
SMART DUE DILIGENCE

USING THE RIGHT EXPERTISE TO
AVOID PITFALLS AND UNCOVER
TRUE OPPORTUNITIES



INTRODUCTION

In today's volatile business environment, the mergers and acquisitions (M&A) environment is challenging, not only due to the ever-increasing potential of competitive pressures from disruptive technologies and business process innovation but also as a result of the uncertain geopolitical dynamics caused by the coronavirus pandemic. Private Equity (PE) companies need even greater certainty in relation to driving effective investment strategies and ultimately achieving the identified operational improvements and financial returns.

Through the M&A process, it is of critical importance to achieving a deep understanding of the investment target, specifically concerning the markets it serves and the competitiveness of the solutions portfolio it offers. An integrated commercial and operational Due-Diligence (iCodd) is probably the most important factor in delivering a successful acquisition that will deliver the required RoI.

This is particularly important when the target acquisition is a specialist industrial equipment supply business, serving key infrastructure industries such as power, oil and gas, aviation, water, and other specialist sectors. The acquiring company needs deep-domain expertise in such deals to ensure they have robust, data-based insights into the target asset's real positioning and potential before committing to any transaction. Getting this element right, dramatically reduces the emergence of unforeseen risks to be managed in the post-acquisition phase. While the due diligence process must address the financial and legal perspectives, in practice, the opportunities and risks arising from market dynamics and the business' operational performance will overwhelmingly drive the attractiveness or otherwise of the target asset.

In recognition of the importance of iCodd, this paper highlights some of the commercial and operational risks and opportunities that often remain hidden during a typical due diligence process, particularly when the target asset is a specialist industrial supply business.

UNDERSTANDING THE DEAL VALUE DRIVERS

The value-drivers we need to focus on to truly understand the positioning and competitiveness of a target asset are listed below. Investors must not underestimate the seller's ability to expertly present a business in the best possible light to generate a higher asking price. It falls on the iCodd team to deliver a comprehensive evaluation of actual operational and commercial risks and opportunities facing the target company based around these value-drivers:

MARKET POSITIONING AND PERCEPTION



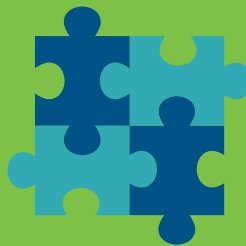
CAPABILITIES &
CAPACITY TO MOVE
WITH THE MARKET



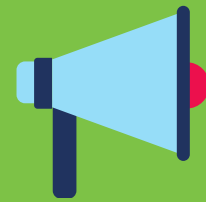
CUSTOMER PROXIMITY



ORGANIZATIONAL
AND OPERATIONAL
CULTURE



PRODUCT AND AFTERMARKET OFFERING RELEVANCE



RISK & OPPORTUNITIES
AWARENESS AND
ABILITY TO RESPOND



Ultimately, for a given target asset, the ability to recognize and respond to the emerging issues across these value-drivers determines the real value and growth potential. Gaining deep insight into these parameters will determine the right target value and, when needed, will reveal when to walk away from a deal.

Having in-depth industry knowledge and expertise is the only way investors can fully evaluate the business in the context of these value-drivers that otherwise could easily be considered relatively risk-free.

To illustrate this point, a few examples:

LATENT OUTCOMES

Leading up to a potential sale process, to swiftly improve financial performance, the incumbent management may have forced a rapid reduction in R&D spending. Even though the objectives are transparent and evident, going forward, these short-term actions could have complex and latent implications that could dramatically impact the mid-term product pipeline and the delivery of the promised business plan.

INDUSTRY DISRUPTORS

In a business plan, an enterprises' historical CAPEX profile is often used to assess and forecast future CAPEX needs. Similar or incremental CAPEX requirements may be judged against recent references. However, the industry's intimate knowledge may reveal a lack of understanding or preparation for disruptors in the industry and the need for re-purposing. Understanding the potential impact of trends that are just "around the corner" is critical. For example, the rapid shift from fossil-based power generation toward renewables can have significant negative impacts on a business' market positioning and perception if the product offering cannot diversify into emerging or adjacent markets.

RETAINING KEY PEOPLE

Often, a buyer will focus on retaining senior management during an acquisition. That said, for industrial businesses, the real value is far more likely to be found in the knowledge held within the sales and technical teams. Identifying the appropriate core leadership or even its absence requires an experienced industrial perspective and is critical to maintaining and growing a business.



PROJECT ANOMOLIES

Revenues in a project-based organization can be significantly skewed by just one project. It takes an experienced eye to reveal if this is an isolated instance with little chance of recurring or a trending feature. One, or even a few, large outlying projects can harbor substantial risks or longer-term effects that are not immediately transparent in the financial record. A limited understanding of the "nuts and bolts" of project-based companies may leave a buyer with a very different business post-acquisition than anticipated.

WIDER INDUSTRY QUESTIONS

Indirect impacts on the core business growth plan often come from unforeseen sources, such as regulatory changes or a macro downturn. For example, it could be thought that oil price would not impact a project organization that builds power plants. However, if its business forecast is made around revenues from the Middle East region, infrastructure investment is likely to be among the first areas hit by an oil-price slowdown.

REALIZING THE POTENTIAL

Investing in the right integrated Commercial and Operational due diligence know-how can prove to be the real differentiating factor in successful acquisitions.

While the economic potential behind pursuing a deal is obvious, the ability to turn potential into reality is the endgame. For this reason, every buyer's concern is to ensure the right Rol by understanding and evaluating the risks and maximizing the potential opportunities around the above value-drivers. With the right iCODD team in place, these value-drivers will be correctly and fully addressed, ensuring the search for all possible options and upsides is comprehensive and detailed.

With the above iCDD approach, it provides the ability to recognize key business parameters, distinguishing between what is good and what is less desired:

- Understanding the infrastructure markets and ecosystems a business serves is key to being able to assess the positioning of the business
- What is the level of business process and systems optimization? Is there real potential to deliver meaningful operational and SG&A synergies?
- Is there potential for additional value-creating supplementary acquisitions?
- Supply chain efficiency and reach is a critical operational area – how well is the business leveraging the global potential to drive cost without impacting technical capability and quality?
- Channel-to-market options linked with the need for customer intimacy is a critical dynamic to maximize aftermarket revenue streams, especially for complex, end-user mission-critical equipment.

IN SUMMARY

This paper introduces a different and effective approach to performing a thorough commercial and operational due-diligence process. In today's volatile business environment, with the ever-increasing realities of competitive pressures from disruptive technologies and rapid business process innovation, coupled with the uncertain geopolitical dynamics caused by the coronavirus pandemic, it is imperative to build a comprehensive view of the target asset's abilities relative to the critical value-drivers outlined.

The upfront investment in deep-domain commercial and operational know-how is a key differentiating factor to realizing successful acquisitions.

ABOUT US

Emerald Operating Partners is a leader in specialist operational due-diligence and commercial due-diligence for industrial acquisitions, especially those with mission-critical rotating parts.

Emerald has an extensive global network of experts who can immediately evaluate the health of a portfolio company in the context of the evolving marketplace and assess the need for change and adaptations. Founded by top level experts who have held senior decision-making positions within industry, we have earned the widespread respect of major industry players.

We collaborate fully with portfolio management teams to make businesses healthier, more profitable and future-ready to take on challenges and turn the company far healthier with market share gain. Emerald will support your portfolio company management team on a performance plan, and we take pride in our excellent ability to collaborate.

At Emerald, we understand the sectors we serve like no one else, with an exclusive focus on six key industries: power, oil & gas, energy storage, water, aerospace and specialised industries. This allows us to serve our customers with unique insights and advice across a range of services including due diligence services, operations optimization and product strategy.



#1

ADVISOR

In hydrogen generation and storage



#1

ADVISOR

For M&A specialized industrials OEM deals



150+

EXPERTS

With deep domain experience



3

CONTINENTS

In which Emerald experts operate



\$6

BILLION

Total deals in 2020 for infrastructure M&A



\$7

BILLION

Total deals in 2020 for industrial M&A

7 |

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