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FUND MANAGEMENT

Due Diligence in respect of Covid-19



Mohsin Khan, COO of Hedge fund specialist Brooklands Fund Management Limited, outlines the challenges facing investors in the current climate. One of the big questions covered in this article will be if onsite due diligence is still needed or is a virtual due diligence the way forward, and if so, what changes need to be made to the process.

Due diligence has been part and parcel of the fund management industry for over a decade, or at least more recognisable after the 2008 recession.

Due diligence whether it be operational or investment, is a process whereby investors can look for funds with coherent policies and procedures for due diligence purposes that are used consistently throughout the investment process. Such an approach demonstrates to the investor that the fund manager understands the unique industry, market, and operations in which the manager is trying to operate in. Furthermore, it can adequately manage, identify, and mitigate potential risks, including any governance, reputational, trading or operational issues.

Most managers have now accepted the fact that the performance of their funds, or simply having a good “track” is not enough to get the investors to part with their capital. The industry as a whole

has recognised this and now the majority of managers have a fully comprehensive due diligence pack (DDQ, Flowcharts) at hand that they can show to any potential investor(s).

With the current situation, it is now more important than ever for investors to be more diligent and for managers to have a robust framework in place that is not only adaptable, but also very flexible to the current climate.

The pandemic has impacted a lot of managers in different ways, but one of the key areas that investors will be interested in is the financial health of a company. One would think it would be very premature to assume this current period is a reoccurring situation and as such reflects the business in perpetuity. Due care needs to be taken when trying to calculate what the results would have been without the current crisis and the measures used in the calculations. This is very important as investors would need to be vigilant of any subjectiveness in the managers calculations. For example, using EBITDA over a period of years would seem to be the most prudent approach.

Although the financial impact of the crisis may not be permanent, naturally I would expect some changes to the industry that may require new forms of due diligence in the future, a phenomenon known as the “new normal”. An example of this might be employees working remotely permanently which could in itself pose questions around data protection and cyber security risks. With the current restrictions that are in place, including travel in some cases, its almost impossible for investors to carry out any form of due diligence and as a result, are either postponing, attempting to do it all remotely or taking the safe option and allocating to existing managers they already have a good relationship with.

In some ways, carrying out the due diligence remotely is a good acid test to see if the process can be carried out in a way that we have not been accustomed to and achieves the same outcome. The big question would then be is this a more efficient way of doing it or is a physical visit still required.

You may argue that the DD process can be carried out virtually however the true effects of this are not transparent until years after the investments have been made. There are pros and cons of both methods. Whilst spending hours travelling on a plane and spending a lot of money in the process, the same checks can be done remotely thus saving a lot of man power and also leaving a bit extra in your pocket to achieve the same outcome! Contrary to that, doing onsite due diligence exposes you to certain aspects of the business that wouldn't have been apparent over a virtual DD sessions. For example, assessing body language and expression can give you a vital insight into the management style of the team.

In conclusion, as the dust settles on the current crisis, we will all have learnt to adapt and be flexible to one and others requirements. That said, I would not be surprised if we adopt some of the virtual aspects of working in the future.