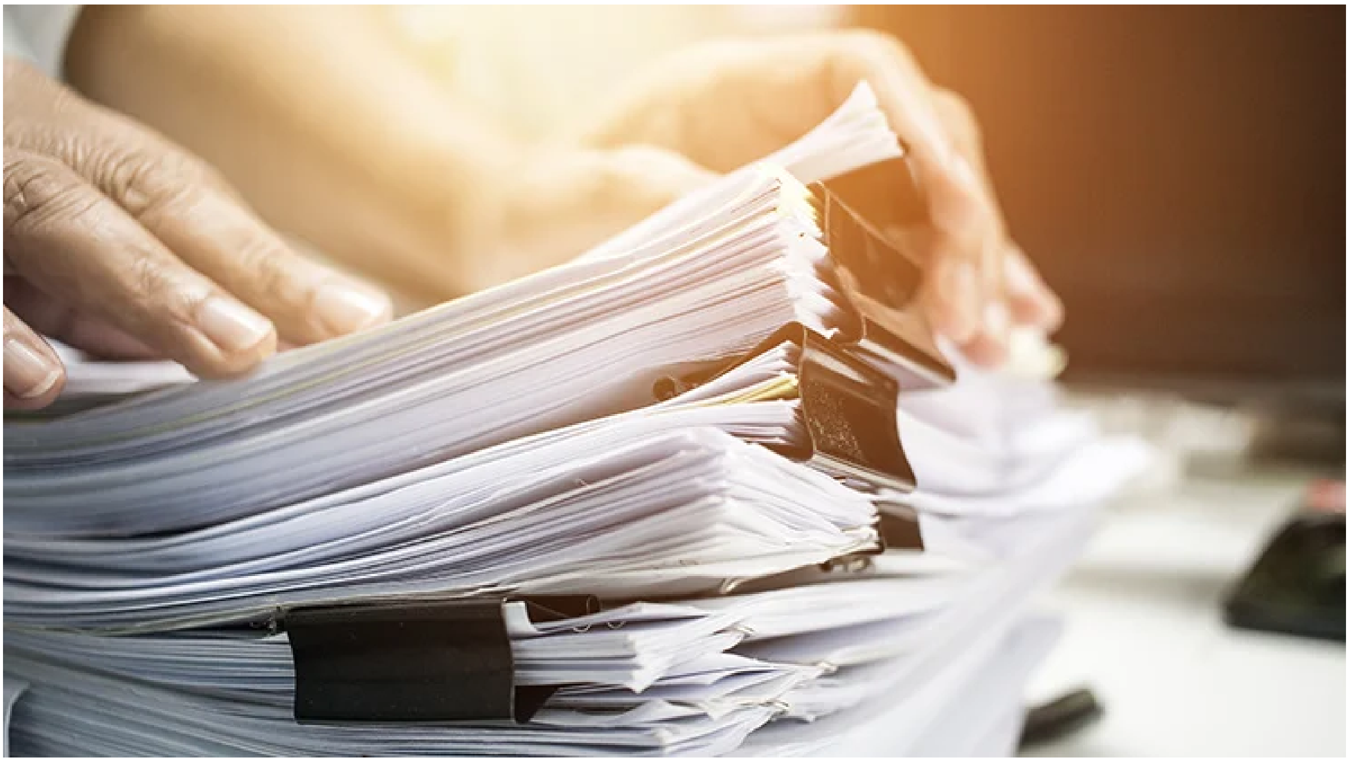
Buying or selling a business?

By Fordham
1 February 2018



It's all in the detail!
When you sell or purchase a valuable item, such as your business, you need to ensure it is fit for purpose and fairly valued. Undertaking thorough due diligence can go a long way to providing some surety for both buyers and sellers...

Avoid the guess work!

Due diligence is a process that helps investors and purchasers evaluate the worthiness of a deal. It allows interested parties to review the deal and the core principles on which the offer is based, and to gain comfort on the investment's value. It helps take the guess work out of the transaction, giving the purchaser and vendor a clearer understanding of the key terms forming the final contract of sale. The more guess work taken out of these complex transactions, the better!

Due diligence also allows the purchaser to assess the value of the business or entity operating the business, as well as the risks associated with buying … ultimately, allowing them to make a more informed decision on whether the purchase will be a viable investment.

Providing detailed information around sensitive financial data can be daunting for any vendor!

The vendor needs to provide information relating to the financial, tax, legal and operational aspects of the business. This is so that the purchaser may gain comfort that the assertions made by the vendor throughout the process, and the assumptions used by the purchaser in formulating their offer, are correct. This information is only seen by parties bound by a confidentiality agreement, providing comfort to the vendor that sensitive information disclosed must be kept confidential. Through this process the vendor will provide information and insights into the following key areas:

Financial and taxation due diligence involves a detailed review of the following types of information:

- Financial forecasts
- Actual results and comparisons to budget
- Copies of annual financial statements, monthly management accounts, tax returns, Business Activity Statements and tax reconciliations
- Details of any extraordinary or abnormal items

Legal due diligence ensures the vendor has clear title over assets and that ongoing arrangements (for example leases) can be transitioned to the purchaser. It is also designed to assist with understanding any potential for litigation which may affect the business and purchaser. This can include:

- Copies of articles of incorporation, minutes of meetings and formation documents
- Key contracts and agreements binding the company
- Warranties or service agreements on company products and any product liability documents
- Employment contracts, including salary and benefits details

Operational due diligence is often performed at the vendor's site as it involves obtaining insights and drawing inferences into how the business is run on a daily basis. This includes discussions and observations that are not confined to documents that can be handed over as a part of the financial, tax and legal aspects of the due diligence process. Activities may include:

- A review of the premises
- Inspection of equipment
- Interviews with key staff
- Discussions with major suppliers or customers critical to the ongoing success of the business

If it doesn't seem right, it probably isn't!

So what information should a purchaser request? During due diligence the purchaser has the ability to gain access to detailed information that has been confidential until this point.

The purchaser now has the opportunity to scrutinise any discrepancies between what is reported and what is actually going on under the surface, as evidenced by the information provided in the above key areas. A key objective for the purchaser is gaining comfort that the accounting records presented correctly reflect the conduct of the business in recent accounting periods. It may be necessary to conduct detailed general ledger and source document interrogation to obtain full comfort.

At this stage the purchaser will also conduct a Q&A process with the vendor. If satisfactory answers are not provided then further questions need to be asked, or further information may need to be requested. Some of these items may go on to form part of the warranties written into the final sale contract.

How should the due diligence process be performed?

With a high number of transactions now involving international parties, and with the constantly changing technological landscape, the vast majority of due diligence is now performed through an established online "data room". Through a data room, information can be compiled, collated and summarised, ready for inspection by potential purchasers and provided in a safe, secure and individually designed environment where confidentiality can be maintained.

The vendor is able to control the data room in the manner in which they see fit, meaning that they have the ability to control user access rights, printing and viewing, and manage all queries through a documented portal. Using an online data room reduces the risks associated with providing sensitive information to those outside the business, while serving as a permanent record should any disputes arise post settlement.

What happens next?

Fordham has helped to facilitate many transactions over the years with great success. So if you are thinking of selling, or alternatively looking at potential acquisitions to bolster your business, speak to your Fordham Partner to discuss how to best structure the transaction and coordinate the due diligence process!

Talk to us today

Get in touch