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# **EMERALD OPERATING PARTNERS**

## **INTEGRATED DUE DILIGENCE Q&A**



# H<sub>2</sub> Hydrogen

# INTEGRATED DUE DILIGENCE Q&A

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## INTEGRATED DUE DILIGENCE Q&A

# WHY EMERALD IS THE RIGHT TEAM FOR YOU?

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### WHY SHOULD INVESTORS WORK WITH SPECIALIST INDUSTRIAL ADVISORY FIRMS SUCH AS EMERALD FOR COMPLEX M&A DEALS?

Investors engaged in power and water infrastructure or specialized industrial deals face highly complex industry-specific challenges that often lay outside mainstream generalist knowledge and competence. For example, understanding the forward-looking market drivers, disruptive future technologies, and the potential for expansion into new or adjacent markets are the real deal success factors. Thus, the profound insights delivered by Emerald's well-coordinated and rounded due diligence team with critical domain knowledge that will include the technology, cost base, and competitive position are imperative. Such experience is what can make the difference in modeling the value of a deal.

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### WHY DO YOU TAKE PRIDE IN YOUR STABLE OF EXPERTS?

Many private equity firms take pride in having access to C-level advisors from tier one companies who previously managed \$5 billion USD+ P&Ls. We too are proud to utilize such executives; however, it is our approach to supplement them with N-1 and N-2 specialists who can drill from the high-level business strategy down to what matters in the execution.

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### ARE YOU ABLE TO DELIVER THE POST-ACQUISITION BUSINESS IMPROVEMENTS THAT YOU RECOGNIZE IN YOUR DUE DILIGENCE PROCESS?

Emerald's team comprises leaders who have previously managed significant P&Ls of their own. Their operational experience allows us to benchmark industry best practices, which means that post-acquisition, we can develop the roadmap and strategy to materialize projected improvement options into the business reality.

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## IS IT POSSIBLE THAT SELLERS CAN "POLISH" A DEAL, OFTEN COVERING UP POTENTIAL RISKS IN THE SALE PROCESS?

The investors cannot trivialize the seller's ability to expertly present a business in the best possible light to generate a higher asking price. Therefore, it falls on the due diligence team to do their job right and deliver a comprehensive evaluation of actual operational and commercial risks and opportunities facing the target company. The real benefit is the insight that can identify the right target value and even reveal when to walk away from a deal.

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## WHERE DOES EMERALD SPECIALIZE, AND WHO WOULD MOST BENEFIT FROM DEPLOYING EMERALD?

Our value is undoubtedly recognized when we work with industrial B2B companies that produce highly engineered mission-critical products with a strong aftermarket offering.

We excel when such companies incorporate turbomachine equipment such as turbines, compressors, reciprocating engines. We also have an excellent understanding of the megatrends in the industrial markets. Therefore we are positioned better than most to advise on the future market growth strategy for such businesses.



## INTEGRATED DUE DILIGENCE Q&A

# WHAT MAKES DEEP DOMAIN INDUSTRIAL EXPERTS BETTER THAN GENERALISTS?

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## HOW DOES THE DD PERFORMED BY EMERALD DIFFER FROM WORK PERFORMED BY GENERALIST BUSINESS?

The Emerald team methodically assesses all business's critical aspects with a proven and tested approach to ensure that we provide the right data to model the actual business value. Our deep domain experts conduct extensive research allowing flagging up any risks or opportunities to present to investment committees.

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## IS IT CRITICAL TO FIND A SPECIALIST TEAM? IS A GENERALIST TEAM WITH TEMPLATES AND PROCESSES NOT SUFFICIENT TO COVER ALL DEALS?

Emerald has profound knowledge and experience in the industrial sectors we serve, which allows our teams to provide deep insights on the value and the risks associated with a deal, allowing the investors to model the valuation with even greater confidence.

Finding a knowledgeable and experienced due diligence team is even more critical in today's extremely challenging mergers and acquisitions (M&A) environment. Achieving the desired return on investment is becoming increasingly challenging and all things considered, investors need higher confidence levels to achieve operational improvements and drive effective market strategies successfully.

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## **HOW DO YOU ENSURE THE QUALITY OF YOUR SERVICE? GIVE AN EXAMPLE OF SOMETHING THAT MAY BE MISSED BY A GENERALIST ADVISORY PERFORMING DUE DILIGENCE.**

Our core team members are industry leaders with an extensive network. When we deploy subject matter experts, we carefully choose trusted and tested experts from within our network who are well acquainted with our working processes and the service and deliverables quality expectations.

We are picky about our collaborators because we know that an untrained eye can miss things that can have significant ramifications to the deal. For example, revenues in a project-based organization can be favorably and significantly skewed by just one project. It takes an experienced insight to reveal if this is an isolated instance with a 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.

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## **CAN DEEP DOMAIN EXPERIENCE HELP ALLEVIATE DUE DILIGENCE CHALLENGES INDUCED BY THE COVID-19 ENVIRONMENT?**

We define deep domain experience as at least ten years of related industry knowledge supported by specific functional expertise, ranging from R&D, manufacturing, service, and aftermarket.

In a due diligence process, we require our advisors to apply their analytical capability to think laterally to identify measurable risks and opportunities that can be substantiated in a financial model.

Nowadays, the Covid-19 restrictions do not easily allow for first-hand management presentations and site visits, and even the factory tours are conducted virtually. Deprivation of the hands-on, direct scrutiny leaves room for unintentional oversight and analytical gaps. In these situations, the deep domain expertise allows the due diligence team to tap into a vast tacit and explicit knowledge, experience, and relevant network to ensure that any ensuing information gaps are filled.

## INTEGRATED DUE DILIGENCE Q&A

# HOW DOES EMERALD TEAM BENEFIT YOU?

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### WHICH AREAS DO YOU FEEL ARE OFTEN OVERLOOKED BY GENERALIST FIRMS DURING OPERATIONAL DD?

#### A. SUPPLY CHAIN IMPACTS ON GROSS MARGIN

In many industrial businesses, up to 70% of the Cost of Goods Sold is often driven by the supply chain. Savings achieved in this critical area flow rapidly to the bottom line. A procurement organization frequently manages the supply chain in a business with staff competencies, systems, and operational approaches to match. Detecting this in an acquisition target presents an opportunity to inject strategic supply chain management thinking and capabilities to gain a rapid improvement in gross margin results that flow to EBITDA or competitive pricing

#### B. DISTRIBUTOR MANAGEMENT

In many B2B equipment supply companies, there is often a failure to recognize the positive impact smart performance management has on the distributor network. Even highly performing businesses concentrate their performance management attention mainly on internal teams, not the external partners. Introducing performance measures for reps and distributors as a direct extension of internal sales and after-sales functions can dramatically improve performance management.

#### C. INDUSTRY DISTRIBUTORS

In a business plan, an enterprises' historical CAPEX requirements are often used to assess and forecast future CAPEX needs' soundness. Inexperienced advisors may project similar or incremental CAPEX requirements against recent references. However, intimate knowledge of the industry may reveal a lack of understanding or preparation for disruptors in the industry and the need for re-purposing.

Investors must give the forethought to accommodate the trends that are just "around the corner," such as the dramatic step away from coal toward renewables, the switch toward the investment in hydrogen fuels, and the impact of additive engineering (3D printing), to name the few.





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## WHY IS IT BENEFICIAL TO THE DEAL TEAM TO HAVE ONE ADVISORY FIRM FOR BOTH OPERATIONAL DUE DILIGENCE AND COMMERCIAL DUE DILIGENCE?

It is quite normal for private equity firms to hire two separate teams for the buy-side deal execution support: one to perform the operational due diligence (ODD) and another to work on the commercial due diligence (CDD). While such an approach may result in positive outcomes, the overriding risk is losing a critical synergy-creating value. As a result, the real upsides and or underlying risks related to the target acquisition may not be fully recognized in the financial model.

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## WHY EARLY DEPLOYMENT OF THE DUE DILIGENCE EXPERTS IS BENEFICIAL TO THE INVESTORS?

We believe that investors should always consider bringing in a dedicated industrial due diligence team from the start of a deal, even before the virtual data room (VDR) is available to potential buyers.

A strategic due diligence firm with a deep domain experience deployed during phase one of the acquisition process can reveal the investment target's real value early on. Such a move would allow the investor to move into round two of the deal discussions equipped with a more profound understanding of the deal's real value. This tactic may cause the buyer's financial modeling to change significantly, which will impact the go/no go decision and the final offer.

Additionally, some investment firms rely on their in-house teams early in the bidding process to filter out less attractive opportunities. While this tactic allows focus and may bring efficiency to the internal selection process, it may be disadvantageous. It could contribute to forgoing some promising options, which can only be brought to light by an experienced industrial due diligence firm.

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## HOW CRITICAL DURING THE DEAL PROCESS IS THE REVIEW OF THE QUALITY OF THE MANAGEMENT TEAMS?

Often in the acquisition, a buyer will focus on retaining the senior management, which is critical to stabilizing the business post-deal close. However, for industrial businesses, the real value is equally likely to be found in the sales and technical teams' knowledge. It is essential during a deal process to quickly evaluate and identify the critical technical knowledge holders or networked sales teams because they are vital to maintaining and growing a business.

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## ARE YOU ABLE TO DELIVER THE POST-ACQUISITION BUSINESS IMPROVEMENTS THAT YOU RECOGNIZE IN YOUR DD PROCESS?

Emerald's team comprises leaders who have previously managed significant P&Ls of their own. Their operational experience allows us to benchmark industry best practices, which means that post-acquisition, we can develop the roadmap and strategy to materialize projected improvement options into the business reality.



# EMERALD IN NUMBERS



#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



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