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Sell-Side Due Diligence

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The importance of Sell-Side Due Diligence in an Exit Transaction

The keys to success in business include a winning strategy, a keen focus on quality, strong operational skills, efficient processes and a solid financial base. After years of dedication and hard work, the time will ultimately come to optimize the value to the owners and other stakeholders in an exit transaction.

Achieving a successful exit will require a similar philosophy. There are many factors to prepare for a successful deal; however, we have increasingly seen that truly successful exits start with sufficient planning and a well thought-out transaction readiness process to include: defining the exit goals of the company, its owners and employees; implementing operational and process improvements; preparing for the due diligence phase of a transaction; and, quantifying the sustainable earnings of the business.

In this article, we will focus on preparing for due diligence and quantifying the sustainable earnings of the business. This can be achieved through the use of sell-side due diligence.

Defining the exit goals

Getting the business ready for a sale starts with thinking about the end goals. For the owners, these goals may include the owners' post transaction role, the financial outcome needed to satisfy personal objectives, and which type of acquirer is best suited to the seller's desires for the management team and employees.

Understanding the seller's objectives will involve input from a sell-side transaction team which includes owners, management, legal counsel, investment bankers and transaction advisory services professionals. They can provide the important insights into how different buyers and types of transactions would satisfy these objectives, so the sell side team is able to plan and implement the strategies which best address the needs of the future acquirer.

Implementing operational and process improvements

The importance of assembling the right sell-side transaction team will allow the owner and management to continue to focus on the business during the sale process. The last thing anybody wants is declining performance as owners become consumed with selling, rather than running, the business.

Equally, the best sell-side transaction teams will help improve performance, by challenging and enhancing the culture, processes, reporting and operations.

Preparing for the due diligence phase through sell-side due diligence

A seller should utilize all the tools available to prepare the company for sale and optimize value to ownership, management, employees and other stakeholders, and start as soon as possible. In addition to the financial, tax and operational aspects addressed in preparing for a transaction, robust processes will include assessments of the following, amongst others: human resources environment, policies and procedures; employee benefit programs and post-retirement benefit arrangements; structure of the organization and the overall capabilities of, and gaps in, the management team; sales and marketing strategies, plans and resources, and future requirements for growth; information systems capabilities, risks and controls and the internal control environment; real estate arrangements along with capacity and utilization and the ability to expand in current facilities; contracts, IP, corporate matters, employment / contractors arrangements, commitments, leases, licenses.

With a thorough assessment of the business, and proper preparation, the seller can maximize the value of the company. However, it is equally important to address issues that could disrupt the successful operations of the business during the transaction process. If a seller does not anticipate issues, the due diligence phase will invariably find issues that are critically important to sophisticated acquirers and investors. And while activity in middle market deals remains strong, the scrutiny a target is placed under during the due diligence phase has intensified over the past several years. Furthermore, with the level of uncertainty in the economy, a strong assessment of the sustainability of a company's earnings and prospects for growth will continue to increase in importance.

Using sell-side due diligence to quantify the sustainable earnings of the business

To counter this increased scrutiny, another trend has gained momentum over the last five years in the United States. Sell-side due diligence has become accepted by the market as an effective process to analyze the quality of earnings, financial, tax and operational aspects of a company. If important issues to potential buyers are not effectively anticipated by the seller, and are then uncovered in buy-side due diligence, these issues can lead to renegotiations that have the potential to derail the deal. Sell-side due diligence puts these issues on the table upfront and minimizes unwelcome surprises arising in the buyer's due diligence, and thus can dramatically increase the certainty of closing the deal.

The benefits from this process consistently demonstrate a high return on this investment. We have normally seen an increase in management adjusted EBITDA results which translate directly to value. As a result, there should be an active dialogue before the process begins, so a seller can understand, appreciate and value the benefits this process can bring to them – especially relative to the cost.

The seller's success in the process is best delivered with an advisory team to provide the important insights from multiple perspectives which will best address and balance the opportunity ahead. Being prepared for what lies ahead before, during and after a transaction will have a positive impact on shareholder value, and pave the way for a successful integration after the deal which translates to success for the management team, customers, vendors and employees.

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