Knox McLaughlin Gornall & Sennett, P.C.
Erie • Pittsburgh • Jamestown, NY
814-459-2800 • www.kmgslaw.com

Mergers & Acquisitions Process Overview: Part 3

Posted on May 26, 2023

In Part 1 of this Mergers & Acquisitions Process Overview Series we discussed the triggers for buyers and sellers and the process by which they come together. In Part 2 we discussed the letter of intent. **In this Part 3 we will discuss the due diligence review that buyers undertake.**

Simply put, **due diligence** is intended to prevent the buyer from acquiring a pig in a poke. Over time, the process and undertaking have become very sophisticated. The advent of digital data sites and artificial intelligent review have facilitated the expansion of the lists of documents available for examination by buyer advisors.

Examples of due diligence request lists are published on the internet. References to “bullet proof” due diligence and excel spreadsheet lists with columns beyond the alphabet give owners heartburn. Some buyers have taken a one-size fits all approach to due diligence and assume that the broadest, most all-encompassing request list is the best approach to examining the target seller. Other buyers utilize a more measured approach that aligns the scope of the review to the cost and risks associated with the transaction.

Regardless of the buyer’s approach to due diligence, the general focus of the documents that will be requested for review deal with the following aspects of the seller’s business:

- Financial
- Operational
- Legal
- Tax matters

You will see many subsets of these categories. For example, the operational category will include employee, benefits and licensing/permitting matters. There will be overlap with legal regarding vendor, customer and employment contracts. Financial will overlap with legal regarding loan and lien matters.

Before generating long lists and asking for documents and reports that don't exist or in a format that cannot be generated by the seller's system, good practice is for the buyer to have a preliminary discussion with the seller to:

- Understand the seller's system and capacity to generate reports;
- Identify a seller representative who has sufficient knowledge of the seller's business to provide the requested information without breaching the confidence that a potential transaction is underway; and
- Identify the representatives from the buyer's team who will be working with the owner or designated seller representative to respond to requests for information.

The operational, legal, financial and tax review by the buyer should be coordinated to avoid siloed, uncoordinated reviews. It is unproductive for the seller to receive multiple requests for the same document or report and it is equally unproductive for the buyer to have different teams of reviewers making the same request.

Some buyers make the mistake of using due diligence review solely for the purpose of discovering issues or liabilities that have to be resolved prior to closing. Without minimizing the importance of that function, a well-coordinated operational, financial and legal due diligence will enhance the post-closing transition of the seller's business and employees into the buyer's fold.

For example, the owner will want to assure the seller employees that health and welfare benefits will continue and, preferably continue at levels comparable to the benefit provided by the seller. Changes by the buyer may necessitate modification of employment or compensation to avoid employee unrest. In this example regarding employee benefits, coordinated due diligence would allow the buyer and seller to present a comprehensive benefit/employment rollout to seller employees.

It can be daunting, but sellers who plan ahead, organize and designate a responsible person will work through the due diligence process with minimal disruption to the business.

Although this Part 3 focuses on the buyer's due diligence, the owner will need to conduct due diligence on the buyer. This is particularly true if part of the purchase consideration is deferred and/or if part of the purchase consideration consists of equity in the buyer. In addition to the financial aspect, is the owner comfortable with the cultural fit of the seller and the buyer? The owner has to be satisfied with both the objective economics and the subjective feel of the transaction.

In Part 4, we will discuss the cornerstone of the transaction process: the acquisition agreement.

If you are considering a purchase or sale we would be happy to work with you in the process. Please contact Bill Helbling or call us at 814-459-2800.

William B. Helbling

William B. Helbling concentrates his practice in the areas of business, tax and securities law, banking and commercial lending, and intellectual property & technology. He has a special emphasis on mergers and acquisitions.

whelbling@kmgslaw.com • 814-923-4903
