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Selling Your Company: Working Through Due Diligence

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Making the decision to sell your business is a hard thing to do, but completing the sale can be even harder. Once you have found a qualified buyer, the real work begins. For the next few months, you and the buyer must work through due diligence, an investigatory process where both parties obtain all the information needed to complete the transaction.

Preparing for the process:

In due diligence, there is no specific rules or order that must be followed, and the length and comprehensiveness depends entirely upon the company and the parties involved. To prepare for due diligence, simply ask yourself, "If I am going to buy/sell the business, what would I want to know?"

Because the majority of due diligence is driven by buyers, sellers should begin preparing even before the business goes to market. Buyers will inevitably request to see many documents, review inventory, inspect the facility and equipment and scrutinize the financials. By preempting the demands, sellers can significantly reduce the stress and frustration. Keeping your business running smoothly before and during due diligence is also important. The price buyers agreed to is dependent upon the quality of the company's performance, and any "blips" on the interim financials statements can reduce the value. To ensure that this situation does not occur, assemble a team of professionals (intermediaries, attorneys and accountants) who will help you mitigate some of the demands during this critical period so that you can stay focused on running the business.

Buyer's side:

The meat of due diligence begins once a letter of intent is signed. Supplying documents will be cumbersome, but it is important for sellers to review each document and understand what they are presenting. The following are some of the most commonly requested items:

- **Financial statements:** Buyers will dissect financial statements to review historical earning trends, potential adjustments to EBITDA, financial ratio analysis and working capital trends. They are also looking for any anomalies or unusual revenues or expenses.
- **Account receivables:** When looking at account receivables, buyers are looking for aging accounts receivable more than 90 days old, write-offs and allowances for bad debts.
- **Inventory:** Inventory records will help buyers understand the speed of turnover, slow-moving inventories and inventory accounting and pricing practices. Buyers will also look at various asset schedules for depreciation methods.
- **Contracts & licenses:** Buyers and their professional advisers will scrutinize contracts, leases and agreements with vendors and customers. They may also look at permits and licenses to ensure that the business is operating legally.

- **Tax returns:** By reviewing the tax returns, buyers will attempt to understand the tax accounting method, depreciation method and inventory method. They will also want to understand any net operating loss, carryovers or other significant tax positions.

For buyers, due diligence is a time to make sure that the company's working condition matches the seller's claims. Many business owners may be surprised to know that buyers tend to be more concerned with what they do not know than with the problems that they know. As such, be candid with the buyer. Any surprise they discover on their own will cast suspicion onto the sellers and the companies, potentially ruining the transaction.

Seller's side:

While due diligence is imperative to buyers, it is equally important for sellers to conduct their own research. During this period, sellers should take time to observe and understand buyers' backgrounds, their financial wherewithal and determine if they have the right management experiences and expertise to run the company.

It is also important for the buyer and seller to have similar views regarding the company's future. The sale of a business is both a financial and emotional decision, and oftentimes the seller wants to know that the company will continue to grow and be profitable. This becomes especially crucial if a portion of the transaction is structured as seller financing or earn out.

Conclusion:

To survive due diligence, remain calm, honest and cooperative. Do not underestimate the need to do your own due diligence and hire a competent team of professionals to help you through the process. Just remember, although the process may be cumbersome, a handsome reward waits at the end.