TobinLeff
M&A Advisors
WHITE PAPER

# How to Get Your M&A Deal Across the Finish Line
## Winning at Due Diligence

By Chuck Gottschalk

The Letter of Intent ("LOI") is the non-binding agreement giving you the price and terms that a buyer is offering to purchase your business. That day has finally come. You've just signed the LOI, and it's time to celebrate, right?

Yes. But not so fast.

It may feel like you've just scored the game-winning touchdown of the Super Bowl. The Letter of Intent is, after all, a critical step in the process of selling your business. But an LOI is by no means the end zone. The reality is, you're only on the 30 yard line, with a lot of game still left to play.

So, what happens after signing the Letter of Intent? This next phase of the process is all about due diligence and, critically, *defending your business value*.

## Due Diligence Before and After the LOI

At its core, due diligence is the time during which your acquirer verifies the accuracy of the information you've provided so far to confirm that it's consistent with what you've presented to them. **It's also the period during which they're likely to look for every excuse they can find to whittle away at the price and terms you've already agreed to – which is why it's critical that you have an experienced advisor by your side who knows what to expect and who can defend your value against the coming onslaught during due diligence and even after closing.**

Elements of due diligence actually need to start *before* you go to market, when you are packaging your company and establishing your valuation. Consider this early due diligence as part of your preparations for game day. If preparations for due diligence have not been done early on during the Mergers & Acquisitions process, things may be uncovered post-LOI that could put your deal in peril. So, how can you keep the sale of your business on track?

To start with, you'll need trusted colleagues on your team (CFO, CPA, attorneys, communications, etc.) when entering into the Mergers & Acquisitions process. You'll also need to make sure their schedules are re-worked to allow for extra capacity during the post-LOI time, because due diligence is labor-intensive. In fact, *you should anticipate that you and*

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*key members of your team may have as much as a new half-time job meeting all the demands of the process.*

An experienced M&A advisor should be your *partner* during this entire process and lift some of this burden onto their own plate. They'll help you and your team navigate the complexities of due diligence, and they should bear some of that extra workload so you can stay focused on running your business.

## Preparing for a Smooth Due Diligence Process

It's never too soon to make sure your house is in order. Begin gathering any needed documents such as leases, phantom/profit-sharing plans, and client contracts the day you first decide to go to market. Larger transactions will require a Quality of Earnings report (QOE) from an outside third party to assess the accuracy and sustainability of your historical and projected earnings. The QOE will require financial information consistent with generally accepted accounting principles (GAAP), and there's a good chance that your reports will have to be restated to comply with this. A knowledgeable M&A advisor should help you with all of this, both by way of preparation and by answering any questions that arise.

Buyers are always concerned with employee retention. You can greatly enhance your perceived value by implementing incentives now for your employees to stay on. Though these various types of retention bonuses may come out of your pocket, they go a long way in carrying deals through closing on favorable terms. TobinLeff has created many strategic incentive plans to serve this purpose.

## Preparing Financial Statements for the Mergers & Acquisitions Process

After the Letter of Intent is signed, the buyer will dig into your records to make sure that you represented yourself accurately pre-LOI. Your financials and operations will be examined in detail, and buyers will do everything they can to ensure they're maximizing their end of the deal.

We can't emphasize enough how important it is to have your financials in order. If the financial legwork hasn't been done pre-LOI, the deal you thought you had can fall apart overnight. You will need:

- accurately prepared and presented financial statements
- your company packaged in a way that presents it accurately, but in the most favorable light
- validation and defense of the numbers throughout the entire Mergers and Acquisitions process and, potentially, beyond to ensure the deal stays on track

If your financials are not in order, then you run the risk of your valuation being unfairly reduced as the buyer challenges information. That potential disconnect between your and the buyer's valuations can mean you'll need to be willing to accept shaving the price, or

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maybe even fail to close. Though an agreed-upon price in an LOI shouldn't change much during due diligence, it needs to be constantly defended to prevent this from happening.

Another key aspect of deal structure is "Working Capital." This is the mysterious, and often confusing, big play that can be the difference between a win and a loss. When no experienced advisors are representing the seller (and often when they are!), the Working Capital clause is frequently given only cursory consideration before the LOI is signed. After due diligence begins, this can turn out be a big mistake. The basis for the Working Capital calculation should be defined in the LOI. Many deals are thrown into chaos when this step is delayed until due diligence. And sometimes, it still needs to be defended even after being defined in the LOI. For one of TobinLeff's clients, our battles over the Working Capital calculation resulted in a defense of $4 million of proceeds for our client!

## Real World Examples

Due diligence is an emotional rollercoaster.

Fortunately, you don't have to go it alone. In fact, you shouldn't. It's not uncommon for deals to hit serious challenges, *before or after* the close. For example…

> We took a client to market and received multiple strong offers. However, when we reviewed our client's most recent monthly numbers before sharing them with the ultimate buyer, we discovered that February's profits had come in at only about 50% of expectations. This was a big problem.
>
> We dug deeply into the numbers and discovered that our client had done a project with a new client of theirs that involved spending a significant amount of time upfront and getting paid in two installments closer to delivery. The billing structure for this engagement was different from what their internal accountant had dealt with previously, and they simply recorded the costs when incurred, leading to artificially reduced results. We were able to show our client an alternative and perfectly legitimate way to present the financials that resulted in a more accurate, above expectation profit for February, which only made the buyer more excited and more committed to the firm value.
>
> For the same client, we also discovered that their internal accountants had recorded no revenue for a significant amount of cash they had received for media buys. We argued that since the media insertions had occurred and were non-cancellable, the commission on these buys should be credited to our client. By discovering, presenting and defending this analysis, we were able to get the buyer to increase the ultimate proceeds received by our client by $180,000.

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For a different client who was receiving payments post-closing during the earn-out portion of a prior sale, we reviewed the buyer's EBITDA calculation for our client and discovered an error in their work. Once again, the buyer agreed with our analysis. This time, our defense of value resulted in additional proceeds to our client in excess of $500,000.

The lesson here is that the work doesn't end when the LOI is signed. It's important that you have knowledgeable advisors who stay with you until the last check has cleared. In just the two examples above, that type of persistence increased our clients' proceeds by more than $680,000.

## Summary

You may be able to get to the LOI 30 yard line with a couple of quick throws and some fancy footwork, but when it comes to that drive into the end zone, you need beasts on your line who can push through the other team's resistance.

There's lots you can do on your own to prepare for due diligence:

- Gather documents early
- Get your financials in order
- Adjust work assignments to allow for due diligence compliance
- Prepare yourself for an emotional roller coaster

But the touchdown won't come without expert planning and a coaching staff that can adapt the game plan to an unpredictable and constantly changing field situation. As Dan Devine said in the movie *Rudy*, "No one, and I mean no one, comes into our house and pushes us around." As your M&A advisors, TobinLeff is always going to be "in your house."

### About TobinLeff, LLC

TobinLeff is an M&A advisory and exit planning consulting firm that helps owners of marketing services agencies and MarTech companies sell to strategic buyers and private equity groups. With over a decade of experience and more than 150 engagements successfully completed, the TobinLeff team of 10 M&A advisors and exit planning consultants is dedicated to the mission of helping owners maximize and monetize their life's work. Please visit our website at www.tobinleff.com for additional information and case studies.

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