Sample

Acquisition & Due Diligence Playbook

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PROSPECT & INITIAL ANALYSIS PLAYBOOK

1. DISCLAIMER

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2. USER NOTES

- This playbook is intended to serve as a useful starting point for a due diligence exercise in the context of a proposed M&A transaction – with the expectation being that it will be customized by the user. The playbook is not intended to be used “off the shelf” and does not set out an exhaustive list of areas to review across a due diligence exercise. It is intended that the playbook will be customized by the user – for example, task line items and related guidance may be deleted or added in, as needed.
- The playbook is sector agnostic so it is important to note that the user will need to add in any industry/sector specific sections/line items (please speak to your Midaxo Customer Success Manager for an overview of other Midaxo playbooks).
- A suggested document index is included at the end of each workstream section (such as Finance, Legal, etc.) – this being where documents should be stored/saved within the Midaxo platform (see “Documents” tab within the Midaxo platform). See here for more > http://knowledge.midaxo.com/project-management/documents/what-is-the-projects-documents-tab
- All of Midaxo’s playbooks are configured to import into the Midaxo platform ‘off the shelf’.
- Midaxo’s Acquisition & Due Diligence Playbook is based on a stage-gated methodology – as follows: Prospect > Initial Analysis > Light Diligence > Detailed Diligence > Transaction (Sign & Close) > Integration.
- This playbook sample contains guidance and tasks across the Prospect, Initial Analysis and Light Diligence Stages the Commercial Due Diligence Workstream section.
- The full – 150+ page – version of Midaxo’s Comprehensive Acquisition and Due Diligence Playbook is available to customers within the Midaxo platform. A follow-on playbook – Midaxo’s Comprehensive Post-merger Integration Playbook – is also available to customers within the Midaxo platform.

3. PROSPECT

3.1. Guidance

The first phase of the buy-side process should be focused on defining the strategy of the organization. As a starting point, a strategic workshop should be considered – with the aim to align the acquisition strategy to the organization's overall mission. Other factors to consider in the early stages of the buy-side/deal origination process include:

- Head Office/Key decision maker buy-in: it's important to get buy-in to the chosen acquisition strategy from Head Office/key decision makers, etc. since Target companies will be presented to them for sign-off/go/no go decisions.
- Story: consider the story you will present to Targets when you approach them and explain why you are looking to acquire them. It's important to be alive to a range of non-price issues such as what will happen to employees post-deal (arguably even more important where smaller Targets are being considered – such as venture backed companies).
- Consider integration early: the ability to integrate a Target should be considered as early on in the Target evaluation/screening process. Where possible, produce a high-level integration plan once enough information on the Target has been gathered (the risk of not doing this is time, people and money being allocated towards the more detailed evaluation of a Target, which would prove problematic when it comes to integration– e.g. due to geographic reasons.).

3.2. Strategy

- A corporate development team should ensure a strong, ongoing connection between M&A and corporate strategy. Ultimately, linking the organization's accumulated deal-making experience to strategic decisions will provide long-term value and maximize the chance of M&A success. Establishing a clear vision from the outset and linking each deal to the overall corporate strategy will enable an organization to be proactive and maximize the likelihood of identifying the most suitable Targets when building its acquisition pipeline. Research conducted by McKinsey suggests that successful acquisitions align closely with an organization's growth strategy. Organizations that accelerate revenue growth via acquisitions do not treat deals as opportunistic events. Rather, they use several different deal models—all linked to their overall growth strategy.
- M&A strategy is an extension of overall corporate strategy and can be regarded as a roadmap for M&A efforts. It helps with the identification of acquisition/investment Targets, provides clarity on how value will be created and enables key decision makers (Shareholders, Board of Directors, C-Suite, M&A and Corporate Development Team, etc.) to get on the same page.

- Pursuing acquisitions or other corporate development projects that do not fit with an organization's overall strategy can cause strategic and cultural issues and may even destroy value, rather than creating it.
- In looking to build an M&A strategy an organization could start by contemplating a number of questions – the idea of such an exercise is to trigger thoughts around the rationale for pursuing M&A (such introspection can uncover some potentially expensive truths).

20 Key Questions an organization should ask itself when considering its acquisition strategy:

1. Why are we doing this?
2. What are our alternative options (outside of M&A)?
3. What lessons have we learned from previous acquisitions?
4. Could growth via acquisition provide a good strategic fit and align with our objectives?
5. Can any growth objectives be achieved more effectively via acquisition than organically?
6. What products/technology requirements does our road map require? (Note: balance the cost of acquiring such products/technology against the cost of build options – buying may not provide 100% of what you are looking for)
7. What products and/or services could we conceivably acquire via acquisition?
8. Do we understand the structure, size, growth and trends of existing markets we are in?
9. How much risk are we willing to take – what is acceptable to shareholders and stakeholders?
10. Are we prepared to acquire pre-revenue/early-stage companies?
11. What geographies do we want to operate in? (Note: as part of this, consider the order of preference for international market entry)
12. Are we prepared to enter significantly different markets?
13. What synergies could typically be realized from an acquisition in the sector(s) we are considering?
14. What is the maximum size of deal we are comfortable with?
15. What is the minimum size of deal we are prepared to dedicate resources to?
16. What level of funding is readily available? What level of additional funding could be obtained, if necessary?
17. How many acquisitions can we execute and integrate in a year without over committing?
18. What types of people, skills and experiences do we need that could be obtained via acquisition?
19. What financial returns do we want to achieve over the next X years? What financial metrics are most important to us?

20. Are we considering a particular acquisition merely to prevent a competitor from accessing an opportunity in the market? If so, what is the value of this competitor not accessing the opportunity?

3.3. Acquisition Profile

An acquisition profile can be considered as a “shopping list” of desirable criteria a Target should possess – with these criteria providing a fit against the acquisition strategy and therefore, the organizations’ overall strategy. Drafting an acquisition profile will help an organization focus on the types of company they should be buying rather than opportunities presented to them.

Example criteria to consider as part of an acquisition profile include:

- Industry vertical;
- Revenue model;
- Financials – e.g. revenue range, revenue growth, profit margin and industry specific KPIs;
- Geography – consider splitting across Tiers, e.g. Tier 1 = North America, Tier 2 = Europe, etc.;
- Value proposition;
- Product/service offering;
- End-user market – e.g. B2B or B2C;
- Market position;
- Acceptable price/valuation;
- History – i.e. how successful has the company been since incorporation;
- Age of the company;
- Legal status and ownership structure.

Once an acquisition profile has been complied it will become clearer which Target companies are potentially suitable – or not.

The idea of the Prospect stage is to build a database/list/pipeline of potentially suitable acquisition Targets – based on the acquisition criteria as previously defined. It is through these criteria that Targets should be initially screened/evaluated and either moved into Initial Analysis or eliminated / “killed” from the pipeline. At this stage of deal origination limited information on Target companies will be known – therefore, best judgement has to be applied.

Identifying the right acquisition Target is arguably the most fundamental component of a successful M&A campaign. Adopting a repeatable and systematic approach to M&A can greatly increase the efficacy of an M&A campaign and prove extremely valuable when it comes to identifying the right acquisition Targets.

If the conceptual question of whether a Target could provide a good fit against the agreed acquisition criteria can be answered with an affirmative “yes” the Target can be advanced to Stage Two – Initial

Analysis. Here, the objective is to collate and analyze more detailed information in order to support the decision as to whether or not a Target should progress to Stage Three – being Light Diligence. The information that will analyzed in Light Diligence is likely to comprise both documents that are available in the public domain – for instance, abbreviated financial statements, annual reports, press releases, product/service catalogs, etc. – and those that have to be requested under cover of an NDA (non-disclosure agreement).

If at the end of Light Diligence, a Target still appears to offer a good fit it can be progressed to the Stage Four – Full Diligence. The purpose of this stage is to screen a Target in more detail – typically using information not available in the public domain. Where an off-market opportunity is being considered it is highly likely that a Target will not be open to entering discussions around a potential sale – in such a case this outright eliminates a Target from the pipeline.

3.4. Consider the Motives

As part of defining an acquisition strategy, an organization should be mindful of the motives on which they are basing acquisition decisions. Three motives could be considered here – as outlined below.

Proactive

Proactive acquisitions are most likely to be successful (in terms of actually being closed and providing a suitable strategic fit) – they directly address points raised in strategic analysis. They are borne out of proactive Target screening - with thought given to how the acquisition can support the organization's strategic objectives. As part of the screening process, the acquirer will likely have given thought to desirability (what synergies are available) feasibility (can the deal be closed) and validity (compare purchase price to expected future performance and synergies – does this seem reasonable?).

Reactive

Reactive acquisitions are characterized by where the acquirer responds to an approach from a seller. In such a situation, the seller (perhaps via an M&A advisor) will typically be approaching numerous potential Acquirers in the same or a related industry as part of an auction process. While a potential acquirer will usually be given a reasonable amount of time to consider such an opportunity (and can therefore screen the Target in context to strategic objectives without making a knee-jerk reaction) the acquisition process may become competitive and provide little scope for negotiating on price and deal structure (e.g. deferred consideration or earn-outs may not be accepted). Furthermore, it is unlikely that the opportunity will offer a strong strategic fit. Nonetheless, an organization in the market for acquisitions may feel obligated to pursue the deal for the reason that it "needs to buy something". This is a dangerous strategy and likely to result in the need for crisis management further down the line.

Opportunistic

Opportunistic acquisitions are the least likely to be successful in terms of enhancing an organization's operations and have the lowest probability of closure. They are associated with where an organization is approached with a seemingly attractive deal – often from a seller in a non-related industry and perhaps attractive in terms of price or deal structure. While such an opportunity may ostensibly represent a means of diversification (which may be one of the over-riding objectives of an organization's overall and M&A strategy) such deals should generally not be pursued for the reason that the Target is very unlikely to relate back to the M&A strategy or provide a strong strategic fit overall.

3.5. Understand the Type of Acquisition being Pursued

Acquisitions may fall under a number of categories – it is useful to understand these since it can help contextualize an M&A strategy.

Synergistic

A synergistic acquisition Target may/may not compete directly in the same geographic market but be involved in the same line of business in terms of products/ services and end markets/ customers. A synergistic acquisition will naturally offer immediate synergies in terms of added customers and market share, streamlining of office/admin functions and other operational and purchasing efficiencies.

Strategic

A strategic acquisition Target will offer similar products/services to the acquirer but sell to other end markets or will offer different products but sell to the same end markets. The cost synergies available from a strategic Target are usually less significant – however, potential revenue synergies and growth opportunities may be vast.

Complementary

A complementary acquisition Target will fall disparately from the acquirer's core competencies. A complementary acquisition could provide an element of overlap in products/services, markets or capabilities, but is unlikely to offer any significant synergy value (where available, synergies are likely indirect and involve sharing resources/know how/ operational best practices).

Diversification

A diversifying acquisition is characterized by where the Target has no overlap with the acquirer. This type of acquisition is usually high-risk and has the lowest probability of success in terms of enhancing an organization's operations and probability of closure (a diversifying acquisition may be borne out of an opportunistic motive).

Transformative

A transformational acquisition (those associated with creating value by fundamentally transforming core operations, processes and/or business units) can offer significant potential for innovation and breakthrough performance. However, transformational acquisitions involve complexity that can go beyond the capabilities of management – therefore providing the potential to bring operations to a standstill if not properly managed. It is therefore vital that any organization considering an acquisition of this nature ensures it has the sufficient people-resources to manage it.

3.6. Market Attractiveness

Once an organization has defined its overall (and supporting M&A) strategy it can start identifying the right market sector(s) to focus on. Taking a market-driven approach helps in selecting Targets in markets that are stable, growing, attractive to consumers and most likely to deliver the expected deal ROI or desired revenue growth, etc. As part of this process, future market demand should be considered – the risk being that if this is not considered an acquisition of a Target in a declining market could be made.

In identifying the right market(s) there is an element of crossover with the process of defining an M&A strategy – for instance, answering questions such as "what geographies do we want to operate in?" and "are we prepared to enter significantly different markets?" (this question should also be asked when the M&A strategy is being defined) will help in formulating some market-driven criteria. Once these criteria have been established (criteria may change over time and/or depending on the nature of the deal being pursued) a deeper-dive research process can be commenced – the idea being that market-criteria will be refined as more about the market(s) is established. Ultimately, defining a number of market criteria will help when it comes to appraising markets against the strategic rationale underpinning the M&A campaign – and therefore, help in the identification of suitable acquisition Targets.

3.7. Broaden the Search

While the end-goal of an M&A campaign may be the acquisition of just one Target, it is very unlikely that pursuing one Target at a time will be enough to result in a closed deal. Taking such an approach is risky and could leave an organization back at the starting line if things do not go as planned. For instance, significant time and effort could be invested only for a single Target to pull out of negotiations, for a competitor to come along and trump an offer, for due diligence to reveal adverse findings or for deal terms to not be agreed upon, etc.

Some estimates suggest that up to 100 potential Targets may have to be screened in order to lead to the closing of just one deal. Working to this estimate, one way to approach the building of an acquisition pipeline is to view it as a funnel – there will be a lot of Targets at the top of the funnel (potentially hundreds) but as the screening process advances some will be eliminated due to lack of fit against the M&A strategy (remember, this is supporting the overall corporate strategy). The screening (elimination or advancement) of Targets is best managed via adopting a well-defined Stage Gate Approval process.

3.8. Consider Internal Competencies

A large number of deals underperform (or result in outright failure) because a one-size-fits-all approach to M&A is taken. As an M&A pipeline is being built it is therefore important that those driving the M&A campaign (i) fully understand the nature of the Targets being considered and (ii) question how those working on the deal may have to adapt across the integration process to ensure success. For example, some Targets may offer cost synergies realizable in the short-term, while others may offer longer-term revenue synergies. In either scenario, the approach to integration is likely to differ.

Depending on the people-resources an organization has at its disposal – and the degree of adaptability – some Targets may have to be "killed" (eliminated from the pipeline) for the reason that they fall outside of an organization's ability to successfully integrate and execute.

In some instances, an organization may be able to adapt from its traditional approach in order to facilitate the successful integration of a Target. One possible approach to addressing adaptability is via gap analysis – i.e. where an organization compares its actual ability to perform against the required ability to perform. Where gaps are extreme, or cannot be bridged, this could determine the Targets that are eliminated from the pipeline (unless a professional advisor can be engaged to assist with the integration process). Crucially, considerations of this nature (and gap analysis, if undertaken) should be a key focus of the deal team as an M&A pipeline is being built – *not post-deal* – when it is too late for the realization that there is a lack of experience and/or resources and that integration will be troublesome.

3.9. People Buy In

For a deal to be successful it is important for people buy-in across an organization (i.e. ensuring there is universal support for a Target). One way to approach people buy-in is to ensure that all stakeholders in the deal process are involved from the point at which the acquisition pipeline starts being built. This could be made possible by utilizing a shared Excel, or via a best practice collaborative system, where all stakeholders can access information on the pipeline in real-time and make judgments as it is being built.

Once the pipeline has been reduced to just a small number of Targets, a business case presentation should be prepared for each Target. The idea is that the presentation brings together all of the criteria considered earlier in the process and focuses the minds of all parties that would be involved if the particular Target in question was to be acquired (essentially, this encompasses a pre-deal review).

A business case presentation should help clarify the end-to-end deal process and ensure that the strategic rationale of the deal in question informs both due diligence and integration processes. On the contrary, a business case presentation could result in a Target being eliminated from the pipeline/

disregarded as a credible acquisition candidate due to a lack of people buy-in. If this happens, a business case presentation should not be viewed as a failed exercise, since it has helped flag the wrong deal before it is too late, and prevented significant costs and resources being dedicated to an unsuitable-fit Target.

NOTE: Midaxo's Comprehensive Acquisition & Due Diligence Playbook contains a 35-page fully customizable, pre-configured PowerPoint business case presentation – complete with Excel hotlinks.

3.10. Building an M&A Team

The type of M&A team an organization requires depends on its M&A strategy and the type of deals being considered. An M&A team is best able to support M&A activity when it is underpinned by a well-defined M&A strategy. As already outlined, an M&A strategy defines an organization's approach to M&A – part of which is the type and number of deals that are to be closed. Accordingly, this sets the level of activity and expertise required for building and screening a pipeline of opportunities, conducting due diligence, negotiating and closing deals and running the post-merger process.

Many organizations determine the size of their M&A teams on the basis of due diligence requirements (arguably the process requiring the most people across the deal lifecycle). However, determining the size of an M&A team on this basis can result in a team that is too focused on the detail or lacking in commercial and strategic awareness (essential capabilities to an acquisition strategy). While vitally important, due diligence is only part of the deal lifecycle – if an M&A team lacks the skills and expertise to effectively screen Targets in line with an acquisition strategy it could easily end up conducting due diligence on an unsuitable Target.

If an organization carefully considers its M&A strategy and looks at its available people resources it may realize it requires a larger M&A team (and perhaps, dedicated expertise) to manage the number and/ or complexity of planned deals. Conversely, an organization may be Targeting a lower number of simple acquisitions and conclude that its current M&A team is fit-for-purpose. Ultimately, an organization should take an overarching view when considering the M&A skills and expertise it has available now and what its future requirements may be. To a large extent, this will be driven by a longer-term approach to M&A - supported by a well-defined M&A strategy.

3.11. Deal Capacity and Other Success Factors

The Target screening process can require a significant amount of time and effort (regardless of the size of Targets being screened) – it is therefore important to introduce some additional structure to the end-to-end pipeline process.

As Targets are screened and advanced through the pipeline there is often a tendency for organizations to place too much emphasis on the minutiae detail of financials and valuation metrics. However, history shows that acquisition failures are most likely to be attributed to sidestepping key success factors that no end of spreadsheet analysis can insure against – these factors include culture, leadership, management and overall strategic fit.

Cultural alignment is fundamental - it should be considered at the outset of the screening progress and continually re-evaluated as a Target is advanced through the pipeline. An assessment of culture should be objective and comprehensive – merely "getting along" during initial discussions with a Target should not be taken as sufficient culture fit.

To safeguard against overlooking key success factors it is sensible for a variety of individuals within an organization to screen Targets – different experiences and backgrounds can help to provide a comprehensive assessment of a Target, rather than a narrow-focused judgment. Furthermore, as part of the screening process the future operating model should be considered – i.e. what changes would be necessary post-deal and how easily would any such changes be to implement? Accounting for such considerations as the screening process is being conducted should help validate any assumptions of a Target made earlier in the pipeline process and promote a more holistic appraisal.

Finally, where Target screening is being conducted at a high-volume, thought should be given to "deal capacity" – i.e. how many Targets can realistically be screened and how many deals can actually be closed in parallel/over a year. Keeping tabs on the number of Targets in the pipeline is therefore important – one possible approach to manage this is to only allow a new Target to enter the pipeline if another is eliminated.

3.12. Go/No Go Decisions

At the start of the initial analysis phase, a list of issues to be studied and an analysis process need to be agreed on. Go/no go decisions are typically the checkpoints/gates in the analysis process. Depending on the size of the deal and the Acquirer's corporate governance rules, there may be multiple go/no go decision points.

3.12.1. Reasons to eliminate a Target/end screening

Potential reasons to eliminate a Target from the M&A pipeline/end screening include:

- Price expectations of the Target;
- Lack of adequate data (for example in an auction deal);
- Anticipating difficulties in financing the deal (potentially due to price expectations of the Target);
- Shortage of deal negotiation resources;
- Unexpected changes in the market, technology or financing rules;
- Anticipated hurdles in Target integration;
- Wrong product/service offering or geography.

4. INITIAL ANALYSIS

4.1. Guidance

This stage of the buy-side process should be focused on collecting discovery facts on Targets that have been considered as suitable to move from the Prospect to Initial Analysis stage. This stage of deal origination is typically undertaken as a "desk study".

- One way to approach the gathering of discovery facts is to group them – e.g. by (i) market intelligence (ii) people (iii) non-people – e.g. financials, products/services, sales channels, etc.
- It's important to remember that the Initial Analysis stage of the buy-side process is not a due diligence exercise. That is to say, the focus should be on gathering enough key facts so that an informed decision can be made as to whether to move a Target to Light Diligence or cease evaluation/screening.
- The purpose of the Initial Analysis stage is to assess how well the potential Target supports/fits with the Acquirer's vision and M&A strategy. Based on this initial screening the Acquirer should establish whether it should continue to move the Target to the next stage of the deal lifecycle (being Light Diligence) – or not.
- Since screening a Target across Light and Full Diligence is costly and time-consuming, very few Target companies are worth being moved forward to this stage.

Target selection can be performed:

- Case-by-case.
- As a continuous process - where the Acquirer's appointed individual or team systematically screens potential M&A Targets.

4.2. Evaluation Criteria

The following should be considered as some evaluation criteria when it comes to Initial Analysis on a Target.

4.2.1. Strategic Fit

- Consider how critical the opportunity is towards helping the organization achieve its purpose, vision and goals, etc. (For further guidance see notes in the Prospect Stage).

4.2.2. Deal Rationale

- Consider the deal rationale/what is driving the potential – e.g. access to new markets/products/services/innovation/R&D/talent/other – and how this supports/links back to the overall strategy of the organization.

4.2.3. Products/Services

- What are the main products and/or services offered by the Target? Would access to such products/services fill a portfolio gap, accelerate a go-to-market strategy, enable the organization to maintain its position in the market/catch-up or over-take the competition, etc.?
- Consider the level of differentiation of products/services within the Target's marketplace, any unique selling points (USPs) and any price premiums.

4.2.4. Geographic Fit

- Which geographies and market segments does the Target focus on?
- Are these markets in line with the current portfolio?
- Further to the above, do these markets fit with the future strategy of the organization?
- Where are the Targets offices/manufacturing locations based, etc.?

4.2.5. Market Health

- Assess the health of the market (and country, if applicable) in which the Target is based from an economic perspective.
- Consider evaluating the market opportunity size, unemployment and GDP growth rates (historic, actual & forecast) and other macro indicators, etc.

4.2.6. Market Position

- Review the brand or product/service offering in relation to competing brands or products.
- Review any competitive advantages of the Target and why these exist – e.g. due to innovation/R&D, etc.
- Review what the main market segments of the Target are – consider by product/service and customer group (as applicable).

4.2.7. Competition

- Assess the degree of market concentration and barriers to entry.
- Review the degree of regulation in the market/sector – e.g. by governments or unions.

4.2.8. Market Stability

- Assess the ease of doing business – where the Target is based overseas consider political stability, corruption, rule of law and acceptability of foreign direct investment, etc.

4.2.9. Regulation Constraints/Considerations

- Assess the implications of entering a market where regulation changes frequently or where regulation is heavy.

4.2.10. Financial Strength & Performance

- To the extent possible (in the early stages of Target evaluation this is likely to be based on information available in the public domain) assess the financial strength and performance around areas such as revenue, profitability and prior investment rounds into the Target (Note: where information is limited this could be based on estimated information).

4.2.11. Comparable Company Analysis & Indicative Valuation

- Perform a high-level valuation based on available financial information and industry specific metrics (such as EV/EBITDA multiples). Note: good sources of comparable company information include CrunchBase & Pitchbook.

4.2.12. Deal Feasibility

- Establish if there are any active investors involved in the Target (such as VC/PE investors) and consider other factors such as the geographic location of the Target (which could prove problematic when it comes to integration and general operations).
- Assess the indicative valuation as part of deal feasibility – i.e. is the valuation within an acceptable range?

4.2.13. Management Team

- How experienced and strong are the management team of the Target? (Note: in the early stages of Target analysis LinkedIn can be a good starting point in establish details of executive/C-Suite level employees).

4.2.14. People

- Review the number of employees – as part of this, consider positions and locations (Note: in the early stages of Target analysis LinkedIn can be a good starting point in establish details of executive/C-Suite level employees).
- Review bios of the management team (consider company website and LinkedIn profiles) and their prominence in the industry/sector.
- Review rankings and the quality of any blogs/thought leadership articles, etc.

4.2.15. Funding Stage (if applicable)

- Assess the funding stage of the Target – for example, Series A, B, etc. Private Equity backed, etc. (NOTE: good sources of such information include CrunchBase and Pitchbook).

4.2.16. Ownership Structure/Shareholders

- To the extent possible, review the ownership structure of the Target. As part of this pay attention to group structure and any majority shareholders, etc.

4.2.17. Initial Integration Considerations

The earlier integration is considered the better. While information at this stage of Target evaluation will be limited it's still a valuable exercise to undertake. Examples of high-level integration criteria include:

- Location/geography;
- Range of products/services;
- Key people;
- Customers;
- Sales channels and key markets.

4.2.18. Other

- Number of employees;
- Key customers;
- Awards;
- Press coverage (consider good and bad);
- Product/service reviews;
- Social media summary.

4.3. Contacting a Target

Towards the end of this stage, an out-reach might be made to a Target – this could be via an expression of interest letter, for instance. Contacting a Target/initial out-reach may be achieved via one of the following – depending on the nature of the Target (e.g. size) and who you are dealing with (e.g. business unit head of a multinational or owner-manager of a family run company). Approaches to consider include:

- Phone call;
- Principal to principal;
- Expression of interest letter;

- Email;
- LinkedIn InMail;
- Networking event/conference, etc.

4.4. Confidentiality/Non-disclosure Agreements (NDA)

Before formally starting negotiations, a Non-Disclosure Agreement (NDA) or Confidentiality Agreement (CA) is typically signed. It's imperative that the Acquirer's legal department is consulted prior to the signing of any documents with a potential Target.

In a situation where there has not been any prior business relationship or other contact with the Target, the initial approach needs to be more formally planned and executed than in cases where an informal dialogue already exists. Advisors can often be helpful in establishing contact and building trust with sellers that are not familiar with the Acquirer.

4.4.1. DOCUMENT INDEX – PRE NDA/CONFIDENTIALITY AGREEMENT

4.4.1.1. Articles of incorporation

4.4.1.2. Company & legal structure

4.4.1.3. Company overview

4.4.1.4. Corporate brochure

4.4.1.5. Corporate history

4.4.1.6. List of locations (offices, warehouses, premises, etc.)

4.4.1.7. List of officers and directors

4.4.1.8. Pitchbook report (or similar)

4.4.1.9. Press releases

4.4.1.10. Summary financials

4.4.1.11. Website downloads

4.4.1.12. LinkedIn profiles of key management

4.4.1.13. Glassdoor profile and reviews (if available)

4.4.1.14. Teaser document from the Target (if applicable – i.e. if the Acquirer is in an auction process)

4.4.1.15. Investor relations report (if public company – usually available from the Investor Relations section of a website)

4.4.1.16. Details of previous M&A/investment activity (e.g. Review of CrunchBase)

5. LIGHT DILIGENCE PLAYBOOK

5.1. Guidance

All of the work conducted in stages 1 (Prospect) and 2 (Initial Analysis) will provide the foundations for a more detailed review of a Target across a Light Diligence exercise. It is assumed that an NDA will be in place with a Target prior to Light Diligence commencing.

5.2. Evaluation Criteria

The following should be considered as some evaluation criteria when it comes to Light Diligence on a Target.

5.2.1. Strategic Fit

Building on the early strategic assessments conducted in the Prospect and Initial Analysis stages, consider in detail whether the Target provides a strong fit with the overall strategy of the organization.

5.2.2. Summary of Operations

- What exactly does the Target offer – products/services or a mixture.

5.2.3. Current Ownership Structure/CAP table

- Who owns the Target – e.g. is it private equity backed?
- The current ownership structure could impact the feasibility of the deal (see below);
- What does the CAP table look like – e.g. how many shareholders are there and are there any options, which would be triggered by a sale, etc.?
- Have there been any funding rounds – if so, review details of these (to the extent possible) such as via CrunchBase or Pitchbook.

5.2.4. Sales by Region

- Where are the Target's core sales regions and do these offer scope for cross-selling, etc.;
- Revenue Analysis – e.g. what does revenue mix look like across product/service lines, is there likely to be seasonality and how diversified is the Target.

5.2.5. Proposed Market Expansion

- How could the Target support any proposed market expansion activities?

5.2.6. Summary of Financial Performance

- How is the Target performing overall – e.g. is revenue increasing year-on-year or static / are profit margins acceptable and do costs appear to be under control, etc.;
- To the extent possible, review cash flow, debt management, cost structures, cash flow and prior investment rounds into the Target.

5.2.7. Balance Sheet Summary

- How strong is the balance sheet / what does the working capital position look like / do receivables and payables look acceptable, etc.

5.2.8. Cash/Debt Position

- What is the cash current cash position?
- What is the current debt positions and what classes/categories of debt is the Target subject to?
- Is the level of debt/gearing acceptable?

5.2.9. Business Environment

- Assess macro, market and industry forces affecting the Target and key trends (such as those which may impact adversely on demand).

5.2.10. SWOT

- Strengths/Weaknesses/Opportunities/Threats (see Midaxo's Business Case Presentation and the Commercial Due Diligence Workstream for guidance on SWOT).

5.2.11. Proposed Transaction Process & Timetable

- Consider the key steps across Due Diligence, Transaction Negotiations, Close and Integration, etc. and indicative timelines.
- Key Focus Areas for Due Diligence - consider the key risks across areas such as Financial / Commercial / Legal / Operations / HR, etc. Additionally, consider any industry specific or potential regulatory risks.

5.2.12. Comparable Company Analysis & Indicative Valuation

- Perform a high-level valuation based on available financial information and industry specific metrics (such as EV/EBITDA multiples).

5.2.13. Funding: Sources & Uses

- How would the deal be financed / where would funding come from and how would it be deployed? Additionally, thought should be given to the extent to which further investment/CAPEX would be needed in order to reach post-acquisition objectives (e.g. the extent to which a large organization may need to deploy financial resources to help a smaller Target achieve its business plan) and to the integration budget – e.g. estimates of costs likely to be incurred before both cost and revenue synergies can be realized.

NOTE: see Midaxo's Business Case Presentation for an example of Sources and Uses analysis.

5.2.14. Transaction Rationale

- Sense-check the transaction rationale/reason for the deal to the acquisition strategy and overall strategy – question, does the deal really make sense?

5.2.15. Feasibility

- How feasible is an acquisition of the Target – could there be blockers such as majority shareholders or regulatory issues (consider anti-trust and competition authorities, etc.)?

5.3. Management Team

5.3.1. Management Team Experience

- How experienced and strong are the management team of the Target?
- Assess the strength of the management team and whether it needs to be replaced.
- Consider management churn and skills/capability gaps, etc.

5.3.2. Retention of Management

- Consider if the management team of the Target is to be retained post-transaction.
- If "yes" to the above, is the Target's management team committed to remaining in place post transaction?

5.3.3. Alignment of Management

- Are the interests of the Target's management aligned with those of the Acquirer? If "no" consider the extent to which this could be a "deal breaker".

5.3.4. Communication

- Does the Target's management view the potential transaction positively or as a threat? If as a threat, consider the extent to which this could represent a "deal breaker".

5.3.5. High Level Integration Plan

A high-level outline of the integration plan (a blueprint) should be prepared – areas to consider include:

- How would the Target be integrated – e.g. full or partial or stand-alone as a subsidiary? Any potential integration issues should also be raised here;
- Level of integration (full integration vs. independent part of operation);
- What will change in the offering to customers?
- Draft of post-closing organization and operational principles;
- Synergy potentials (cost savings and revenue gains)
- Identification of focus areas and preparation of stream road maps;
- Estimated integration budget;
- Communication plans (during transaction and post-closing internal/external);
- Identification of risks and planning of mitigation actions;
- Draft timetable - the draft should be aligned with the transaction process and updated once additional data is gathered during the subsequent stages of the deal;
- Consideration of what cost and/or revenue synergies could be realized (and a high-level merger model where sufficient information has been gathered).

5.3.6. Investment/Capital Requirement

- Consider any additional investment or capital injection required post deal.

5.4. Site Visits and Management Meetings

Valuable silent information and visual observations can be gathered during face-to-face meetings with the Target's management and visits to the Target's physical sites. Issues like cultural, technology and customer management fit can be evaluated.

Good preparation is necessary. In larger deals, every member of the Acquirer's deal team cannot visit all sites, so division of tasks is important. As the first meeting starts to generate attitudes and expectations among the Target's managers, it is important to plan the impression the Acquirer wants to create.

Tacit knowledge is difficult to gain. Building trust is the key both across the Due Diligence phase and later across integration efforts. Information sharing is voluntary and only happens, if trust has been built.

Each site visit needs to be followed by a discussion amongst participants with a detailed summary of the findings, including implications to the Transaction phase (signing and closing) and across Integration planning.

5.5. Business Case Presentation

The business case presentation should include:

- Executive summary (incl. deal rationale);
- Target description;
- Product/Service offering;
- Business breakdown (by product, customer segment, etc.);
- Financial summary;
- Initial Valuation;
- Synergy Targets;
- Due Diligence key focus areas;
- High-level integration plan.

NOTE: Midaxo's Comprehensive Acquisition & Due Diligence Playbook contains a 35-page fully customizable, pre-configured PowerPoint business case presentation – complete with Excel hotlinks.

5.6. Letter of Intent/Heads of Agreement/Memorandum of Understanding (MOU)/Term Sheet

The LOI is a typical requirement before proceeding to Full Diligence. The LOI resembles a written contract but is usually not binding in its entirety on the parties. However, the LOI may contain binding provisions, such as non-disclosure agreements, a covenant to negotiate in good faith and a "stand-still" or "no-shop" provision promising the parties exclusive rights to negotiate on the proposed transaction.

Alternatives to an LOI may be used – such as Heads of Agreement or a Memorandum of Understanding (MOU), Term Sheet or similar There is a difference between an LOI and Heads of Agreement and MOU. An LOI is the intent from one party to another and does not in this case have to be signed by both parties, whereas both Heads of Agreement and an MOU are mutual agreements between two or more parties and thus require signing by both parties to be valid.

5.7. Letter of Intent/Heads of Agreement Meeting

A Letter of Intent/Heads of Agreement meeting with the Target provides the opportunity to finalize the terms and conditions of a proposed transaction.

A suggested agenda covers:

- Update since the last meeting – e.g. what has changed/orders won/customers lost/etc.;
- Confirmation of what is included as part of the deal;
- Details of the earn-out formula (if applicable);
- Details of the structure and timing of deferred payments (if applicable);
- Details of IP – it is essential to understand what exactly is included as part of the sale. Additionally, confirmation must be obtained over the ownership of IP – e.g. is it owned by the Target company, an individual, or companies outside of the Target group, etc.
- Key employees – discussion of roles post-acquisition, etc.
- Exclusivity – where possible it is important to establish a period of exclusivity (or lock out) to allow due diligence to be conducted without a competitive threat.

During initial discussions with a Target the project team should naturally seek to learn as much as possible about the Target and its business environment. To the extent possible, the team should also collect intelligence on potential rival bidders as well as the Targets valuation expectations and potential other alternatives.

Based on the preliminary discussions between the parties, the deal team should form an initial understanding of the following deal parameters, which will be referenced in the LOI:

- Valuation (enterprise value) and indicative price range (equity value) based on assumption of net cash/debt;
- Transaction structure;
- Purchase price mechanism and payment structure (upfront/fixed payment vs. earn-out);
- Exclusivity to negotiate;
- Due diligence requirements and plan for execution;
- Securing the commitment of key individuals;
- Clarifying the preferred transaction structure;
- Specifying financing needs.

5.8. Notes on Indicative Valuation

Valuation is a crucial aspect of M&A as it has the highest impact on the price paid for the Target. When the Acquirer's representatives have made their preliminary review of the Target material, the Acquirer needs to estimate a purchase price for the Target.

Note:

- Value and price are not to be confused!

- The value of the Target will be different to the Acquirer than to the Target!

Estimating the Target's value includes:

- Reviewing the key factors, the valuation and purchase price are based on;
- The possibility to negotiate the price;
- Setting of minimum and maximum limits on the offer price;
- Follow-up methods to ensure that the price limits are not crossed;
- Draft(s) of a plan to finance the deal;
- Estimation of purchase and integration costs.

Some valuation questions include:

- Strategic fit of a Target: how well a Target fits with the Acquirer's acquisition strategy?
- What synergy savings and/or value generation opportunities can be expected?
- Estimate of integration costs and risks
- The financing possibilities for a Target?
- Initial cost estimates for deal financing

Through the valuation process the Acquirer analyzes the strategic fit of the Target and its potential to add value when integrated with the Acquirer. The Seller and Acquirer naturally have different views of the value of the Target. There are many methods available to value the Target:

- Benchmark with comparable companies in the same industry;
- Discounted Cash Flow (DCF);
- Price to Earnings Ratio (P/E Ratio);
- Enterprise Value to Sales Ratio (EV/Sales);
- Replacement Cost;
- The final purchase price for the Target is a result of negotiations.

5.9. Indicative Valuation/Pricing – Information Requirements

Indicative valuation/pricing should be considered towards the end of the Light Diligence stage of evaluation so that that decisions are made on the basis of as much information as possible. Information an acquirer will typically require prior to making an initial offer via an LOI (or similar) includes:

- Latest full year forecasts;
- Current financial results with outturn expectations – e.g. management accounts;

- New customer wins (e.g. last and current quarter);
- New hires/recent resignations;
- Details of shares being purchased;
- Any exclusions from the sale – e.g. subsidiary companies or patents;
- Personal objectives of the seller (of greater relevance where the Target is small, e.g. owner managed) – these may include future role, salary, equity, etc.
- Market and sales channel strategies;
- Status of pipeline/potential customers/new projects;
- Cash flow status;
- Any operational issues, which could impact a post-acquisition plan.

5.10. DOCUMENT INDEX – POST NDA

5.10.1. Audited financial statements covering the past 3 years

5.10.2. Latest business plan & assumptions

5.10.3. List of current shareholders

5.10.4. Cap table

5.10.5. Latest management reporting pack

5.10.6. Confidential information memorandum (if available)

5.10.7. Management presentations/first meeting

5.10.8. Summarized meeting notes

5.10.9. Notes from management presentation Q&A

5.10.10. Reports from office/site visits

5.10.11. Business case presentation

5.10.12. Financial model/forecasts (with detailed assumptions)

5.10.13. Signed NDA (with Target)

5.10.14. Signed engagement letter with M&A advisor (if applicable)

5.10.15. Signed engagement letter with legal advisor

5.10.16. Signed engagement letters - other

5.10.17. Copies of all meeting agendas

5.10.18. Written sign-off from M&A steering committee

5.10.19. Signed LOI

6. TRANSACTION SENSE-CHECK

6.1. Purpose

The purpose of a Transaction Sense-check is to take a step back and reconsider the proposed transaction in question before jumping head first into a potentially very expensive and time-consuming due diligence exercise on what could be a poor fit Target. This is also the stage at which the "scope" of due diligence should be considered.

6.2. Scope of Due Diligence

The scope of due diligence will be dictated by the Acquirer. It will typically be focused on key deal issues/value drivers and will cover limited detailed verification testing (due diligence is not an audit exercise). It is notable, however, that the scope of due diligence is ultimately dependent on the availability and quality of information and how it is organized within the Target (for instance, smaller companies or early stage start-ups may not produce monthly/quarterly management accounts due to immature internal governance).

The objectives of the Acquirer (or investor) will include building a deeper understanding of the business, learning about the company's operations to understand the opportunities and synergies and evaluating the financial, legal and regulatory risks related to the acquisition.

Due diligence typically covers at least the past 2 years and trailing/last twelve months (LTM) 12-month period – with areas pertaining to tax extending well beyond this.

Understanding the different workstreams (such as financial, legal, HR, etc.), as well as the business "drivers" to due diligence, and the due diligence standards applicable to particular enquiries, is an essential starting point for any due diligence process. From a business perspective, due diligence is a component of the valuation/risk assessment process, as well as key element of planning for eventual integration of new operations into an ongoing organization. With this in mind, the deal team should be cognizant of the potential integration effort (should the proposed transaction proceed).

6.3. Approaching Due Diligence

Even for companies with reasonably effective due diligence processes, the pace of global change and cross-border cultural realities require review of existing practices. Taking the time to consider two key areas around best practice improvement can greatly increase the efficacy of a due diligence project – (i) understanding the why and (ii) establishing assessment priorities.

6.3.1. Understanding the Why

By hurrying to evaluate a Target, organizations can easily miss the essential first step that is the ultimate harbinger of success: *understanding the why*. Due diligence should only commence when the reason for acquisition (or investment) is clear and the rationale for Target pursuit is compelling. Deal teams should therefore consider the following questions:

- Does the deal accelerate corporate objectives and align with the overall strategy?
- What revenue and/or cost benefits are *actually* realizable?
- How is the Target/deal specifically beneficial to the broader strategy, goals or mission?

As clarity around these questions is gained, M&A teams should undertake a soft transaction "sense check" on a Target. This step is a basic business review and should be viewed as a prerequisite to any additional planning and due diligence. Here, deal teams are considering financial, market, management and corporate structure basics to determine if the Target is fundamentally suited to deliver in the affirmative on the question of *why.*

Understanding the *why* and undertaking a basic diligence process can help a company steer-clear of value-destroying deals. And while areas such as post-merger integration are generally blamed when deals fail, it is useful to consider whether the deal should have even been pursued in the first place.

6.3.2. Establishing Assessment Priorities

The due diligence process should help determine an ultimate "go" or "no-go" decision. For every organization and every Target, the specific areas of emphasis in this phase of the deal lifecycle will differ. That is, not all areas of diligence are created equal and the required level of detail and areas of focus to suitably address risks and opportunities inevitably shift from deal to deal.

By way of example, when an organization's objective is deriving value from a Target's technology, specific technology-related due diligence should be prioritized. Organizations should perform deeper dives here to assess the stability, extensibility and validity of the Target's technological capabilities (with the original Target evaluation criteria in mind). A technical assessment of this nature may cover the following:

- Expandability and scalability;
- Lifespan;
- Costs to operate and support;
- Support methods and stability;
- Company dependency on the technology;
- Risks;
- Planned initiatives;
- Capital investment required;
- Software licensing and ownership of all technologies;
- Nature of IP and ownership;
- Infrastructure requirements;

- In the above case, if technological issues are a primary concern, it is better to understand the implications earlier in the process rather than later, when people and money resources have been wasted on less-critical evaluations.

7. COMMERCIAL DUE DILIGENCE PLAYBOOK

7.1. Overview

7.1.1. Scope of Due Diligence

Commercial due diligence considers the market in which a Target company sits, for example involving conversations with customers, an assessment of competitors and a fuller analysis of the assumptions that lie behind the business plan. All of this is intended to determine whether the business plan stands up to the realities of the market.

Commercial due diligence should cover a review of the Target's current operations, historical and forecast performance from the perspective of markets, customers, competitors, high-level finances and its internal capabilities.

Several areas of the commercial due diligence process will have been considered (at least in some detail) in earlier stages of target screening – namely Initial Analysis and Light Diligence. It is notable that Commercial Due diligence may be regarded as a precursor to a broader due diligence exercise – for instance, areas relating to finance and HR will be covered in more detail when fed into dedicated workstreams.

Across the Commercial Due Diligence process, it is advisable to have valuation in mind – for instance, if future forecasts have been priced into valuation a detailed review of the assumptions underpinning these should be conducted. If findings differ to expectation this could impact on valuation. The same is true for revenue – for instance, if valuation is being based on a multiple of revenue and commercial due diligence reveals that some customer are not under contact the multiple will likely need to be reduced.

The main output of the commercial due diligence process should be detailed, objective and fact-based review of the Target's strategic risks and future opportunities, as well as a quantitative assessment of the growth projections used as a basis for the transaction.

7.2. Summary/Overview

7.2.1. Company Profile

- Ensure that a robust company profile has been compiled – refer back to information gathered across Initial Analysis and Light Diligence stages and presented in the Business Case Presentation and ensure no areas have been missed (perhaps, due to information not being made available by the Target earlier on in the screening/evaluation process).

7.2.2. Scope of Services/Product Offering and USP

- What are the main products and/or services offered by the Target?

- Assess the level of differentiation of products/services within the Target's marketplace, any unique selling points (USPs) and any price premiums charged by the Target or its competitors.
- Assess if the level of differentiation observed between the Target and its competitors is acceptable based on the risk profile of the Acquirer.
- Further to the above, if the Target is not suitably diversified in terms of its product/service offering, what measures would need to be taken to bring the level of differentiation to a suitable level?

7.2.3. Financial Summary

Note: there are a number of shared areas with the financial workstream so a more a detailed analysis of the Target's finances and financial position should be performed under the Financial Due Diligence Workstream.

7.2.3.1. Profit and Loss

Review the profit and loss, paying attention to:

- Revenue and gross margin;
- Other operating income;
- Distribution expenses and channels;
- Research and development costs and whether costs are being appropriately expensed or capitalized;
- Administration costs;
- EBITDA;
- Normalization adjustments and exceptional items (impacting EBITDA);
- Effective tax rate and the utilization of any tax losses;
- The overall financial result for the prior year and current year.

7.2.3.2. Balance Sheet

Review the balance sheet, paying attention to:

- Fixed assets – composition of fixed assets, depreciation charged, current book value and any possible impairment charges;
- Inventory – nature of inventory, carrying value [this should be at the lower of cost and net releasable value], inventory turnover/days, location of inventory [and any possible synergies realizable via changes to distribution networks];
- Accounts receivable – including any large balances, ageing profile and any potentially irrecoverable amounts;
- Accounts payable - including any large balances, ageing profile and significantly overdue amounts;
- Liabilities – including the nature of liabilities, how the value has been calculated, the likelihood of payment having to be paid and the timing of this [it is important to

consider any off-balance sheet liabilities such as in relation to warranty provisions or litigation];
- Equity – consider the composition of the cap table, including any significant/majority shareholders and option holders.

7.2.3.3. Cash Flow

Review the target's cashflow and consider the following:

- Review the current cash balance and consider headroom;
- Review historic cashflow forecasts against actual cash balances and investigate any significant/material variances;
- Establish which areas of the Target is absorbing/burning the most cash;
- Determine historical and projected capital expenditure requirements. Does the company have enough cash to pay for its capital investment needs?
- Ensure a detailed understanding of all regular cash in/out-flows;
- Identify and investigate any exceptional items of cash in/out-flow;
- Review seasonality of sales (if seasonality is applicable to the Target's operations) and consider the impact on working capital – for example, is cash injection (e.g. via an overdraft or revolving credit facility) required at certain times of the year?
- Review reliance on any external funding – such as regular use of an overdraft, revolving credit facility or similar.

7.2.3.4. Quality of Earnings

A quality of earnings report provides a detailed analysis of all the components of a company's revenue and expenses. Evaluating the quality of earnings will help the financial statement user make judgments about the "certainty" of current income and the prospects for the future. As part of a quality of earnings review, consider if any accounting principles have changed since the last reporting period. If so, assess the earnings impact of any such changes and investigate the rationale for the changes (e.g. could this be suggestive of "window dressing").

Quality of earnings analysis includes:

- Breakdown of revenue by components, such as customers and product/service lines;
- Analysis of historic revenue trends;
- Determination of one-time expenses vs. recurring expenses;
- Determination of fixed vs. variable costs;
- Analysis of impact on both revenue and expenses due to management changes;
- Analysis of assumptions used in cash flow projections and scenario analysis.

Sources of earnings may include:

- Sales of goods to independent customers under normal payment terms;

- Sales of goods to related parties;
- Sales under instalment agreements or special arrangements;
- Sales with contingencies or after-sale obligations;
- Costs of goods/services sold;
- Earnings from investment sources;
- Gain/loss on sales of assets;
- Gain/loss on settlement of litigation;
- Release of warranty provision;
- Release of bad debt expense;
- Inventory reserve changes;
- Impairment charges;
- Pension expense;
- Gain/loss on derivatives;
- Gain/loss on investments;
- Reserve changes.

7.2.4. SWOT

Consider the Strengths, Weaknesses, Opportunities and Threats. A high-level SWOT should have been completed as part of the Business Case Presentation.

7.2.4.1. Strengths

This is a “what is the Target good at” question. Consider the following:

1. Financial Strengths: What is the Target’s most reliable source of financial growth? Is it, for example, the current customer base? A particular product? Or the service fee structure, etc.?
2. Customer Strengths: Where is customer growth coming from – out-bound/in-bound sales, referrals, or a particular industry segment? Are sales B2B, B2C or both? Why are customers choosing the Target over its competitors?
3. Internal Strengths: What does the Target do well as an organization? Is the Target the first to innovate products in its industry? Does the Target have strong customer relationships or partnerships?
4. People Strengths: Are there any ways in which the Target excels with respect to employees? What is the sense of culture in the Target company?

7.2.4.2. Weaknesses

This is a “what is the Target not good at?” or “where does the Target have scope to improve” question. Consider the following:

1. Financial Weaknesses: What is the Target's biggest financial weakness? Examples could include over-reliance on a small number of customers, seasonality of sales and cashflow, debt/high gearing, squeezed profit margins, etc.
2. Customer Weaknesses: Where do the Target's customers believe there is room for improvement (review websites and NPS feedback can be used to ascertain this information)? Examples could include investment in products/new service offerings, opening of new locations, changes to pricing, improvement in customer service, etc.
3. Internal Weaknesses: Is there anything the Target does poorly from an operations perspective?
4. People Weaknesses: What are the biggest challenges with employees? Does the Target have particularly high turnover in certain departments or a negative perception of the organizational culture? Or does the Target find it difficult to recruit talent?

7.2.4.3. Opportunities

This is a "what are the possibilities" question. Consider the following:

1. Financial Opportunities: What is the biggest opportunity for the Target to improve its finances? Examples could include: a new product line, increasing customer retention, or Targeting a new geographical area.
2. Customer Opportunities: How could the Target improve relationships with customers? Examples include improving online presence and better understanding the buying habits of customers.
3. Internal Opportunities: How could the Target improve operationally?
4. People Opportunities: What opportunities does the Target have to improve its relationship with employees? Are there any cultural changes that could be made so as to improve retention (if this is a problem)?

7.2.4.4. Threats

This is a "what do we see on the horizon as being potentially harmful to the Target?" question. Consider the following:

1. Financial Threats: What threats could impact adversely on the Target's financial health? Examples include socio-economic or political factors, competition, impending regulation changes, supply chain problems, etc.
2. Customer Threats: What is the biggest threat with regards to customers? Examples include high customer turnover, increasing customer cost of acquisition (CAC), decreasing NPS (net promoter score), etc.
3. Internal Threats: Are there any current business operations being run in a way that could damage the Target in the future?
4. People Threats: Are there any people threats within the Target organization? Examples include low morale (referenced by way of ENPS – employee net promoter score), high employee turnover and losing staff to competitors.

7.2.5. Operating Model

Assess the Target's operating model and revenue drivers. Areas of consideration should include:

- The core work processes that are needed to create and deliver the value proposition;
- The equipment and technology needed to execute core processes;
- The information systems needed to support core processes;
- The processes needed to support the core processes, such as financial processes or HR processes;
- The suppliers needed to support the processes and the supplier agreements needed to keep the most important suppliers engaged;
- The people needed to do the work and the "offer" that will attract and retain these people;
- The organisation structure, decision rights and accountabilities needed to 'govern' and support people;
- The locations, buildings and ambiance where the core and support processes will be executed.

7.2.6. Track record

Assess the Target's track record in terms of sales and margin growth by:

- Product/service offering;
- Geography;
- Organic vs. acquisitive (i.e. sales growth via inbound sales initiatives versus revenue "acquired" via M&A").

7.2.7. Previous Sell-side Processes

- Establish if the Target has attempted to sell before/been part of an M&A process. If yes, establish what happened (to the extent possible). It's notable that past unsuccessful sell-side activity may be indicative of underlying operational, risk, or valuation issues, etc.

7.2.8. Sector M&A

- Review related acquisitions in the Target's marketplace. If companies similar to the Target have put themselves up for sale, assess what is driving such trends – this could be indicative of market consolidation or attributed to other factors (such as legacy technology).

7.3. Market Environment

7.3.1. Market Size & Segments

- Assess the market size/total addressable market and what the main market segments of the Target are – consider by product/service and customer group (as applicable).

7.3.2. Historic Market Growth

- Review the rate at which the market has grown over time – as part of this, investigate any peaks/troughs.
- Where the acquirer is looking to enter a new market (perhaps as part of a diversification strategy) ensure that leading industry research/thought leadership has been considered.

7.3.3. Forecast Growth

- Review what the forecast/expected annual market growth rate over the next three years is and the nature of the main growth drivers.
- Establish if all segments of the market are expected to grow at the same rate.

7.3.4. Growth Drivers

Review the main growth drivers – these could include:

- People;
- Digital/technology/innovation;
- Operations;
- Customers;
- Funding/finance;
- Inorganic opportunities (M&A, corporate ventures, alliances, JVs, partnerships).

7.3.5. Legal and Regulatory Framework

Review the legal and regulatory framework under which the Target operates – for example:

- The extent of industry/country regulations and how stringently these are enforced;
- The frequency at which regulations change;
- Any penalties the Target could be subject to in the event of non-compliance with regulations;
- Any past instances of non-compliance with regulations;
- The level of effort and expense required to be fully compliant with regulations;

- The governing law(s) under which the Target operates (this is important to understand – such as with regards to the tax regime(s) the Target must adhere to.

7.3.6. Sector/Industry Specific Trends

- Review trends in the Target's market to establish if there have been changes in profit levels or the size of the market and whether the Target may be exposed to changes in technology (and if so, how it may respond?).

7.3.7. Key Risks

- What are the key risks associated with projected growth?
- Is there a history of cyclicality/risk of downturn or the potential for demand disruptions, which could have an adverse impact on growth?

7.4. Competitive Landscape

7.4.1. Key Competitors

- Review key competitors in the Target's marketplace, the relative market shares of the Target's main competitors and determine the competitive niches of each one (if applicable) and how these may impact on the Target.

7.4.2. Market Share Trends

- Research whether the Target has lost market share historically. If so, investigate the reasons for this and establish whether the Target is still losing market share.

7.4.3. Barriers to Entry

- Review the existence and extent of barriers to entry and how the Target may respond to a new market entrant(s).

7.4.4. Corporate Strategy

- Assess the corporate strategy (by reference to any business plans reviewed and conversations with key management) and establish whether this is appropriate given current and projected trends in the sector/vertical.

7.4.5. Business/Sales Drivers

Review the key business/sales drivers. These might include:

- Number of locations (if applicable);

- Average size (i.e. square m) per location;
- Number of products sold (volume);
- Prices of products/services sold;
- Size of sales team;
- Effectiveness of sales team (e.g. revenue per sales rep);
- Traffic volume to a website;
- Conversion rate of traffic to a website/bounce rate;
- Production output for manufacturing (e.g. units per hour/person);
- Efficiency rates and downtime;
- Salaries and wages per employee.

7.5. Geography

7.5.1. Markets

- Which geographies and market segments does the Target focus on?
- Are these markets in line with the current portfolio?
- Further to the above, do these markets fit with the future strategy?

7.5.2. Location of Operations

- Map out the Target's main locations (infrastructure, personnel, head office, sales, etc.)?

7.5.3. Geographical Reach

- Review the geographical reach of the Target – local/national/regional/global and the spread of the Target's market;
- Is there potential for further geographical expansion?
- Has the Target embarked on any geographical expansion in the past? If so, to what extent was this successful?

7.5.4. Sales regions

- Review the structure of any sales regions and consider how these could be effectively integrated into any existing group structure.

7.5.5. Exposure to Volatile/Conflict Regions

- Does the Target have operations in any volatile countries – being those currently subject to war, civil war, civil unrest, political uprising?

- If yes to any of the above, consider how these operations of the Target would be integrated into existing operations or whether they would be divested of or closed down (financial risk/reward should be considered here).
- Does the Target trade with any countries currently or recently subject to any international sanctions or trade embargos, etc.? If "yes" gain an understanding of the extent of such operations in terms of the % of revenue and earnings they contribute.
- What would be the impact to the Target if operations in risky/volatile regions were to cease (consider in terms of reduced revenue and earnings and market perception)?
- If the Target has been trading with any countries subject to international sanctions and embargos, establish the quantum of any fines/penalties the Target may be subject to (and review details of any past fines/penalties incurred, if applicable).

7.6. Sales and Customers

7.6.1. Customer Analysis

Gain a detailed understanding of the Target's customer base across:

- Type;
- Size/status;
- Location;
- Length of relationship with the Target;
- Contract terms;
- Frequency of purchase;
- Customer demographics (if B2C) – such as age, location, income, etc.;
- Annual spend, etc.;
- Status of customer [active/inactive/legacy];
- Average number of end users per customer (if applicable).

NOTE: Conduct further investigation into any key customers – see below.

7.6.2. Key Customer Analysis

- Establish who the Target's key customers are;
- Do any key customers account for a significant proportion of revenue – if so, what would be the impact on the Target if such a customer was to be lost? Perform sensitivity analysis here;
- What measures are in place to protect the revenue deriving from any key customers (typically by way of long-term contracts, etc.).

7.6.3. Sales/Order Pipeline

The sales/order pipeline provides management with a representation of where prospects are in the sales process and should allow for the forecasting of revenue. In reviewing the sales/order pipeline consideration should be given to the following:

- Current value of pipeline – including breakdown of value across prospects and details of how pipeline value has been calculated;
- Split of pipeline value across confirmed purchase orders and mere expression of intent to buy;
- Historic conversion rate (covering the conversion of total opportunities to realized revenue – e.g. if opportunities are not being converted to realized revenue investigate the reasons behind this);
- Understand the categorization of prospects – e.g. across Tier 1, Tier 2, A, B, C or warm/cold lead, etc.

NOTE: ensure there is understanding of the difference between the sales pipeline and sales forecast. A sales pipeline will typically include every opportunity a sales team is handling, while a sales forecast is an estimate of the opportunities likely to close in a given time period.

7.6.4. Customer Cost of Acquisition

- Calculate Customer Cost of Acquisition and consider the reasonableness of this against industry benchmarks (if available).

NOTE: Customer cost of acquisition (CAC) measure the cost to acquire a customer. A basic formula to arrive at CAC = Total Marketing + Sales Expenses / # of New Customers Acquired. It is notable, however, that this basic formula does not account for the salaries of the sales and marketing team, for example.

7.6.5. Sales Cycle and Management

Review the sales cycle and consider the following:

- Length of sales cycle (days or months) and compare to the industry norm;
- Overview of sales stages and requirements for advancing through the pipeline;
- Touch points across sales funnel (e.g. are there points across the sales cycle where a prospect customer is handed from one sales rep – or team – to another?
- Consider if there are any ways in which the sales cycle can be expedited. As part of this, investigate any factors that are blocking sales;
- Description of discounting practices and approval processes.

NOTE: The sales cycle refers to the process/steps a company undertakes when selling a product or service to a customer.

7.6.6. Distribution Channels

Review the Distribution channels of the Target (being the paths that products and services take on their way from the manufacturer or service provider to the end consumer). Examples of distribution channels include:

- Direct channel (to new customers);
- Upsell – expanding sales to an existing customer across the same product line;
- Cross sell – expanding sales to an existing customer across new product lines;
- On premise – e.g. from dedicated retail location;
- Online - a review of online sales should be given sufficient attention across commercial due diligence;
- Via partners or re-sellers;
- Wholesale.

7.6.7. Receivables/Debtor Management

Review receivables/debtors and consider the following:

- Ageing profile (e.g. due in 30/60/90/120+ days) and compare against standard contract terms with;
- Large or unusual balances;
- Largest balances by customer;
- Penalties/interest incurred by customers for late payments and reason for late payment;
- Recoverability of aged debts;
- Provision for doubtful debts and the reasonableness of this.

7.6.8. Sales Organization

Review the sales organization and consider the following:

- Level of skill and experience;
- Sales methodologies used;
- Approach to training and onboarding of new sales team members;
- Sales incentive/bonus/commission plan and detail of payments made over the past [X] years;
- Sales organization chart (showing all members of the sales team);

- Definition of each role, including salary and tenure;
- List of any 3rd party productivity tools used;
- List of key metrics used for measurement;
- List of sales regions.

7.6.9. Know Your Client/Customer

- Gain an understanding of the "know your client/customer" procedures undertaken by the Target when agreeing new work/contracts (this is the process of identifying and verifying the identity of clients/customers).
- Are these procedures adequate and do they suitably address the relevant risk areas?

7.7. Profitability/Margins/Pricing

7.7.1. Profitability

- How profitable is the industry in which the Target operates? Has the industry recently been subject to any notable downturns? If so, can these downturns be easily explained?

7.7.2. Margins

- What margins are the Target's competitors making? It is suggested that publicly available financial accounts are reviewed to ascertain such details.
- Is there any risk of margin erosion? If so, where from?

7.7.3. Pricing

- Is the Target subject to any apparent price pressures?
- Are the prices of products/services stable or subject to occasional or frequent volatility (such as commodities)?
- If yes to the above, are there any ways to hedge against such volatility?

7.7.4. Future Profitability

- Assess the profit potential of the Target and how significant the steps required to achieve such profitability are.

7.8. Budgeting and Planning

7.8.1. Latest Business Plans

- Review the latest business plans and compare them to the Target's actual performance to see if the management team is capable of implementing its objectives.

7.8.2. Previous Business Plans

- Review progress made against previous business plans based on the Target's current financial position and strategy.

7.8.3. Overview of Business Activity – Current Year

- Ensure a thorough understanding of current year business activities is established. Where new initiatives or significant changes to business activity have been made, gain an understanding of what these are, why changes were made and what the impact/ROI has been to date.

7.8.4. Forecasting Assumptions

- Obtain details of all assumptions used for financial forecasting and consider the reasonableness of these.

7.8.5. Sensitivity/What if Analysis

- Perform sensitivity / "what if" analysis on the financial forecasts – one way to approach this is to work through the P&L and flex one or several material financial statement line items.

7.9. Production, Purchasing and Suppliers

7.9.1. Main Production Locations

- Review details of all production locations (if applicable) and consider any cost synergies that could be realized (e.g. consolidation of locations held by the Acquirer and Target).
- Where applicable, consider the benefits of maintaining/or closing down one or several of these locations.

7.9.2. Production Capacity

- Review the production capacity of the Target (where applicable) and consider factors such as (i) weekly/monthly/annual output [and compare to industry standards] (ii) the current production capacity of the Target – i.e. has full capacity been met or could currently unutilized resources be put to use?

7.9.3. Future Investment/Capital Commitments

- Obtain details of any future investment/capital commitments - investigate the nature of these and establish whether a purchase order has been signed.

7.9.4. Quality Management

- Consider the approach the Target takes to quality management – for example, across: (i) products/services (ii) customers (iii) leadership (iv) people (v) processes (vi) R&D/innovation, etc.

7.9.5. Payables/Creditor Analysis

Review payables/creditors and consider the following:

- Ageing profile (e.g. due in 30/60/90/120+ days) and compare against standard contract terms with;
- Large or unusual balances;
- Largest balance by supplier spend;
- Penalties/interest incurred for late payments and reason for late payment;
- Any breach of terms with suppliers, which could damage a relationship.

7.9.6. Main Supplier Contracts

Review main/material supplier contracts across categories – such as:

- One-time services;
- Multi-year delivery of services;
- Multi-year outsourcing of services;
- Short-term project services;
- One-time goods acquisition;
- Multi-year goods delivery;
- Capital projects.

7.9.7. Contract Management

Consider the following with respect to contract management. A review of contracts is important across the commercial due diligence since it can help identify areas of possible cost synergies – such as via the consolidation of procurement contracts across Acquirer and Target.

- Compliance with the contract terms and conditions by all parties;
- Satisfactory performance by the contractor during the term of the contract;
- Value for money was received;
- Post-contract evaluation summaries (if applicable).

7.9.8. Contract Performance

Consider the performance of contacts across the following:

- Identification of any problems or deficiencies as per the Statement of Work;
- Remedial actions taken where necessary;
- Interpersonal skills and relationships of contractor resources;
- Failure to meet terms and conditions.

7.9.9. Post Contract Reviews

Establish whether post-contract reviews are conducted – if so, assess the following:

- Were products/services provided as per the contract terms and conditions?
- Were the end user needs met?
- Areas of improvement in procurement;
- Whether the contractor would be considered again for similar services in the future.

7.9.10. Supply Chain Risk Management

Gain a detailed understanding of the Target's supply chain and consider the approach to risk management across the following:

- Exposure to corruption, malpractice and ethically unsound purchasing;
- Source/origin of any products procured;
- Trace the supply chain across countries (as applicable) and review the countries the supply chain touches against Transparency International's Corruption Perception Index (CPI) > https://www.transparency.org/cpi2018
- Assess exposure to any potential "supply shocks" across the supply chain, which could have an adverse impact on production output.
- Assess exposure to "price shocks" across the supply chain and any risk mitigating strategies employed (such as hedging);

- Assess exposure to long lead times across the supply chain and the potential for significant delay.

7.9.11. Purchasing Organization/Procurement

Obtain details of how the purchasing organization/procurement works – for instance:

- How is budget allocated across departments/divisions/business units?
- Who has authority to spend?
- What are the spending limits?
- What controls are in place [e.g. consider segregation of duties]?

7.10. Organization and Personnel

7.10.1. Organizational Chart/Group Structure

Review the organizational chart/group structure and consider:

- Subsidiaries/other entities;
- Where each subsidiary/entity is incorporated;
- The ownership structure of each subsidiary/entity;
- Whether the Target's group structure is overly complex (therefore requiring restructuring efforts pre/post-transaction).

7.10.2. Consider the Complexity of the Target

- Consider the complexity of the Target – if it involves a large number of subsidiaries it may be too difficult to integrate into any existing group structure.

7.10.3. Existence of Overseas Subsidiary Companies

- Does the Target have overseas subsidiary companies, which are to be acquired? If so, consider the logistics of (i) a deal process managed from overseas and (ii) the practicalities of an overseas post-merger integration project.

7.10.4. Management Team

7.10.4.1. Management Team Experience

- How experienced and strong are the management team of the Target?
- Assess whether the management team is strong or whether it needs to be replaced.
- Consider management churn and skills/capability gaps, etc.

7.10.4.2. Retention of Management

- Consider if the management team of the Target is to be retained post-transaction.
- If "yes" to the above, is the Target's management team committed to remaining in place post transaction?

7.10.4.3. Alignment of Management

- Are the interests of the Target's management aligned with those of the Acquirer? If "no" consider the extent to which this could be a "deal breaker".

7.10.4.4. Communication

- Does the Target's management view the potential transaction positively or as a threat? If as a threat, consider the extent to which this could represent a "deal breaker".

7.10.5. Staff Training/Development

Review the approach to ongoing staff development – such as across:

- Frequency of training;
- Inclusiveness of training (i.e. are training opportunities available to all employees);
- How certain training needs might be prioritized over others;
- Cost of training – per month/year/per department, etc.;
- Is training delivered in house of by external consultants;
- How training is conducted – e.g. in person or via online e-learns.

7.10.6. Employee Productivity

Review employee productivity across the following:

- Overtime hours worked (regular overtime hours could be indicative that the Target needs to increase the number of employees – if this is apparent the costs of additional employees need to be estimated using robust assumptions);
- Turnover rate;
- Sales growth;
- Customers served/units produced/calls made/gross billings per employee, etc.

7.10.7. Salaries

- Review salary structures across levels of seniority and departments/divisions/business units and compare to industry/sector/country norms.

7.10.8. Bonus/Incentive Scheme

- Review any bonus or incentive schemes operated across levels of seniority and departments/divisions/business units and compare to industry/sector/country norms;
- Review how bonuses are calculated/how an employee achieves a bonus;
- Establish the quantum of bonuses paid out over the past two years and whether a bonus accrual is in place for the current year.

7.10.9. Pensions and Other Payments

- Review details of any pension schemes (or other long-term payment schemes) operated by the Target.

NOTE: See the Financial Due Diligence Workstream for more on Pensions.

7.11. Values & Working Practices

7.11.1. Values

- Are the values of the Target (and its employees) similar to those of the Acquirer?

7.11.2. Working Practices

- Is the Target's way of working similar to that of the Acquirer?

7.11.3. Culture

- Could there be a "clash" of cultures? See the HR Due Diligence Workstream for guidance on running a Cultural Diagnostic;
- Has a culture diagnostic been considered as part of due diligence? *See the HR Due Diligence Workstream for more on this.*

7.11.4. Risk Management

Assess the Target's approach to risk management – for example across:

- Finance;
- Operations;
- Reputation;
- Compliance.

7.11.5. Corporate Governance

Assess the Target's approach to corporate governance – for example across:

- The board of directors;
- Managers;
- Shareholders;
- Creditors;
- Auditors;
- Regulators and other stakeholders.
- Any guidelines/rules/procedures.

7.12. Post-Transaction Matters

7.12.1. Changes to Business Operations

- Assess whether it will be necessary to make significant changes to the Target's business operations (e.g. turnaround, re-location of operations, etc.) post transaction?

7.12.2. Customer Perception

- How would the Target's customers and suppliers view the proposed transaction?

7.13. Document Index

7.13.1. Customers

7.13.1.1. Customer purchasing policies

7.13.1.2. Credit policies

7.13.1.3. Top customers by spend (i.e. top 10 or 20)

7.13.1.4. Customer churn analysis

7.13.1.5. Customer contracts

7.13.1.6. Major lost customers – past 12 months and details of reasons for

7.13.1.7. Advertising and marketing programs

7.13.1.8. Competitors

7.13.1.9. Details of any countries the Target does business with subject to embargoes or sanctions, etc.

7.13.2. Sales & Marketing

7.13.2.1. Positioning of company and products

7.13.2.2. Marketing opportunities & risks

7.13.2.3. Customer cohort analysis

7.13.2.4. Marketing & sales costs

7.13.2.5. Recent advertising/other sales material

7.13.3. Business Development

7.13.3.1. Business and marketing plans

7.13.3.2. Details of the R&D process

7.13.3.3. Product registrations

7.13.4. Supply Chain

7.13.4.1. Supply chain overview

7.13.4.2. Details of any transportation and freight services used

7.13.4.3. Details of CRM used (if applicable)

7.13.5. Policies & Procedures

7.13.5.1. Accounting policies (revenue recognition, etc.)

7.13.5.2. Industry and company pricing policies

7.13.5.3. Credit policies

7.13.5.4. Return policies

7.13.5.5. Warranty policies

7.13.5.6. Financial projections - annual

7.13.5.7. Financial projections – quarterly

7.13.5.8. Projections by product type, segment, customers, channel, geography, etc.

7.13.5.9. Major growth drivers and prospects

7.13.5.10. Pipeline analysis of sales opportunities

7.13.5.11. Historic pipeline conversion rate

7.13.5.12. Strategic planning documents

7.13.5.13. Business and marketing plans

7.13.5.14. Financial arrangements (loans, overdrafts, etc.)

7.13.6. Products

7.13.6.1. Current services and products & those under development

7.13.6.2. Complaints and warranty claims

7.13.6.3. Summary of product testing programs

7.13.6.4. Product descriptions

7.13.6.5. Research and development strategy & history

7.13.6.6. Competitive analysis by product

7.13.6.7. New product pipeline/product enhancements

7.13.7. Marketing, Sales & Distribution

7.13.7.1. Strategy and implementation documents

7.13.7.2. Domestic and international distribution channels

7.13.7.3. Marketing opportunities/marketing risks

7.13.7.4. Sales structure

7.13.8. Indebtedness & Obligations

7.13.8.1. Copies of all documents and agreements evidencing outstanding borrowings of the Target

7.13.8.2. Copies of all documents and agreements, not previously disclosed, evidencing other material financing

7.13.8.3. Copies and description of amounts and other terms of any indebtedness or other obligations of or to the Target

7.13.8.4. Copies of guarantees or indemnity undertakings given by the Target

7.13.9. Relationships

7.13.9.1. Details of partnerships, alliances and joint ventures

7.13.9.2. Subsidiary agreements

7.13.9.3. Financing agreements

7.13.9.4. Guarantees

7.13.9.5. Distribution and supply agreements

7.13.9.6. Standard contract forms

7.13.9.7. Other important contracts

7.13.10. Use of Outside Professionals

7.13.10.1. Details of consulting firms and other professional services used – including agreements/letters of engagement, etc.

7.13.11. Corporate Overview

7.13.11.1. Corporate overview (e.g. from website)

7.13.11.2. Articles of incorporation

7.13.11.3. Board minutes

7.13.11.4. Shareholders' agreements

7.13.11.5. Management bios and contacts

7.13.11.6. Details of Board members

7.13.11.7. Details of key executives

7.13.11.8. Overview of any subsidiaries

7.13.11.9. Name and address of each shareholder of the Target

7.13.11.10. Copy of the organization chart of the Target and its subsidiaries

7.13.11.11. Organizational charts – key people

7.13.11.12. Charter documents, as currently in effect

7.13.11.13. Minute books of the Target including minutes of shareholders meetings, directors' meetings, etc.

7.13.11.14. Certificates of authority and good standing in jurisdictions where the Target is qualified to do business

7.13.11.15. Addresses of the Target's principal & registered offices & its registered agents & their addresses

7.13.11.16. Copies of all shareholder agreements, voting trusts, voting rights agreements and all other agreements

7.13.11.17. All information gathered in early stages of the transaction (such as the CIM and notes on management presentations, etc.) – see "Document Index pre/post NDA)

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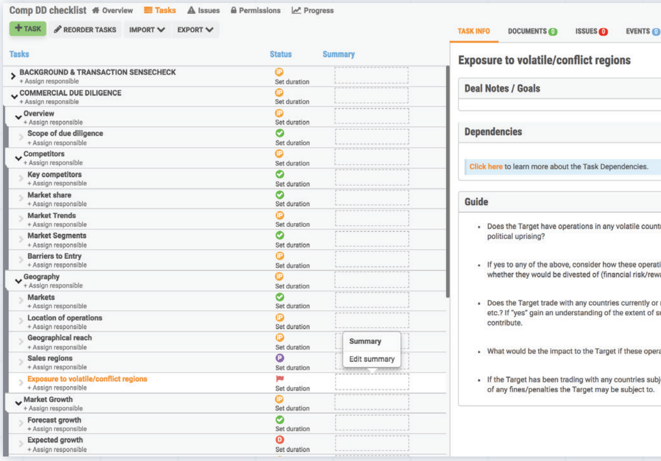
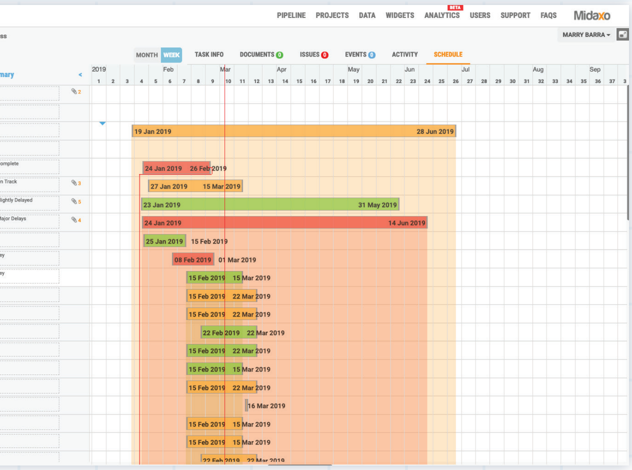


Centralize Playbook Execution and Collaboration with Midaxo's Easy-to-Use Platform



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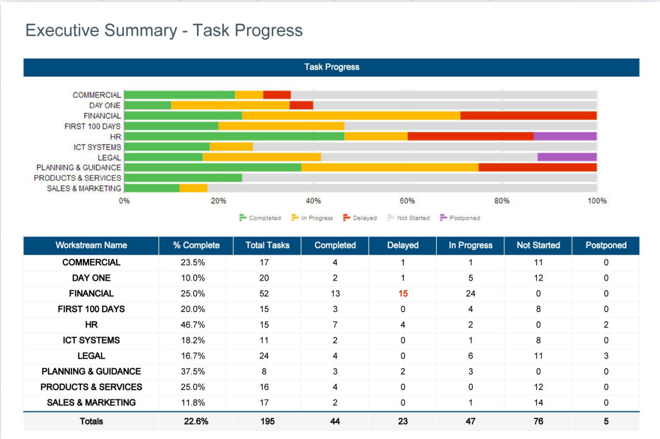

Workstream Name	% Complete	Total Tasks	Completed	Delayed	In Progress	Not Started	Postponed
COMMERCIAL	23.5%	17	4	1	1	11	0
DAY ONE	10.0%	20	2	1	5	12	0
FINANCIAL	25.0%	52	13	15	24	0	0
FIRST 100 DAYS	20.0%	15	3	0	4	8	0
HR	46.7%	15	7	4	2	0	2
ICT SYSTEMS	18.2%	11	2	0	1	8	0
LEGAL	16.7%	24	4	0	6	11	3
PLANNING & GUIDANCE	37.5%	8	3	2	3	0	0
PRODUCTS & SERVICES	25.0%	16	4	0	0	12	0
SALES & MARKETING	11.8%	17	2	0	1	14	0
Totals	22.6%	195	44	23	47	76	5

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