

## **DUE DILIGENCE ISSUES**

Due Diligence is the process of conducting a “forensic” or detailed review of the acquisition candidate. It involves giving proper attention and care to issues, stated and unstated, and is needed to protect all parties.

During the due diligence period, buyers often ask for and examine information related to:

### **Background and General Information –**

- Reason(s) for selling the business
- Business plans and SWOT analysis
- History, business structure and form of ownership
- By-laws, minutes, articles of incorporation
- Shareholder agreements
- All contracts
- Industry growth rates and trends

### **Financial Matters –**

- Annual Financial Statements and tax returns for 3-5 years
- Current year-to-date financial information
- Annual budgets and comparison to actual results
- Financial ratios
- Internal Controls environment
- Accounting methods (cash/accrual, FIFO/LIFO)
- Cash flow needs and historical monthly cash balances
- Projected cash flow for next 12 months
- Accounts receivable aging, disputed claims
- Credit policies
- Inventory by product line and turnover rates
- General condition and quality of inventory
- Property, machinery and equipment detail
- Depreciation methods and schedules
- Lease agreements and detail
- Insurance coverages
- Current liabilities and payment practices
- IRS, state and local audit reports

- Contingent liabilities and threatened litigation
- History of professional and legal costs and yearly fluctuations
- Borrowings, assets pledged, restrictive covenants

### **Markets, Customers and Products –**

- Sales by product
- Profitability by product
- Geographical coverage
- Seasonal or cyclical sales patterns
- Dependence on repeat sales
- Market size and market share by product
- Sales channels and lead generation
- Market expansion capabilities
- Present and future pricing policies
- Major customers and annual value of sales
- Major competitors and their products
- Contractual arrangements with customers
- Warranty terms
- Product recalls
- Consignment sales
- Channels of distribution
- New products planned
- Marketing and communications strategy and costs

### **People –**

- Organization chart and position descriptions
- Employee Handbooks
- Training programs
- Key employees, compensation and responsibilities
- Absenteeism and employee turnover
- Methods of compensation
- Wage structure compared to competitors
- Extent of day-to-day involvement of owner and family
- Employment contracts
- Morale and productivity

- Compliance with federal, state and local employment laws
- Employee benefit plans
- Workers compensation claim history
- Unemployment insurance records
- Discrimination problems, EEOC claim history

### **Operations –**

- Trademarks, patents, licenses
- Major suppliers and purchasing terms
- Schematic of work flow
- Economic order quantities
- Production schedules
- Storage and warehousing facilities
- Availability of raw materials
- Backlog of orders
- Quality control
- Components of production cost compared to industry norms
- Fixed costs, variable costs and break even analysis
- Breakdown of overhead
- Remaining economic life of equipment
- Percentage of production capacity utilized
- Limitations on production capacity
- Research and development spending needs
- Age and condition of production equipment, maintenance records
- Regulatory issues and investigations

The due diligence list can be extensive and the above list is not all-inclusive. Every buyer should consult with their Intermediary, their attorney and other members of the transaction team to have a due diligence checklist tailored to their needs and the complexity of the target business.