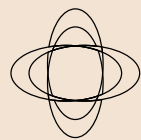




BY MICHAEL HOFER



DUE — — DILIGENCE

A Guide for a Successful Due Diligence

www.bymichaelhofer.com



BY MICHAEL HOFER



ABOUT MICHAEL

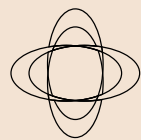
Welcome to my guide for a successful due diligence!

My name is Michael, and I created this guide to help other executives and employees who work on mergers and acquisitions projects. A little bit about myself: I have been a senior executive in international companies for over 20 years. I have a Ph.D., an MBA, a Master in Accounting, received the Elijah Watt Sells Award for my CPA exam, and went to Wharton Business School for my executive education. Based on 30+ M&A transactions, my specialty is in all topics around mergers and acquisitions including performance improvement plans and restructuring. This guide is an introduction, and you can read more about M&A on my website.

Enjoy the guide!

Michael

www.bymichaelhofer.com



Understanding mergers and acquisitions is difficult because of its complexity. Nevertheless, you usually follow **five steps** from the beginning to the end of an M&A process.

Once you have defined that **M&A is one of the strategic tools** for long-term growth, the **development of a target pipeline** is next. After you analyze your targets with an M&A scorecard, you start with **initial discussions**, followed by a term sheet and **Letter of Intent (LOI)**. Next comes a more detailed data analysis in the **due diligence, which is the focus of this guide**. You take this information and develop a **business case and investment thesis/value capture approach**. Afterward, you continue with the **negotiations** and **close the deal** if you still believe that it creates value for your company. The operational **integration** comes after the closing in parallel with any required **post-closing adjustments**.

THE M&A PROCESS

1

Strategy Formulation and Pipeline Development

2

Initial Discussions with Target and Letter of Intent

3

Business Case and Due Diligence

4

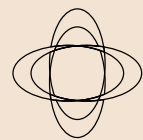
Negotiation and Closing

5

Post-Closing Adjustments and Integration



BY MICHAEL HOFER



INTRODUCTION TO

01 DUE DILIGENCE

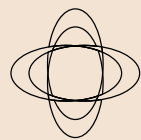
Due diligence is the process of collecting and analyzing information from the M&A target company. In a broader sense, due diligence is any kind of research and analysis of a company for a business transaction. It is a crucial step in the mergers and acquisitions process. Here are **a few general tips** to make the due diligence successful:

1. Build a **due diligence team** with people from different functions
2. Combine internal teams with **external experts**
3. **Question everything** in the reporting and planning assumptions
4. Based on the due diligence findings, **develop a business case and investment thesis/value capture approach**
5. In parallel with the due diligence, **prepare an integration plan**
6. **Organize check-ins** to exchange information between teams
7. **Work closely together** with the M&A project and negotiation leader





BY MICHAEL HOFER



DUE

02

DILIGENCE TEAM

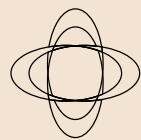
The main goal of a due diligence process is to understand the target company better and get more data on the financial performance. It includes the competitive situation, go-to-market strategy, operational processes and customer service, management of administrative processes, and financial statements. When you go through those topics, you immediately understand why the **due diligence team needs to have a broad background and good business knowledge**. Within a short time, you need to understand why the target has been successful, what doesn't work currently, and where is an opportunity for improvements and synergies.

Choose an experienced project manager to lead the team operationally together with the M&A lead person, who is usually more strategic.

www.bymichaelhofer.com



BY MICHAEL HOFER



03

GET

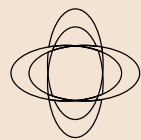
EXTERNAL HELP

Certain elements in due diligence are complex. Examples are the legal, financial, and tax due diligence, including a quality of earnings (QoE) report. I propose you **work with an external law and accounting firm** for those due diligence items. When you have a target with R&D and product development, hiring an external expert for those areas may also be helpful.

I always found that **combining internal teams and external experts results in a better analysis.** Also, consider that the workload for people on the due diligence team is high, and **adding external resources helps you to avoid overloading your employees.**



BY MICHAEL HOFER



DUE DILIGENCE AREAS

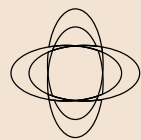
04

Understanding a target company is complex. It includes the **competitive situation, go-to-market strategy, operational processes, customer service, management of administrative processes, and financial statements**. I propose to have for each of those areas a due diligence team that can focus on the details. **In this guide, I include only a few of those topics:** Financial, tax, legal, commercial, and IT due diligence. **Ensure you also cover all other important aspects in your next due diligence.**





BY MICHAEL HOFER



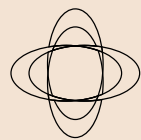
FINANCIAL DUE DILIGENCE

05



The main focus of the financial due diligence is on all facets of the **accounting** approach (i.e., accounting standards and policies), **cash management** (treasury), and the **financial performance** of the target company. The tax due diligence is a separate topic. Focus on the following issues:

1. Use an external accounting firm and **include a quality of earnings (QoE) report** in the scope, which normalizes the reported numbers
2. **Understand first the business model**, then the numbers
3. **Focus on the cash flow, then the income statement and balance sheet**; cash flow/income statement differences should be only due to timing => continuous big differences are a red flag
4. Think about **what is missing** in the numbers (because some companies adjust the reported financials)
5. Don't assume compliance with accounting rules; even big companies sometimes have poor **quality of accounting**



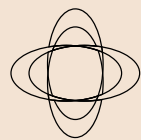
06

TAX DUE DILIGENCE

Besides the legal due diligence, one of the technically more complicated topics is the tax due diligence because **every country (and sometimes region) has different tax rules**. Here are some examples from my M&A transactions that will help you with your next due diligence.



1. Ensure that the target company has **complied with filing requirements**, which is not always the case
2. Identify **potential tax risks** and evaluate the **target's tax strategy** (conservative vs. aggressive approach)
3. Understand the **transfer pricing approach** for intercompany transactions
4. Check whether there is a risk of **permanent establishments** in other countries
5. Analyze the **impact of the M&A transaction on tax positions**
6. Think about **different tax structuring options** for the group after the closing



07

LEGAL DUE DILIGENCE

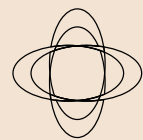
The legal due diligence process is one of the fundamental elements of the overall due diligence process. The reason is that **every aspect of a company has at least some legal touchpoint**. Whether you talk about employees or analyze assets and liabilities on the balance sheet, there is a legal topic that you need to address in the due diligence. Moreover, the **legal due diligence must address issues that may arise during the due diligence from other workgroups** and **use those findings in the preparation of the M&A purchase agreements** later in the process. Here are some tips for your next legal due diligence:

1. Understand the **regulatory environment** in the target's country
2. Start with the analysis of the **legal entity structure**
3. Go through all **balance sheet and income statement items to identify legal topics**
4. **Intellectual property (IP)** is a big topic; work with an external expert on it
5. Analyze **past, ongoing, and potential litigation**
6. Include **Environmental, Social, and Governance (ESG)**; it is a growing topic with a significant impact





BY MICHAEL HOFER

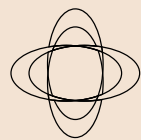


08

COMMERCIAL DUE DILIGENCE

The commercial due diligence is another essential element of the mergers and acquisitions process. It is at the heart of **understanding the competitive market position of the target company and digs into other aspects of marketing and sales**. Here are a few topics:

1. Define the addressable market and understand first the **market and the target's competitive position**
2. Continue with the **business model and go-to-market strategy** before digging into the numbers
3. Get the details of the **client list and revenue development assumptions**
4. Understand the **target's gross margin calculation** because companies have very different approaches
5. **Benchmark marketing and sales costs** for potential synergies



09

IT DUE DILIGENCE



Technology plays a vital role in the success and growth of businesses across industries and around the world. With **increased reliance on technology** comes an inherent risk, which is where IT due diligence steps in, providing a comprehensive assessment of an organization's IT infrastructure, systems, and processes.

IT due diligence systematically evaluates an organization's IT assets and capabilities during M&A. It aims to assess the current state of an organization's IT infrastructure, cybersecurity measures, software and hardware assets, data management practices, IT governance, and compliance protocols. IT due diligence also helps identify potential risks associated with an organization's technology infrastructure, including data breaches, system vulnerabilities, inadequate disaster recovery plans, compliance issues, and outdated or incompatible software. By conducting a thorough assessment, businesses can mitigate these risks and make informed decisions based on a clear understanding of potential challenges.



BY MICHAEL HOFER



CONCLUSION

Due diligence can be a lengthy and complicated process; however, it is one of the most crucial elements in the M&A process, and there is no way around it. **Based on your due diligence findings, you develop your business case and investment thesis/value capture approach.** In parallel with the due diligence, **you also work on the integration plan.** An M&A process is a stage-gate process, meaning you have **multiple go/no-go decisions** throughout the process. The end of the due diligence is certainly one of those points where you need to decide whether you continue the process or not.

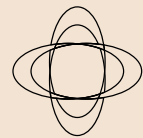
The good news is that you don't have to reinvent the wheel. You probably have at least some employees who worked on M&A projects before, and there are experts that you can hire. **You don't have to do it alone.**

You can do it!





BY MICHAEL HOFER



**Interested in
More M&A Tips and Ideas?**



www.bymichaelhofer.com