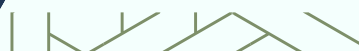




Due Diligence Checklist By HotelMergers



A URAHL Venture



Due Diligence Checklist

This is a preliminary list of information and documentation that may be required during the due diligence process. Since each investigation will vary in terms of specific requirements, the following can serve as a general guide for preparation.

What is Due Diligence?

Due diligence is a crucial process used by companies and private equity firms to assess a potential merger or acquisition. Buyers conduct due diligence on the target company to verify the accuracy of the seller's claims, minimize risk, and gain a thorough understanding of the operations before finalizing the deal. Although the process can be time-consuming and detailed, it helps prevent costly surprises down the line and enhances the likelihood of a successful M&A outcome.

What Should I Include in a Due Diligence Checklist?

General information

The initial due diligence process involves reviewing general records and the business plan to assess the corporate structure and standing of the company. This step lays the foundation for a more detailed and focused investigation. Key documents to examine include:

- Articles of Incorporation
- Corporate Bylaws and any amendments
- Minute Book (including ownership details and board meeting minutes)
- Certificate of Good Standing
- List of subsidiaries and any other entities with which the company holds equity interests (e.g., partnerships, joint ventures)
- Jurisdictions where the company is authorized to operate
- Documents related to reincorporation or restructuring
- Business Plan (including executive summary, market analysis, operational plan, and complete financials)

Organization and ownership information

The organizational and ownership due diligence phase focuses on the company's personnel structure and ownership details, which are crucial when considering acquisition or merger. Key aspects to examine include:

- List of officers and directors
- Organization chart
- Records of stock, options, and warrants issuances or grants
- Shareholder List
 - Number of shares, dates of issuance, and type of consideration received
- Documentation of past and current shareholder agreements, rights, and ownership matters
 - Copies of voting agreements, trusts, or proxies
 - Copies of right of first offer/refusal and preemptive rights
 - Transfer restriction agreements and registration agreements

Administrative

Administrative due diligence verifies key administrative details about a company, such as its business facilities, occupancy rates, and workstations. Key elements to review include:

- List of all business locations
 - Properties owned or leased by the company
 - Locations where the company maintains employees or conducts business
 - Relevant details such as occupancy rates and number of workstations

Regulation and compliance

This stage of due diligence evaluates regulatory and compliance matters related to the target company or the overall transaction. It is especially critical in heavily regulated industries or when dealing with large entities. Particular attention should be given to potential antitrust risks associated with the deal. Key documents to review include:

- Copy of the company's compliance policy and written standards of conduct
- Copies of any governmental licenses, permits, or consents
- Correspondence, citations, notices, or documents related to regulatory agency proceedings
- Documents filed with the SEC or any state or foreign securities regulatory agency (if applicable)
- Material reports submitted to government entities and agencies (including the EPA and OSHA)
- Analysis of potential antitrust issues (if applicable)

Accounting/Financial

The accounting and financial due diligence phase verifies the seller's financial performance by reviewing accounting and financial records. The goal is to uncover any unreported liabilities, assess the target's current financial position, and determine whether earnings are sustainable. This helps establish a realistic valuation of the target and justify the purchase price. Key documents to examine include:

- Documentation related to the company's capitalization
- Audited financial statements for the past three years, including auditor reports
- Unaudited financial statements for comparison
- Most recent interim financial information
- Financial projections for the future
- Strategic plan descriptions
- Budget plan
- Auditor communications with management from the past five years
- Schedule of accounts receivable and accounts payable
- Details on depreciation and amortization methods, as well as any changes in accounting methods over the past five years
- Copy of the company's general ledger
- Copies of debt financing documents (e.g., loan agreements, credit agreements, promissory notes, compliance certificates)
- Copies of equity financing documents (e.g., stock purchase agreements, subscription agreements)
- List of internal control procedures
- Schedule of deferred revenue

Operational

Operational due diligence assesses the target company's systems and processes to identify risks associated with the execution of its business functions. Buyers evaluate the effectiveness of the target's operating model, including sales, marketing, technology, supply chain, and production, to identify any gaps and areas requiring investment or development. The goal is to determine if the current operations can support the business plan presented by the target company. Key areas to review include:

- Overview of the company's operating model, highlighting key systems and processes (both insourced and outsourced)
- Description of the change management process for modifying the operating model
- Copies of documented procedures
- Overview of the organizational and functional structure of teams
- List of primary and support activities within the company
- Summary of tests, evaluations, studies, surveys, and other data related to existing and under-development products or services
- Identification of key performance indicators, value drivers, and cost drivers
- Information on sales and marketing procedures, including research, messaging, CRM systems and processes, and lead generation practices
- List of all third parties involved in the supply chain
- Breakdown of products manufactured, personnel employed, shifts, and capacity by manufacturing site
- Documentation related to supply chain processes (e.g., delivery times, inventory availability, transportation modes/costs, facility costs, inventory investment, contract manufacturers)
- List of main suppliers, including discounts, terms, and credit limits
- Details of the distribution model and channels

Tax

Tax due diligence focuses on examining the target's tax profile, including tax returns and the company's tax structure. This area is crucial, as the acquiring company will inherit any tax liabilities. Key documents to review include:

- Federal, state, local, and foreign income tax returns for the past three years
- State sales tax returns for the past three years
- Excise tax filings for the past three years
- Employment tax filings for the past three years
- Documentation of the company's tax structure and key tax elections
- Any audit adjustments proposed by the IRS
- Documentation of tax liens or settlements
- Copies of audit and revenue agency reports

Legal

Legal due diligence examines the legal matters affecting a company, including risks associated with contracts and litigation. It plays a critical role in determining whether a deal proceeds and its structure, as issues such as restrictive contracts, noncompete clauses, and pending litigation can significantly impact the transaction. The buyer will assume liability for any obligations, contingencies, and restrictions after the deal is completed. Key documents to review include:

- Pending or threatened litigation involving the company
- Settled or concluded litigation involving the company
- All active litigation files
- Consent decrees, injunctions, judgments, settlements, or other legal orders
- Copies of all contracts
- Loan agreements, bank financing agreements, and lines of credit involving the company
- Licensing or franchise agreements
- Copies of all guarantees involving the company
- Information about any past or ongoing governmental investigations
- Copies of all attorneys' responses to audit inquiries and attorneys' letters to auditors

Technological

The technological due diligence process evaluates the company's IT assets to assess their sustainability, value, cost, scalability, and potential for evolution. It also examines how the company's systems would integrate with the buyer's operations or portfolio. As cybercrime continues to rise, it is critical to assess vulnerabilities in the IT infrastructure. Key aspects to review include:

- List of software used by the company and copies of relevant licensing agreements
- IT outsourcing agreements
- Current system usage and age
- List of interfaces linking systems together
- Documentation of IT processes, including application development, IT operations, disaster recovery, IT security, and cost management
- Information about the company's security and controls framework
- Details of any cybersecurity incidents, such as hacks or breaches

Physical assets

Asset due diligence focuses on verifying the tangible assets owned by the target company, including confirming the existence, value, age, quality, and ownership of real estate, fixed assets, and inventory. Key documents to review include:

- List of all owned or leased properties with relevant details (e.g., rent amount, location, dates)
- Information on major capital equipment sales and purchases over the last three years
- Copies of all equipment lease agreements
- Copies of real estate deeds, appraisals, mortgages, leases, surveys, title policies, use permits, and any other relevant documentation
- Schedule of owned and leased fixed assets, including description, acquisition date, value, and location
- Copies of any equipment appraisals
- Copy of inventory listing, including item description, item number, date, units, and cost for the most recent year-end and month-end
- Description of inventory practices related to aging, valuation, obsolescence, and any changes in methodology
- Any UCC filings

Intellectual property (IP)

Intellectual property (IP) due diligence is especially important in technology-driven industries, as a target company's IP portfolio significantly influences its value and relevance to the acquiring company. The objective is to assess the importance of the IP portfolio and ensure there are no ownership issues. Key areas to examine include:

- Schedule and copies of all intellectual property registrations and pending applications, including:
 - Patents and patent applications
 - Trademark registrations, applications, and trade names
 - Registered and significant unregistered copyrights
- Copies of chain of title records
- Documentation of any claims or potential claims related to IP, either by or against the company
- Copies of IP-related agreements (e.g., licensing, collaboration, research and development)
- List of the company's active websites and social media accounts
- Documentation of proprietary and/or customized software and IT systems used by the company
- General descriptions of proprietary know-how, trade secrets, technologies, and processes
- Documents outlining the company's approach to IP protection and enforcement (e.g., confidentiality and non-disclosure agreements, employment agreements related to IP)
- List of all licensing revenue and expenses

Human resources

Human resources (HR) due diligence evaluates the people aspect of the M&A transaction, focusing on employee information such as numbers, demographics, compensation, benefits, policies, contracts, and organizational structure. The insights gained will help the acquiring company identify key employees and plan for integration if the transaction proceeds. Key areas to review include:

- Employee demographic data (age, location, title, tenure, skillset, compensation, etc.)
- Employee handbook covering policies, benefits, procedures, and training
- Files related to employee relations matters, including any past or current disputes or complaints
- Employee, non-disclosure, non-solicitation, and non-compete agreements
- Copies of all stock option and stock purchase plans
- Resumes of key employees
- Documentation of qualified and nonqualified retirement plans
- Assessment of employee competencies, skillsets, and capabilities
- Performance review schedules and structure
- Recruiting and onboarding processes
- Copies of payroll documents
- Copies of any labor or employment contracts

Commercial

Commercial due diligence assesses the target's position within its market ecosystem, focusing on factors like market conditions, trends, competitors, consumer behavior, and opportunities/threats. The aim is to understand the target's market standing and identify key differentiators. Key areas to review include:

- List of products and services offered, as well as those in development
- Market research covering market size, share, trends, drivers, demand, conditions, opportunities, threats, differentiators, and outlook

- Profiles of major competitors
- List of top customers
- Customer analysis, including segments, demographics, churn rate, satisfaction, customer acquisition cost, NPS score, and lifetime value
- List of major suppliers
- Identification of any barriers to entry in the marketplace
- Summary of all complaints or warranty claims
- Copies of long-term sales contracts
- Agreements with distributors, value-added resellers, and dealers

Environmental

Environmental, health, and safety due diligence identifies potential issues that could impact the value and reputation of the target business, as well as the acquiring company. This process focuses on environmental and workplace safety risks that may arise. Key areas to review include:

- Interviews with past and present owners, operators, and occupants
- Copies of any violations, complaints, or information requests regarding environmental, workplace safety, and health issues (from private parties or government authorities)
- Historical records, such as aerial photographs, fire insurance maps, chain of title documents, and land use records
- Federal, state, local, and tribal government records
- Records related to neighboring or adjoining properties
- Permits and records concerning environmental matters, including underground storage tanks, air quality, water use, solid/liquid wastes, and hazardous waste management
- Records of environmental cleanup liens
- Listing of hazardous substances (e.g., asbestos, pesticides, petroleum products) and any spills/releases (intentional or accidental)
- Details about workplace safety and health programs, including any reports of unsafe working conditions and corrective actions taken

Cultural

Cultural due diligence focuses on understanding the cultural dynamics of a potential acquisition, including values, perceptions, traditions, and working styles. It is more subjective in nature and aims to assess how well the cultures of both organizations align. Key activities include:

- Documents outlining the company's values, mission, vision, and shared beliefs
- Interviews with external stakeholders
- Interviews and focus groups with internal stakeholders
- On-site visit for observation
- Employee surveys and questionnaires to gauge cultural context and sentiment toward the potential merger or acquisition

Strategic

Strategic due diligence takes an analytical view of all other due diligence results to determine whether the transaction in question will be of benefit to the buyer. It seeks to assess a target's fit within the buyer's larger organization and whether it will maintain its value through and post-integration.

- List of value drivers for the acquisition (i.e. including the addition of technologies/products, key personnel acquisition, market access, revenue enhancement, cost savings, operational and financial synergies, etc.)
- Identification of marginal costs that may be generated by the acquisitions
- Assessment of strategic fit within the larger buyer organization

