Mergers & Acquisitions: Due Diligence & Your Advisory Team

Arthur F. Rothberg, Managing Director, CFO Edge, LLC

In our last article, we looked at the potential benefits of growing your company through a merger with or acquisition of another business. A merger or acquisition may enable you to achieve rapid growth very quickly when compared with organic growth, which usually occurs more slowly and steadily over time.

In this article, we will take a closer look at the merger and acquisition process itself—in particular, how CEOs and CFOs should conduct due diligence in searching for merger and acquisition candidates, and how to assemble a strong advisory team of M&A experts.

The Importance of Thorough Due Diligence
The ongoing uncertainty in today's business and economic environment makes merger and acquisition due diligence more important now than ever. In your M&A due diligence efforts, pay especially close attention to these areas:

Earnings and cash flow — More than buildings, equipment or even employees, this is what you are really buying when you acquire another business: a future stream of earnings and revenue. Therefore, it is critical that you scrutinize a company's financials and business plan to make sure that future income and cash flow projections are as accurate as possible. If they aren't, realizing your anticipated return on investment from the acquisition will be difficult, if not impossible.

Existing customer contracts — These tie directly into future earnings and revenue, so review all customer contracts with a fine-tooth comb. How far into the future do they extend? How legally binding are they? It's a good idea to have your attorney review contracts as well.

The management team — After cash flow and contracts, this may be the next most important thing you're acquiring. How experienced and loyal is the existing management team? Are they committed to sticking around and helping you through the transition? You may need to offer them financial incentives (including, perhaps, an equity stake in the business) to keep them on board.

Customer concentrations — Businesses where a large percentage of sales and profits are concentrated among just a few customers are more risky than those where sales and profits are more spread out among a larger number of customers. If a large customer leaves after the acquisition, the anticipated benefits of the merger could also disappear.

Accounts receivable — Look carefully at the accounts receivable aging reports to gauge the true status of outstanding A/R. Discount the value of any that are more than 90 days past due, since the chances of actually collecting them (either partially or in full) are relatively low.

Capital equipment — In capital-intensive industries, it's important to physically inspect all machinery and equipment to make sure it is in good working condition, as well as current and modern from a technology perspective. If you have to repair, replace or update vital equipment after the acquisition, this will impact your anticipated ROI.

Your M&A Advisory Team
It's also critical to assemble a top-notch team of M&A advisors who are experts in all the various disciplines of mergers and acquisitions. An M&A advisory team typically includes the following professionals:

Investment banker — This person is typically the leader of the M&A team, performing a variety of different tasks: helping locate acquisition candidates, performing due diligence, weighing in on business valuation, and negotiating and drafting the letter of intent, to name a few.

Business broker — The business broker helps connect business buyers and sellers. The investment banker may serve in this role, which would eliminate the need for a separate broker.

CPA or accountant — There are myriad financial and accounting intricacies involved in a merger or acquisition, which makes the CPA or accountant an integral member of the M&A advisory team.

Attorney — Similarly, there are also many legal nuances involved in an M&A transaction. You'll want to look for an attorney who specializes in mergers and acquisitions, ideally within your specific industry.

An outsourced CFO services provider can also play a vital role on your M&A advisory team. He or she can provide expert financial assistance and in-depth analysis of any potential deals, as well as help perform detailed financial due diligence. Perhaps most importantly, an outsourced CFO services provider can offer perspective and input from someone outside your firm, thus helping you view the transaction from a more objective perspective.

Concluding Thoughts
Los Angeles and Southern California CEOs and CFOs may be wondering whether a merger or acquisition is the right growth strategy in today's environment. Every situation is unique, so there's no single answer that's right for every company. An outsourced CFO services provider can help you weigh your options and devise the best growth strategy for you and your business.

About CFO Edge
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