Crowe Horwath.

Don’t Sell Your Business in the Dark

Crowe Sell-Side Due Diligence Services for Business Owners

Audit / Tax / Advisory / Risk / Performance

Smart decisions. Lasting value.™

Transaction services professionals from Crowe can help shed light on all the right issues.

Sell-Side Due Diligence

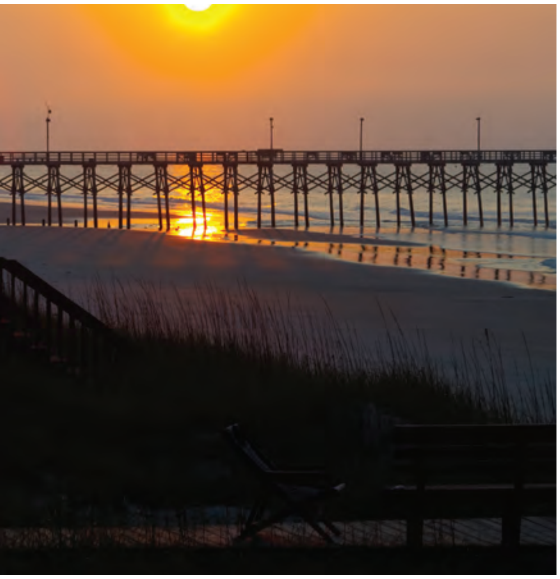
You have made the decision to sell your business. This is a significant decision with a potentially lucrative outcome. Now comes the difficult part.

Sell-side due diligence is an investment in higher valuations for the selling shareholders. A combination of strong deal preparation and the right team of experienced advisers can result in a significantly greater sale price. Sell-side due diligence is a proactive approach to deal preparation at a reasonable cost to the seller and no cost to the buyer. Providing the buyer a comprehensive due diligence report prior to commencing negotiations helps to increase the buyer's confidence level in the results. It also allows for up-front consideration of issues that can be considerably more costly if discovered later in the process.

Selling a business is a difficult and time-consuming process. Many sellers, especially in the middle market, may underestimate the amount of time and effort that goes into finding and selecting a buyer, negotiating agreements, performing various types of due diligence, and ultimately closing the transaction. In addition, sellers often don't fully understand how their company's financial results can affect the transaction or the transaction issues that often result in reductions to the buyer's offer price.

Buyers in today's market are experienced and sophisticated. They are experts at executing transactions and are surrounded by skilled advisers. By contrast, sellers often have limited experience in selling a business. Unless they have experienced advisors to help them prepare and negotiate effectively, they can miss out on significant deal value.

It is important for the seller to be prepared and establish credibility with the buyer up front. Buyers do not like surprises such as accounting issues and/or misstated earnings, and will react adversely if these are first discovered during buy-side due diligence. In addition, buyers tend to see less risk, and thus pay higher prices for companies, when they are more comfortable with the quality of the financial reporting and results. Therefore,t it is critical for a seller to do its own front-end due diligence to be as prepared as possible for an expected transaction.



What Is Financial Due Diligence?

Financial due diligence is a cash flow-oriented approach to financial statement analysis that focuses on critical factors affecting the selling company's historical operating results and cash flows, as well as the ability of the seller to generate sustainable recurring operating cash flows. In plain English, financial due diligence involves performing an analysis of a selling company, with the goal of analyzing the recurring earnings (that is, its "run rate"), working capital, and quality of assets, based on current operating circumstances.

Virtually all acquisitions involve some level of financial due diligence that is performed by the buyer. The cost of this work is typically passed on to the seller through the purchase agreement. The amount of work to be performed and the timetable for completion is typically negotiated between the two parties.

What Is Sell-Side, or "Vendor," Due Diligence?

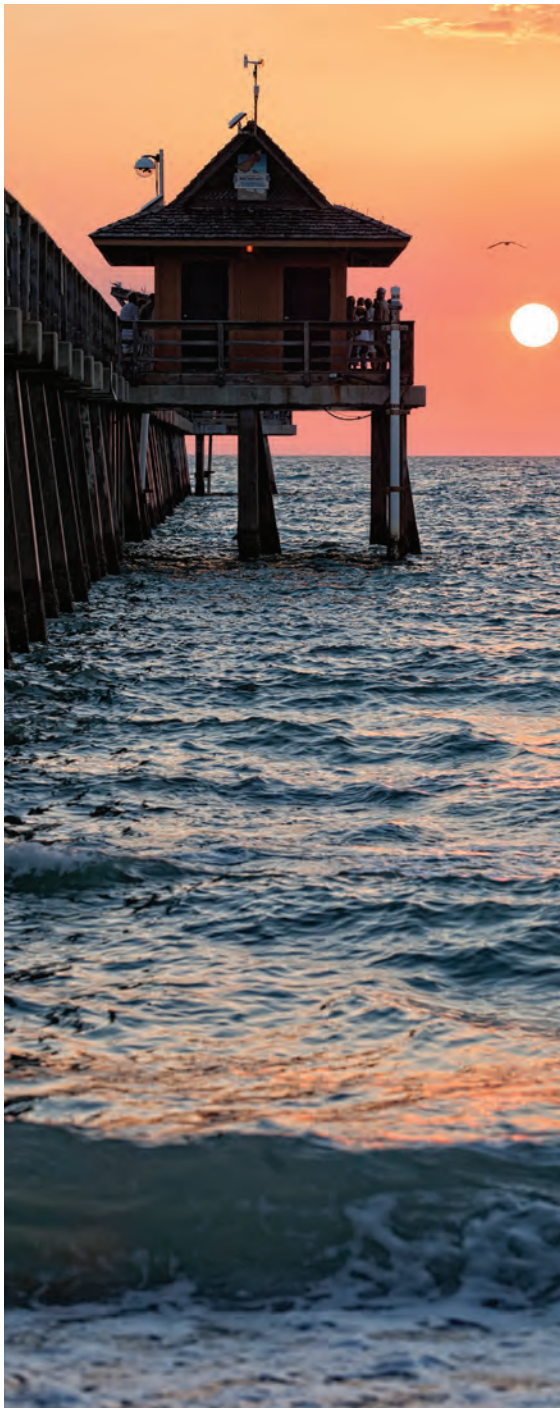
Sell-side, or "vendor," due diligence is an engagement where the seller engages a firm such as Crowe Horwath LLP to perform financial due diligence on its historical financial statements. The procedures, scope of analysis, and time frame are determined by the seller, with the firm's advice, before starting work. The procedures are frequently comparable to those that a buyer would perform in its financial due diligence. By engaging the financial due diligence, the seller has more control over the time frame and has the opportunity to address specific concerns it may have about its financial reporting.

Sell-side diligence prepares sellers and maximizes value

Why You Need Sell-Side Financial Due Diligence

Crowe has assisted buyers and sellers of middle-market companies on hundreds of due diligence engagements. We have encountered many examples where sell-side financial due diligence can help to maximize valuation.

1. Buyers tend to seek greater valuation revisions for accounting issues and earnings adjustments noted during buy-side due diligence as opposed to those that are identified and understood by both parties prior to the transaction via sell-side due diligence.
2. You expect that many potential buyers are interested in your company, and intend to allow several parties the opportunity to bid on your business. A sell-side due diligence report will provide you with leverage to limit each buyer's due diligence to a few days of targeted procedures, saving you and your employees significant time during the process. Prospective buyers will have more information with which to analyze the business in a short time frame. This will give buyer(s) a greater comfort level in their analysis, hopefully resulting in a higher purchase price. We are also available to assist in answering questions and can provide copies of certain analyses to prospective buyers, which reduces disruption to day-to-day operations.
3. Your company may not have audited financial statements, which could be a concern to potential buyers and their lenders. Most buyers and lenders will accept a sell-side due diligence report in lieu of audited financial statements. In addition, a sell-side due diligence engagement can typically be performed much faster than audits of prior-period financial statements at comparable or even lower cost.
4. Your company may have a relatively small accounting staff that lacks the resources to respond to an aggressive buy-side due diligence engagement, let alone multiple engagements. Sell-side due diligence can be performed on a timetable that you control. This will allow you to complete the process and stay current with your day-to-day work requirements. In addition, we are available subsequent to the engagement to assist with data room preparation and inquiries and analyses requested by potential buyers, which saves you and your staff valuable time.
5. Your company may be selling a subsidiary or joint venture that is immaterial to your company as a whole. Therefore, you may not have engaged a financial statement audit or rigorous financial reporting during the analysis period. Sell-side due diligence provides a detailed financial analysis of the entity and can help management to identify deal issues that might not be known. In addition, we can work with management to identify "stand-alone" costs that should be considered if the transaction is a carve-out from a larger entity.



What Is Included in Sell-Side Financial Due Diligence?

Typically, sell-side financial due diligence includes the following analyses:

- **Quality of earnings**. Crowe analyzes the company's pro forma EBITDA, which is considered a proxy for cash flows by transaction professionals. Most transactions are priced either directly or indirectly based on adjusted EBITDA. Buyers typically look to adjust purchase price if the company's EBITDA is less than what was originally proposed in the transaction. Typical adjustments to EBITDA include nonrecurring income and expenses and out-of-period items, such as reserves from one period that are reversed in the following period.
- **Working capital analysis**. Most deals include a working capital "hurdle," whereby the purchase price is adjusted up or down from the expected amount identified in the purchase agreement, depending on the amount of working capital delivered at closing. We analyze monthly or quarterly working capital for a defined period of time, adjusted for certain exclusions and adjustments.
- **Quality of assets**. We analyze the company's balance sheet with a focus on working capital assets and liabilities and an emphasis on reserves. Typically, a high percentage of pro forma adjustments to EBITDA result from changing or releasing calculated reserves.
- **Income statement analysis**. We analyze sales and gross margin by customer and product line as applicable. We also analyze fixed versus variable costs for costs of goods sold and for selling, general, and administrative expenses over a predetermined number of periods.
- **Business issues**. We attempt to identify the business issues which, if detected later in the transaction, may cause a buyer to adjust its price or withdraw the bid. Generally, buyers are more willing to work through such issues if they are aware of them before executing a letter of intent.
- **Commitments and contingencies**. We help identify and summarize financial commitments, contingencies and off balance sheet liabilities, such as purchase commitments, leases, litigation, change-in-control agreements, and guarantees, which may be of interest to a potential buyer. In addition, we address how such items could affect current or future EBITDA and cash flow.
- **Accounting issues**. We help identify departures from generally accepted accounting principles, which may require adjustments to EBITDA. Again, it is better to identify such issues before the buyer commences due diligence.

Why You Need Sell-Side Tax Due Diligence

Tax due diligence is often overlooked in sell-side projects; however, tax diligence can maximize transaction valuation, mitigate tax exposure, and speed the buy-side diligence process. Some examples include:

- Sellers often miss out on the upside of net operating losses, carryforwards, and business credits. While these do not affect EBITDA, they can increase the valuation of the business.
- Sell-side tax diligence may identify previously unknown tax issues and allow for early mitigation.
- A sell-side tax diligence report can provide you the opportunity to speed the buyer's tax diligence investigation and likely avoid buyer-identified tax deal issues.
- Your company may access previously unclaimed tax benefits or limit exposure based on refining tax elections and filing previously unfiled returns.

Is Sell-Side Human Resources Diligence Necessary?

Employees are often viewed as company's most valuable assets. Crowe has assisted numerous buyers and sellers to understand the potential impact of employee-related matters that both effect EBITDA and operations. Such considerations include:

- Historical costs and liabilities related to:
  - headcount
  - regulatory compliance and employee litigation
  - salaried, incentive, and deferred and equity-based compensation plans
  - health and welfare plans
  - qualified retirement plans

- Projected costs and liabilities related to:
  - employment agreements, change of control provisions, retention agreements, and severance polices
  - planned health and welfare and compensation plan changes
  - expected hiring, voluntary turnover and reductions-in-force
  - leadership team capabilities and succession plans
  - organizational culture factors which may help or hinder achievement of transaction and integration goals

Benefits of Sell-Side Information Technology Diligence

Crowe's information technology diligence provides findings and recommendations that

- Create organization and a strategy roadmap that greatly increases the perception of IT strength
- Highlight proprietary or state of the art technology that provides a competitive advantage
- Reveal security gaps that should be addressed prior to sale
- Provide quick hit improvements that can increase value with a low level of investment
- Develops strong documentation to serve as inputs to data rooms

Why Crowe Sell-Side Due Diligence Services?

We have assisted private equity and strategic buyers on hundreds of acquisitions of middle-market companies. Our experience as buy-side advisers gives us unique insight and perspective into the issues and concerns of potential buyers. We can use this insight throughout the due diligence process to help you prepare for the transaction. We use an experienced team of dedicated transaction services professionals who are middle-market experts. Our project teams include on-site leadership from our executives and senior managers.

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About Us

Crowe Horwath LLP is one of the largest public accounting, consulting, and technology firms in the United States. Our dedicated professionals create value for our clients by connecting deep industry and specialized knowledge with innovative technology, while maintaining a commitment to independence, integrity, and objectivity. By listening to our clients, we learn about their businesses and the unique challenges they face. We forge each relationship with the intention of delivering exceptional client service while upholding our core values and strong professional standards. We invest in tomorrow because we know smart decisions build lasting value for our clients, people, and profession.

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