

## Only 24 Hours to Complete Operational Due Diligence?



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In a perfect world, private equity firms would have weeks to evaluate a target company's operations and dive deeply into opportunities for value creation and areas of hidden risk. They'd be able to give attention to everything from revenue trends and cost saving opportunities to S&OP processes, leadership capabilities, and maintenance practices.

But the chances of that happening today are far and few between. Given the abundance of dry powder waiting to be invested coupled with intense competition for deals, the luxury of time is virtually nonexistent. Operating

partners are lucky if they have a couple of days to do an assessment. And, in most cases, they have to settle for a due diligence "drive by" that may be further hindered by limited access to operating data and/or the organization's leadership team.

## **Resist the urge to drink from the fire hose.**

When you're working in a compressed due diligence window, it can be tempting to skim the surface of every potential operational factor. Overall, we believe there are 13 key areas that can be a source of both opportunity and risk in a deal. (Download our info graphic: [Operational Due Diligence: 13 Areas of Risk and Opportunity](#)). However, if you spend your limited time trying to touch every piece of the puzzle, you'll end up with only a cursory overview of each and may miss the opportunity to uncover the insights that matter most to your deal's success.

## **Use your investment thesis to narrow your operational due diligence scope.**

To make the most of the time you have, focus on the two or three examination areas that most align with your vision and objectives for the acquisition. For example, when a middle market PE firm in the food and consumer sector was looking to acquire an Asia-based manufacturing company that could help it accelerate growth, verifying that factory conditions and business operations were up to its standards was the most critical factor in the deal's success. While data and access to site leadership were limited during the due diligence phase, during a one-and-a-half-day onsite visit conducted by TBM consultants, the operating partners were able to validate the manufacturer's full process capabilities, check for all required certifications, and gain an understanding of the company's environmental, social, and governance (ESG) practices. TBM also examined supplier relationships, material sourcing, and in-house workshop capacity and capability. Ultimately, the PE firm closed the deal, feeling confident that the target company's operations could meet its expectations for product quality, safety, compliance and responsiveness to customer requirements and support its growth agenda.

Sometimes the motivation behind a deal is more about capitalizing on cost savings and operational improvement opportunities to drive value creation. In this type of scenario, operational due diligence should focus on identifying addressable EBITDA opportunity and quantifying the investment and effort it would take to realize that opportunity while also understanding any risk factors in the business. By focusing in the right areas, it's possible to gain this level of insight even on a tight timeline.

For example, another private equity firm where we worked could only give us one day to visit a target manufacturing company's three sites. Without much data to go on, limited access to the leadership team, and just one hour to spend in each location, the PE firm looked to TBM to examine the manufacturing production

process and deliver a go-forward value creation plan. Using the investment thesis as the lens and information from the initial desk analysis completed by an offsite analyst, TBM consultants focused on the target company's automation CapEx plan. While we identified up to \$9 million in EBITDA opportunity, we found that the company would need to pursue additional automation investments across all available lines in order to support the deal thesis. The PE firm ultimately declined further pursuit based on a fragmented M&A pipeline in combination with the CapEx risks and requirements involved to achieve the targeted value creation.

## **Gain an objective perspective.**

When time and data are both in short supply, outsourcing the **operational due diligence effort to consultants** who are intimately familiar with the manufacturing and distribution environment can help. From a logistical perspective, entrusting a team of experts can help you be in multiple places at once, and veterans can often quickly glean critical insights based purely on a walk-through and observation, turning up issues that may otherwise go unnoticed and helping you perform a thorough look under the hood.

TBM recently helped a PE firm looking for platform companies and add-on acquisitions conduct a thorough operational review of target organization's facilities during a half-day plant walk through. In a half-day at the plant, coupled with an interview of the COO and an initial analysis of plant data, we were able to evaluate site operations; look for any red flags in quality, management practices, safety, product integrity, or workforce; understand capacity management and utilization; and evaluate CapEx strategy and supply chain scalability. In this short timeframe, we identified up to \$5.9 million of addressable EBITDA opportunity and put together a go-forward value creation plan that the PE firm had us help execute after closing on the deal.

When the clock is ticking, you can't afford to waste precious minutes in areas that will have minimal impact on your value creation plan. Your goal should be to quickly identify and quantify untapped sources of value that directly map to your objectives while keeping an eye out for potential deal breakers. Post-deal, when you have more time, you can do a deeper analysis to turn up additional areas of opportunity. But when the heat is on, working with experts you trust can ensure that even a drive by due diligence effort gives you the confidence you need to either pull the trigger on the deal or walk away without regret.



### **Bob Brennan, Managing Director, Private Equity Practice**

Bob Brennan is a senior executive with extensive general management and manufacturing operations leadership experience with significant achievements in turning around troubled operations and bringing about lasting cultural change. He is a Managing Director with responsibility for serving our growing base of private equity clients in the US.