HELIXR

Our Integrity. Your Future.

A guide to effective due diligence

Effective due diligence is key to avoiding litigation post transaction

NEIL LITTLEJOHN
Founder & Executive Director

Contents

Introducing our Divestitures Expert

Neil's career has been shaped through over 20 years of extensive experience across multiple sectors and disciplines.

His experience in leading high performing teams has ranged from completing financial audits and delivering digitisation initiatives for healthcare practitioners, to delivering complex business restructuring programs within major Life Sciences corporations.

A Founding Director at Helixr, Neil has a hunger and passion for driving progress within the Life Sciences sector. Heading up Business Development at Helixr, he thrives on flexing his visionary and conceptual ability to help craft strategies with realistic and tangible outcomes.

Known for making complex things simple, Neil's motivation and guiding mantra is his resolution and commitment to solving the problems of others. He strongly believes that through collaboration and cohesion, a team can achieve more than the sum of its parts, to the benefit of the whole organisation.

NEIL LITTLEJOHN
Founder & Executive Director
neil.littlejohn@helixr.com

Contact me

Executive Summary

Most M&A transactions fail as a consequence of unforeseen circumstances and the discovery that the benefits of the proposed transaction cannot be achieved.

The due diligence process focuses on discovering the skeletons in the closet that could stop the transaction process from proceeding, or lead to significant challenges during integration.

This whitepaper will explore the three crucial phases of due diligence: preparation, execution and reporting, as well as the types of due diligence to consider in M&A transactions.

80%

The failure rate for M&A transactions currently sits at around 80%

45-65%

of the expected value creation from acquisitions is directly linked to the success of IT integration

Introduction

Due diligence is defined as a process in which reasonable steps are taken by a party to satisfy a legal requirement, particularly in buying or selling something.

A prospective buyer must undertake due diligence to establish the assets and liabilities of their target, as well as evaluate its commercial potential.

There is often a risk that due diligence is focused primarily on the financial aspects of a transaction to the detriment of others, such as the commercial, operations and human resources aspects.

Benefits of thorough due diligence

Both buyers and sellers benefit from thorough due diligence in many ways by avoiding issues and conflicts during and after the transaction. Due diligence can be costly yet is a lot cheaper than litigation post-transaction.

Some of the key benefits include:

- Early identification of the current or future potential of the target, as well as realised liabilities
- Determining the apportionment and warranties/ indemnities that should be included in the legal purchase contracts
- Providing an early warning system to identify a non-viable transaction before excessive costs are incurred
- Highlighting the challenges that will be faced during the transaction itself and the integration phase
- Ensures that the data used in a public offering is trustworthy and reliable

Due diligence scope

The scope of due diligence required varies depending on the type of transaction and the industry involved, but typically will focus on the following areas:

- Financial
- Legal
- Commercial
- Information Technology
- Human Resources
- Management
- Pensions
- Taxation
- Environmental
- Technical
- Intellectual Property
- Insurance and Risk Management
- Antitrust

Phases of due diligence

The following sections will discuss the requirements and considerations for each of the three key phases of due diligence:

- Phase I – Preparation
- Phase II – Execution
- Phase III – Reporting

PHASE I

Preparation

Due diligence is a time-bound activity therefore, careful and thorough planning is fundamental to its success.

Only by knowing yourself can you properly analyse

To ensure that the transaction is a correct fit and the due diligence process is refined to address the buyers requirements, the buyer should ensure that the following are clearly defined:

- Merger/acquisition strategy and what is required from the target firm for it to be a correct fit
- What synergies they are seeking
- How their own company is structured e.g. operational structure, management and IT
- Their baseline and maximum purchase price
- The necessary skills, expertise and resources required in-house to complete the transaction in the allowable time
- Has the seller been engaged effectively to conduct the exercise?

Planning

Like any distinct activity, planning and preparation are key to success. The buyer must:

- Prepare and agree on the phases and timetable of the transaction
- Select and agree on ways of working with advisers
- Ensure clarity of roles and responsibilities between buyer, seller and advisers
- Agree on inputs and outputs to the due diligence process
- Ensure that all legal controls are in place such as non-disclosure agreements
- Conduct effective briefing sessions (see below)

Briefing internal and external resources

All personnel must be adequately and consistently briefed on the purpose of due diligence and the expectations of behaviour throughout this phase, as well as throughout the transaction.

Both internal and external briefings must include the following key information and activities:

- Nomenclature - the agreement and use of code words for the transaction
- Overview of the target business, locations and contact details
- Outline of the request for information process
- The agreed due diligence plan and expected deliverables
- Circulate copies of confidentiality agreements
- Communicate the reasons for the acquisition – for example, strategic alignment or access to synergies
- Educate all resources on the technical landscape (if required)
- Specify materiality limits
- Outline the post-due diligence process and transactional steps with planned dates
- Include any internal knowledge such as existing research and potential concerns
- Walk through roles and responsibilities of all parties involved and address any gaps

Information requests

An information request should be delivered to the seller in due time to allow collation of the necessary information (and allow sufficient time for negotiation of the level of detail) before the commencement of the due diligence phase. An example of this can be seen in Appendix 1.

Data governance and clean rooms

Robust data governance policies should be adhered to by both parties throughout, whilst also ensuring that the data disclosure is not limiting. To achieve this, the following should be established:

- All key personnel must sign confidentiality agreements (covered in the briefing stage)
- A clean room and team structure should be established for the exchange of sensitive data
- After due diligence is complete and an agreement is reached by all parties to proceed, the Day 1 announcement needs to be issued publicly
- Post Day 1, any further requests for information required to complete the execution phase should be managed by the legal teams of both parties

PHASE II

Execution.

The due diligence process should be comprehensive enough to conduct an accurate assessment of the viability of the transaction. However, some aspects are often overlooked in favour of others, causing gaps in the knowledge required to make a thorough assessment.

Information technology due diligence

IT can pose significant benefits and risks during a merger or acquisition. Conducting proper due diligence allows the acquiring company to discover and qualify any potential synergies to develop robust synergy cases, whilst also identifying and addressing any challenges or risks that could arise during or post-transaction.

The key activities undertaken in IT due diligence to achieve these objectives are, therefore:

- Evaluation of the IT landscape and its fit to the post-transaction target operating model
- Review of current business processes and underlying supporting systems
- Assessment of information security
- Cataloguing of all IT assets including assets such as hardware, infrastructure and software licences
- Backup and business continuity review
- Assessment of communications
- Analysis of IT processes and policies: development, testing, service management etc
- Understanding of current and planned IT projects
- Review of staffing, skills and their fit to the post-transaction target operating model
- Audit of the Transitional Service Agreement (TSA) design, construction, costing, dependency and risks

> "Due diligence is the first opportunity teams have to size up the post transaction integration challenges."

NEIL LITTLEJOHN
Founder & Executive Director

Financial due diligence

One of the most critical, and often the most widely considered forms of due diligence is financial due diligence. The objective of a financial audit is to provide certainty of the performance of the target company and objectively examine potential cost savings.

An important aspect of the process is to validate that the financial matrices provide a true and accurate view of the target and enumerate potential liabilities to feed into the contracting stage of the transaction.

The key activities undertaken in financial due diligence to achieve these objectives are, therefore:

- Clarify the historical development of the target including but not limited to its formation, ownership, funding, legal structure, group structure and management interests
- Critically assess the target's performance in terms of turnover, market share, margins, threats and opportunities, or new products and services
- Assess the underlying market conditions by analysing trends, competitors and barriers to entry
- Evaluate the supply chain, for example, the target's relationships with suppliers, trade terms, and supply chain volatility
- Assess any production constraints, costing models, processes, plant maintenance, lead times and quality controls
- Catalogue both tangible and intangible assets, and assess factors such as valuation, depreciation, replacement cycles, technologies and lease agreements
- Liaise with HR to assess all aspects of employment from employee contract terms, pensions, benefits and remuneration policies to staff turnover and performance systems
- Assess accounting policies, procedures and controls including adherence and differences between the target and acquiring company
- Review past and current financial statements and management accounts
- Review financial forecasts for the short, medium and long-term

Legal due diligence

Legal due diligence is primarily undertaken to mitigate any existing or potential future liabilities for the buyer. Uncovering any legal or contractual obstacles that need to be addressed, such as issues with employment or supplier contracts, that could influence the negotiation process, final purchase price and agreements.

The key activities undertaken in legal due diligence to achieve these objectives are, therefore:

- Investigate the legal structure of the target over the last six or more years including; corporate records, related parties, details of past incorporations, acquisitions, mergers, divestitures, and liquidations
- Review and summarise major matters arising from board minutes and shareholder meetings
- Assess shareholdings in terms of class, agreements, dispensations and historical movements
- Investigate the indebtedness of the target and any subsidiaries – i.e. loans, mortgages, insolvency orders and charges
- In liaison with the finance team, assess any property rights, tenancies and leases
- Evaluate intellectual property rights and any covenants
- Inspect wide-scale agreements such as distribution, quality, manufacturing, subcontract, supply, warranty, and union agreements
- Assess the terms, benefits, pension, profit-sharing, stock options, personnel policies, and termination provisions in existing employee contracts
- Ascertain regulatory, statutory and taxation compliance, as well as any other relevant compliance information
- Judge all pending and potential material litigations, actions, investigations, disputes, correspondences and inquiries

Commercial due diligence

Undertaking commercial due diligence allows the buyer to assess the commercial attractiveness of the target company such as how likely the target is to hit its commercial targets, and how the target will perform as a stand-alone business and under new ownership. This allows for validation of the expected future benefits of the acquisition.

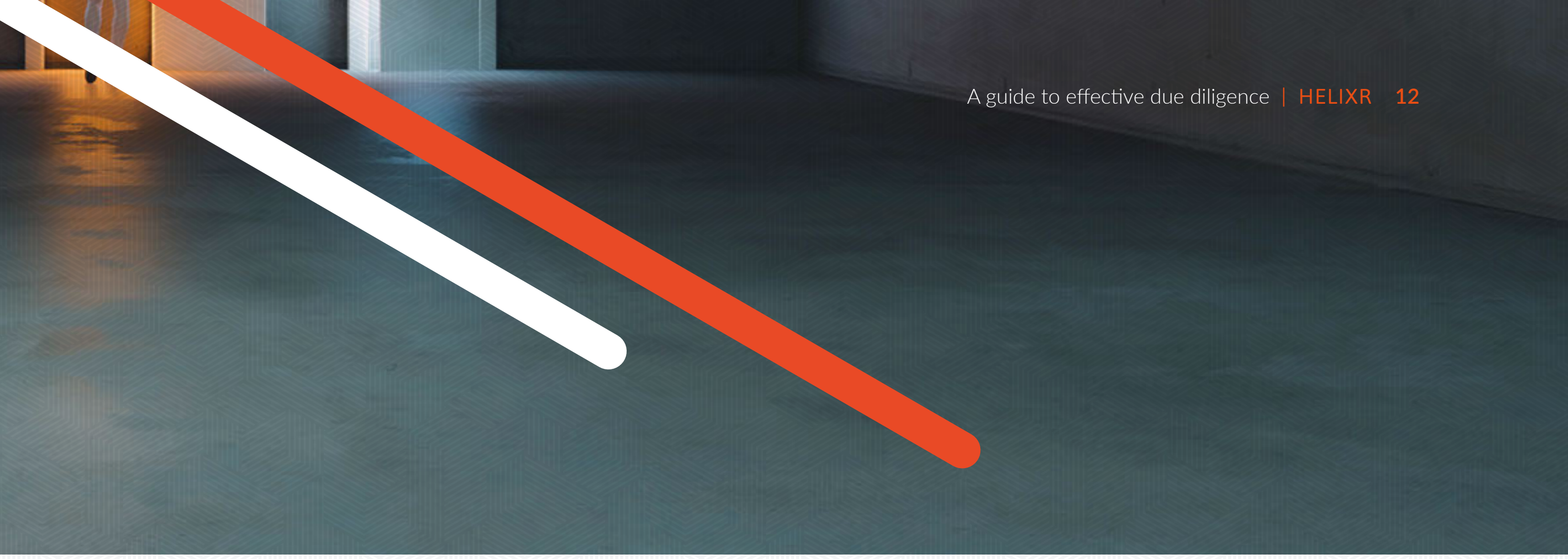
The key activities undertaken in commercial due diligence to achieve these objectives are, therefore:

- Critically assess the business plan and conduct a mini-strategy review
- Analyse the market (product/services, size, structure, growth, share, customers, competitors, suppliers, R&D)
- Assess the resources and capabilities of the target
- Review the benefit of the acquisition based on anticipated synergies, challenges, threats, and market reaction

Human resources due diligence

The objective of HR due diligence is to determine whether the cultural environment of the target is a suitable fit, as well as verify compliance of employment contracts, for example from a union standpoint.

This is also the opportunity to identify the HR issues that may need to be dealt with after the transaction such as redundancies, and retention.



The key activities undertaken in HR due diligence to achieve these objectives are, therefore:

- Analyse the current employee landscape - employment status, absenteeism, employment history, skill gaps
- Assess any legal challenges in terms of liabilities, employee claims, tribunals, legislation, union action, employment law compliance, and equal opportunities
- Review payroll and benefits packages
- Assess integration challenges stemming from redundancies, cultural change, retraining, remuneration alignment, retentions schemes, golden parachutes
- Audit industrial relation issues such as ongoing disciplinary action or disputes,, union memberships, works councils, health and safety, equality and human rights commission, data protection, and inland revenue

Management due diligence

Post-acquisition retention of key personnel is crucial to a successful execution. Conducting management due diligence provides an objective assessment of the capabilities of the senior management team and highlights where retention is most critical for operations.

The key activities undertaken in management due diligence to achieve these objectives are, therefore:

- Assess each manager's capabilities against the target operating model and the existing acquirer's management competencies
- Assess the proposed team's capabilities against the target operating model

Pensions due diligence

If the pension scheme is being acquired as part of the transaction, the key objectives of pensions due diligence are to ensure the scheme is adequately funded and does not contain any hidden costs that would require an injection of funds by the acquirer post-acquisition/merger.

The key activities undertaken in pensions due diligence to achieve these objectives are, therefore:

- Obtain and review the pension scheme documentation
- Analyse the latest actuarial report and ascertain if there is any gap that may need to be addressed
- Verify that this is compliant with local regulations (i.e. HMRC/Pensions Regulator or Revenue Contributions Agency)

Tax due diligence

Typically, most contracts include a tax indemnity (tax deed) in essence allocating all pre-acquisition taxes solely to the seller. However, this is generally dependent upon geography.

The primary objectives of tax due diligence are to find and quantify any tax exposure not accounted for in the purchase price and document how the structure created can be handled in the most tax-efficient manner.

The key activities undertaken in tax due diligence to achieve these objectives are, therefore:

- Review tax filings, computations and returns
- Obtain and review any correspondences with tax authorities
- Analyse any tax-deferred or current provisions and related suspense/clearing accounts in the financial statements
- Evaluate if any tax opportunities or threats may arise from the transaction – i.e. double taxation, relief, withholding taxes, VAT attributable

Environmental due diligence

Verifying that the target company's processes and facilities are in environmental compliance can assist in avoiding considerable costs post-transaction. The due diligence process should identify any environmental risks such as pollution surcharges or de-contamination that will be inherited, as well as quantify any ongoing obligations and costs of meeting environmental standards.

The key activities undertaken in environmental due diligence to achieve these objectives are, therefore:

- Research into the environment of the target facility – e.g. hydrology and geology studies
- Review of environmental policies, reports, hazardous materials, accidents, spillages, consent breaches, and enforcement notices

Technical due diligence

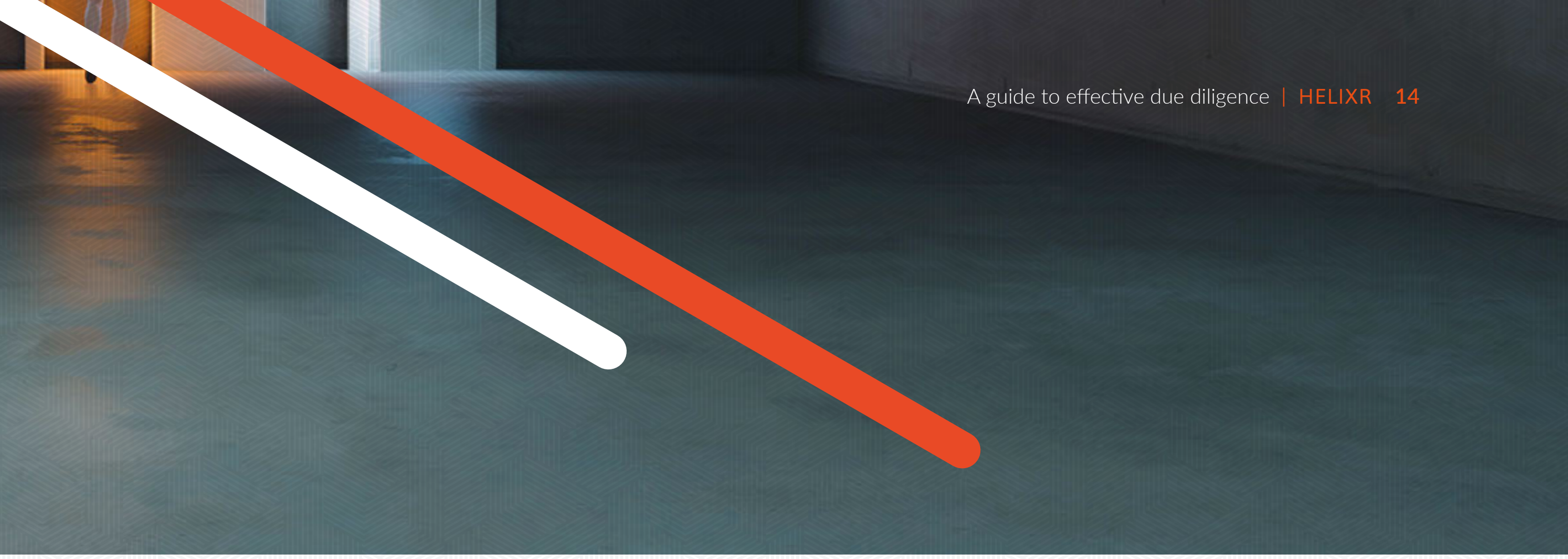
This area of due diligence assesses the product or service itself. Considerations include whether it meets customer expectations, ensuring product management is properly carried out, and that key personnel, intellectual property rights and infrastructure are correctly secured in the transaction.

The key activities undertaken in technical due diligence to achieve these objectives are, therefore:

- Investigation into customer satisfaction (i.e. interviews, calls, surveys, feedback, complaints, product backlog, etc)
- Review of relevant contracts and agreements to identify and ensure the security of key resources and technical support infrastructure

"Due diligence focuses on discovering the skeletons in the closet that could stop the transaction or significantly impact the timings of realising synergies."

NEIL LITTLEJOHN
Founder & Executive Director



Intellectual property due diligence

Closely linked to technical due diligence, intellectual property due diligence is key to identifying the intellectual property rights held and owned by the company, such as patents and trademarks, whilst also assessing that the rights remain valid in the new target operating model.

The key activities undertaken in intellectual property due diligence to achieve these objectives are, therefore:

- Review of the intellectual property rights held by the target firm (patents, trademarks, copyrights, trade secrets, designs, inventions, etc)
- Review of licences, royalties, agreements and other documentation
- Assess the age and remaining life of licences and their coverage (global vs local coverage)

Antitrust due diligence

One of the primary checks of an acquiring company should be to conduct antitrust due diligence.

The key objectives of this are to assess any prior antitrust violations by the target company and how this may affect reputation, as well as any antitrust implications of the transaction itself.

The key activities undertaken in antitrust due diligence to achieve these objectives are, therefore:

- Collate the merger control filing and assess the likelihood of clean clearance
- Review the impact to the ongoing business on any infringement of antitrust legislation

Insurance and risk management due diligence

The key objectives of insurance and risk management due diligence are to assess the past, present and future risk exposure, as well as the cost of the insurance programme.

The key activities undertaken in risk management due diligence to achieve these objectives are, therefore:

- Review current risk management assessments
- Gain an understanding of the current risk management processes of the target
- Obtain and assess current insurance contracts and their impacts on the transaction
- Assess the impact of the combined company on existing risk management processes and/or insurance arrangements

> "Diligence is the mother of good fortune."

BENJAMIN DISRAELI

PHASE III

Reporting

Due diligence is one of the most vital components of valuing and finalizing an acquisition. It presents buyers and sellers with a comprehensive view of the challenges and benefits of potential acquisitions.

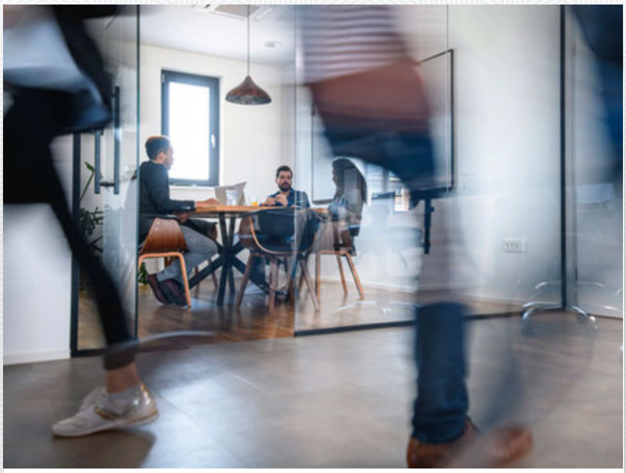
The final product of due diligence is a thorough report that summarises the findings and supplements the decision-making process. The contents of the report should, in essence, be every essential finding from the investigation.

Every detail in the report must be valid and up to date by:

- Reflecting the process carried out during due diligence
- Clearly presenting the current state of the company
- Validating findings with the accurate research data found in the investigation
- Conducting internal reviews with the seller (non-sensitive sections) and buyer

"At Helixr, we believe that retaining the same between due diligence and integration is fundamental to a smooth transition."

NEIL LITTLEJOHN
Founder & Executive Director



How can Helixr help your business?

For the latest information about our product and services, and how we can assist with the complex due diligence process, visit our website:

- Read our insights
- Read our Case studies
- Contact us

Appendices

Appendix 1 - Sample Information Request

AREA	Information requested	
Information Technology		
Strategy & Management	• IT Strategy of target • IT Strategy of Acquirer	• IT Staff Listing (incl skills) • IT organisation chart
Architecture	• IT Landscape • Infrastructure Stack	• IT Architecture Diagram
Business Process Documentation	• ERP Processes • CRM Processes	• Sale System Processes • Manufacturing Processes
IT Assets	• Log of all IT Assets • Log of all 3rd Party Satellite Systems / Interfaces	• Log of all communication methods
Policies	• Development • Testing • Configuration Management	• Performance Management • Helpdesk / Support • Service Management
Financial		
Accounting Policies	• Last two years auditors' management letters • Accounting Manual	• Key accounting policies disclosed in Annual Statements
Financial Statements	• Audit Accounts for last three years • Audit Accounts for current and last years	• List of year-end/quarter-end journals • Reconciliation between local / management and statutory accounts
Capital Commitments	• Capital Expenditure Budget	• Last 3 years Capex Spend
Agreements	• HP / Lease agreements • Rental agreements	• Loan agreements
Cash flow	• Legal Registry • Articles of Association	• Memorandum of Association • Certificate of Incorporation
Legal		
Agreements	• Agreements with major customers • Distribution agreements • Sales / Agent agreements • Franchisee agreements • Quality agreements • Warranty agreements • Contracts with Suppliers • Subcontract Agreements • Partnership / JV agreements • Sponsorship agreements	• Property lease/maintenance agreements • Tenancy agreements • Machinery lease/maintenance agreements • Service agreements • Contracts relating to Acquisitions/Disposals in last six years (i.e. BTA) • Intellectual Property agreements (incl. In-licensing)
Legal Structure	• As above in finance • Minutes of Board Meetings	• Memorandum of Association • Certificate of Incorporation
Human Resources		
Agreements	• Employee Contracts, terms and conditions • Union agreements • Management contracts • Termination agreements • Golden parachutes	• Profit Share agreements • Employment Agency / Recruiter agreements • Consulting agreements
Antitrust		
General	• Filing requirements for authorities • Covenants not compete • Confidentiality agreements	• Restrictive agreements • Trade association memberships

Appendix 2 - Helixr Service Offerings

CODE	AREA	OFFERING	COMMENTS
A	**General**		
A01	Planning	●	
A02	Project Management	●	
A03.	Risk Management	●	
A04	Data Governance and Data Rooms	⊘	
B	**Due Diligence Scope**		
B01	Information Technology	●	Specialism in ERP
B02	Financial	●	
B03	Legal	⊘	
B04	Commercial	⊘	
B05	Human Resources	⊘	
B06	Management	⊘	
B07	Pensions	⊘	
B08	Tax	⊘	Tax Technology services included in IT Due Diligence
B09	Environmental	⊘	
B10	Technical	⊘	
B11	Intellectual Property	⊘	
B12	Antitrust	⊘	
B13	Insurance & risk Management	⊘	

● Full Service ○ Provided by Partner ⊘ Not Provided

HELIXR
Our Integrity. Your Future.

Helixr is a business restructuring and ERP services consultancy, based in the UK, with a global reach, expertise and experience that focuses on the Life Sciences sector.
Want to find out more? Book a consultation today.

CONTACT US (UK)

+44 148 367 0249 | info@helixr.com
Helixr, Waltham House, Mill Lane, Guildford, GU1 3TZ

CONTACT US (IRELAND)

+353 1 437 6901 | info@helixr.com
Helixr, 92 George Sweet Lower, Dún Laoghaire, Dublin, A96 VR66, Republic of Ireland

Due-diligence/WP 1.1