

# CAPRICORN CONSULTING

## Buying a Business: Due Diligence Checklist

So you have decided to purchase an existing business. Regardless of whether the deal is structured as an asset transaction, a stock transaction or a merger, make sure you know what you are getting into by requiring detailed information from the seller regarding its business operations and finances. The following is a checklist of information and documents you should review.

### ***A. Organization and Good Standing.***

- The Company's Articles of Incorporation, and all amendments thereto.
- The Company's Bylaws, and all amendments thereto.
- The Company's minute book, including all minutes and resolutions of shareholders and directors, executive committees, and other governing groups.
- The Company's organizational chart.
- The Company's list of shareholders and number of shares held by each.
- Copies of agreements relating to options, voting trusts, warrants, puts, calls, subscriptions, and convertible securities.
- A list of all countries where the Company is authorized to do business and annual reports for the last three years.
- A list of all countries where the Company owns or leases property, maintains employees, or conducts business.
- A list of all of the Company's assumed names and copies of registrations thereof.

### ***B. Financial Information.***

- Audited financial statements for three years, together with Auditor's Reports.
- The most recent unaudited statements, with comparable statements to the prior year.
- Auditor's letters and replies for the past five years.
- The Company's credit report, if available.
- Any projections, capital budgets and strategic plans.
- Analyst reports, if available.
- A schedule of all indebtedness and contingent liabilities.
- A schedule of inventory.
- A schedule of accounts receivable.
- A schedule of accounts payable.
- A description of depreciation and amortization methods and changes in accounting methods over the past five years.
- Any analysis of fixed and variable expenses.
- Any analysis of gross margins.
- The Company's general ledger.
- A description of the Company's internal control procedures.

### ***C. Physical Assets.***

- A schedule of fixed assets and the locations thereof.

- All leases of equipment.
- A schedule of sales and purchases of major capital equipment during last three years.

**D. Real Estate.**

- A schedule of the Company's business locations.
- Copies of all real estate leases, deeds, mortgages, title policies, surveys, zoning approvals, variances or use permits.

**E. Intellectual Property.**

- A schedule of domestic and foreign patents and patent applications.
- A schedule of trademark and trade names.
- A schedule of copyrights.
- A description of important technical know-how.
- A description of methods used to protect trade secrets and know-how.
- Any "work for hire" agreements.
- A schedule and copies of all consulting agreements, agreements regarding inventions, and licenses or assignments of intellectual property to or from the Company.
- Any patent clearance documents.
- A schedule and summary of any claims or threatened claims by or against the Company regarding intellectual property.

**F. Employees and Employee Benefits.**

- A list of employees including positions, current salaries, salaries and bonuses paid during last three years, and years of service.
- All employment, consulting, nondisclosure, non-solicitation or non-competition agreements between the Company and any of its employees.
- CVs of key employees.
- The Company's personnel handbook and a schedule of all employee benefits and holiday, vacation, and sick leave policies.
- Summary plan descriptions of qualified and non-qualified retirement plans.
- Copies of collective bargaining agreements, if any.
- A description of all employee problems within the last three years, including alleged wrongful termination, harassment, and discrimination.
- A description of any labour disputes, requests for arbitration, or grievance procedures currently pending or settled within the last three years.
- A list and description of benefits of all employee health and welfare insurance policies or self-funded arrangements.
- A description of worker's compensation claim history.
- A description of unemployment insurance claims history.
- Copies of all stock option and stock purchase plans and a schedule of grants.

**G. Licenses and Permits.**

- Copies of any governmental licenses, permits or consents.
- Any correspondence or documents relating to any proceedings of any regulatory

agency.

#### **H. *Environmental Issues.***

- Environmental audits, if any, for each property leased by the Company.
- A listing of hazardous substances used in the Company's operations.
- A description of the Company's disposal methods.
- A list of environmental permits and licenses.
- Copies of all correspondence, notices and files related to national or local regulatory agencies.
- A list identifying and describing any environmental litigation or investigations.
- A list identifying and describing any known superfund exposure.
- A list identifying and describing any contingent environmental liabilities or continuing indemnification obligations.

#### **I. *Taxes.***

- National, local, and foreign income tax returns for the last three years.
- VAT returns for the last three years.
- Any audit and revenue agency reports.
- Any tax settlement documents for the last three years.
- Employment tax filings for three years.
- Excise tax filings for three years.
- Any tax liens.

#### **J. *Material Contracts.***

- A schedule of all subsidiary, partnership, or joint venture relationships and obligations, with copies of all related agreements.
- Copies of all contracts between the Company and any officers, directors, 5-percent shareholders or affiliates.
- All loan agreements, bank financing arrangements, line of credit, or promissory notes to which the Company is a party.
- All security agreements, mortgages, indentures, collateral pledges, and similar agreements.
- All guaranties to which the Company is a party.
- Any instalment sale agreements.
- Any distribution agreements, sales representative agreements, marketing agreements, and supply agreements.
- Any letters of intent, contracts, and closing transcripts from any mergers, acquisitions, or divestitures within last five years.
- Any options and stock purchase agreements involving interests in other companies.
- The Company's standard quote, purchase order, invoice and warranty forms.
- All nondisclosure or noncompetition agreements to which the Company is a party.
- All other material contracts.

#### **K. *Product or Service Lines.***

- A list of all existing products or services and products or services under development.

- Copies of all correspondence and reports related to any regulatory approvals or disapprovals of any Company's products or services.
- A summary of all complaints or warranty claims.
- A summary of results of all tests, evaluations, studies, surveys, and other data regarding existing products or services and products or services under development.

***L. Customer Information.***

- A schedule of the Company's twelve largest customers in terms of sales thereto and a description of sales thereto over a period of two years.
- Any supply or service agreements.
- A description or copy of the Company's purchasing policies.
- A description or copy of the Company's credit policy.
- A schedule of unfilled orders.
- A list and explanation for any major customers lost over the last two years.
- All surveys and market research reports relevant to the Company or its products or services.
- The Company's current advertising programs, marketing plans and budgets, and printed marketing materials.
- A description of the Company's major competitors.

***M. Litigation.***

- A schedule of all pending litigation.
- A description of any threatened litigation.
- Copies of insurance policies possibly providing coverage as to pending or threatened litigation.
- Documents relating to any injunctions, consent decrees, or settlements to which the Company is a party.
- A list of unsatisfied judgments.

***N. Insurance Coverage.***

- A schedule and copies of the Company's general liability, personal and real property, product liability, errors and omissions, key-man, directors and officers, worker's compensation, and other insurance.
- A schedule of the Company's insurance claims history for past three years.

***O. Professionals.***

- A schedule of all law firms, accounting firms, consulting firms, and similar professionals engaged by the Company during past five years.

***P. Articles and Publicity.***

- Copies of all articles and press releases relating to the Company within the past three years.

# Sample Due Diligence Checklist

## I. Financial Information

### A. Annual and quarterly financial information for the past three years

1. Income statements, balance sheets, cash flows, and footnotes
2. Planned versus actual results
3. Management financial reports
4. Breakdown of sales and gross profits by:
  - a. Product Type
  - b. Channel
  - c. Geography
5. Current backlog by customer (if any)
6. Accounts receivable aging schedule

### B. Financial Projections

1. Quarterly financial projections for the next three fiscal years
  - a. Revenue by product type, customers, and channel
  - b. Full income statements, balance sheets, cash
2. Major growth drivers and prospects
3. Predictability of business
4. Risks attendant to foreign operations (e.g., exchange rate fluctuation, government instability)
5. Industry and company pricing policies
6. Economic assumptions underlying projections (different scenarios based on price and market fluctuations)
7. Explanation of projected capital expenditures, depreciation, and working capital arrangements
8. External financing arrangement assumption

### C. Capital Structure

1. Current shares outstanding
2. List of all stockholders with shareholdings, options, warrants, or notes
3. Schedule of all options, warrants, rights, and any other potentially dilutive securities with exercise prices and vesting provisions.
4. Summary of all debt instruments/bank lines with key terms and conditions
5. Off balance sheet liabilities

### D. Other financial information

1. Summary of current federal, state and foreign tax positions, including net operating loss carryforwards
2. Discuss general accounting policies (revenue recognition, etc.)
3. Schedule of financing history for equity, warrants, and debt (date, investors, dollar investment, percentage ownership, implied valuation and current basis for each round)

## II. Products

### A. Description of each product

1. Major customers and applications
2. Historical and projected growth rates
3. Market share
4. Speed and nature of technological change
5. Timing of new products, product enhancements
6. Cost structure and profitability

### **III. Customer Information**

**A. List of top 15 customers for the past two fiscal years and current year-to-date by application**  
(name, contact name, address, phone number, product(s) owned, and timing of purchase(s))

**B. List of strategic relationships**  
(name, contact name, phone number, revenue contribution, marketing agreements)

**C. Revenue by customer**  
(name, contact name, phone number for any accounting for 5 percent or more of revenue)

**D. Brief description of any significant relationships severed within the last two years.**  
(name, contact name, phone number)

**E. List of top 10 suppliers for the past two fiscal years and current year-to-date with contact information**  
(name, contact name, phone number, purchase amounts, supplier agreements)

### **IV. Competition**

**A. Description of the competitive landscape within each market segment including:**  
1. Market position and related strengths and weaknesses as perceived in the market place  
2. Basis of competition (e.g., price, service, technology, distribution)

### **V. Marketing, Sales, and Distribution**

**A. Strategy and implementation**  
1. Discussion of domestic and international distribution channels  
2. Positioning of the Company and its products  
3. Marketing opportunities/marketing risks  
4. Description of marketing programs and examples of recent marketing/product/public relations/media information on the Company

**B. Major Customers**  
1. Status and trends of relationships  
2. Prospects for future growth and development  
3. Pipeline analysis

**C. Principal avenues for generating new business**

**D. Sales force productivity model**  
1. Compensation  
2. Quota Average  
3. Sales Cycle  
4. Plan for New Hires

**E. Ability to implement marketing plan with current and projected budgets**

### **VI. Research and Development**

**A. Description of R&D organization**  
1. Strategy  
2. Key Personnel  
3. Major Activities

## **B. New Product Pipeline**

1. Status and Timing
2. Cost of Development
3. Critical Technology Necessary for Implementation
4. Risks

## **VII. Management and Personnel**

### **A. Organization Chart**

### **B. Historical and projected headcount by function and location**

### **C. Summary biographies of senior management, including employment history, age, service with the Company, years in current position**

### **D. Compensation arrangements**

1. Copies (or summaries) of key employment agreements
2. Benefit plans

### **E. Discussion of incentive stock plans**

### **F. Significant employee relations problems, past or present**

### **G. Personnel Turnover**

1. Data for the last two years
2. Benefit plans

## **VIII. Legal and Related Matters**

### **A. Pending lawsuits against the Company**

(detail on claimant, claimed damages, brief history, status, anticipated outcome, and name of the Company's counsel)

### **B. Pending lawsuits initiated by Company**

(detail on defendant, claimed damages, brief history, status, anticipated outcome, and name of Company's counsel)

### **C. Description of environmental and employee safety issues and liabilities**

1. Safety precautions
2. New regulations and their consequences

### **D. List of material patents, copyrights, licenses, and trademarks**

(issued and pending)

### **E. Summary of insurance coverage/any material exposures**

### **F. Summary of material contacts**

### **G. History of SEC or other regulatory agency problem, if any**

## **DISCLAIMER : SPEAK WITH ALL STAKEHOLDERS**

**CAPRICORN CONSULTING Bvba**

**Helping your business to grow**