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Corporate and Commercial Lawyers

DUE DILIGENCE IN BUSINESS ACQUISITIONS

Some Tips and Observations

WA Club
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BASIC PRINCIPLE IN BUSINESS ACQUISITIONS

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- **Caveat Emptor** (let the Buyer beware)

  Strategies to Reduce Risk include:

  (a) Vendor Warranties;

  (b) Personal inspection/Trial Periods;

  (c) Due Diligence.

DUE DILIGENCE – What is it?

- Structured Exercise of identifying:

  (a) Key representations made by a Vendor are reasonably based;

  (b) Assumptions of Vendor <u>and</u> Purchaser are reasonably based;

  (c) There are no business or regulatory impediments in achieving the outcomes of the acquisition;

  (d) Overall risks and rewards of proceeding with the acquisition;

Note: Due Diligence is <u>not</u> a guarantee against problems with business acquisition.

KEY QUESTIONS

- **What is the value in this business?**
  - What does this business rely on to make its money? **(<u>Step 1</u>)**

- **What is the value of this acquisition to our current business?**
  - How will this acquisition increase the value of our current business? **(<u>Step 2</u>)**

VENDOR FEARS OF DISCLOSURE

- Consider:

1. Confidentiality Agreement

2. Exclusive Dealing Agreement

3. No disclosure of especially sensitive material until just before Completion

4. Third parties holding sensitive material and verifying it (e.g. IP)

STAGES OF THE DUE DILIGENCE

1. Initial Disclosure to the Market (e.g. Information Memorandum) (Initial disclosure)

2. Partial Disclosure to selected bidders (Greater disclosure)

3. Due diligence by final bidder (Greatest disclosure)

Note: Due Diligence Reports – determine the format in advance.

LENGTH OF THE DUE DILIGENCE PROCESS

1. Lengthy DD means the information may “go stale”.
2. Too short for DD period – incomplete or rushed result.
3. Beware of advisors promising short DD periods. Overall exercise and the teams engaged must be considered.
4. Allow time for “assumption testing”.
5. Identify what is to be done and what is unnecessary.
6. Allow for testing the cashflow and other financial issues e.g. do the bank statements show cash banked?
7. Long periods of DD can compound “silo” effect.
8. Checklists – review initially and delete unnecessary tasks and add new key task and review regularly.

SOME TIPS

- Cashflow Statements – has the money been banked i.e. check bank statements.
- Checklist – review at the start of the process and identify the unnecessary tasks and the vital ones (including any not on the checklist initially).
- Hire professionals – know what they can and cant do. Make sure who controls the process.
- Identify contingent liabilities in customer contracts.
- Identify speed of inventory/work in progress to invoices to cash.
- Check the Personal Property Securities Register.
- Operational transition –
    - How will it occur?
    - How will suppliers/customers/staff be retained?

SOME TIPS – cont’

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- Earnouts -
    - Purchasers may need to supply security
    - Who is in charge “post acquisition”
    - What is the ability to “earn out”

“Betting the Company” (extra care required)

Resting during acquisitions i.e. bedding it down before the next acquisition.

THANK YOU