

Due Diligence Manual

Comprehensive Checklist for Business Evaluation

Partner for Equity Playbook
Comprehensive Business Acquisition Strategies

This Due Diligence Manual provides a comprehensive framework for evaluating businesses for potential partnership or acquisition. Use these checklists to systematically assess transfer of value issues, operational risks, and growth opportunities before committing to any deal. The manual is organized into key categories that align with the transfer of value issues identified in Play #6. Each section contains specific items to investigate, verify, and analyze.

I. Financial Due Diligence (80+ Items)

Revenue Analysis

- Review 3-5 years of financial statements (P&L, Balance Sheet, Cash Flow)
- Verify revenue sources and categorize by product/service line
- Analyze revenue trends (growth rate, seasonality, cyclicalities)
- Identify largest revenue streams and their stability
- Calculate revenue concentration by customer
- Verify recurring vs. one-time revenue
- Review contracts for future committed revenue
- Analyze pricing strategy and gross margin by product/service
- Compare against industry benchmarks
- Verify revenue recognition policies

Profitability Analysis

- Calculate EBITDA for past 3-5 years
- Identify owner compensation and discretionary expenses
- Calculate adjusted/normalized EBITDA
- Analyze gross margin trends
- Review operating expense ratios
- Identify cost of goods sold components
- Verify inventory accounting methods
- Calculate break-even point
- Analyze profit margins by product/service
- Compare profitability to industry standards

Cash Flow Analysis

- Review historical cash flow statements
- Calculate free cash flow
- Identify working capital requirements
- Analyze accounts receivable aging
- Review accounts payable terms
- Calculate cash conversion cycle
- Identify seasonal cash needs
- Review credit lines and utilization
- Verify cash reserves adequacy
- Identify capital expenditure requirements

Tax Compliance

- Review 3-5 years of business tax returns
- Verify sales tax compliance and filings
- Review payroll tax records and compliance
- Identify any tax liens or outstanding obligations
- Review property tax assessments
- Verify tax treatment of major transactions
- Identify potential tax exposures
- Review any tax audits or disputes
- Verify estimated tax payments
- Assess impact of personal expenses run through business

Debt & Liabilities

- List all outstanding loans and credit facilities
- Review loan agreements and covenants
- Identify any personal guarantees
- Verify payment status on all debts
- Calculate debt-to-equity ratio
- Review lease obligations
- Identify contingent liabilities
- Review vendor credit terms and payment history
- Assess debt service coverage ratio
- Identify any off-balance-sheet liabilities

Financial Systems

- Assess accounting system adequacy
- Review chart of accounts structure
- Verify internal controls
- Evaluate financial reporting frequency and quality
- Assess budgeting and forecasting processes
- Review audit trail capabilities
- Verify bank reconciliation processes
- Evaluate accounts receivable management
- Assess inventory management systems
- Review fixed asset tracking

II. Customer Due Diligence (60+ Items)

Customer Concentration

- List top 10 customers by revenue
- Calculate percentage of revenue from each major customer
- Identify customers representing >10% of revenue
- Review customer contracts and terms
- Assess customer relationship strength
- Identify at-risk customer relationships
- Verify customer tenure/retention rates
- Analyze customer acquisition costs
- Calculate customer lifetime value
- Assess customer payment history

Customer Base Analysis

- Total number of active customers
- Customer growth rate over past 3 years
- Customer churn rate
- Average customer size
- Customer geographic distribution
- Customer industry diversification
- New customer acquisition rate
- Repeat purchase rate
- Customer referral sources
- Customer satisfaction metrics

Customer Contracts

- Review all customer contracts >\$10K annually
- Identify contract terms and renewal dates
- Assess change-of-control provisions
- Review cancellation clauses
- Verify pricing structures
- Identify auto-renewal terms
- Review service level agreements
- Assess liability and indemnification clauses
- Verify intellectual property ownership
- Identify any exclusivity arrangements

Customer Relationships

- Identify key customer contacts
- Assess owner's role in customer relationships
- Evaluate account management structure
- Review customer communication frequency
- Assess customer dependency on owner
- Identify transferable relationships vs. personal relationships
- Review customer complaint handling
- Evaluate customer onboarding process
- Assess cross-selling effectiveness
- Review customer feedback mechanisms

Marketing & Sales

- Document all customer acquisition channels
- Assess marketing effectiveness by channel
- Review marketing budget and ROI
- Evaluate brand strength and positioning
- Assess website traffic and conversion
- Review social media presence
- Evaluate content marketing efforts
- Assess email marketing effectiveness
- Review advertising spend and results
- Identify referral program effectiveness

III. Operations Due Diligence (70+ Items)

Owner Dependency

- Document owner's daily responsibilities
- Assess time owner spends in business
- Identify functions only owner can perform
- Evaluate owner's role in sales
- Assess owner's role in operations
- Review owner's customer relationships
- Identify owner's vendor relationships
- Assess employee dependency on owner
- Evaluate decision-making structure
- Identify knowledge residing only with owner

Management Team

- Organization chart with names and roles
- Review key employee resumes
- Assess management team depth
- Identify succession planning
- Review employee compensation structure
- Evaluate employee retention rates
- Assess key person dependencies
- Review employment contracts
- Identify non-compete agreements
- Assess team capability vs. growth needs

Employees

- Total employee headcount (FT, PT, contractors)
- Employee growth trend over 3 years
- Turnover rate by department
- Average tenure by role
- Compensation benchmarks vs. market
- Benefits package details
- Review employee handbook
- Assess training and development programs
- Review HR policies and procedures
- Identify any labor issues or complaints

Systems & Processes

- Document all standard operating procedures
- Assess process documentation quality
- Review quality control procedures
- Evaluate production/service delivery processes
- Assess technology systems and software
- Review IT infrastructure
- Evaluate data backup and security
- Assess customer relationship management system
- Review project management tools
- Identify process bottlenecks

Facilities & Equipment

- List all locations and square footage
- Review lease agreements and terms
- Assess facility condition and maintenance
- Identify capital improvement needs
- Review all equipment and assets
- Assess equipment condition and age
- Identify equipment maintenance schedules
- Evaluate equipment capacity vs. demand
- Review insurance coverage on assets
- Identify any environmental issues

Vendors & Suppliers

- List top 10 vendors by spend
- Assess supplier concentration risk
- Review vendor contracts and terms
- Evaluate vendor payment terms
- Assess supplier relationship strength
- Identify alternative suppliers
- Review vendor performance and quality
- Assess supply chain reliability
- Evaluate inventory management
- Review vendor credit standing

IV. Legal & Compliance (50+ Items)

Corporate Structure

- Verify business entity type (LLC, S-Corp, C-Corp)
- Review articles of incorporation/organization
- Verify state of incorporation and good standing
- Review operating agreement or bylaws
- Identify all shareholders/members and ownership %
- Review shareholder agreements
- Verify registered agent information
- Review minutes of board meetings
- Assess corporate governance practices
- Identify any pending corporate changes

Licenses & Permits

- List all required business licenses
- Verify license status and expiration dates
- Review professional licenses required
- Assess industry-specific certifications
- Review zoning compliance
- Verify building permits and certificates
- Assess environmental permits
- Review health department approvals
- Verify insurance licenses if applicable
- Identify any license violations or issues

Contracts & Agreements

- Review all customer contracts
- Review vendor and supplier agreements
- Assess lease agreements
- Review loan and financing documents
- Evaluate partnership agreements
- Review franchise agreements if applicable
- Assess licensing agreements
- Review service agreements
- Identify distribution agreements
- Verify independent contractor agreements

Intellectual Property

- Identify all trademarks and status
- Review patents and patent applications
- Verify copyright ownership
- Assess trade secrets and protections
- Review domain name ownership
- Verify software licenses
- Assess proprietary technology
- Review IP assignment agreements
- Identify any IP disputes
- Verify non-disclosure agreements

Litigation & Disputes

- Identify any pending lawsuits
- Review past litigation (5 years)
- Assess customer disputes
- Review vendor/supplier disputes
- Identify employee claims or complaints
- Review insurance claims history
- Assess regulatory investigations
- Verify compliance violations
- Review settlement agreements
- Identify potential legal exposures

V. Industry & Market (40+ Items)

Industry Analysis

- Define primary industry and SIC/NAICS codes
- Assess industry growth trends
- Evaluate industry life cycle stage
- Identify industry disruptions or threats
- Review regulatory environment
- Assess barriers to entry
- Evaluate profit margin trends
- Identify consolidation trends
- Review industry best practices
- Assess technological changes impacting industry

Competitive Position

- Identify top 5-10 competitors
- Assess market share
- Evaluate competitive advantages
- Review pricing vs. competition
- Assess quality vs. competition
- Evaluate service levels vs. competition
- Identify unique value propositions
- Review customer reviews and feedback
- Assess brand strength
- Identify competitive threats

Market Opportunity

- Define target market size
- Assess addressable market
- Evaluate market growth rate
- Identify market trends
- Assess customer needs evolution
- Evaluate geographic expansion opportunities
- Identify product/service expansion opportunities
- Assess acquisition opportunities
- Review strategic partnership potential
- Evaluate exit market conditions

SWOT Analysis

- List all key strengths
- Identify all weaknesses
- Document opportunities
- Assess threats
- Prioritize strategic initiatives
- Evaluate resource allocation
- Assess competitive responses needed
- Identify quick wins
- Review long-term strategic positioning
- Evaluate alignment with acquisition goals

VI. Transfer of Value Assessment (50+ Items)

Customer Concentration Risk

- Calculate revenue from top customer
- Calculate revenue from top 3 customers
- Calculate revenue from top 10 customers
- Assess customer contract terms and stability
- Evaluate customer switching costs
- Identify customer retention strategies
- Assess impact of losing largest customer
- Review customer diversification plan
- Evaluate new customer pipeline
- Assess customer acquisition effectiveness

Owner Dependency Assessment

- Quantify owner's time in business (hours/week)
- Document owner's critical functions
- Assess owner's role in revenue generation
- Evaluate owner's technical expertise requirements
- Identify owner-specific customer relationships
- Assess owner's role in operations
- Evaluate owner's decision-making authority
- Identify knowledge transfer requirements
- Assess succession planning status
- Evaluate impact of owner departure

Financial Quality

- Assess financial record quality (1-10 scale)
- Verify bookkeeping systems
- Review reconciliation processes
- Assess financial reporting timeliness
- Evaluate accounting policies appropriateness
- Identify personal expenses in business
- Assess inventory accounting accuracy
- Review revenue recognition consistency
- Verify cost allocation methods
- Evaluate financial controls

Sales Process Transferability

- Document complete sales process
- Assess owner's role in sales
- Evaluate sales team capability
- Review sales training and materials
- Assess CRM system effectiveness
- Identify sales process documentation
- Evaluate lead generation systems
- Review sales conversion metrics
- Assess sales cycle length
- Identify sales process improvements needed

Systems & Process Documentation

- Assess SOP documentation completeness
- Evaluate process standardization
- Review training materials quality
- Assess operational manuals
- Verify quality control procedures
- Review job descriptions and responsibilities
- Evaluate technology documentation
- Assess disaster recovery plans
- Review business continuity planning
- Identify documentation gaps

Due Diligence Summary

This comprehensive due diligence checklist contains over 400 specific items organized into six major categories. Use this manual systematically to:

- Identify transfer of value issues early in the process
- Uncover potential deal killers before significant time investment
- Quantify risks and opportunities objectively
- Support partnership or acquisition decision-making
- Create a foundation for value creation strategies

Remember: The goal isn't to find perfect businesses, but to identify businesses with fixable problems that create partnership opportunities. Transfer of value issues that prevent traditional acquisitions are exactly what make consulting for equity arrangements so valuable.

As you complete your due diligence, maintain detailed notes and documentation. This information will be critical for:

1. Structuring the partnership terms
2. Defining performance milestones
3. Creating your 90-day action plan
4. Setting realistic expectations with the business owner
5. Protecting your interests in legal agreements

Use this manual as a living document, adding industry-specific items and refining your process with each partnership evaluation.