

*Due Diligence
For Transactions*



Agenda

- Introduction: Objective and Purpose
- Due Diligence V Audit
- Need of Due Diligence
- Scope of Due Diligence
- Approach
- Report
- Conclusion

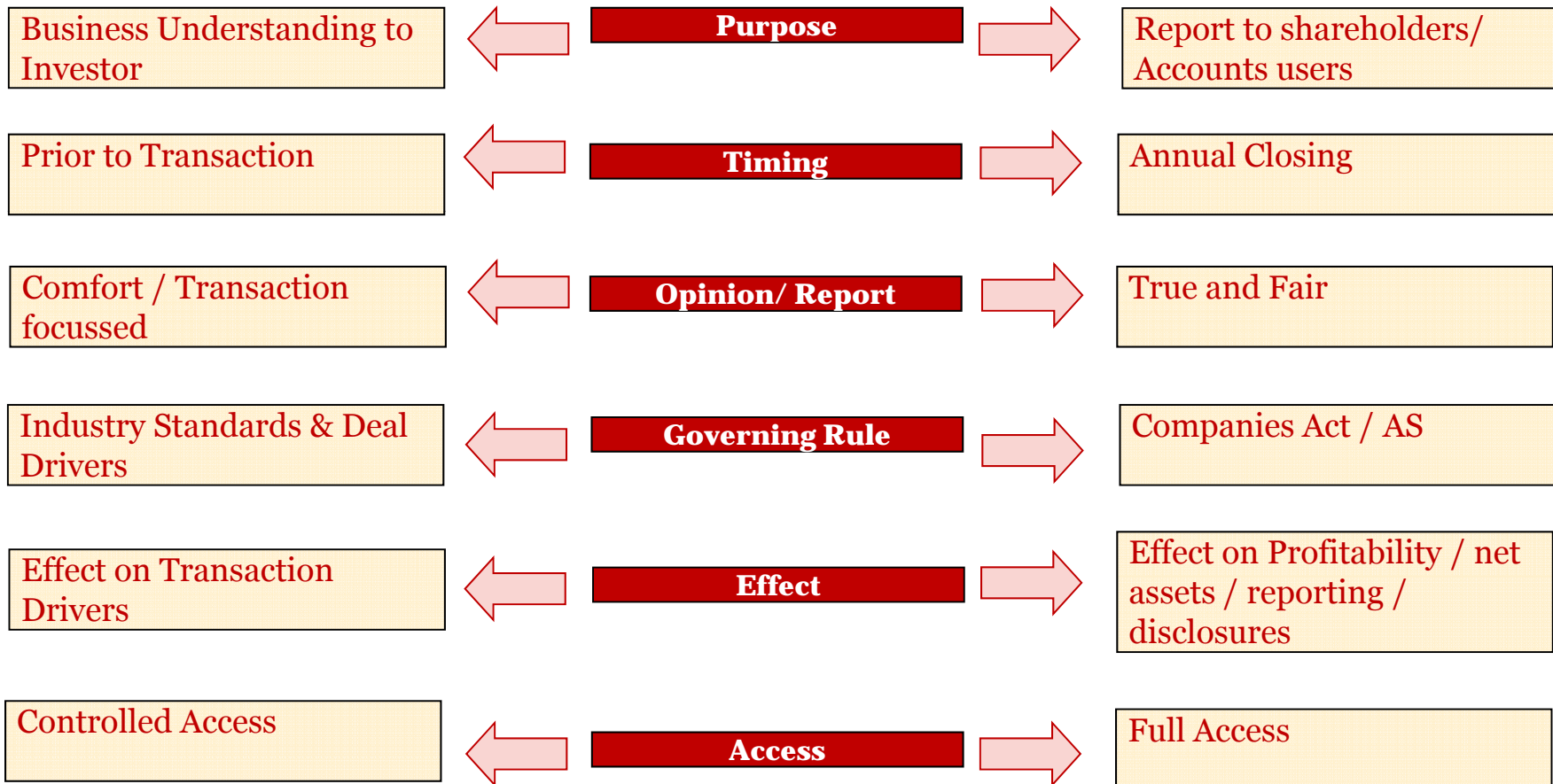
Introduction: Objectives



Due Diligence vs Audit

Due Diligence

Audit



Purpose : Buy Side Vs Sell Side Due Diligence?

Are you buying what you think you are buying??

**Buy Side
Due Diligence**



**Assist the buyer maximise
his return on the deal**

**Do you know the issues a potential buyer may negotiate
on?**

**Sell Side
Due Diligence**



**Assist the Vendor / Seller
get the best value on the
deal**

SCOPE OF DUE DILIGENCE

Scope of Due Diligence varies depending upon the kind of Transaction

Unlike a statutory audit, there is no defined law / process by which the due diligence has to be conducted, it has evolved by practice and requirements of the transaction

A. Typically, in a 100% acquisition of shares, Joint Ventures, Private Equity Transactions, the following is the scope of coverage of the due diligence exercise

- Background and business overview of the target company*
- Constitutional Documents and Corporate Records*
- Share Capital – Clear title of shares to be acquired*
- Details of the directors, auditors and bankers*
- Corporate Governance*
- Details of Shareholders*
- Agreements and Contracts*

SCOPE OF DUE DILIGENCE

Contd.

- Licences and Approvals
- Properties – Owned and Leased
- Financial and Taxation records
- Exchange Control (FEMA aspects)
- Loans and Borrowings and Guarantees extended
- Investments
- Intellectual Properties
- Litigations
- Employees and Personnel
- Insurance Coverage
- Miscellaneous

SCOPE OF DUE DILIGENCE

B. In case of an Asset acquisition / Business / Undertaking acquisition **Contd.**

In such acquisitions, the focus is the on Asset(s) / Business / Undertaking to be acquired instead of the Company / its shares

- Assets – their title and ownership
- Encumbrances on the assets
- Agreements and Contracts – related to assets
- Approvals with respect to the use of the assets
- Intellectual Property
- Litigation on the use and ownership of the assets
- Employee Matters, Trade Union and Labour
- Health, Safety and Environment Laws
- Insurance Coverage on assets

SCOPE OF DUE DILIGENCE

C. Specific caution in case of due diligence of a listed company

Contd.

- *Confidentiality Agreement / Non-Disclosure Agreement is executed with the parties involved in the transaction*
- *Standstill provisions to be agreed with various parties – restricting them from dealing in shares of the listed company while in possession of unpublished price sensitive information*
- *Generally, no disclosure to the stock exchanges when the due diligence is undertaken*
- *Disclosure to stock exchanges when the transaction is finalised and executed*
- *Dissemination of confidential information to the exchanges before closing the deal*

SCOPE OF DUE DILIGENCE

D. FCA and Anti-Corruption Issues

Contd.

- Mostly required by MNC (US Companies) as significant portion of the due diligence
- FCPA allows for payments (speed money / facilitation payment) made to government official for routine with requisite disclosures
- Prevention of Corruption Act, 1988 is stringent in India and prescribe for imprisonment and penalties for offences committed under the law . Does not permit any form of payment, not even facilitation payment
- These payments are difficult to track – they are mostly unrecorded
- Even if tracked the reason for these payment informed that these payments are quite prevalent

SCOPE OF DUE DILIGENCE

E. Specific and Industry Focused Areas of Diligence

Contd.

- Telecom
- Information Technology
- Export Oriented Units
- Healthcare
- Metals & Mining
- Insurance

PROCESS PRE-DUE DILIGENCE

Step-1

Agree with the Client on Scope and Timelines

- Scope
 - Areas to be covered
 - Manner of maintenance and collection of data
 - Final work product
 - Due Diligence Report
 - Only Executive Summary
 - Comprehensive Bible with Executive Summary, detailed report on all segments, data sheets
- Timelines
 - Time within which the exercise is to be complete

PROCESS PRE-DUE DILIGENCE

Step-2

Getting Ready

- Obtain copies of Information Memorandum, MOU, draft transaction documents, if any.
- Draw up your wish list / checklist for circulation to Target and team
- Circulate information, if any, about the transaction including available documents to the team, divide up responsibilities
- Identify major issues concerning the transaction
- Set out process and expectations

PROCESS PRE-DUE DILIGENCE

Step-2

Getting Ready

- Pick the members of the Team based on expertise required for the various components of the due diligence
- Assess whether you need any outside consultant / expert for any aspect, e.g. labor related issues, real estate issues
- Make sure that the consultant has the same level of transaction overview as the rest of the Team and understands the scope of his work clearly
- In case a Non-Disclosure Agreement is to be executed by the client ensure that the consultant executes the same
- Read all documents circulated relating to the transaction very carefully
- Read up on industry and regulatory issues that may be relevant to the Transaction
- Identify specific issues that may be relevant

PROCESS PRE-DUE DILIGENCE

Step-2

Getting Ready

Pre-diligence Deliberative Overview

Prior to commencement of the process, an overview of issues considered to be of significance for the successful execution of the Transaction are normally deliberated upon between the Acquirer and Target representatives and their respective accountants and legal and business advisers

This pre-diligence deliberative overview stage is of critical significance as it sets out the basis for setting out the scope and intensity of the due diligence process specific to the contemplated Transaction at hand

PROCESS PRE-DUE DILIGENCE

Step-2

Getting Ready

Components of the Deliberative Overview

- ***Transaction Structure*** i.e. concerned parties, whether structured as share or asset purchase, tax considerations, restrictive covenants, etc.;
- ***Transaction Funding*** i.e. how is funding contemplated and preliminary consideration of any significant issues in respect thereof;
- ***Regulatory Issues*** such as restriction on foreign holding, subsidiaries, approvals, competition law issues and foreign exchange considerations;
- ***International Aspects*** including the question of engaging overseas professional advisers;
- ***Timelines*** i.e. determination of time schedules for various stages of the contemplated Transaction;
- ***Confidentiality Agreements*** i.e. whether Target seeks powers to restrict the release of certain information or data and review of covenants in relation thereto (Particularly in a listed company);

PROCESS PRE-DUE DILIGENCE

Step-2

Getting Ready

Components of the Deliberative Overview

- ***Exclusivity or Lock-In Arrangements*** as per negotiations between the parties;
- ***Data Room Guidelines*** regarding the due diligence process on Target entity;
- ***Overall Due Diligence Strategy*** and consideration of the due diligence checklist as is usually circulated prior thereto; and
- ***Specialized Issues*** such as industry-segment and relevant sector-specific issues including any specialized legislative requirements and such other details.

DUE DILIGENCE PROCESS

Constituents of the Process

- Two separate aspects of the due diligence process:
 - ***Formal Process***
 - ❖ Review and analysis of data provided in the form of documents
 - ❖ Review and analysis based on interviews with representatives of the Target to get clarity on the missing links
 - ***Informal Process***
 - ❖ Significant information regarding the Target is obtained through discussions, informal meetings with key persons of the Target

POST DUE DILIGENCE

Preparation of the Due Diligence Report

- Upon formal completion of the due diligence process, the due diligence Team usually finalizes the due diligence report
- The due diligence report must seek to provide the most pertinent information at a given point in time in the most easily absorbed form possible
- It is particularly critical to relate the due diligence report to the strategic objectives of the due diligence process.
- The due diligence report is to be shared *inter se* the Acquirer and its legal and business advisers
- Although a final report is usually finalized after all due diligence investigations are completed however negotiation process benefits from frequent interim feedback especially in the context of any adverse factors coming to light

POST DUE DILIGENCE

Constituent Sections of the Due Diligence Report

- *The due diligence report is usually prepared on the basis of terms of reference as agreed with the client*

- *The due diligence report would typically consist of the following three sections:*
 - ***Executive Summary:*** *This draws to the attention of the Acquirer, any items of concern or otherwise requiring attention and could usually start with the most critical points or deal breakers*

 - ***Main Body:*** *This would ideally follow the order and headings of the terms of reference or the checklist*

 - ***Appendices:*** *This section includes data sheets and/or documentation which are relevant to a critical issue*

NOTE OF CONCLUSION

- Due diligence enables negotiating team in a transaction to take on critical decisions pertaining to the said transaction
- Accordingly, the process allows negotiating team to strategize the course of action and terms of negotiations going forward
- Strategies for Acquirer on the basis of findings of the due diligence process include the following:
 - Requiring certain adverse factors to be remedied prior to closing of the Transaction
 - Seeking specific representation and warranties and providing for indemnification thereof – due diligence is not an exception to the representation and warranties
 - Negotiating more favorable terms such as reduction in price, trade-offs against matters already conceded to Target, retention of part of purchase price to improve cash flow of Acquirer; and deferral of purchase price
 - Drawing up certain conditions precedent and conditions subsequent to the transaction

NOTE OF CONCLUSION

- Restructuring Transaction altogether for example from a share purchase to an asset acquisition
- Obtaining financial guarantee from a more solvent third party as compared to the Target
- “Walking away” from negotiations, which may be necessary where
 - There are adverse factors of such magnitude that adequate compensation or protection would not be feasible
 - The Acquirer does not trust the Target and has calculated that the maximum potential disadvantages are too high
- Due diligence further identifies potential deal breakers enabling Acquirer to deliberate and focus upon the same during the course of negotiations
- Due diligence additionally provides critical inputs on trustworthiness of Target

NOTE OF CONCLUSION

- Due diligence most importantly allows Acquirer to determine whether proposed approach regarding Transaction fits within original strategic objectives of Acquirer
- Due diligence constitutes a critical component of corporate transactions per se and the determinative basis of steps taken subsequent thereto for execution of such transactions.

NOTE OF CONCLUSION

- *Keeping in mind clearly the objectives of the transaction*
- *Expectations of the Client*
- *Cordial relation with the Target, its advisors and representatives*
- *Excellent team work – follow the team leader*
- *Adherence to the timelines*
- *Professional etiquettes*
- *Managing stress*
- *Providing timely inputs to the negotiating team as and when required*

On a lighter note...

"Behind every great business deal is a Due Diligence advisor advising against it"

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Thank You for your attention

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