



Twoeyes Insight to Due Diligence

Presented by:
Conor McKenna

Information on Due Diligence and a Sample Check list

Established in 2000, Twoeyes is a strategic advisory firm that brings together highly experienced business specialists who provide outstanding clarity to help small, medium and large organisations reach their potential. We help private business owners and public and not for profit Boards, CEOs and Executive teams by providing clarity that only experience brings, to avoid unnecessary pitfalls and to more effectively and expediently develop, grow and improve performance.

Clarity
from
Experience



About Due Diligence

Companies intending to market some or all of their equity in order to raise growth capital should be prepared for the significant amount of due diligence that a venture capital or Private Equity investor and its advisors may require before consummating an equity financing. Even angels are requiring many of these things be under control today at earlier development stages.

A broad definition of Due Diligence is an investigation into the financial, legal, commercial, marketing and operational activities of a business in connection with a proposed acquisition of said business, so that the acquiring party enters into the purchase with full knowledge of the facts.

A Due Diligence exercise is carried out to validate strategic ideas and to provide an independent review and support for assumptions underlying the investment appraisal. It identifies negotiation points and can help determine practical solutions for the tactical implementation of a strategy. It may also form the basis of the sales memorandum. In short, it is a report which has rapidly assimilated relevant facts marshaled as a document of record.

The brief by the prospective purchaser/investor will usually be to obtain everything possible concerning the target and its operations. To do so he will appoint a team and ensure an appropriate mix of expertise and specify a Project Co-ordinator.

It is up to the purchaser/investor to provide clear instructions and confirm in writing what is being done and by whom, the order of importance of the tasks and to agree a price for the whole. It should be remembered that common causes of failure to achieve the acquisition/investments commercial objectives are a lack of understanding of the market, a lack of quality of products/services, failure of management and poor post-acquisition integration.

There are many areas of Due Diligence that ought to be of particular concern to a prospective buyer/Investor. These include employment terms and contracts, retirement obligations, outstanding litigation, major contracts, IT systems and more.

When selecting the wider DD team - or the team preparing the company for DD, Twoeyes strongly cautions that any accountants and lawyers who are to be involved in the investigation have relevant prior experience.



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Due Diligence Checklist

The following is a sample Due Diligence Checklist, which acts as a compliance request to the Company of all relevant documents and information. In appropriate circumstances, some of the listed items can be scaled back. Some may not be applicable, depending on the country and its requirements.

Corporate Documents of the Company and Subsidiaries

1. Articles of Incorporation and all amendments thereto.
2. Bylaws and all amendments thereto.
3. Minutes of all Board of Directors, committee and shareholders meetings and all consents to actions without meeting.
4. List of states and jurisdictions in which qualified to do business and in which the Company has offices, holds property or conducts business.
5. Material information or documents furnished to shareholders and to directors during the last two years.
6. Most recently obtained good standing certificates for all countries, states and jurisdictions where the Company is qualified to do business.

Previous Issuances of Securities

1. All applications and permits for issuance/transfer of securities.
2. Sample copy of stock certificates, warrants and options.
3. Shareholder information, indicating number of shares held, dates of issuance, and consideration paid.
4. All stock option, stock purchase and other employee benefit plans and forms of agreements
5. List of any outstanding stock options and warrants.
6. Any voting trust agreements, buy/sell agreements, shareholder agreements, warrant agreements, proxies, or right of first refusal agreements.
7. Any registration rights or pre-emptive rights agreements.
8. Powers of attorney on any matter.
9. Convertible debt instruments.
10. Other contracts, arrangements, or public or private documents or commitments relating to the stock of the Company.
11. Any debt arrangements, guarantees or indemnification between officers, directors or the shareholder and the Company.

Material Contracts and Agreements

1. List of banks or other lenders with whom Company has a financial relationship (briefly describe nature of relationship - lines of credit, equipment lessor, etc.).
2. Credit agreements, debt instruments, security agreements, mortgages, financial or performance guaranties, indemnifications, liens, equipment leases or other agreements evidencing outstanding loans to which the Company is a party or was a party within the past two years.
3. All material correspondence with lenders during the last three years, including all compliance reports submitted by the Company or its accountants.
4. List of major clients and their locations.
5. Any other material contracts.



Litigation

1. Copies of any pleadings or correspondence for pending or prior lawsuits involving the Company or the Founders.
2. Summary of disputes with suppliers, competitors, or customers.
3. Correspondence with auditor or accountant regarding threatened or pending litigation, assessment or claims.
4. Decrees, orders or judgments of courts or governmental agencies.
5. Settlement documentation.

Employees and Related Parties

1. A management organisation chart and biographical information.
2. Summary of any labour disputes.
3. Correspondence, memoranda or notes concerning pending or threatened labour stoppage.
4. List of negotiations with any group seeking to become the bargaining unit for any employees.
5. All employment and consulting agreements, loan agreements and documents relating to other transactions with officers, directors, key employees and related parties.
6. Schedule of all compensation paid to officers, directors and key employees for most recent fiscal year showing separately salary, bonuses and non-cash compensation (i.e. use of cars, property, etc.).
7. Summary of employee benefits and copies of any pension, profit sharing, deferred compensation and retirement plans.
8. Summary of management incentive or bonus plans not included in (7) above, as well as other non-cash forms of compensation.
9. Confidentiality agreements with employees.
10. Description of all related party transactions which have occurred during the last three years (and any currently proposed transaction) and all agreements relating thereto.

Financial Information

1. Audited financial statements since inception (unaudited if audited financials are unavailable).
2. Quarterly income statements for the last two years and the current year (to date).
3. Financial or operating budgets or projections.
4. Business plan and other documents describing the current and/or expected business of the Company including all material marketing studies, consulting studies or reports prepared by the Company.
5. A description of all changes in accounting methods or principles during the last three fiscal years.
6. Any documents relating to material write-downs or write-offs other than in the ordinary course.
7. Revenue, gross margin and average selling price by product or service.
8. Management letters or special reports by auditors and any responses thereto for the last three fiscal years.
9. Letters of counsel to the Company delivered to auditors for the last three fiscal years.
10. Aging schedules for accounts receivable for the last two years.
11. Breakdown of G&A expenses for the last two years.
12. Copies of any valuations of the Company's shares.
13. Description of all contingent liabilities.



Property

1. List of real and material personal property owned by the Company.
2. Documents of title, mortgages, deeds of trust and security agreements pertaining to the properties listed in (1) above.
3. All outstanding leases with an original term greater than one year for real and personal property to which the Company is either a lessor or lessee.
4. Documents pertaining to proprietary technology developed/owned by the Company, including any copyright or patent filings. This will also include information confirming that the Company's systems, software and technology is owned solely by the Company and does not infringe on any other party's rights.

Taxation

1. Any notice of assessment, revenue agents' reports, etc. from federal or state authorities with respect to any currently "open" years.
2. Income tax returns for the last three years.
3. Evidence of Company being current and compliant on all other mandatory tax payments.

Insurance and Liability

1. Schedule or copies of all material insurance policies of the Company covering property, liabilities and operations, including product liabilities.
2. Schedule of any other insurance policies in force such as "key man" policies or director indemnification policies.
3. All other relevant documents pertaining to the Company's insurance and liability exposure, including special reserve funds and accounts.

Acquisition, Partnership or Joint Venture Agreements

1. All acquisition, partnership or joint venture agreements.
2. Documents pertaining to potential acquisitions or alliances.
3. Any agreements regarding divestiture or assets.

Governmental Regulations And Filings

1. Summary of Workplace inquiries for past three years.
2. Summary of federal and state, or other governmental agency inquiries during the past three years.
3. Material reports to government agencies for past three years
4. Copies of all permits and licenses necessary to conduct the Company's business.
5. Summary of applicable federal, state and local laws, rules and regulations.

Miscellaneous

1. Press releases during the last three years.
2. Articles and other pertinent marketing studies or reports relating to the Company or the industry.
3. Information regarding competitors.
4. Customer satisfaction surveys, if any.
5. Current brochures and sales materials describing the Company's services.



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Typical suggestion for a Due Diligence Checklist

CORPORATE ORGANISATION

1. Constitution/Articles of Incorporation
2. Bylaws
3. Recent Changes in Corporate Structure
4. Shareholder List
5. Show Number of Outstanding Shares and Percent Owned
6. Share Option or Share Appreciation Rights Plans
7. Parent, Subsidiaries and Affiliates
8. Shareholder's Agreements
9. Minutes of the Board of Directors
10. Professional Profiles of Board Members

BUSINESS INFORMATION

1. Product Offering
2. Depreciation Method
3. Asset Register of all Patents, Trademarks and other protected Intellectual Property
4. Management Information System

MARKETING

1. Pricing Strategy
2. Patents
3. Distribution Channels
4. Promotion Tactics

CUSTOMER BASE

1. Top Ten Customers By Product Line - Showing Volume
2. Market Share By Product Line

BUSINESS PLANNING

1. Current Strategic Plan & Review
2. Current Five Year Business Plan
3. Current Marketing Plan
4. Current Operations Plan
5. Current Financial Plan
6. Prior set of Strategic, Business and Functional Plans



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FINANCIAL STATEMENTS

1. 5 Years of Historical Audited Statements
2. Income Statement
3. Balance Sheet
4. Statement of Cash Flows
5. Change in Equity Statement
6. Year-to-Date Internally Generated Monthly Statements
7. Most Recent Five Year Projections
8. Monthly Sales Projections Taking Seasonality Into Account

TAX STATUS

1. Historical Tax Rate
2. Net Operating Losses

OPERATING DATA

1. Accounts Receivable
2. Turnover or Days
3. Aging
4. Control and Credit Policy
5. Seasonality
6. Inventory
7. Turnover or Days
8. Obsolescence Policy
9. Sources of Supply
10. Valuation Method
11. Backlog
12. By Product Line
13. Five Year History
14. Current
15. Seasonal Issues

CONTRACTS

1. List Major Contracts by Product Line
2. Terms & Conditions

CAPITAL EXPENDITURES

1. Last Five Years
2. Five Year Gross Projection
3. Detailed Priority List With As Much Analysis as Possible



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EQUIPMENT

1. List
2. Age
3. Appraisal
4. Orderly Liquidation Value
5. Replacement Value

DEBT AND LEASES

1. Lender
2. Terms
3. Interest Rate
4. Payment Schedule

LITIGATION

1. Current
2. Description
3. Potential Damages
4. Potential
5. Description
6. Potential Damages

PROPERTY

1. Description
2. Recent Acquisitions or Spin-Offs
3. Expansion Plans

INSURANCE

1. Property
2. Motor Vehicle
3. Liability
4. Worker's Compensation
5. Other

COMPETITION

1. By Product Line
2. Name, Address and Phone Number
3. Organisational Structure
4. Names of Board Members, Senior Executive Team
5. Names of key Shareholders
6. Size of Overall Company
7. Size of the Business Unit that is the Competitor
8. Market Share
9. Competitive Advantages and Disadvantages
10. Trade Publications



MANAGEMENT

1. Organizational Chart
2. Resumes
3. Ownership Interest
4. Compensation and Contracts
5. Performance Evaluation Criteria
6. Profit or Gain Sharing Policies

EMPLOYEE RELATIONS

1. Unions
2. Name of Union
3. Name of Local President, Address and Phone Number
4. Copy of Contract

SUPERANNUATION

1. Funding Status
2. Balance Sheet Treatment
3. Ten Year Projected Cash Expense

RETIREE MEDICAL BENEFITS LIABILITIES

1. Funding Status
2. Balance Sheet Treatment
3. Ten Year Projected Cash Expense

ENVIRONMENTAL LIABILITIES

1. Description
2. Phase One Studies
3. Phase Two Studies
4. Five Year Projected Remediation Cost
5. Five Year Projected Compliance Cost

LAST CORPORATE TRANSACTIONS

1. Description of Each Purchase and Sale Agreement of Each.