



# Manufacturing MINUTE

## Before You Buy

Buy-side due diligence brings confidence, and consists primarily of financial due diligence, tax due diligence and an operational assessment.

### Financial Due Diligence

Financial due diligence is a blend of exploratory, analytic and financial skills. It establishes the critical facts for negotiations with a buyer, as well as laying groundwork for the future. "Good financial due diligence should help executives develop strategies for leveraging the acquisition during integration," says Guthrie, "such as identifying key players who need to be on board and untapped growth opportunities." Financial due diligence will focus on factors such as:

- Adherence to GAAP
- Sales and earnings analysis (profitability by customer, product, service, region, etc.)
- Analysis of working capital components
- Understanding liabilities on and off the balance sheet
- Purchase price adjustments
- Abnormalities that may skew reported earnings
- Financial issues that may impact current and future earnings

- Contingent liabilities affecting financial outcomes (positively or negatively)

### Tax Due Diligence

The financial value delivered by an acquisition often hinges on how well the target entity has managed its tax accounting, as well as how the two taxable parties entering the M&A process emerge as a single tax entity post deal. All deals present various tax exposures and implications, and require expert guidance in structuring alternatives to address these issues. But to deliver optimum tax outcomes, due diligence is required to thoroughly understand the seller's tax position.

Tax due diligence will review all manner of tax documents of the seller, including tax returns (federal, state, local and international), documents that drive tax figures (e.g., sales reports, payroll reports), and documentation with tax implications (e.g., liens, past or pending audits). "Through a tax review, we identify the seller's adherence to tax codes for the applicable years and jurisdictions," says John Marquardt, Tax partner and member of BDO's Manufacturing & Distribution practice. "In doing this we also search for overly aggressive tax positions, such as undervalued inventories, as well as tax liabilities that could be inherited by the buyer."

In addition to financial and tax due diligence, it may be necessary to research more deeply into a company and its leading executives. Investigative due diligence will search for unethical or corrupt business practices,

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improper relationships with vendors and/or customers, and unusual corporate or personal behaviors.

### Operations-Integration Assessment

An operations-integration assessment is a sort of “compatibility test” for the seller and buyer. “Some issues that could prevent a merger may have emerged when building the list of candidates, but with more access within the seller’s company, operational details stand out,” says Sosoff. “You get to really see how an organization operates and the efficacy of systems and processes that support it on a day-to-day basis — and, with that, you revise the estimates of the cost and effort it will take to join the two entities.”

In reviewing business processes and systems, buyers should look for compatible approaches to operations and process improvement. This doesn’t necessarily mean that both organizations follow the same methodology (e.g., lean manufacturing), but that both have foundations in place (leadership commitment, workforce involvement, culture) that will allow them to operate as one. This may or may not be the buyer’s approach, particularly if a deal is completed to access process-improvement expertise.

Similarly, information technologies (IT) should be compatible in the near term — or, if not, can be cost effectively replaced or upgraded. The security of a seller’s IT systems and processes must also be assessed to prevent post-integration gaps in data protection.

The operations-integration assessment will identify other costs and challenges in combining the two organizations as well, including:

- Management and staff costs for those working on the integration
- Advisory costs for conducting due diligence, evaluating operations, coordinating IT systems and drafting legal documents
- Costs and challenges in addressing physical redundancies (office or facility closures) and management redundancies (duplicate roles and responsibilities)

Manufacturing Minute is provided by GBQ’s Manufacturing Team for our clients and other interested persons upon request. Since technical information is presented in generalized fashion, no final conclusion on these topics should be made without further review.

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