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CORPORATE ACQUISITIONS AND DUE DILIGENCE

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CORPORATE DUE DILIGENCE AND ACQUISITION FOR PROSPECTIVE BUYERS

Kenneth J. Dalto & Associates have been involved in numerous transactions from both the seller and buyer side, totaling hundreds of millions of dollars over its 20+ years of experience. The following table has been developed to explain to prospective buyers and their advisors the key steps leading to a successful and sensible purchase of a company, and the value that our firm can provide to reach their goal.

1. Strategy and Planning

From the outset, you need to establish the why, what and how of the business acquisition.

Strategic goals: We assist you in establishing clear criteria to focus your search and/or negotiation according to your strategic goals.

2. Searching, Screening, and Approaching Candidates

By pre-screening potential candidates, you avoid wasting your time with companies and seller that are not worth it.

Search: If needed, we assist you in identification of the largest pool of qualified, potential candidates. We use our channels of attorneys, CPAs, investment bankers, business brokers, and other intermediaries, as well as direct targeted mailings.

Screening: We collect and study every available element on the candidates, including the prospectuses and other data, assessing them based on your acquisition criteria.

Approach: We approach the pre-selected targets or their representatives. After a non-disclosure agreement has been issued, we gain access to the offering memorandum and analyze it.

3. **Negotiating**

We help you determine not simply the company's fair market value, but its actual value to YOUR specific firm's situation and goals.

While "Gut feeling" is important, serious third party investigation is crucial.

Meetings: Prior to the meetings, we assist you in defining your script, advising you on what you should say and should not say.

Counter-Valuation: We build an objective, counter-valuation of the candidate using established methods.

Letter of Intent: We assist you in determining the letter's structure and terms, stating information known and understood by you and the seller.

Due Diligence: We perform comprehensive in-depth investigation of the targeted business prior to further negotiation. Following this investigation you will know whether you are buying what you are told you are buying, and you will be able to make important decisions such as adjusting your price offer, requesting warranties and indemnities, and even decide whether to continue the acquisition process.

4. **Acquisition Financing**

Financing: If outside financing is necessary, we help you identify and assess your best financing sources and options, and assist you in the preparation of the financing package.

5. Final Purchase Agreement and Closing

We facilitate your negotiations, providing a buffer for you during potentially tense talks.

Negotiation and Structuring: We assist you in negotiating the terms, including the price, the best deal structure for you, and to assess key elements such as each option's tax consequences.

Final Review: We help you review all the documentation and agreements for the transaction and will assist in resolving any last minute differences. We help you address the variety of events that can make a deal fall apart at the last minute.

6. Transition and Post-Merger Integration

Without appropriate planning of the transition and post-acquisition strategy, even the best deal can yield to organizational, operational, and financial troubles.

Transition: We can assist you and the seller, as needed, to implement a smooth transition. This includes communication with customers, vendors, staff, business processes such as administrative tasks, new payroll and benefits processing, finances, operations, marketing, and numerous practical details.

Strategic Issues: We strongly advise that you develop a proactive plan for this transition phase and for your post-acquisition strategy will in advance. We can assist in planning, implementing and then monitoring this transition and post-acquisition plan effectively.

OVERVIEW OF THE ACQUISITION PROCESS

- 1. Establish Acquisition Objectives and Criteria**
- 2. Identify and Screen Potential Candidates**
Narrow to a short list
- 3. Contact Target's Management**
Phone call, meetings
- 4. Evaluate Acquisition Feasibility**
- 5. Valuation and Offering Price**
- 6. Letter of Intent**
- 7. Due Diligence Analysis**
- 8. Acquisition Financing**
- 9. Purchase Agreement**
- 10. Closing**

REASONS FOR ACQUISITIONS

- 1. Market Growth**
Buy markets, customers
- 2. Geographic Expansion**
- 3. Product Diversification**
- 4. Technological Innovation R & D, Proprietary Technology**
- 5. Vertical Integration**
In house capabilities
- 6. Horizontal Integration**
Acquire supply or distribution channels
- 7. Industry Consolidation Trends**
- 8. Buy up Competition**
- 9. Survival in Nature Industry**
- 10. Specialized Niche**

TYPES OF ACQUISITIONS

1. Stock Acquisition

Buyer acquires stock ownership and assumes business liabilities.

2. Asset Acquisition

Buyer acquires all or part of the assets at the seller.

Buyer accepts only critical liabilities.

Must comply with bulk sales laws and inform all creditors.

3. Merger

Two corporations combine and one corporation survives and the other is dissolved.

4. Consolidation

Both parties to the transaction disappear and a new, third corporation is formed.

IDENTIFYING ACQUISITION CANDIDATES

A. In-House Search

- *Target Geographic Areas*
- *Internet Search Engines – Google, Yahoo, etc.*
- *Business Directories – D&B, Standard & Poor's, Ward's, etc.*
- *Trade Associations and Publications*
- *Yellow Pages (online or print)*
- *Website of Targets*

B. Networking/Referrals

- *Banks*
- *Accountants*
- *Lawyers*
- *Consultants*
- *Municipalities/Development Authorities*
- *Clients*
- *Suppliers*
- *Business Associations, Chambers*

C. Outside Intermediaries – Hired to Find Targets

ACQUISITION CRITERIA

Develop profile of acceptable acquisition target – What to look for

- 1. Meets Operating Objectives – Strategic Fit**
- 2. Provides Acceptable Return**
- 3. Can We Manage It?**
- 4. Can We Afford It?**
- 5. Size of Target**
- 6. Product/Service Mix – Complementary**
- 7. Marketing Feasibility Customer Base, Competition**
- 8. Price Range of Target**
- 9. Sales Volume and/or Market Share**
- 10. Sales Growth**
- 11. Earnings, Profit Margin**
- 12. Operating Strengths, Capabilities**
- 13. Compatibility of Corporate Cultures**
- 14. Management and Personnel Competence, Knowledge**
- 15. Location**

WHAT TO AVOID

- 1. Over Paying**
- 2. Target Too Big to Manage, Handle**
- 3. Incompatibility of Corporate Cultures**
- 4. Failure to Keep Key Personnel of Acquired Company**
- 5. Fraud by Seller**
- 6. Unrealistic Financial Projections**
- 7. Companies in Financial Distress**
- 8. Labor Troubles**
- 9. Other Contingent, Legal or Regulatory Issues**

NEGOTIATION TIPS

- 1. Negotiate only with parties who can make the acquisition decision.**
- 2. Be optimistic and enthusiastic, but cautious**
- 3. Do your homework - - have a backup compromise offer**
- 4. Never lose control of your emotions**
- 5. Be prepared for the next move, keep the process moving**
- 6. Project the favorable consequences of the transaction**
- 7. Use each meeting to sell your position**
- 8. Keep control of meeting dates**
- 9. Remember a win-win has to be fair to both parties**
- 10. Be persistent - - it pays**

LETTER OF INTENT

- 1. Non binding agreement in principle**
- 2. Exclusive agreement, so seller cannot shop it around**
- 3. Issued by the buyer**
- 4. States terms subject to due diligence**
- 5. Describes what is to be acquired**
- 6. Amount and type of payment**
- 7. Arrangement with Target's key employees**
- 8. Fee arrangements with broker's, attorneys and investment bankers, etc**
- 9. Describe source and use of outside acquisition financing**

DUE DILIGENCE

- **Management**
 - *Background, character, experience, depth, leadership, planning skills*
- **Marketing and Product/Service**
 - *Quality, competition, target market, demand, customer base, realistic sales projections*
- **Financial Situation**
 - *Credit rating, capital structure, controls, accuracy of financial documents*
- **Assets**
 - *Capital, equipment, property, proprietary protection, realistic values, title*
- **Liabilities**
 - *Taxes, creditors, liens, contingent liabilities, hidden liabilities, legal liabilities, contracts, leases, agreements*
- **Earnings Capacity**
 - *Strength of operations, history and potential growth, comparison with competition*
- **Operations**
 - *Operations efficiency, service, productivity, quality, measures, suppliers*
- **Facilities**
 - *Location, capacity, utilization, ownership*
- **Employee Relations**
 - *Compliance with labor laws, cost, benefits, pay scale, skills, training*
- **Regulatory Compliance**

ACQUISITION FINANCING (PRIVATE COMPANY)

1. Senior and Secured Bank Debt

- *Real Estate Mortgage*
- *Equipment Term Loan*
- *Line of Credit on Receivables and Inventory*

2. Subordinated Debt

- *Mezzanine or Bridge Loans*
- *Alleviates Senior Debt Risk*
- *Funds above Collateral Amount*
- *May be Required by Secured Lender*

3. Equity

- *Preferred Stock*
- *Common Stock*
- *May be Required by Secured Lender*

4. Convertible Debt

- *Warrants to Convert to Common Stock*

5. Contingent Payments

- *Seller Note to be Paid in Future*
- *Lowers Immediate Cash Needs*

PURCHASE AGREEMENT

- 1. Preamble identifies parties and assets being sold**
- 2. Provision for transfer of assets and the price paid**
- 3. Representations and warranties of seller**
- 4. Representations and warranties of buyer**
- 5. Statement by seller of condition business prior to closing**
- 6. Obligations of buyer at closing**
- 7. Terms and conditions**
- 8. Summary of closing**
- 9. Post-acquisition agreements**
- 10. Indemnification provisions**

VALUATION AND PRICING ACQUISITIONS

- 1. Determine a range of possible values based on today's market conditions**
- 2. Ensure that transaction is not under priced or overpriced**
- 3. Establish reasonable price expectations**
- 4. Strengthen sale negotiations**
- 5. Determine available methods of financing**
- 6. Understand tax ramifications**
- 7. Methods of valuation**
 - a. Market Rate*
 - b. Capitalization of Earnings*
 - c. Discounted Cash Flow – future performance*
 - d. Cost - value*

CLOSING

- 1. Circulation of Purchase Agreement**
- 2. Attach all exhibits and schedules prior to closing**
- 3. U.C.C. search report prior to closing**
- 4. Transfer documents prior to closing**
- 5. Signing of Purchase Agreement**
- 6. Transfer of funds**
- 7. Transfer of title**