



PURCHASING A BUSINESS? DO YOUR DUE DILIGENCE!

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I've heard that the best time to invest is when there is "blood in the streets", which basically means when prices are at or near catastrophically depressed values. Well, right now, we're experiencing a U.S. economic recession, among other problems. We all know that one important tenet of investing is "buy low, sell high". Now may be a good time to buy a business if the valuation is attractive.

But, be careful not to be seduced by low valuations alone. First, embark upon a due diligence investigation to target and possibly invest in or simply buyout smaller undervalued private businesses, if you have or can get the assets to do so. The following is an instructive list of questions and considerations upon the commencement of a thorough due diligence investigation:

Beware of Start-Ups. Companies with no revenues and less than one or two years of performance are the riskiest because there is no evidence of performance at all. The management team, if any, might be relatively untested. And, the products and/or services will not yet have been tested in the marketplace. Although it may be a start-up, be thorough; read the business plan.

Cash is King. Cash-flow is one of the most important attributes of a company. It's great news if the company has consistently high monthly operating revenues that consistently outpace monthly expenditures. Look for trends and negative performance. Does the company need cash?

Products and Services. Which products and services are selling and selling the best? Does the company have a strategic economic advantage? Any niches or specializations? Any intellectual property? Is the intellectual property registered? Analyze the competition and the industry.

Customers. Which are the best customers? Who are the target customers? Does the company rely solely upon a few very large customers for most of its revenues?

Management Team. Are they talented and experienced? Do they work well together? Did they participate in writing the business plan? Is their compensation too high? Is there high turnover? Any employment contracts?

Tax Matters. Review the tax returns and discover whether there are issues paying taxes or filing returns. Does the company have any tax exposure in sales tax, income tax or employment tax?

Financial Statements. Do the financial statements need to be adjusted to account for non-recurring items? Do the financial statements match the information reported on the tax returns for the same periods?

Litigation. Is the company involved in litigation? Has litigation been threatened? What are the expected costs of litigation, even if there is likelihood of success?

Contracts. Are the contracts in signed writings or on handshakes? Are the terms favorable or do they need to be re-negotiated? Are there loopholes or issues with terms, execution or enforcement?

Employees. How many employees are actually productive? Are there contracts with employees or unions? Need more (or less) employees?

Debt. Does the company have a lot of debt? Any defaults in the past or imminent? Are any terms of the loans unfavorable? Are there minimum working capital requirements or other restrictions under the loan?

Macroeconomics. How does the company fare during a recession? Is the company a seasonal or cyclical business?

Of course, the above list is not meant to be exhaustive and every business is different and requires an independent thorough examination. But, the above list is certainly among the basic areas of a sound and prudent due diligence investigation. The above list, if employed completely and intuitively, will help protect you and, if necessary, prevent you from getting into a bad deal, which is more important than getting into no deal at all, despite how attractive valuations may appear. Also, remember that prices could be bargains simply because the company is very weak and possibly about to go out of business. Rather, look for companies that are thriving or at least on the cusp of thriving.

As an attorney, certified public accountant and master of laws in taxation, I've conducted due diligence for well over one hundred mergers and acquisitions for buyers and sellers. Call my office so that I may assist you with your prospective deal. ■