

## Life Sciences

### Points of view & Insights

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#### Driving an operational due diligence: experience of the business' sector and due diligence process are essential

Once a potential buyer has shown its interest for a firm or a business to be sold, it enters a process of check and analysis, called due diligence. This process aims to reach an overall view of the business, but also of the risks related to the deal. The due diligence covers several topics, each of them being analysed by a specialists' team. We are dealing here with the operational due diligence.

The purpose of a legal, tax or accounting due diligence is to check that the data provided by the firm are correct and hide no risk. **The operational due diligence also have to confirm the deal strategic and industrial logic:** increase its market share, diversify its business, expand to new geographic areas...

In practice, unlike a legal or accounting due diligence where the analysis relies on documents and well established standards, the operational due diligence implies various elements and requires to be able to assess the business working by itself.

#### Operational due diligence distinctive characteristics

	Legal, financial, tax, accounting, social, environmental due diligences	Operational due diligences: R&D, commercial, manufacturing, IT...
<i>Purpose</i>	<ul style="list-style-type: none"> <li>• Check the exactitude of situation</li> <li>• Identify any potential risk</li> </ul>	<ul style="list-style-type: none"> <li>• Confirm deal logic</li> <li>• Assess related risks</li> </ul>
<i>Sources</i>	<ul style="list-style-type: none"> <li>• Internal documents</li> <li>• Management interviews</li> </ul>	<ul style="list-style-type: none"> <li>• Internal documents</li> <li>• Site visit, customers &amp; suppliers meetings,</li> <li>• Management meetings</li> </ul>
<i>References</i>	<ul style="list-style-type: none"> <li>• Standards</li> </ul>	<ul style="list-style-type: none"> <li>• Knowledge of the business, the sector</li> <li>• External market studies</li> </ul>
<i>Assessment</i>	<ul style="list-style-type: none"> <li>• Risk assessment</li> <li>• Check accuracy and exactitude of data</li> </ul>	<ul style="list-style-type: none"> <li>• Assessment of target's business plan</li> <li>• View of post-merger businesses</li> <li>• Synergies valuation</li> <li>• Related risks assessment</li> </ul>
<i>Key success factors</i>	<ul style="list-style-type: none"> <li>• Specialized assessment (legal, tax...)</li> <li>• Knowledge of the sector</li> </ul>	<ul style="list-style-type: none"> <li>• Knowledge of the sector</li> <li>• Business expertise</li> <li>• Activity understanding</li> </ul>

A due diligence takes place in an edgy context: the buyer has to gain an accurate understanding of the target but faces confidentiality requirements and divergent wills from different players: seller, financial partners, shareholders, investment banking, etc.

The support of a consultant able to understand the sector's stakes and familiar with the due diligence process allows to take full advantage of operating teams' skills.

Four issues have to be overcome:

1. Set a framework for operating teams analyses
2. Drive the operational due diligence from day to day
3. Interact with all clients
4. Anticipate the difficulties related to an « asset deal »

## 1. Set a framework for operating teams analyses

When a due diligence starts, potential buyers have access to the target's critical data: financial, strategic (customers portfolio, marketing plans, state of products' developments...), and operational data (firm's and departments' organization, manufacturing process, products characteristics, cost price...). The data required to assess the firm's value and validate the logic deal have to be extracted from a bulk of data, which is often incomplete. The analysis and synthesis of data has to give an overall view of the integrated business, of costs synergies, upsides and downsides on the business plan, etc.

What needs to be done:

- **Cover the entire scope:** a prerequisite for analyzing the activity is to assign precisely the topics to each operational team, in order to limit the uncovered subjects.

Does the analysis of the supply chain belong to manufacturing or commercial teams? Is the assessment of products in development under the responsibility of R&D or marketing teams? These questions have to be clearly settled from the beginning of the due diligence, to avoid any unexpected adverse event or misunderstanding of each team's scope.

- **Set a frame / guiding teams:** setting precisely a list of topics to be investigated and hypothesis to be confirmed for each team maximizes the productivity of works. In practice, **the preliminary drawing of a detailed table of content for the due diligence report helps operating teams to guide their work and analyses.**

## 2. Drive the operational due diligence from day to day

For managers, being in charge of the analysis of an asset to be bought, in addition to their operational daily work can be complicated. Yet writing a high quality report requires time and involvement, and it is one of the factors that may persuade the shareholders and potential financial partners of the legitimacy of the deal. Deadlines are tight and stress is severe that's why team management is essential.

What needs to be done:

- **Consolidate and follow the analysis from operational team:** set precise milestones and monitor the progress reports by redirecting analysis if necessary. To guide and to coordinate operational teams, knowledge of the sector is required in order to identify inconsistencies or contradictions between analyses.

- **Follow carefully the Q & A (Questions & Answers):** if any subject is not covered by the available elements from the data room the buyer should ask questions and the seller should reply. In order to refine the analysis, each team must trace its questions, which should be filtered and consolidated before transmission to the seller in order to improve answer reactivity.
- **Facilitate interaction with other stakeholders (auditors, lawyers, ...):** the answer to a question may be held by another team of due diligence, on which to rely to complete the analysis.

### 3. Interact with the different clients

Management team is the preferred customer's operational due diligence team. However convincing the shareholders and attracting new potential financial partners is also essential.

What needs to be done:

- **To build an attractive but realistic report for all customers:** the balance between attractiveness and rationality is essential. Any business plan or synergies assumption must be supported by logical arguments. An investor looks for a solid project, generating cash flows on the basis of realistic assumptions, even offering two distinct scenarios (one conservative, the other more optimistic). The report should also be understandable by a novice in the industry.

### 4. Anticipate the specific difficulties of an « asset deal »

In the case of a "share deal" the purchaser will acquire the majority of shares of one or more companies. An "asset deal" concerns only a part or a company's activity. The difficulty is then to define the scope of the assignment. Functions can be shared between the assigned branch and other selling company's activities - including support functions - Some intangible assets may belong to another company, not the divested business - intellectual, industrial licenses, etc. - and / or require the consent of a third party to be transferred to the buyer - purchasing contracts, etc. A transfer is essential for business continuity.

What needs to be done:

- **Delineate precisely the scope of discontinued operations:** the analysis of the data room gives a first idea of the scope. If any elements are not clear they should be clarified with the seller.

If some secondary functions are not part of the method scope, collaboration seller can be organized through TSAs (Transition Services Agreements) or SLAs (Service Level Agreements) covering services essential to the pursuit of the acquired business. The drafting of the list of services required during the transition is a long and tedious job, it is necessary to regularly solicit the teams on their vision of services essential to the continuity of the acquired operations.

- **Identify potential "deal breakers"**: certain strategic assets - patents, intellectual property, industrial licenses, contracts - may belong to a legal entity that is not disposed of, or require the consent of a third party. The transfer of these assets will be a condition of closing.

## Key success factors

To help a company during an operational due diligence implies an understanding of business of the target and its environment: business, business opportunities, product development, potential risks, reorganization following the integration, partnerships, etc. It is necessary to understand all these elements in order to:

- Set a framework and guidance to operational teams,
- Have a quick understanding of the analyzes,
- Have the capacity to challenge some estimates,
- To provide an informed opinion on the results and conclusions (evaluation of the business plan, synergies, operational risk)
- Ensure consistency and readability of the final report.

The experience of this type of operations enable to anticipate deadlines, to ensure efficient team management and to increase their understanding of the process of due diligence. An experienced consultant with a process of this type is also known that the management of the purchaser is not the only interlocutor and can support it to interact with other players.

## Conclusion

The diversity of actors and their interactions, stress and challenges necessitate the support of a **consultant** on an unusual project for operational managers. **He will guide the teams to anticipate blocking points, to essentially light and lead a relevant operational due diligence. This will avoid ultimately to the buyer to invest as risk of missing an opportunity and maximize the chances of closing the right transaction.**