



Soft Due Diligence Should Deliver Hard Results for Food & Agribusiness Deals



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 **Quick read**

Introduction

Due Diligence (DD) put simply, is an investigation or audit of a target by a buyer, to evaluate historic performance and future potential. However, more conventional approaches relying solely on past documented performance of the assets being acquired, can sell buyers short. It is critical to evaluate the whole supply chain in which the target is merely a single entity.

Hard DD follows a pro-forma, lookback approach, usually involving legal and financial information on a target. While this formal approach is important, it usually provides very little insight into the future operational or commercial capacity and value generation potential of the target. The addition of Technical Due Diligence (TDD) and Commercial Due Diligence (CDD), which include the focus on soft areas of the target, should provide much deeper operational and strategic insights. This is particularly critical in the domain of private firms, which are off-limits from the scrutiny of publicly quoted exchanges or stock markets.

The primary objectives of DD include:

- To identify key internal & external risks
- To validate & support valuation process
- To identify integration issues & requirements



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Why do Technical and Commercial Due Diligence?

After the market crash of 2008 and a long season of drought, Mergers and Acquisitions (M&A) are finding their way back in the corporate mainstream. However, it is claimed that 83% of all mergers and acquisitions fail to deliver expected value and more than 50% of the transactions destroy the firm values in the longer term.

- Due Diligence is the investigation of a target by a buyer evaluating historic record & future potential
- Meaningful DD means evaluating the whole supply chain in which the target is embedded
- Commercial & Technical Due Diligence provides deeper insights into future performance
- DD identifies key risks, supports valuation process and identifies issues
- A high failure rate in acquisitions meeting value makes DD vital in minimising bad outcomes
- Outputs from DD include deal value and Go/ No Go decision
- Advantages of TDD include informed decisions & improved negotiating position
- Sound CDD means having sector experts deployed on the ground

Therefore, not only is it critical for the buyer to conduct comprehensive DD but it is equally important for the target to conduct a “reverse diligence” broadly in line with primary DD conducted by the buyer. This reduces the chances of failure of the acquisition and any resulting damage to reputation.

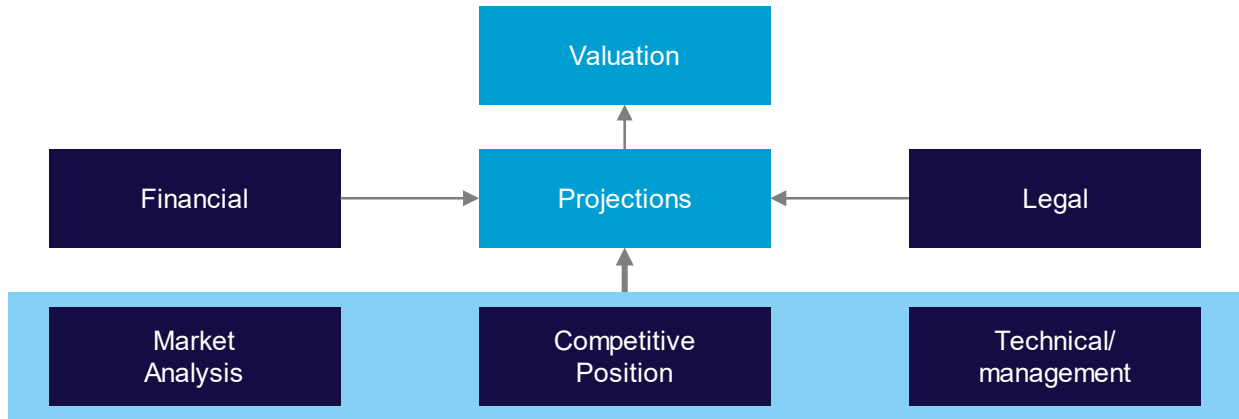
TDD and CDD should not just look at a business as a standalone entity, but also from a wider supply chain perspective.

The process is not just a box-ticking exercise, but the foundation of any deal, as reflected in figure 1. TDD and CDD help understand the target’s potential, potential risks and mitigation, market size; all to make a more informed decision and increase future value creation potential. The outputs of such DD directly affect:

- Deal value
- Go / No-Go” decision



Figure 1: The Technical and Commercial “Roots” of a M&A Deal



Source: Farrelly & Mitchell

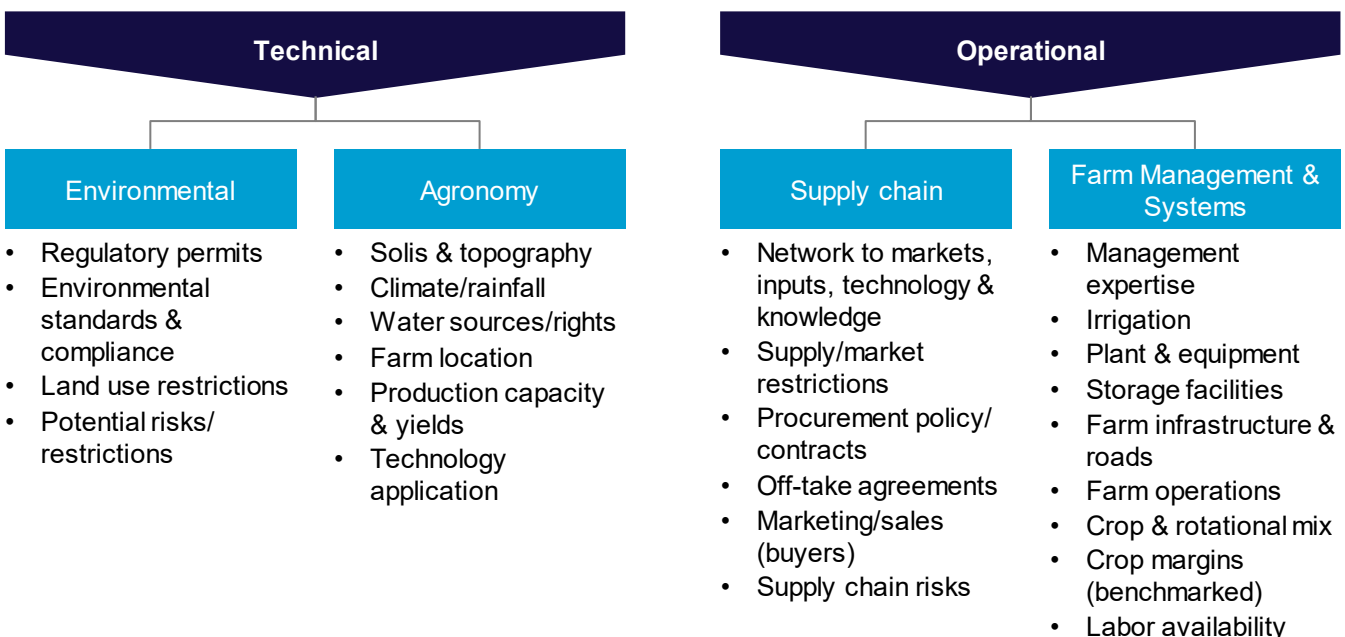
“ From our experience of working on numerous international M&A food and agribusiness acquisitions, we have seen deals fail, despite a “Go” from a Financial Due Diligence (FDD) and Legal Due Diligence (LDD) standpoint.

Technical Due Diligence

Technical DD is conducted to evaluate the target’s assets, technology and human resources. In the case of large-scale farmland transactions, it involves a thorough technical assessment of environmental and agronomy standards. From an operations viewpoint, a detailed understanding of the supply chain and farm management systems needs to be developed.

Soft DD evaluates human capital to make sure that the target management can deliver. It is critical to have unbiased sector experts with relevant supply chain expertise to conduct technical and operation DD analysis. Lack of attention to detail across the key areas pertaining to investment in land, as illustrated in figure 2, can prove very costly and could lead to the M&A deal turning sour..

Figure 2: Technical and Operational Due Diligence in M&A Largescale Farmland



Source: Farrelly & Mitchell



From our experience of working on numerous international M&A food and agribusiness acquisitions, we have seen deals fail, despite a “Go” from a Financial Due Diligence (FDD) and Legal Due Diligence (LDD) standpoint. Failure to complete comprehensive technical assessment exposes deals to significant operational

risks and potential failure overlooking real life operational challenges such as poor sales systemisation or distribution capacity or lack of management expertise.

The benefits of effective Technical and Operation DD include:

- Informed decision making: Through independent analysis
- Improved buyer negotiating position and avoidance of hidden pitfalls: By having seasoned sector experts with attention to detail conduct TDD analysis
- Enhanced time and resource utilisation by highlighting any unrealised technical or operational benefits
- Identification of industry best practices: Seasoned experts are privy to industry best practices and they can help target’s implement alternative or complementary technologies to increase production and operational efficiencies

Commercial Due Diligence

Commercial DD involves detailed analysis of the marketplace, the target and its positioning in its served market. The buyer should have a solid understanding of the target’s customer base including the level of concentration of the largest customers, revenue generated by biggest customers as well as the sales pipeline.

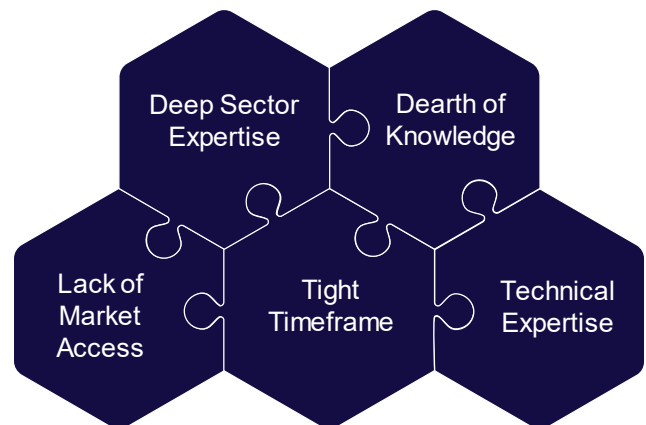
The challenges that need to be overcome to ensure sound CDD in developing markets are illustrated in figure 3. These challenges include lack of published information which inhibits sound understanding of the supply chain. From our experience, to tackle this, it is critical to complete informal market intelligence, in the form of sector experts deployed on the ground.

This allows the buyer to benefit from deep sector expertise in a relevant setting. The expert’s ability to conduct in market research through their network of contacts and industry connections helps paint a holistic picture of the whole supply chain and to provide relevant market insights in relation to the target.



Effective Commercial DD also provides insights to potential opportunities for growth and expansion to support any follow-on value creation phase.

Figure 3: The Commercial Challenges in Successful M&A Deals



Source: Farrelly & Mitchell

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When can Technical and Commercial due diligence be done badly?

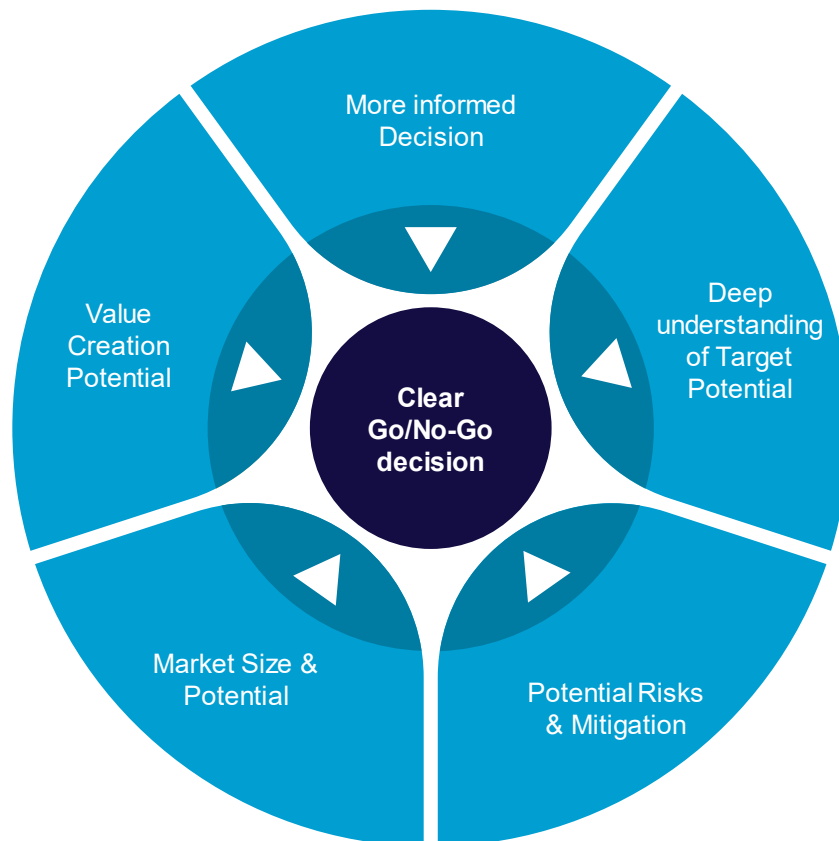
- **Timing:** TDD is often “last in line” and usually does not take place until the FDD is well advance
- **Exclusivity Period:** Time constraints can mean additional time pressure for TDD and seller fatigue with the process can also be a challenge at this stage of the process.
- **Goals of DD are not well understood:** FDD and LDD focus on risk reduction, whereas for successful target operations, what happens after the deal is signed operationally and commercially, is equally important.

Key outputs of TDD and CDD from our experience should include:

- Detailed findings on the Target
- Technical deficiencies and gaps
- Sales performance gaps
- Benchmark all important physical and financial KPI’s
- Quick-wins’ that can be achieved - first 100 days post acquisition
- ‘Go’ or ‘No Go’ recommendation on the acquisition

The deals which could be unqualified “Go” financially maybe heavily qualified “Yes” technically or commercially, often acting as “Maker or Breaker” of M&A deals, directly impacting on the short- and longer-term deal value.

Figure 4: Adding Value to M&A Deals





Conclusion

Technical and Commercial DD evaluates the target company and the market it serves, from a commercial and operational current and future capacity and capability perspective. Essentially it helps buyer's make more informed decisions around the target's deal value.

This part of the DD process should also assess and determine the potential risks and mitigation strategies to increase the target's future value generation potential.



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