DUE DILIGENCE IN VENTURE CAPITAL M&A TRANSACTIONS VS. INDUSTRIAL TRANSACTIONS - ARAOZ & RUEDA

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The due diligence process can be defined as the means by which an investor undertakes the relevant investigation and evaluates an investment opportunity before committing funds, including, inter alia, the gathering of data, the analysis of such data in order to identify any risk areas or circumstances and the use of the information obtained to set out the price and the commitments of the parties to the transaction – especially the vendor's representations and warranties, the compensations payable in case of breach of these commitments and the drafting of walk away clauses for the benefit of the investor.

Francisco Aldavero, socio de Araoz y Rueda, detalla las diferencias en el grado y contenido de "due diligence", esencial en ambos casos para detectar vicios ocultos en los activos en operaciones de M&A. Por lo general, afirma que en una operación de M&A, existe una diferencia importante entre la "due diligence" efectuada por un comprador de capital riesgo y la de un comprador industrial. En

muchas operaciones de capital riesgo, el fondo adquiere el negocio mediante compraventa de acciones con el fin de venderlo con beneficios importantes A corto O medio plazo. En íºltimo caso, el comprador casi siempre pertenece al mismo sector que el vendedor y por lo tanto su prioridad es identificar las posibles sinergias que existen entre las dos empresas.
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Although somewhat standardised due to its prolific use in M&A and other types of transactions, the means and scope of a due diligence process and the contents of the due diligence report need to be tailor made for each transaction, being the type of investor and the structure of the transaction - the latter in its turn determining the former on most occasions, among other things, crucial factors that will determine these.

In relation to the type of investor, it is common to talk about industrial versus venture capital or finance investors. The main difference between these is that, when involving themselves in M&A transactions as investors, the former, usually being in the same or similar business sector as the target company, shall seek to achieve business synergies with the acquired company, and the latter, with a less deep interest in the target's business sector, shall seek to achieve in a medium-short term period of time an easy way out from the investment with the expected maximum profitability.

In this scenario, private equity transactions are usually structured as the purchase of a whole business via a purchase of shares, whereas it is not uncommon to find industrial investor's transactions where only individual assets or a specific business unit are acquired.

The different structures of the transaction also have a direct impact on the due diligence process. If a purchase of shares or of a business unit is chosen, a full financial, business and legal – excluding corporate in the case of the purchase of a business unit – due diligence should be undertaken as the investor shall be acquiring the assets and the liabilities in a bulk. If only individual assets are to be purchased, the due diligence would be limited to the technical and legal aspects– in relation to ownership titles and relevant licences.

Additionally, from a legal due diligence perspective, the election of structure shall be material as the protection granted ipso iure to the investor under Spanish civil law for any hidden defects and from eviction in acquired assets will only apply to the acquired asset itself, ie, if the M&A transaction is structured as a purchase of shares, as is common in private equity transactions, the investor, regardless of whether the vendor has been negligent or not, shall have recourse against the vendor for any hidden defects, or eviction, on the shares of the target company but shall not have recourse for any hidden defects, or eviction, on the assets owned by such target company (including its portfolio companies) or its business, financial and legal situation.

In this case, the due diligence process shall therefore be fundamental in identifying any possible hidden defects appearing in the company's material aspects so that the economic cost for any liabilities is allocated to the greatest extent possible on the vendor via contractual comprehensive representations and warranties.

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