Due Diligence – successful management of this important phase in the purchase process.

After the Letter of Intent has been signed is not the time to let your guard down as a seller or become too casual with the "new owner". While most buyers are highly ethical there are plenty that use the due diligence process to find reasons to give the Seller a "haircut" and lower the price.

This purpose of this document is to outline specific strategies and provide a "Do's and Don't" list for the Seller to successfully manage the process and maintain or exceed the value that has been created and negotiated in the Letter of Intent and auction phase of the process. We sometimes call that "Keeping what is yours".

Strategy

Ethical Buyers are looking to validate the purchase price they have agreed to, uncover any risk or discrepancies that are potentially that are unknown and get to know the Company more thoroughly. In order to run a smooth process it is important to do the following with a Buyer:

1) Be organized – We advocate that any documents that are requested by the Buyer you make a copy of and insert in a Due Diligence Binder. The Due Diligence Binder should be organized exactly how the Buyer ask for additional information. Follow their outline by category and question. Use tabs to help organize the binder based on their format. It is critical that besides the binder you make for the Buyer, you also make a copy for yourself and one for your attorney.
    a. Questions that just ask for a document – provide without commentary
    b. Questions that are very subjective – give a concise written response if you can otherwise respond: "To be discussed during due diligence visit".
    c. Questions that are not relevant – answer "Not Applicable".

2) Use the Due Diligence Binder as a "living document" to be updated when applicable.

3) Appoint someone on your team to manage the due diligence binder. The qualifications are someone who is very detailed oriented and organized. Typically this should not be the CEO because they need to be focused on running the business to meet projections up until and through the close. The CFO is usually a good person for this.

4) Dataroom – If the Seller has used a data room during the sales process you can refer the Buyer to that for posted documents but we would suggest that you still maintain a printed copy of the due diligence binder because after the data room is turned off post- closing you will want to be able to refer to this.

This issue brought to you by:

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Anderson LeNeave & Co is a middle market investment bank focused on serving the needs of entreprenuers and owners of privately held companies. Services include Merger and Acquisition Advisory Service and Corporate Finance which include capital formation, sellside advisory, acquisition financing, management buyouts and buyside advisory services. Through our membership in Business Enterprise Institue we provide a structured and proven Exit Planning Process which has enabled thousands of business owners to develop and execute successful exit strategies.

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Before the data room is finally turned off, make sure you make a hard copy printout of the activity log so you can document who was on the site and when.

5) Discussion – any follow up discussions with the Buyers's representatives should be documented with internal notes or a confirming note to the Buyer.

    a. Prior to the onsite visit, ask the Buyer to produce an agenda. Understand that this might change after they start their process but this is critical to minimize disruption to your business and yet efficiently give them what they want.

6) Visit – Coach the senior managers and managers on your team who will be interacting with the Buyer during the on-site portion of due diligence. This should start with what the Buyers expectations will be and what your expectations will be of your employee.

    a. Plan on giving the Buyers team a conference room or office space so they can work confidentially.

    b. Sit down with them when they arrive and review their agenda and coordinate your peoples time. They shouldn't expect to have free run in your facility.

    c. Let your employees know that you are still their employer until a deal is consummated and if you will be staying with the Buyer that you will remain so. This helps eliminate employees who think this might be a time to vent frustrations etc.

    d. Show confidence by allowing your senior managers to meet one on one with Buyer. As President Ronald Regan once said "trust but verify". Make sure you speak to your employees afterward so you can close the loop and see if there are any issues that the Buyer is particularly interested in or confused about. An "open kimono" approach will be appreciated by the Buyer and assures them that there is "nothing being hidden".

    e. Many a deal has been destroyed by "Premature Elaboration" – You and your people should answer questions as concisely as possible to insure crisp communications relative to the business.

        i. If a sensitive issue should arise have your Managers feel confident that they should defer to you and likewise if you feel uncomfortable with a question use the members of you advisory team to either craft a response for you or respond to the Buyer.

    f. Build the relationship – you and your key managers should spend time with the Buyer's due diligence team to build a personal relationship. Take them to dinner, get to know them personally.

    g. Finalize – within a week or so of the on-site visit a Buyer should know if they have issues. Have your advisor flush that out by asking if the Buyer has completed the due diligence and if there are any further questions or concerns.

Running the business prior to Close

While the due diligence process is going on, typically the attorneys on both sides are creating, negotiating and finalizing a purchase agreement. Along with the purchase agreement there are several other important ancillary documents such as employment agreements, non-compete agreements etc. It is very easy as the owner of a business to start counting the money or be too involved in this process. It is critical that you keep running the business so that you deliver the business to the new owner in great shape. You owe this to the buyer, to your customers and to your people. Many times there will be an earnout or other critical calculations that occur post-closing that you need to think about. These can include: earn outs based on future sales growth, adjusted EBITDA for a period of time or working capital. Here are some "Do's and Don't" to help you through this process.

1) **Do keep focused on continuing new customer sales**

2) **Do keep focused on managing your P&L – profit drives your valuation**

3) **Do Maintain the same accounting process** and treatments that you used before the LOI was signed, during due diligence and post close. Buyers will frown and often penalize Sellers who all of a sudden change their revenue recognition policy and process for example.

4) **Do share Good news** – Keep the decision makers at the Buyer energized with occasional communications and share good news. It assures them that they have made a good decision before they have to send you their money.

5) **Do share Bad News** – don't shy away from share that with the key decision maker or other appropriate representative. For example if you lost a critical customer during that time frame let them know but take some time and think about how to communicate that, to whom and have a plan. If it is something that "might" happen and is a significant threat to the business shortly after closing you should let them know you are working on a "situation". Don't "awfulize" a situation with all the potential outcomes but if you think it might bite you later, let the air out of the balloon on slowly.

6) **Do Manage cash flow** – aggressively manage the AR collections process.

7) **Do not** make personal purchases or expenses that would be called into question.

8) **Do not** speak with people outside of your advisors about the details of the transaction until complete.

9) **Do** talk to customers and your employees honestly.

10) **Don't** overshare with your employees and customer the details of the transaction.

While the due diligence process can be very time consuming and nerve wracking, think of it as both a selling process and a chance for you as the owner to learn more about the Buyer before the deal is consummated. We often say that for a Seller to "keep what you get" you have to be organized during due diligence.If you have any questions about establishing a business continuity agreement for your company or its role in helping you exit your business in style, please contact us to discuss your particular situation.