

13 SEPTEMBER 2023

Corporate & Commercial ALERT

IN THIS ISSUE

The route from A to DD: A roadmap for a successful due diligence

The value of a thorough due diligence process in any merger/acquisition transaction cannot be overstated. Not only does a due diligence (DD) provide comfort to an investor that the financial, operational and legal risks of its investment have been identified and mitigated, but it also provides scope for assessing and testing the valuation of the target. Despite their benefit, due diligence investigations are often viewed as a "*grudge spend*" by investors or an administrative hoop to jump through in order to obtain approval for an investment. However, there are ways in which an investor can approach and structure a due diligence investigation in order to maximise the benefit of the process and, very often, reduce costs.



CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

The route from A to DD: A roadmap for a successful due diligence

The value of a thorough due diligence process in any merger/acquisition transaction cannot be overstated. Not only does a due diligence (DD) provide comfort to an investor that the financial, operational and legal risks of its investment have been identified and mitigated, but it also provides scope for assessing and testing the valuation of the target. Despite their benefit, due diligence investigations are often viewed as a “grudge spend” by investors or an administrative hoop to jump through in order to obtain approval for an investment. However, there are ways in which an investor can approach and structure a due diligence investigation in order to maximise the benefit of the process and, very often, reduce costs.

In this article we explore a number of factors that are often not fully considered by investors when undertaking a due diligence in connection with a potential investment.

Determining the DD scope

The first point of call is to determine the scope of the DD, or in other words, the subject matter of the investigation. Commissioning a full-scope due diligence may not be necessary in order to obtain sufficient comfort to make an investment and it may benefit an investor to conduct a high-level internal due diligence of a potential target in order to understand the business before engaging professional advisors to conduct a DD.

An investor can choose to conduct a full-scope DD into all aspects of a target’s business, including, legal, financial, business, tax, and environmental, social and governance. In relation to the legal due diligence, a full-scope investigation may include an analysis of group status, commercial contracts, finance and banking,

employment, real estate, litigation, IT, intellectual property, insurance, environmental, health and safety, and regulatory, to name a few of the common workstreams. This approach works best when the investor has limited knowledge of how the target’s business is run and requires a comprehensive understanding from its advisors.

However, if an investor already has some knowledge of the target’s business through its own investigations and consultations with the target’s management, then the investor may be comfortable with limiting a DD’s scope to areas of greater risk based on the nature of the target’s business. For example, looking at the environmental aspects of a financial services business is not likely to be of great use to a potential investor, but looking at the financial regulatory environment in which the business operates will be critical to the value that the DD can bring to the investment process.

A legal advisor can assist in determining the scope of the legal DD and highlighting the areas of high risk that should be focused on.



The LEGAL 500 EMEA

Corporate, Commercial/M&A 2023 Rankings

Corporate & Commercial practice is ranked in Tier 1.

CDH Kenya's Corporate & Commercial practice is ranked in Tier 3.

Leading Individuals:
Willem Jacobs | David Pinnock

Recommended Lawyers:
Vivien Chaplin | Peter Hesselting
Justine Krige | Sammy Ndolo
David Thompson | Roxanna Valayathum
Njeri Wagacha

Next Generation Lawyers:
Justine Krige

Hall of Fame:
Ian Hayes

The route from A to DD: A roadmap for a successful due diligence

CONTINUED

Organising the virtual data room

Once the scope has been determined, the target will need to start collecting and collating the relevant requested information into a central data repository, usually a virtual data room (VDR).

It is important to ensure that the VDR is set up in the most user-friendly manner possible and for the VDR to be fully populated before the DD starts in earnest. A disorganised VDR can prolong the due diligence process and cause unnecessary costs due to advisors being required to locate relevant documents and, potentially, revisit them when information comes to light during the course of the DD.

It is helpful for the target to be provided with a folder directory by the legal advisors conducting the DD before the VDR is populated, to ensure that the VDR is well-organised before it commences. The arrangement of the VDR will differ from business to business, based on the way in

which the business is structured. A well-organised VDR also assists further down the line in the due diligence process, as documentation provided in responses to additional queries can be placed in the correct folder in an intuitive manner, which can then easily be communicated to the due diligence team.

Managing timelines and target management

It is critical to ensure that clear timelines are set up at the beginning of the due diligence process, and that these timelines, as well as the entire due diligence process, are communicated to the target before the DD commences.

The relationship between the investor and the target needs to be carefully managed at all times. This is because the role of responding to information requests will often fall to a handful of the target's management team. These people need to attend to the needs of the DD advisors in addition to their day jobs. On larger DDs where

additional information requests can be voluminous, it can be taxing on the target's management team to manage the flow of information.

Establishing a timeline with the relevant advisors and the target at the start of the process and adhering to this timeline as far as possible can ensure that the process runs smoothly and with greater co-operation from all involved. As the investor will likely need to establish a healthy working relationship with the management team of the target group, creating boundaries for a well-managed due diligence process can ensure that the relationship gets off on the right foot.

Choosing the type of due diligence report

The due diligence report is the product presented to the investor and will set out the advisors' findings, recommendations, and identified risks. However, before the report can be prepared, it is vital for an investor to understand and communicate the type of report that is required.

The route from A to DD: A roadmap for a successful due diligence

CONTINUED

There is a fundamental (and often misunderstood) difference between the **scope** of a DD and the **type** of DD that is conducted. The scope of the DD speaks to the type of subject matter that is reviewed and reported on, whereas the type of DD speaks to the manner in which an advisor presents its findings to the investor.

A due diligence report can take the form of a comprehensive summary of all the different elements of the business and commercial contracts concluded by a target group. Alternatively, a report can set out only the key risks which a potential investor would want to be aware of and other matters material to the acquisition/investment. The latter form of report is commonly referred to as a “*red flag*” or “*exceptions-based*” report. Most often, there is more value to an investor in opting for a red flag report, as only material matters and risks are highlighted and advisors are not required to spend time summarising contracts, except to the extent that it is necessary in order to contextualise any risks that are identified.

However, there are instances where a more comprehensive report may be advisable or have appreciable commercial benefit, as discussed below.

Considering the role of warranty and indemnity insurance

Before commencing any due diligence process, an investor should determine whether it wishes to take out warranty and indemnity (W&I) insurance for the transaction. Where a transaction is secured with W&I insurance, each warranty and indemnity that is sought in the transaction agreement needs to have been adequately assessed in the DD. In order to determine this, underwriters use the due diligence reports prepared by advisors to assess whether the investor has conducted sufficient due diligence into all warranties sought to be provided in relation to the transaction.

In these circumstances, a high-level exceptions-based report may not provide insurers with adequate comfort that a fulsome due diligence

exercise has been conducted. A more detailed report that exhibits the breadth of the due diligence exercise may be more appropriate.

Vitality, being able to determine the type of report required upfront will save greatly on time and costs, as the legal advisors will not need to revisit the documents in the VDR to amend the report to be more suitable to a W&I insurance process, should it be determined later on that W&I insurance is a requirement for the transaction.

In conclusion, in order to ensure a successful due diligence process, the above areas should be carefully considered before any decisions are made. Having a clear idea of the direction the DD should take before any work is conducted will assist in reducing costs, limiting the time that the due diligence process will take and will provide an end-product fit for an investor’s purpose.

**Nicola Stipinovich and
Andrew Giliam**

OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:



Ian Hayes

Practice Head & Director:
Corporate & Commercial
T +27 (0)11 562 1593
M +27 (0)83 326 4826
E ian.hayes@cdhlegal.com



David Thompson

Deputy Practice Head & Director:
Corporate & Commercial
T +27 (0)21 481 6335
M +27 (0)82 882 5655
E david.thompson@cdhlegal.com



Sammy Ndolo

Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Kate Anderson

Director:
Corporate & Commercial
T +27 (0)11 562 1105
M +27 (0)82 418 3784
E kate.anderson@cdhlegal.com

Tessa Brewis

Director:
Corporate & Commercial
T +27 (0)21 481 6324
M +27 (0)83 717 9360
E tessa.brewis@cdhlegal.com

Vivien Chaplin

Sector Head: Mining & Minerals
Director: Corporate & Commercial
T +27 (0)11 562 1556
M +27 (0)82 411 1305
E vivien.chaplin@cdhlegal.com

Clem Daniel

Director:
Corporate & Commercial
T +27 (0)11 562 1073
M +27 (0)82 418 5924
E clem.daniel@cdhlegal.com

Johan de Lange

Director:
Corporate & Commercial
T +27 (0)21 481 6468
E johan.delange@cdhlegal.com

Andrew Giliam

Director:
Corporate & Commercial
T +27 (0)21 481 6363
M +27 (0)83 359 7069
E andrew.giliam@cdhlegal.com

John Gillmer

Joint Sector Head: Private Equity
Director: Corporate & Commercial
T +27 (0)21 405 6004
M +27 (0)82 330 4902
E john.gillmer@cdhlegal.com

Allan Hannie

Director:
Corporate & Commercial
T +27 (0)21 405 6010
E allan.hannie@cdhlegal.com

Peter Hesselting

Director:
Corporate & Commercial
T +27 (0)21 405 6009
M +27 (0)82 883 3131
E peter.hesselting@cdhlegal.com

Quintin Honey

Director:
Corporate & Commercial
T +27 (0)11 562 1166
M +27 (0)83 652 0151
E quintin.honey@cdhlegal.com

Willem Jacobs

Director:
Corporate & Commercial
T +27 (0)11 562 1555
M +27 (0)83 326 8971
E willem.jacobs@cdhlegal.com

Brian Jennings

Director:
Corporate & Commercial
T +27 (0)11 562 1866
M +27 (0)82 787 9497
E brian.jennings@cdhlegal.com

Rachel Kelly

Director:
Corporate & Commercial
T +27 (0)11 562 1165
M +27 (0)82 788 0367
E rachel.kelly@cdhlegal.com

Yaniv Kleitman

Director:
Corporate & Commercial
T +27 (0)11 562 1219
M +27 (0)72 279 1260
E yaniv.kleitman@cdhlegal.com

Justine Krige

Director:
Corporate & Commercial
T +27 (0)21 481 6379
M +27 (0)82 479 8552
E justine.krige@cdhlegal.com

Dane Kruger

Director:
Corporate & Commercial
T +27 (0)21 481 6362
M +27 (0)74 914 1402
E dane.kruger@cdhlegal.com

André de Lange

Sector Head: Agriculture, Aquaculture
& Fishing Sector
Director: Corporate & Commercial
T +27 (0)21 405 6165
M +27 (0)82 781 5858
E andre.delange@cdhlegal.com

Jaco Meyer

Director:
Corporate & Commercial
T +27 (0)11 562 1749
M +27 (0)83 477 8352
E jaco.meyer@cdhlegal.com

OUR TEAM

For more information about our Corporate & Commercial practice and services in South Africa and Kenya, please contact:

Anita Moolman

Director:
Corporate & Commercial
T +27 (0)11 562 1376
M +27 (0)72 252 1079
E anita.moolman@cdhlegal.com

Wayne Murray

Director:
Corporate & Commercial
T +27 (0)21 405 6018
M +27 (0)79 691 0137
E wayne.murray@cdhlegal.com

Francis Newham

Executive Consultant:
Corporate & Commercial
T +27 (0)21 481 6326
M +27 (0)82 458 7728
E francis.newham@cdhlegal.com

David Pinnock

Joint Sector Head: Private Equity
Director: Corporate & Commercial
T +27 (0)11 562 1400
M +27 (0)83 675 2110
E david.pinnock@cdhlegal.com

Allan Reid

Director:
Corporate & Commercial
T +27 (0)11 562 1222
M +27 (0)82 854 9687
E allan.reid@cdhlegal.com

Jess Reid

Director:
Corporate & Commercial
T +27 (0)11 562 1128
M +27 (0)83 571 6987
E jess.reid@cdhlegal.com

Megan Rodgers

Sector Head: Oil & Gas
Director: Corporate & Commercial
T +27 (0)21 481 6429
M +27 (0)79 877 8870
E megan.rodgers@cdhlegal.com

Ludwig Smith

Director:
Corporate & Commercial
T +27 (0)11 562 1500
M +27 (0)79 877 2891
E ludwig.smith@cdhlegal.com

Tamarin Tosen

Director:
Corporate & Commercial
T +27 (0)11 562 1310
M +27 (0)72 026 3806
E tamarin.tosen@cdhlegal.com

Roxanna Valayathum

Director:
Corporate & Commercial
T +27 (0)11 562 1122
M +27 (0)72 464 0515
E roxanna.valayathum@cdhlegal.com

Roux van der Merwe

Director:
Corporate & Commercial
T +27 (0)11 562 1199
M +27 (0)82 559 6406
E roux.vandermerwe@cdhlegal.com

Andrew van Niekerk

Head: Projects & Infrastructure
Director: Corporate & Commercial
T +27 (0)21 481 6491
M +27 (0)76 371 3462
E andrew.vanniekerk@cdhlegal.com

Njeri Wagacha

Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E njeri.wagacha@cdhlegal.com

Charl Williams

Director:
Corporate & Commercial
T +27 (0)21 405 6037
M +27 (0)82 829 4175
E charl.williams@cdhlegal.com

Christelle Wood

Director:
Corporate & Commercial
T +27 (0)11 562 1372
M +27 (0)83 498 2850
E christelle.wood@cdhlegal.com

Emma Hewitt

Practice Development Director:
Corporate & Commercial
T +27 (0)11 562 1635
E emma.hewitt@cdhlegal.com

Alecia Pienaar

Counsel:
Environmental Law
T +27 (0)82 863 6279
E alecia.pienaar@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

PLEASE NOTE

This information is published for general information purposes and is not intended to constitute legal advice. Specialist legal advice should always be sought in relation to any particular situation. Cliffe Dekker Hofmeyr will accept no responsibility for any actions taken or not taken on the basis of this publication.

JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.

Dx 154 Randburg and Dx 42 Johannesburg.

T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.

T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI

Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.

T +254 731 086 649 | +254 204 409 918 | +254 710 560 114

E cdhkenya@cdhlegal.com

STELLENBOSCH

14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.

T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

©2023 12659/SEPT