

# Technical Due Diligence – define risks and evaluate potentials

Guest article by Christian Frühwirth, Director IT-Advisory, KPMG Austria

Mainly driven through the COVID-19 pandemic more and more Austrian tech start-ups are closing higher investment rounds. These developments lead to a higher size in valuation as well as in overall invested capital. Besides the well-known valuations' driver like revenue number or profit margin, another valuation driver is becoming more important for the overall company valuation: the functionality and scalability of a product or service. These "secret sauce" can ensure if a company is as promising, innovative, and disruptive as often claimed by itself. But how can be ensured that the claimed value drivers are as stated? The best way to ensure if these claims are justified is by technical due diligence.

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## What is a technical due diligence?

Technical Due Diligence is a process of in-depth analysis of the technical aspects of a product or a service. Like the "common" due diligence process, the tech DD happens typical before fundraising rounds or mergers and acquisitions. The scope of the process should include all technical aspects as well as the identification of potential red flags. The result of the tech DD can be essential for investors, as it is also the basis for the overall valuation. Now that we have defined the term tech DD, we would like to present a typical case based on our experience.

## Acquisition of a young software company in the telecommunication industry

In this case the process focuses mainly on the technical due diligence and a "Red Flag" analysis.

### Entrepreneurial challenges

The client was in the progress of a possible acquisition of a young software company. An assessment of the technical quality, possible pitfalls for future scaling and operation of the product was not possible due to the given documentation situation.

### KPMG approach

First, an initial conduct of structured technical interviews and an inventory of the actual product architecture with the technical managers and developers was initiated. Particular attention was paid to understanding how the individual services work. The question of how databases, presentation and logic tiers are connected to each other was explored.

In the next step, a technical analysis of the code quality and architecture was performed. Code quality in the system is one of the most important aspects. A badly built system can cause a heavy "technical debt" on an organization.

Furthermore, an assessment of legal and licensing risks was conducted as well as an identification of technical limitations for future scaling.

### Key results

The client received a fit for purpose DD report which appeared to be crucial to future decision making. In addition, a detailed DD report for technical follow-ups and guidance on product adoption was created.

### Client benefits

The technical DD carried out by KPMG enables a comparison between the information provided

by the vendor and of the existing documentation with the status quo of the product. The scalability capabilities of the software/hardware are tested as well as potential limitations.

In early stage companies, the center of attention is on scalability (ability to adapt quickly), while in later stage companies, the DD focus is in Maintainability and Compliance (IPO, Exit).

For most investors, the existence of IP rights is essential. All IP, open source or third-party components being used by the company are tracked. Likewise, existing patents are checked and traced regarding potential interference with other IP rights (not company owned).

The audit conducted by KPMG provides an improved basis for decision-making in the acquisition process.

The client benefits from concrete recommendations for the first steps of the acquisition process and advanced scaling of the product.

We at KPMG are eager to provide all the above services. Whether for a company acquisition, the sale of a company, the preparation for a future investment round or simply to re-check your current IT system, a tech due diligence is a useful instrument to embrace an overall picture of a company or organization.

Furthermore, KPMG can provide experience in a variety of fields, from small software companies to global players.

To receive the complete tech dd, scope of services and points to be considered-Please feel free to contact us and our team:

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