The M&A Growth Bulletin
News and Insights on M&A for the Middle Market

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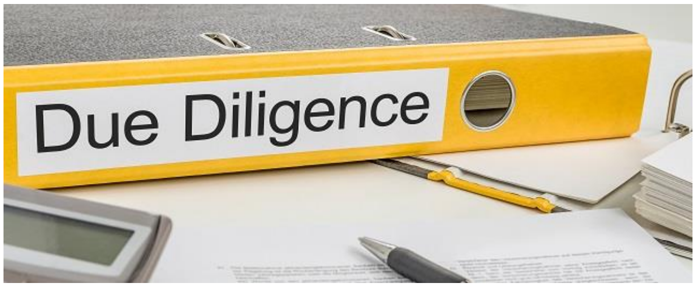
Three Common Due Diligence Mistakes and How to Avoid Them



In October 2017, four months after closing its $4.48 billion acquisition of Yahoo, Verizon announced that all three billion Yahoo accounts had been hacked in 2013. On October 23, 2018, Yahoo agreed to pay $50 million in damages to affected users. As the acquirer, Verizon will shoulder half the costs.

Obviously, most of us would like to avoid a situation like this where a large liability "suddenly" appears after the deal closes. This is why most due diligence guides focus on uncovering hidden risks. While failing to identify liabilities may be the most obvious due diligence mistake, it is certainly not the only one companies make. Here we have outlined three common due diligence blunders and how you can avoid them.

Mistake # 1 – Only looking for risks – The traditional approach to due diligence is to identify any risks that might derail the deal. Once found, acquirers will walk away or use these red flags to beat down the prospect on price. While identifying liabilities is still important, this approach limits your perspective.

Solution – Identify opportunities – A better way to conduct due diligence is to seek out opportunities as well as risks. On the one hand, outdated technology may be seen as a red flag because of the costs required to replace it. On the other hand, this could be an opportunity for you as the new owner to add value and increase employee morale with newly purchased solutions.

Mistake # 2 – Asking for data piece-by-piece – Not only is this practice irritating to the Target, it is also an ineffective method for processing information. Receiving documents piecemeal can prevent you from seeing the big picture and the Target will be frustrated in what is an already emotional time for both parties.

Solution – Get organized – Due diligence yields a plethora of information and it is best to have an orderly way to process all of it. Before you even ask the Target for one document, take some time to organize your thoughts and come up with a list of items you would like to obtain from the other party. Then, send this list to the Target. You may have follow up requests for additional information as you learn more but try not to constantly badger the seller. You want to maintain a positive relationship with the owner.

Once you do receive the data, assign a member of your acquisition team to act as the librarian to keep track of and organize it in a meaningful way. This may mean using a project management software or it might be just a simple excel spreadsheet, depending on how complicated the transaction is. The main point is that you must have a system for identifying and processing what is most significant to your company.

Mistake # 3 - Letting due diligence drag on – In due diligence, acquirers must balance thoroughness with speed. While it may be tempting to prolong the process in hopes of getting more information, at some point you must come to a decision to move forward or walk away from the deal. If the process drags on for too long, you lose momentum, which can slow down and even kill the deal.

Solution – Understand your risk tolerance and priorities – One of the main reasons due diligence drags on is fear. Acquiring a company, especially for the first time, can be scary because an acquisition, as with any business endeavor, carries a certain amount of risk. There are a few ways to overcome this psychological hurdle. First, have a clear (and honest) understanding of your company's risk tolerance before you embark on any acquisition program. Second, realize that you will never uncover everything during due diligence and instead, focus on the aspects that are most important to you. Everything is not created equal so do not dedicate too much time to insignificant issues. Use your resources effectively. We recommend only spending between 30 to 60 days to conduct thorough due diligence.

Due diligence is an important step in the acquisition process. Learn from the mistakes of others to ensure your success. Strategic acquirers focus on identifying opportunities as well as risks, organize their findings systematically, and are not afraid to move a deal forward.

Do you have questions about M&A? We would love to hear from you. Please contact us at 703-854-1910 or Growth@CapstoneStrategic.com.

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David Braun's Tip for Growth

Be Specific About Price In the Letter of Intent

Don't rush to get a signed letter of intent (LOI) by kicking the can down the road on price. A signed LOI is a significant milestone in the M&A process, indicating mutual interest in an acquisition. The document covers the basic parameters of the deal that both buyer and seller agree to including what will be acquired, deal structure, and pricing.

Unfortunately, far too often in their eagerness to obtain a signed LOI, buyers will avoid negotiating about price by putting a large range in the LOI. While this may speed up the pre-LOI negotiations, I strongly recommend you do not take this approach because it complicates matters as the deal progresses.

Let's say you put a range of $90 to $100 million. What commonly happens is the seller remembers $100 million, while the buyer remembers $90 million. Unfortunately, in this situation, negotiations can become tense over a document that is supposed to represent a meeting of the minds.

While the price cited in the LOI is nonbinding and will likely change upon your discoveries during due diligence, writing down a specific number or at least a narrow (and realistic) range will help to keep both parties aligned moving forward. Spending time with the seller pre-LOI discussing will save you time and effort and protect your relationship with the seller in the long run.

It's a Big Deal: M&A in the News

Arby's owner buys Sonic for $2.3 billion to compete in the consolidating restaurant industry. As part of the deal, Inspire Brands, the parent company of Arby's, Buffalo Wild Wings, and Rusty Taco will get 8,000 locations allowing it to gain scale to better compete with rivals like McDonald's, Burger King, KFC, Taco Bell, and Pizza Hut.

Daimler sets up a joint venture with China's Geely Group to compete with market leader Didi Chuxing, which purchased Uber's Chinese operations back in 2016. The market for ride-hailing in China is currently worth $23 billion and growing rapidly.

AstraZeneca purchases a 9.8% stake in French biotech company Innate Pharma to gain access to an experimental immunotherapy drug. Like other big pharmaceuticals, AstraZeneca is interested in furthering its expertise in immune-oncology.

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