMATION: KEY ISSUES WE WILL FOCUS ON

### 5.1. MAIN AREAS OF FOCUS FOR LEGAL DUE DILIGENCE

**title:** the title to the target's shares and the target's title to key assets, property and rights comprised in the target's business;

**licences and consents:** the existence and continued availability of any licences, permissions and consents required to carry on the target's business;

**finance and security:** the target's financing arrangements (intra-group borrowing arrangements, as well as external borrowings and parent company guarantees) or associated security granted over the target's business and assets;

**material contracts:** whether there are any unusual contractual terms for key contracts with the main customers and suppliers of the business, with particular focus on price and payment mechanisms and contractual term/termination rights;

**change of control:** whether the target's key employees, customers and suppliers will remain with the target following the investment, e.g. whether the investment will trigger a change of control clause that will lose the target a key customer or supplier;

**key employees:** the terms of employment of key personnel;

**known liabilities:** any liabilities associated with the target that the investor will acquire, e.g. liabilities to employees and former employees and any pending litigation;

**Any conditions to completion:** identifying whether any conditions to completion of the investment will

be required for any reason, e.g. in case any consents must be obtained from third parties;

## 5.2. SPECIFIC AND INDUSTRY-WIDE ISSUES

Throughout the process our industry specific advisers will carry out separate revisions of the target's business and local business environment, as well as the historic position and future potential of the markets.

## 5.3. REVISION OF CORPORATE DOCUMENTATION

We will, as previously mentioned undertake company searches at the Companies registrar against all relevant companies associated with the target at the outset of the transaction, the target, and any subsidiaries of the target and, where applicable its shareholders. We will also periodically check during the course of due diligence process as to whether there have been any further filings.

We will also review the target's constitutional documents, together with those of its subsidiaries (if any).

The target's statutory registers will also be checked in order to confirm that they accord with Companies registrar filings and that the target has kept records and registers in accordance with all applicable and legal requirements.

Any charges registered will be checked to define its list of current liabilities.

We will conduct a revision of internal corporate documentation that may include shareholders' agreements, statutory registers, board/shareholders meeting and resolutions, etc.

## 5.4. REVISION CONTRACTUAL DOCUMENTATION

In the course of due diligence, we will need to include a review of the target's key contracts and in particular focus on those contracts which are material to the target's business, which, could affect the investor's valuation of the target. The legal due diligence questionnaire will therefore include a materiality threshold, especially where the nature of the target's business is such that it enters into numerous contracts.

Other contractual documentation that will be reviewed include:

- **parties:** to ensure that the target contracting party to all the key contracts and agreements, licences and leases in the name of the target or associated group or company;
- **valid contract created:** to ensure that all the elements have been legally satisfied, validly executed, and proper consideration given to contractual certainty;
- **term and termination:** will include checking if any contracts have a fixed term, a rolling term or if the terms are open-ended, and what are the termination provisions.

## 5.5. WARRANTY AND INDEMNITY COVER

All warranties and indemnities, including potential liabilities under warranties and indemnities, and including the time limits for claims yet to expire will be checked to ensure that any warranties negotiated in the investment agreement will not necessarily impact on the effectiveness of warranty protection being given.



## SUMMARY

This information was prepared by The Inside Knowledge, a firm of International Accountants and Lawyers.

This information is intended for general information purposes only and has been compiled to provide an overview and scope of the Due Diligence Process and what it will entail.

Whilst a lot of the information and the process might sound onerous and complicated, in reality it is fairly straight forward and in most cases can be conducted in a relatively short period of time.

***We look forward in being able to work together with you, in order to facilitate your investment requirements.***




## CONTACT US

For further information about how we can add value and support to your individual or business needs, please contact us.



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