Pre-acquisition due diligence: The Baronsmead Operational Audit

Ensuring the successful implementation of the100 Day Plan

Due diligence generally focuses on reviewing an organisation's financial and legal records. It will often include an investigation of current practices, processes and policies. Attention is paid to how the purchase should be structured and how much should be paid, yet often little attention is paid to maximising the benefits that could be derived from the acquisition. Conventional due diligence is unlikely to offer any assistance in advising what practical steps need to be taken from Day One. Negotiating a 'good deal' may be the focus, but the real challenge comes after the ink is dry. Detailed planning must start *before* signing yet the importance of this is frequently underestimated.

Baronsmead has significant experience of business regeneration combined with a financial transaction, based on producing and validating a strategic plan. In a traditional restructuring there are three components:

- Business Plan - An analysis of the business, its prospects and management, covering strategic, operational and operational issues.
- Financing Structure – The appropriate level of debt that the business can support.
- Operational Restructuring - Immediate changes to maximise post-acquisition performance.

In a stressed transaction there is usually very little time to undertake sufficient due diligence as stakeholders will already have fixed timescales in view. Therefore it is essential to use expert practitioners who can accelerate an Operational Audit leading to the creation of what is widely known as the First 100 Day Plan.

The Operational Audit must have a full understanding of acquisition synergies and post deal implementation, as these can provide a competitive advantage when preparing a bid. The knowledge of the benefits that will accrue from a swift implementation of the business plan will enhance the purchaser's position when it comes to determining the bid price in.

There are five elements in the Operational Audit:

Relationship
Assessment
Planning
Implementation
Delivery

Relationship

The Audit deals with the strategic components of the transaction and in particular the need to add shareholder value. To ensure there are no overlaps with the other due diligence teams, the scope will be agreed in advance and information shared. The work is undertaken by an operational team who review the feasibility of the business plan, including the key changes and drivers, the external environment, and the impact on major stakeholders.

Assessment

The proposed acquisition has a business plan, but is it deliverable with existing skills and resources? Is the management team capable of effecting change? Plans often contain projections that are based upon the status quo, not on what could be done to transform the business. It is important to evaluate the current structures and competencies so synergies can be realised as soon as the deal completes, as well as to assess the best way to integrate and deliver benefits from the acquisition. Therefore, information gleaned at this stage will be very relevant to the structuring of the Sale & Purchase Agreement (SPA).

For example, working on behalf of a private equity house, Baronsmead liaised with the financial and commercial due diligence teams. We were therefore able to assess the viability of the three manufacturing sites and the management team. This led to a step down plan that consolidated the three sites into one. The previously loss making business was generating cash within three months of acquisition.

Planning

The First 100 Day Plan is now well established in the lexicon of M&A but in practice the commercial logic of ensuring its execution is often waylaid by events and/or by management who have not implemented this sort of strategy before.

In turnaround assignments there is often a cash crisis and a need for immediate stabilisation. Underperforming businesses typically suffer from a swiftly deteriorating cash position. The turnaround team must move quickly to take control of the situation. It is these skills that can be used to produce a rapid operational change in situations where there is no cash issue.

After acquisition, there is a honeymoon period when it is easier to effect changes and start leveraging benefits. The long term value of the deal will be greater if the 100 Day Plan starts on Day One, but this needs to be planned in advance. For example, when properly managed and communicated, on acquisition, an immediate exit of those who will be leaving the organisation will lead to an easier transition. Creation of the 100 day plan draws on the advisor's strategic and analytical experience, who at the same time, work alongside management, challenge the overall business plan, identify and prioritise the step-by-step actions, and make sure everyone buys in to the changes. Most importantly, the 100 Day Plan will have milestones, as well as correctly focused financial measures of performance. A communications strategy encompassing key messages will also be agreed.

Baronsmead was called into assist an AIM listed company where the management team had focussed so much time and energy on the acquisition they had neglected their core business. This lack of attention and direction meant that the core business had deteriorated and was consuming cash. Coming from a position of weakness the acquired business had to be disposed of and was sold for less than it had been purchased for.

Implementation

Upon acquisition the 100 Day Plan needs to be implemented to ensure that all elements are delivered on time. Defining the rules and the new culture is essential. Leaving the implementation in the hands of the existing management poses a risk: management should be focusing on running the business and not distracted by such a non-core activity.

When undertaken effectively integrations are major events, which can transform a business and add considerable value for stakeholders. If done badly they can be distracting and disruptive and shareholder value can be eroded. The importance of using a skilled team is often underestimated. Failure to implement a detailed plan can lead to delays in achieving the benefits and divert attention from the day-to-day management of the business. Depending upon the size and complexity of the plan the management team may require some assistance. This may mean the establishment of a Project Management Office. These sort of tough decisions should be taken early.

A listed leisure business, with which we worked, had embarked on a trail of acquisitions, but had only undertaken a rudimentary amount of due diligence. None of the acquired companies had been integrated into the group, nor had they changed their style of operating or reporting. Unsurprisingly, all the acquisitions performed well during the initial years, during which the total purchase price (earn out) was still being assessed. Subsequently, every acquisition lost money. To protect the core group, the recently acquired companies were either closed or sold, always at a lower price than had at first been paid.

Managing stakeholder relationships is always key to any successful change programme, especially where it includes integration. The stakeholder communications plan should be rolled out and regular feedback sought to make sure everyone is on board with the transformation.

The alternative is a transaction without a 100 day Plan and implementation team, which is likely to end in early failure for all concerned.

Delivery

Profit and liquidity improvements are a good indicator that the plan is being delivered. Even so expectations of immediate results can be wide of the mark. A lasting turnaround will almost always take more than 100 days to deliver strong, tangible benefits. Nonetheless, it is the intensity and pace of actions in those first 100 days which sets the seal on what follows, often under new management brought in for the medium and longer term. Plans always need to be flexible as circumstances change and markets shift.

In many cases the acquisition is just the start of the process. Some purchasers, especially Private Equity, will immediately be looking for an exit for the business. This will require further guidance to ensure that profits and exit valuations are maximised.

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