

# Strategic Buyers and Financial Buyers: Do You Know the Difference?

By James A. Russell

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The stage of acquisition known as due diligence is the deep-dive part of the process: a scrupulous reality check that takes place between the buyer's submission of a letter of intent (LOI) to acquire and the formal closing of the deal. In due diligence, the buyer reconfirms that all the details of the transaction are in fact what they appear to be. It's basically about avoiding the kinds of surprises that trigger buyer's remorse after ownership changes hands, when it may be too late to do anything about them.

The LOI usually will specify that the buyer has 30 to 90 days to complete due diligence, during which time the financing and the preparation of legal documents also will be finalized. In our experience, a 30- to 60-day window is wisest to shoot for, as it encourages the buyer to bring potential negatives to light as quickly as possible.

Think of due diligence as a cross-examination of evidence previously presented. The goal is not necessarily to add new information to the picture, but to vet and verify what the buyer already has learned about the company he or she intends to purchase. This means asking pointed questions that the seller, hopefully, will be candid in answering. The due diligence checklist that we recommend to our acquisition-minded clients would include, among other things, the following key points:

**Understand company culture.** Sadly, many a deal has failed because the seller's values and behaviors didn't align with the buyer's. Without this kind of harmony, no acquisition can succeed in the long run. Admittedly, "culture" can be a tough thing to gauge, but getting personally acquainted with the seller and key management personnel during negotiations will provide clues. So will finding out whether the company boosts morale by congratulating employees on their birthdays, hosting picnics and holiday parties, or conducting other team-building activities. These things can be every bit as vital to the health of a business as its sales.

**Confirm quality of earnings, with support for major assumptions being made.** A buyer will want to ensure that recent revenue and expenses are accurate, and have not been impacted by some unusual, one-time event: for example, loan forgiveness under the Paycheck Protection Program (PPP). Another area to investigate is validating add-backs: confirming that expenses a seller has represented as discretionary and will not be incurred after closing are in fact not key to business success. Depending on the buyer and the size of the transaction, a third-party firm is frequently engaged to perform the Quality of Earnings report.

**Beware client concentration and sales vulnerability.** A "20/80" imbalance in the client list, with a small number of accounts producing an excessively large share of total sales, is an obvious red flag. Losing any of these accounts post-sale would be a severe financial blow. To assess that risk, the buyer should visit the seller's top customers as part of due diligence – but only at the very end of the process, perhaps a day or two before the anticipated date of closing. This is the surest way to get a sense of their immediate moods and the strength of the relationships that the buyer is about to inherit.

**Identify tenure and concentration issues among the sales team.** Along the same lines, the buyer will want to find out whether the seller has placed too much business in the hands of too few salespeople – especially long-serving sales reps who might decide to leave and bring their accounts with them once the new owner takes over. Due diligence is an opportunity for both parties to review who has what and, if necessary, redistribute the accounts more efficiently.

**Compare business pricing models: low-cost provider vs. high-margin producer.** A high value-added printer enjoying better-than-average margins gains no advantage by acquiring commodity work sold at prices that will be difficult to raise to market rate. Scrutinize the seller's customer list for low-ball accounts, and plan accordingly.

**Determine the management team's long-term intentions.** How can the buyer be sure of retaining key personnel whose presence will be essential to making the transition of ownership a success? This is something to nail down with the help of the seller, who may, for example, offer the key players bonuses for staying on for a set period of time. In most cases, senior managers with long records of service probably won't be thinking of leaving – but taking steps to cement their loyalty is still a good idea.

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**Working capital needs: does the working capital target provide enough capital to operate the business going forward?** In its simplest form for a business transaction, working capital equals current assets (accounts receivable, inventory, prepaid expenses) minus current liabilities (accounts payable, accrued liabilities). A transaction based on a multiple of EBITDA includes a fixed amount of working capital as part of the value of the company being acquired. This is the money that the buyer will use to run the business for the first couple of months after closing. If it's not enough to cover day-to-day requirements, the buyer will have to put in his or her own cash to bridge the gap.

**CapEx requirements: will the acquired company need a significant CapEx investment in the near term, after the deal is finalized?** If the seller's equipment is being purchased as part of the deal, the buyer ideally will want that equipment to have a substantial amount of productive life left in it. But, if a press is at the end of its tether, its capacity will have to be replaced – at the buyer's expense, post-sale. This usually means reducing the purchase price by the amount of capital expenditure needed. Expert equipment appraisal during due diligence will clarify the buyer's likely CapEx obligation.

**Customer perceptions: how is the company being purchased viewed in the marketplace?** Alignment with the buyer's image and goals is crucial. Combining two companies with clashing reputations can never produce a whole greater than the sum of the parts, and customers will be the first to spot the mismatch. They know the difference between low-end shops and industry leaders. No aspect of the deal should be allowed to compromise the favorable marketplace perception that the buyer has worked hard to build and maintain.

**Confirm that the property has no environmental issues.** If building and grounds are being acquired as part of the deal, they must be fully compliant with all environmental regulations. Look at records of past inspections, noting any violations, fines, and corrective actions related to them. Find out also whether there are situations on the premises, such as buried fuel tanks, that may need remediation in the future. Consultation with an environmental specialist may be needed here.

These recommendations don't cover every angle of due diligence, but they highlight the care that buyers must take at every step of the way toward the home stretch of the acquisition. Strict attention to detail is the best prescription for sleeping peacefully – and confidently – on the night before closing.

New Direction Partners is an investment banking and financial advisory services formed by Peter Schaefer, Paul Reilly, Jim Russell and Tom Williams to serve the printing and related industries. Services include merger advisory services through the representation of selling shareholders as well as buy side representation, valuation services, financing and refinancing efforts, turnaround and restructuring services, and temporary/interim management consulting. To learn more about New Direction Partners, visit New Direction Partners' website at [www.newdirectionpartners.com](http://www.newdirectionpartners.com).