

Business Valuation Outline On Due Diligence

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Mr. Lannom has been actively involved in the appraisal profession since 1969 and has prepared, supervised, or consulted upon appraisal assignments covering most facets of valuation relative to business enterprise and intangible property. He is a past international president of the American Society of Appraisers, an instructor in ASA's Principles of Valuation series and a contributing author to "Handbook of Business Valuation". Additionally, Mr. Lannom is a member of the Institute of Business Appraisers and a member of the Valuation Advisory Committee for ESOP Association.

The roots of business valuation due diligence are found in federal securities laws. Most business valuation studies do not require as detailed a process as do securities offerings. The appropriate level of due diligence will vary for the purpose, scope and intended users of the information.

A standard of reasonableness is normally applied. The "prudent man" rule, industry standards and independent verification of data are often cited as components of a satisfactory analysis.

The scope of due diligence is a question of degree and a matter of judgment. Each case is unique and the process must be customized on a case-by-case basis. As a minimum, the appraiser should interview appropriate parties; collect and analyze company specific documents; and collect and analyze external documents.

If the assignment involves activities covered by federal securities laws then the valuer should exercise greater caution. It's imperative that the appraiser obtains a well-drafted and complete letter of indemnification.

It is strongly suggested that the appraiser stick to issues involving value. Let the attorneys conduct the legal due diligence and the accountants the audit related issues. The appraiser should ascertain that the other professionals are performing their required functions. Management must prepare and be held responsible for financial forecasts, not the due diligence providers.

The following is a sample due diligence information request list:

- I. Corporate Documents
 - a. Articles of incorporation, including all amendments.
 - b. By - laws, including all amendments.
 - c. Minutes of all meetings and written consents of directors, committees of directors and shareholders, including copies of any written notices (if given) or waivers thereof.
 - d. List of all states where property is owned or leased, where employees are located, or in which the company contemplates undertaking business operations, either directly or through other parties.
 - e. Same documents listed above for any subsidiary.

- II. Shareholder Information
 - a. Lists of all current shareholders and percentage ownership of each.
 - b. Stock options or purchase plans and agreements, and lists of outstanding warrants and options including date of grant, exercise price, number of shares subject to option, and date of exercise.
 - c. All communications with shareholders, if any.
 - d. All voting trust, shareholder or other similar agreements covering any portion of the company's shares.

- III. Financial Information
 - a. Detailed financial statements, complete with auditor's notes and tax returns of the business for the past five fiscal years.
 - b. Monthly financial statements for the past two years.
 - c. Interim financial statements for the most recent year to date period and corresponding period for prior two years.
 - d. Copy of any auditors' letters to management regarding internal accounting controls.
 - e. Information concerning any material subsequent events since latest financial statements.
 - f. Summary backlog figures for most recent period and at the year-end for most recent three years, if appropriate.
 - g. An accounts receivable aging schedule as of the latest financial statement made available.
 - h. Business plan or other documents describing the current and expected business of the company, and financial/operating plans and projections.
 - i. Documentation relating to any equity or convertible debt financing.
 - j. Bank line of credit agreements, lease financing agreements, and other agreements evidencing outstanding loans to or guarantees by the company, including any amendments, renewal letters, notices, waivers, etc.

- IV. Company Background
 - a. Narrative history of the company since inception, if available, including milestone events, which have had a significant impact on the company.
 - b. Brief description of the company's facilities; including location, approximate square footage; distribution of space between manufacturing, warehousing, administration, etc.; whether leased or owned; lease terms, if leased; and description of any planned changes.
 - c. List of real and material personal property owned by the company and all outstanding leases to which the company is either lessor or lessee.
 - d. Description of products or services sold and marketing areas served.
 - e. Approximate number of customers and list of those accounting for more than five percent of revenues.
 - f. Copies of long-term sales contracts or other agreements with customers.
 - g. Forms of warranties and guarantees provided to customers.

- h. Description of supplier requirements, approximate number of suppliers, and list of major suppliers showing total and type of purchases and which are sole sources.
 - i. Description of marketing methods used and copies of all sales literature, including price lists, catalogs, brochures etc.
 - j. Agreements with distributors, OEM's, dealers and sales representatives.
 - k. Copies of all market research or marketing studies conducted in the last three years.
- V. Employees, Officers and Directors
- a. Number of employees broken down by departments or major job classification and location, and whether any employees are unionized.
 - b. Employee benefit, pension, profit sharing, compensation and other plans.
 - c. Collective bargaining agreements or other material labor contracts.
 - d. Organizational chart of key employees, and brief resumes of each director and officer.
 - e. Schedule of all compensation paid to officers and directors showing separately salary, bonuses and non-cash compensation (e.g., use of cars, property, etc.)
 - f. Management bonus plans, retirement plans, deferred compensation plans, profit sharing plans and management incentive agreements.
 - g. Description of any transactions between the company and "insiders" (i.e., officers, director, or major shareholder).
- VI. Miscellaneous
- a. List of all patent applications, trademarks, trade names or service marks held by the company.
 - b. List of proprietary processes controlled by the company and other trade secrets.
 - c. List of licensing agreements.
 - d. List of all non-productive or non-operating assets and liabilities, if any.
 - e. Information concerning any litigation in which the company is either a defendant or plaintiff - including letters from counsel sent to auditors; complaints, orders or other documents in pending or threatened matters seeking injunctive or other equitable relief; active litigation files (including letter asserting claims, complaints, answers, etc.); litigation settlement documents; orders or judgments of courts or governmental agencies.
 - f. Schedule or copies of all material insurance policies of the company covering any property, liabilities and operations.
 - g. Schedule of any other insurance policies in force such as "key man" policies, director indemnification policies or products liability policies.
 - h. List of partnership or joint venture agreements.
 - i. Information concerning any bona fide offers to purchase the company and copies of any appraisals or corporate valuations performed on behalf of the company or shareholders.