REASSESSING THE BUSINESS ASSESSMENT

HOW TO GET THE MOST OUT OF AN OBJECTIVE BUSINESS EVALUATION

DAN WIKEL, MATT KAZIN, AND LEE SWEIGART

Management teams, lenders, and equity investors are often faced with the challenge of objectively evaluating the historical and prospective performance of a business.

These evaluations, due diligence studies, or business assessments (which we will refer to as "Assessments") are generally conducted by independent third parties. They can be narrowly defined and relatively simple, or they can be broad in scope, encompassing a wide variety of complex issues.

Some Assessments are imposed based on current capital structure conditions — required by either prospective or incumbent lenders or equity investors to assess business plans, strategy, or alternative financing decisions. These may be prompted by a potential transaction or investment opportunity or to better understand the current situation.

Other Assessments may be needed to address strategic business issues, such as an operational redirection, development of an M&A strategy, or other special situations. In every case, the purpose of the Assessment is the same: to identify opportunities and to mitigate risk by providing and analyzing information. However, the method to accomplish this can vary substantially based on the situation and the user's requirements.

In order to yield the most value and insight from an Assessment, the keys are to clearly define the objectives (which will drive the scope) and to choose the right resource or team of resources to conduct it in the available timeframe based on your requirements.

CLEARLY DEFINING THE OBJECTIVES AND SCOPE

Assessments may require a quick turnaround, encompassing a very narrow and specific scope. For example, a "basic" Assessment might include only one of the elements below:

- High level review of the short-term forecast or the long-term business plan, considering historical results, recent industry developments, viability of key, underlying assumptions, and execution capabilities
- Identification of the key opportunities and risks associated with the business plan projections
- Review of specific elements of the business strategy, such as the key restructuring plans, revenue enhancements, or cost reduction initiatives

Other Assessments are much more comprehensive, based on a broader scope, and characterized by a more detailed and thorough analysis which typically requires more time to complete. An example of this type of Assessment could include one or several of the following items:

- Full scope due diligence study, including a historical quality of earnings, to review income statement and balance sheet activity for several historical and projected periods
- Detailed review of the company's business strategy, key assumptions, and the achievability of its business plan
- Development of alternative forecast scenarios and sensitivities
- Analysis of the company's market approach, competitive positioning, industry, and/or management team

Because Assessments can be customized to include any or all of these elements, it is important that the party requiring the Assessment focuses on what it needs to make its decisions and achieve its objectives. For example, a lender seeking to support credit committee review or to facilitate underwriters' and originators' understanding and decision-making has very different objectives than a private equity investor seeking to enter a new sector and identify a "platform" acquisition.

Other key considerations include:

- Whether there are scope items required for a particular user's objectives
- If the findings will be shared with other constituents that may want additional work performed
- Whether the scope can be staged with likely "deal killers" in early phases to avoid unnecessary work and minimize costs
- If a prior evaluation or due diligence has been conducted, it may be possible to narrow the focus to a handful of remaining key value drivers to expedite the process

The time available to conduct the Assessment also clearly impacts the project, as a shorter timeframe may necessitate a narrower or less detailed scope. The development of a clear set of objectives and scope items, coupled with communication of deliverable expectations prior to starting the bidding process is of paramount importance to make sure expectations are ultimately met.

CHOOSING THE RIGHT RESOURCES

Clearly defining objectives and scope items is the first step in selecting the right resources, and will ensure two things: that bidder proposals will be based on a clear set of expectations and that the deliverable will meet expectations and be delivered on time.

There are three important factors that should be considered to ensure the right resource is selected to perform the Assessment and that the study is as useful and insightful as possible for the buyer.

1. Consider whether you may need follow-on work at the end of the Assessment. Prior to selecting a resource, consider how the likelihood of additional work post-Assessment will impact

the current scope and ensure your provider has all the capabilities that may be necessary for your situation. Some situations that may require more work include:

- A distressed situation may necessitate restructuring, liquidity management, a forbearance agreement, or capital raise services subsequent to the initial Assessment
- The initial Assessment could uncover operational or other issues that require a more detailed Assessment and/or the creation of plans to address the issues
- The company may need other resources to respond to issues identified in the initial Assessment if the existing team does not have the wherewithal to handle these issues

The response to the issues above may warrant the inclusion of additional procedures in the scope. Moreover, if it is likely that follow-on work will be required after the initial Assessment, you should ensure that the resource hired to perform the work has the appropriate skills to address these post-Assessment priorities.

2. Identify the core capabilities the lead advisor and their team must have. The value of having a senior level team with deep experience involved in the Assessment increases exponentially if there is likely to be restructuring work, forbearance negotiations, the need to execute a capital transaction or refinancing, the requirement to implement recommendations identified in the initial Assessment, or the need for further analysis based on preliminary findings. In these instances, it will be important to choose a team that has the capabilities and industry expertise to provide these services and it may be worth paying more for the Assessment. Using a low-cost provider with limited capabilities may lower upfront costs, but if a change in service providers or additional experts is required due to scope expansion or potential issues, the initial investment of the Assessment and valuable time may be wasted.

3. Make sure the proposals are comparable. Once the scope, timeline and staffing have been finalized based on your objectives and the potential for follow on work, be sure this information is properly shared with all bidders. This will ensure "apples to apples" proposals and that everyone is providing comparable bids. More importantly, it will protect against surprises resulting from missed deadlines or incomplete work product at the end of project.

Realistically assessing your requirements and clearly defining the scope and timeline will enhance the value and quality of the Assessment. Matching those requirements with the capabilities of the firm you hire will maximize success and the return on your investment while minimizing unnecessary risk.

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ABOUT THE AUTHORS

Daniel P. Wikel, CIRA, CTP, Managing Director

Dan is a founding member and Managing Director at Huron Consulting Group and has more than 25 years of business and industry experience. His operational expertise encompasses the areas of strategic planning, investment analysis, operational process improvement, and cost improvement identification. Dan has served as a chief restructuring officer and as an advisor, and his experience relates to executing engagements in corporate turnarounds, lender workouts, bankruptcy situations, and raising debt & equity funding for companies across a number of industries. He has a strong base knowledge of the U.S. Bankruptcy Code and general turnaround process through extensive work with many companies near or in bankruptcy and often offers expert advice and testimony on these topics and has written a number of articles for the turnaround industry. He is a Certified Public Accountant (CPA), Certified Insolvency and Restructuring Advisor (CIRA), and Certified Turnaround Professional (CTP). Dan can be reached at 312-880-3003 or dwikel@huronconsultinggroup.com.

Matthew J. Kazin, CIRA, Director

Matt has 15 years of experience in M&A, restructuring, valuation, litigation advisory services, and corporate development. As an acquirer, he has evaluated hundreds of transactions and executed deals with an enterprise value in excess of $1 billion. He has also spent several years advising clients on matters related to M&A, distress, and strategic initiatives in a number of different industries, including, but not limited to: automotive, manufacturing, metals, heavy equipment, healthcare, higher education, transportation, and distribution. Matt can be reached at 248-244-2418 or mkazin@huronconsultinggroup.com.

Lee Sweigart, CIRA, Director

Lee has more than 15 years of experience providing business advisory services, including restructuring and turnaround, disputes and investigations, and evaluation of business operations for due diligence, business plan review, capital raising, and other purposes. His experience covers a variety of industries including airlines, manufacturing, technology, automotive, wholesale distributors, and financial services. Lee can be reached at 312-880-3085 or lsweigart@huronconsultinggroup.com.

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