How to conduct due diligence on a business purchase

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James Price, JPAbusiness Pty Ltd
David McGuiness and Fleur Gibson, Watson Mangioni Lawyers Pty Ltd
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**Disclaimer:** This booklet is a general guide to matters to consider when acquiring a business or shares in a company. You ought to seek professional advice before taking action or relying on any topic in this booklet. The material in this booklet is not advice and should be regarded as a general guide only.
Introduction

Comments by James Price
JPAbusiness Pty Ltd

A successful business purchase is about doing your homework upfront and making sure you are well prepared. In business circles this is called ‘doing your due diligence’.

In terms of normal due diligence on a business acquisition there are usually three main areas a potential purchaser and their advisor will focus on:

• Commercial due diligence
• Financial due diligence
• Legal due diligence

As advisors to business we provide financial and commercial due diligence and often coordinate the legal due diligence with our client’s solicitor.

Meet our contributors

For this eBook we have called on the expertise of Watson Mangioni lawyers David McGuiness and Fleur Gibson for the legal due diligence section.

David is a commercial lawyer with over 20 years’ experience in both private practice and as an in-house counsel. David specialises in general counsel and transactional work for companies across a broad range of industries including technology, media, broadcasting, health, retailing and construction.
Fleur has been practising since 2001 in private practice and has provided legal advice across a broad range of industries including aviation, agriculture, technology, retail, manufacturing, mining and finance. Fleur specialises in mergers and acquisitions, due diligence, corporate structuring, corporate governance and compliance, and commercial agreements.

David and Fleur have kindly agreed to share their experience and insights with us in the area of legal due diligence.
Chapter 1: How to conduct due diligence on a business purchase

Comments by James Price
JPAbusiness Pty Ltd

As advisors to clients looking to purchase businesses, we regularly prepare custom due diligence checklists, tailoring these documents to ensure robust information collection for each potential business purchase.

As part of this process we focus on three main areas:

- **Commercial** due diligence
- **Financial** due diligence
- **Legal** due diligence

**Commercial** due diligence components include:

Real property/premises; plant and equipment; stock and inventory; systems and processes; employees; customers; products and services; suppliers; business IP and other assets; market trends and issues; contracts and agreements.

**Financial** due diligence components include:

Financial performance; business maintainable earnings (BME); debtors; creditors; work in progress; salaries and wages; employee entitlements; guarantees and bonds; pre-payments and insurance.

**Legal** due diligence components include:

Claims and warranties; patents, trademarks and business names; Australian Tax Office (ATO) and other statutory audits and risks; ATO and other statutory payments; unrealised legal claims/risks; contingent and other potential liabilities; transfer of employee entitlements; contract terms, conditions including vendor warranties and indemnities.
The JPAbusiness Due Diligence Checklist

As due diligence issues often overlap and stretch across more than one of the three main areas, we have created a due diligence checklist that helps to cover multiple areas by addressing five key components of business:

1. Customers and markets  
2. Inventory and suppliers  
3. People and processes  
4. Contracts, licences, registrations and agreements  
5. Business and financial performance

The checklist is not meant to be prescriptive in terms of how you conduct due diligence under every circumstance, but instead provide some helpful questions to consider as you work through the process.

In Chapter 2 I will provide a brief explanation of some issues to consider under each of the checklist headings.

You can use the checklist on the following pages or download a copy from our website: www.jpabusiness.com.au/e-books-templates
### JPAbusiness Due Diligence Checklist

As business advisors, the JPAbusiness team provides financial and commercial due diligence for clients considering business purchases and we often coordinate the legal due diligence with our clients’ solicitors.

On the following pages you will find questions to consider when conducting your own financial and commercial due diligence, or when discussing the process with your advisors.

Legal due diligence can be a very detailed undertaking, so for the sake of brevity we have included a much-simplified legal due diligence checklist on the final page. This checklist contains some of the basic information to seek from vendors when conducting legal due diligence. This information has been kindly supplied by specialist commercial lawyers Watson Mangioni who conduct detailed legal due diligence for a wide range of clients.

<table>
<thead>
<tr>
<th>Due diligence questions to consider</th>
<th>Info received</th>
<th>Notes</th>
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<tbody>
<tr>
<td>Customers and Markets</td>
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<tr>
<td>Is there a diversity of sales by major product line over the past two years?</td>
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<tr>
<td>What was the $/% margin earned on each main product and service over the past two years?</td>
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<tr>
<td>At completion, what is the shape of the work pipeline (quotes, orders, work in progress) – is it similar to business as usual?</td>
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<tr>
<td>Where does the business receive sales inquiries from and how does it market its propositions?</td>
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<tr>
<td>What do key recent customers think about the business’ product and service offering?</td>
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<tr>
<td>What are the key trends, business issues, competitive dynamics and regulatory changes impacting the sector and geography that the business operates in?</td>
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</table>
### Due diligence questions to consider

<table>
<thead>
<tr>
<th>Inventory and Suppliers</th>
<th>Info received</th>
<th>Notes</th>
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<tbody>
<tr>
<td>How closely do inventory levels for major products match historic and expected sales levels for an industry relevant timeframe (sales cycle)?</td>
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<tr>
<td>What are the specific payment and supply terms (by written agreement or verbal) for each main supplier to the business?</td>
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<tr>
<td>What do the business’ key suppliers think about the business and its performance, strengths and weaknesses?</td>
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<tr>
<td>What portion of the business’ inventory could be classified as slow moving or obsolete?</td>
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<tr>
<td>Do you have enough decision support and information to conduct a stocktake at completion?</td>
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</table>

### People and Process

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<thead>
<tr>
<th>People and Process</th>
<th>Info received</th>
<th>Notes</th>
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<tbody>
<tr>
<td>What is the current organisational structure, and specific roles and responsibilities of the main roles driving the business?</td>
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<tr>
<td>Have you sighted a complete payroll schedule, with remuneration and entitlements per employee (see Legal checklist below)?</td>
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<tr>
<td>Are there any risks and issues with the transfer of employees, including entitlements, claims and other liabilities?</td>
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<tr>
<td>Have you reviewed all employment documentation (contracts, verbals, promises, other) and considered the implications for transfer?</td>
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<tr>
<td>What are the key processes and procedures that drive business performance (e.g. the job/project management process (from order through to deliver and billing) and do you understand each step (system, manual, other)?</td>
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</tr>
<tr>
<td>Due diligence questions to consider</td>
<td>Info received</td>
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<tr>
<td><strong>Contracts, Licences, Registrations and Agreements</strong></td>
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<tr>
<td>Have you reviewed and considered all key agreements (documented and verbal) that require an obligation from the business?</td>
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<tr>
<td>Have you confirmed the legal and practical status of business name and any trademarks, logos, and other valuable information such as IP, designs, drawings, logins, subscriptions, prepaid advertising etc?</td>
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<tr>
<td>Have you identified and confirmed any assignment or transfers requirements for any items or agreements critical to the business operations that need to occur upon completion?</td>
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<tr>
<td><strong>Business and Financial Performance</strong></td>
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<tr>
<td>Have you cross-checked and undertaken an analysis to substantiate any adjustments to the financial accounts to confirm Business Maintainable Earnings (BME)?</td>
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<tr>
<td>Have you conducted a reconciliation of management accounts to the accountant’s financial accounts for the latest two years to confirm any differences?</td>
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<tr>
<td>Have you identified any material variances in the financial performance over the past 2-3 years, why these occurred and the implications?</td>
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<tr>
<td>What are the risks associated with the business’ current debtor and creditor profile (e.g. arrears and poor payment, working capital impacts, etc)?</td>
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<tr>
<td>Have you reviewed and assessed the monthly cash flow profile of the business to identify light periods that impact working capital and why?</td>
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<tr>
<td>Have you conducted a tax and BAS/GST liability reconciliation to confirm status and any variances of a material nature?</td>
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<tr>
<td>Does the business adequately measure up (positively) against your acquisition, financial and other objectives? If not, does the current offer/acceptance have appropriate risk mitigation strategies, or do you need to reconsider your offer and/or contract provisions?</td>
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## Legal due diligence checklist

<table>
<thead>
<tr>
<th>Information to seek from vendors</th>
<th>Received</th>
<th>Notes</th>
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</thead>
<tbody>
<tr>
<td>A group structure diagram (including any wholly or partly owned subsidiaries and any other companies or entities which are integral to the business, with shareholding details where applicable).</td>
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<tr>
<td>A list of all governmental, statutory or other permits, authorities or licences held by each group entity required by them to conduct their business.</td>
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<tr>
<td>For each group entity, full details of:</td>
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<tr>
<td>• all material assets owned by the entity, details of any purchase price outstanding, and the value, condition and location of the assets</td>
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<tr>
<td>• any encumbrances over the material assets</td>
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<tr>
<td>• all material contracts entered into by the entity</td>
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<tr>
<td>• the intellectual property rights, business names, domain names and software owned by the entity</td>
<td>☐</td>
<td></td>
</tr>
<tr>
<td>• all freehold properties owned by the entity, and any properties leased or rented by the entity.</td>
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<td></td>
</tr>
<tr>
<td>Copies of documents relating to guarantees or security given by any member of the group in respect of the debts of any other company or person.</td>
<td>☐</td>
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<tr>
<td>A list of all financing arrangements entered into by the group companies.</td>
<td>☐</td>
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</tr>
<tr>
<td>Details of each employee of the group companies (including name, position, location, start date, accrued leave entitlements, salary, superannuation and other benefits paid to the employee).</td>
<td>☐</td>
<td></td>
</tr>
<tr>
<td>Full details of any current, pending or threatened litigation against any group entity.</td>
<td>☐</td>
<td></td>
</tr>
</tbody>
</table>
JPAbusiness Due Diligence Checklist

Disclaimer

This Due Diligence Checklist is a general guide to matters to consider when acquiring a business or shares in a company. You ought to seek professional advice before taking action or relying on any topic in this checklist. The material in this checklist is not advice and should be regarded as a general guide only.

If you would like to learn more about the business advisory and broking services offered by JPAbusiness, please contact the team by visiting www.jpabusiness.com.au/contact-jpabusiness

For information about the wide range of commercial law services provided by Watson Mangioni Lawyers, go to http://www.wmlaw.com.au

Please feel free to post this template on your blog, or email, tweet and share it with your network.
Chapter 2: Issues to consider in a due diligence process

Comments by James Price
JPAbusiness Pty Ltd

Due diligence is a similar process for everyone, but it’s not the same process. The depth of your analysis will depend on your appetite for risk, the particular business you are looking at and your specific requirements for a business.

Having said that, the following high-level areas of focus will usually be considered to some degree in every due diligence process:

1. Customers and markets
2. Inventory and suppliers
3. People and processes
4. Contracts, licences, registrations and agreements
5. Business and financial performance

Customers and markets

Portfolio of customers

Think about a business’ customers as being a portfolio of earnings potential.

Ask yourself:

• What is the strength of that portfolio? Is it skewed to one type of customer, one particular geography, one particular product line?
• **What does the pipeline of business with potential customers look like?** How many quotes are there, how many orders, what’s the work in progress look like?

• **Where does the business come from?** If I’m buying a retail store, does the business come from the footpath? Other than that, does it come from interaction with a customer database? If I’m buying a wholesale leisure goods business, where do the referrals come from? What are the networks? Where does that business effectively originate from?

• **What do the customers think of the business?**

**Operating environment**

The operating environment involves considering the trends and issues facing the market and how they might materially impact the business you’re looking to purchase.

An example is the newsagency sector. This sector is being – and will continue to be – heavily impacted by trends and issues that are somewhat outside its control, both regulatory changes and trends in customer purchasing habits.

For instance, the online trend is having a huge impact on print media readership which is impacting the number of customers through the doors of newsagencies.

In NSW, Tatts Lotto will be deregulated come June 2018 which will mean a Lotto agency may be found in a corner store or a service station, not just in a newsagent.

Those are two external market forces which are very important considerations in a due diligence process.
Inventory and suppliers

Inventory levels

Often people look at a business’ product or service range but don’t necessarily look at the corresponding inventory levels.

Imagine the business you’re looking to purchase is selling air conditioner model XYZ. XYZ is one of the business’ top five sellers and for the past two years the business has averaged 55 sales per year of this model. The current inventory level of XYZ is 78 units, with each having a wholesale value of $5000.

You now need to consider what impact this inventory level will have on your working capital position. Do you want to buy 78 air conditioners on day one, when chances are you will only sell 55 per year? You will be holding a surplus of 23 units – that is $115,000 of extra working capital you will be outlaying on day one.

Obsolete and slow-moving stock

We talked about inventory management in detail in our eBook Managing Cash Flow and Working Capital and one of the topics discussed was obsolete and slow-moving stock.

When assessing inventory levels in due diligence it’s important to recognise the difference between overstocked items – like air conditioner XYZ – and obsolete and old stock items.

Be careful not to wind up paying face value for stock you may have difficulty moving.
Supplier relationships

Due diligence in this area also requires pressure testing the value of relationships with key suppliers.

It’s just like customers: think of the suppliers as a portfolio of relationships that have elements of value to bring to the table i.e. products. They may each be operating under different terms, which you will need to understand.

They will also have their own views on the business you’re buying, so engage them in early discussions to understand their perspective on the business:

- Where are the weaknesses?
- Where are the strengths?
- What are the opportunities?

Stocktake

The final piece of this section, if inventory is part of the sale process, involves doing a stocktake. This usually comes after all of your other due diligence and just prior to completion.

Stocktake is an important part of the due diligence process because any ‘red flag’ issues you identify regarding inventory levels may necessitate a price renegotiation or discussions on other remedies.
People and process

People

What you’re trying to do in this stage of due diligence is understand the quality of the team you have available upon transfer:

• What are their strengths?
• What are their weaknesses?
• How are they performing?
• What are their roles?
• Do they have defined position descriptions?
• What are their expectations of their roles?
• What are their employment conditions and entitlements?
• What is the risk of losing key staff when you take over?
• How involved is the current owner in key roles and how will that impact the success of transfer?

Processes and procedures

This issue is very important for a successful transfer and you will want the following information:

• What are the key processes in the business?
• Are they documented?
• Are they standardised?
• Who is responsible?
Once you have an understanding of the processes you need to consider to what extent those processes have potential areas of failure that could impact the financial position of the business.

For example, how do those processes mitigate the risk of poor or inconsistent pricing in quotes, or even the risk of fraud?

**Contracts, licences, registrations and agreements**

This is a very important area of due diligence and is covered in more detail in our next chapter, *Legal due diligence in a business sale.*

One important part of this process is looking for formal or informal agreements or understandings between the business owner and key people or organisations. These people may be customers, suppliers or collaborators.

The agreements could be anything from the actual premises lease documents and what’s required in terms of lease obligations, assignment and transfer, to a verbal agreement with a sub-contractor to provide product installation services on an hourly rate basis, with no documentation at all.

When buying a business as a going concern, the legal contract will help protect you from some obligations, but you will still find yourself approached by people with views on your commitments to them, and you’re going to need to know what they are and whether they’re appropriate.
Business and financial performance

When thinking of **due diligence most people think of numbers**.

This area of due diligence may be very extensive or less so depending on your risk appetite and also on the work you’ve already done in getting to the stage of due diligence.

Typically there are a few things we like to look at here, including:

- **Reconciling accounts** – We like to reconcile the management accounts of the business against the accountant’s financials to see if there are any variances and to ensure we can explain those variances. If we can’t, and they are material variances, that gives rise to consideration of remedies.

- **Debtors and creditors** – We like to look at the ageing profile of debtors and creditors, because this has a large impact on your working capital. We want to know how much money is outstanding, on what terms the money is paid, and get a sense of any risks around that customer portfolio from a financial perspective.

- **Cash flow profile** – We usually start by looking at the bank statements of the business’ trading account on a monthly basis and go back one to two years to see the flow of funds in and out of the business to determine how it has tracked from a cash flow perspective.

- **Taxation** – Finally, we look at a range of tax due diligence aspects. These relate to making sure the business has met its taxation liabilities correctly over the years and we also look at Business Activity Statements (BAS) to match them up against reported sales and expenses.
Chapter 3: Legal due diligence in a business sale

Comments by David McGuiness and Fleur Gibson
Watson Mangioni Lawyers Pty Ltd

What is the purpose of legal due diligence?

The purpose of legal due diligence is to enable an intending purchaser to assess the legal risks associated with either a business or a company, in order to make an informed decision as to whether they will proceed with the transaction and, if so, on what terms.

Where issues are thrown up during legal due diligence and the buyer still wishes to go ahead, they may renegotiate the purchase price they’ve initially offered and also request additional warranties from the vendor.

Legal due diligence can also make a buyer aware of the risks and pitfalls in the business they’re buying, so they can factor that into their working capital budget going forward.
Does everyone do legal due diligence on potential business purchases?

Whether or not you do legal due diligence tends to be a factor of your appetite for risk and the price of the business you are considering purchasing.

For example, if you’re looking at buying a small business such as a café and you have worked in the industry all your life, you may feel you have enough of a handle on the potential risks that you won’t invest in legal due diligence. Instead you may engage a third party to do a little commercial due diligence for you, and then do a little of your own ‘bush lawyer’ due diligence.

Also, in situations where a company has gone into liquidation, the liquidator is selling the assets and the purchase price is quite low in relation to the business’ potential, a buyer will often buy the assets without doing much due diligence at all. This is because they appreciate they are getting a bargain.

For buyers who aren’t in either of those situations, due diligence can save them from making expensive mistakes.

How does legal due diligence interact with commercial and financial due diligence aspects?

Legal due diligence interacts substantially with commercial and financial due diligence and the best way to show this is with some examples:

**Example 1**

As part of a legal due diligence we often review the material contracts of a business or company. Typically those contracts are with customers and underpin the revenue of the business.

The legal due diligence interacts with commercial due diligence when the strength of those contracts is assessed.
Issues to consider when assessing the strength of contracts will include:

- How well prepared are the contracts?
- What is the term of the contracts?
- How easily may one party terminate a contract?
- When do the contracts expire?
- Do the contracts have any termination trigger events which will be triggered by the transaction itself?

The final point in that list is a key consideration when conducting due diligence and has two components.

Firstly, if it is an asset or business purchase, we would look to transfer the contracts from the vendor to the purchaser. Usually there is a provision in well-drafted commercial contracts that requires the consent of the contracting party in order to do that.

As part of the legal due diligence we would go ahead and identify those contracts where consent is required and then it becomes a commercial decision on the part of the purchaser and vendor as to what they believe is the likelihood the counterparty to the contracts will actually give consent. If the parties form a view that consent would not be given – which admittedly is fairly rare – it may be a deal breaker.

Secondly, if it is a company or share purchase, we would look at the material contracts to see if there is a ‘change in control provision’. This provision means a contract termination may be triggered when there is a change in control of the company being purchased.

In those circumstances we would need the consent of the other party to the contract for there to be a change in control. If that consent wasn’t forthcoming there would be potential for the contract to be terminated and that would create a risk for the buyer, as the revenue derived from that arrangement in the past may not be there going forward.
Example 2

An important part of legal due diligence is to investigate what existing legal claims and threatened claims currently exist against the purchase target.

If financial due diligence indicates the company has historical earnings of ‘X’ amount but those earnings are underpinned by one or two commercial arrangements, one of which is the subject of a dispute and unlikely to continue, that would be a way the legal due diligence impacts or identifies a risk to the financial side.

What are the main items and issues that might be covered in a legal due diligence?

The answer to this question depends on the nature of the transaction, i.e. whether you are purchasing a business or assets, or whether you are purchasing all the shares in a company.

If it’s the former, the due diligence questions will be focused on the assets being transferred, rather than the liabilities. This is because, other than employee liabilities, the business’ liabilities will usually not be transferred across to the purchaser as part of the sale.

If, on the other hand, you’re looking buy all the shares in a target company, you will acquire all of the assets and all of the liabilities as they exist. In that case the legal due diligence will be more comprehensive as it will need to consider the liability side as well.
Some of the key areas for consideration when conducting legal due diligence on a company sale transaction are:

- **Corporate structure**
- **Solvency risks**
- **Financials**
- **Material contracts**
- **Licences and approvals**
- **Banking and finance** – If the company has loan facilities we would check whether any third parties have registered security interests in the company at the PPSR (Personal Property and Securities Register). A buyer would want to acquire the company free of any security interests so we would check those interests have been released prior to completion.
- **Intellectual property** – This would be a key factor if you were acquiring a technology business where the major assets were proprietary software, or a company that relies heavily on the goodwill associated with its brand name.
- **Property leases** – It is often necessary to get a landlord’s consent in order for a business to continue operating from the same business premises after a sale.
- **Employees** – Check what the employee liabilities are, whether the employees are paid large salaries or have large amounts of annual or sick leave banked up, and whether there is a long history of workplace claims – that would ring alarm bells for a potential purchaser.
- **Litigation and legal claims** – This is a key area, particularly if you’re buying a company, as you are buying the liabilities as well as the assets.
- **Insurances** – It is important to know whether or not the company has relevant insurance policies in place or, of particular interest, if they have applied for cover and been denied for any reason.
- **Business and domain names** – This is a key area, particularly for online businesses.
Legal due diligence case studies

Case study 1

We acted for a company that was acquiring a complementary business that owned some heavy vehicles. The purpose of acquiring the vehicles was to use them throughout Australia.

In due diligence we discovered the vehicles did not have the correct licences to allow them to move interstate and carry the weights required.

This was a critical issue and delayed the transaction while the vendor obtained the necessary licences. If that hadn’t been picked up our client may have faced heavy fines or delays in being able to operate the business.

Case study 2

A couple of years ago we operated for a purchaser acquiring a meat processing plant.

On due diligence we discovered the plant didn’t have current Environment Protection Authority (EPA) licences necessary for the amount of waste that was going to be emitted.

It can take months to secure such licences and without them it would have been impossible for our client to operate the business as they had planned. We had to make sure the relevant EPA licences were applied for and in place by the time of purchase.

Case study 3

In this case we acted for a client who was purchasing a service and maintenance business.

The business needed a particular electrical services licence to operate in Queensland and didn’t have it. Instead the business had been operating under someone else’s licence, but that agreement was not part of the sale.

We picked this up in due diligence and advised our client. The purchaser then requested, as a condition of the sale, that the vendor obtain a licence in Queensland.
Chapter 4: Eight due diligence tips

Comments by James Price
JPAbusiness Pty Ltd

1. Understand that due diligence is different for every person

Due diligence is different for every person – and it should be different – because we all have different risk appetites.

Imagine two people looking to buy a regional heating and cooling business servicing the industrial and commercial market:

- **Buyer 1** is coming from exactly the same sector – they own pretty much the same business in a different geographic location.
- **Buyer 2** is coming out of the corporate marketing area of a telecommunications company and has been in an employed environment for 20 years in a capital city location.

Both of these people will have different risk profiles regarding this particular business and therefore the detail or otherwise of their due diligence will be calibrated against their risk profile in each of the five checklist areas mentioned in Chapter 2.

As advisors working for those parties, we would still go through the same information gathering, analysis and review process, but how detailed the due diligence needs to be in each of the checklist areas would be different for each interested party.
For example, consider Buyer 1 who already has a strong understanding of the industry and probably has relationships with most of the suppliers that this business has relationships with.

In the case of Buyer 1, doing detailed due diligence on the supplier agreements, the depth of those relationships, and the credit terms with those suppliers is, to a large extent, a waste of money.

I’m not saying Buyer 1 shouldn’t do due diligence on those things, but they wouldn’t need to cover it to the same degree as Buyer 2, who is coming from outside and would have little understanding of the risks and issues they might be taking on with those supplier accounts.

2. Due diligence needs to relate directly to your requirements for a business

Your due diligence needs to be framed around your requirements for a business.

For example, if you require the business to deliver earnings before tax of $550,000 per annum, and you want to get a strong indication that level of earnings is likely in each of the next five years, your due diligence has to be framed around that requirement. As such, it would focus heavily on market dynamics, the competitive environment, the strength of contracts, customers and their purchasing habits, and so on.

3. Be 80% sure you want the business before conducting due diligence

Due diligence processes can be expensive and time consuming. Don’t get into a due diligence if you’re still 50-50 about whether you want to be there, because it will cost money, time and effort that may be better spent looking at other opportunities which may be a better fit for your requirements.
As a purchaser you should be about 80% sure you want to buy a particular business before embarking on a due diligence process.

Once you have made the high level commitment that the target business is for you, the role of due diligence is to confirm there aren’t any hidden, material issues which would impact you in a material, negative way and/or severely impact the value you have placed on the business in your offer price.

4. Use the due diligence process to prepare yourself for running the business

Due diligence is very useful for a potential purchaser to frame their future business plans.

Treat it as an **opportunity to learn more about the business**, and not just the hard data in the financial accounts. Seek out the ‘soft’ information that might be in the heads of your managers, suppliers, current owners and customers.

The more information you have, the easier it should be to transition into the business.

5. Be wary of parties who get ‘cold feet’ during due diligence

Due diligence is **like the last stage before the ‘marriage’**. If, in a due diligence process, the vendor or purchaser is not being forthcoming in their disclosure of information, or they demonstrate they’re getting cold feet or withdraw, that is a good sign the marriage may not be a great idea.
6. Don’t be afraid to ask hard questions

Often I see purchasers who are very uncomfortable about asking hard questions of the vendor because they ‘don’t want the sale to fall over’. Instead they say ‘we had better go softly, softly around this’.

Yes, due diligence is a sensitive process because it’s going to the next level of detail regarding commercially sensitive and private information, but the bottom line is that what’s you do a due diligence for!

If the vendor is genuine about selling their business they should be prepared to share with you sufficient information to answer your questions in the fullest way.

If you find that, as a purchaser, you simply don’t feel comfortable asking commercially sensitive questions, then engage a good due diligence business advisor who can handle the sensitivity while still getting to the bottom of important issues.

7. Keep detailed records of your due diligence

It goes without saying that often due diligence is a condition of a sale contract: a contract or heads of agreement will be exchanged, and the sale will be conditional on the purchaser’s satisfaction with their due diligence.

Most contracts include tolerances and provision for small anomalies, but where you find large, material issues during due diligence you may need to renegotiate aspects of the contract.

It’s important to have detailed notes from your analysis to support your position when renegotiating.
8. Use the ‘black box’ to obtain sensitive information

Sometimes in a due diligence process we have what is called ‘black box information’, which is commercially sensitive data the vendor does not feel comfortable sharing with outside parties.

An example of this might be the names of customers. For instance, the business owner may say: ‘Why would I give a potential purchaser my customers’ names? That’s the biggest value of my business. If they pull out of the sale they can go and set up their own business and target my customers.’

In this situation the customer names would be ‘placed’ in the black box. Data on customers would still be provided, but they would be disguised as Customer 1, 2, 3 etc. Post due diligence the contract would provide for the black box information to be shared prior to completion, once certain conditions are met.

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