



Exit Planning

NAVIGATOR

Exit Planning Strategies for the Entrepreneur



Issue 53

Pre-Sale Due Diligence

This article is for those who have ever given thought to selling their companies to a third party. In order for you to attract a buyer to your company, you must engage in the pre-sale due diligence process well before your anticipated departure date.

This process has been compared, not unfavorably, to the removal of wisdom teeth without anesthesia. This is an unfair comparison. Due Diligence takes far longer. Both processes involve trained professionals. Properly performed, both are relatively painless and are absolutely required for health and appearance sake.

Because Due Diligence is not inexpensive and is an endeavor most businesses don't voluntarily undertake, it is useful to explain why Due Diligence is best begun well in advance of the Sale Process.

"An ounce of prevention is worth a pound of cure" and "A stitch in time saves nine" are familiar quotes from would be investment bankers. These observers understood that the primary purpose of Due Diligence is to evaluate your company in the same manner and at the same level of scrutiny as a buyer preparing to spend millions of dollars to acquire it.

What is Due Diligence? Simply put, it is the buyer's investigation of every aspect of your business.

Why undertake Due Diligence *before* a potential buyer requires it? After all, it costs money, it takes time, and it potentially involves the efforts of other employees within your company who may (or may not) become aware of your desire to sell the business.

Thorough presale due diligence is absolutely imperative for the following reasons:

- It allows your Advisor Team to uncover and to correct potential problems and to avoid pitfalls to a sale before you expose the business to buyers.
- Through the process, members of your Advisor Team, come to know and understand your company as well as you do—and far better than a potential buyer. This understanding enables your transaction advisor to prepare the sale memorandum and other marketing materials that fully describe and highlight the strengths of your business.
- Pre-sale due diligence is an essential part of the investment banker's determination of a sale price for your business.

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(continued)

- By discovering not only the strengths but also the weaknesses of your company *before* undertaking the Sale Process, your advisors can focus on making the company more valuable. In some cases, Due Diligence uncovers significant “repairs” that must be made to increase value. Maintenance and repair activities designed to make the company more valuable include: hiring key management, eliminating overhead, delaying the purchase of significant capital equipment, resolving shareholder disputes, and so on.
- Pre-sale legal due diligence allows your transaction attorney to identify and, usually, to correct any legal issues that require resolution prior to a sale.
- Pre-sale financial due diligence consists primarily of obtaining either a reviewed financial statements or audited financial statements for the three years prior to the year of sale. Doing so allows your accounting firm to correct financial errors, recast financial information and prepare your financial information in the professional manner buyers require.

Completing Due Diligence creates a squeaky-clean business; any skeletons lurking in your business closet are removed and given a decent burial. Nothing is worse than having a buyer discover (whom you have identified and contracted with to sell your company), on its own, a potential deal-killing problem within your company.

If there are problems that cannot be corrected before your company goes to market, it is **always** best to alert your transaction team so that those problems can be cast in the most favorable light. Make your transaction advisors earn their money—they can’t do so if they don’t have complete information well in advance of taking the company to market.

Subsequent issues of The Exit Planning Navigator® discuss all aspects of Exit Planning.

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