

# The Mergers & Acquisitions Playbook: Due Diligence

**By Wright Lewis**

*Wright Lewis is a Partner at Dunlap Bennett & Ludwig and leads the M&A practice group. Wright has advised purchasers and sellers in M&A transactions ranging from small bolt-on transactions for a few hundred thousand dollars to private equity and public company deals in the mid-eight figures.*





The timing and structure of mergers and acquisitions (M&A) transactions vary, but the importance of due diligence does not. In my experience advising entrepreneurs and founders in M&A transactions ranging from simple asset purchases to complex equity deals in the mid-eight figures, I have found that due diligence always plays a critical role in the transaction. Preliminary due diligence occurs pre-LOI, but the majority of the due diligence process takes place between execution of the letter of intent (LOI) and closing. At the risk of oversimplification, at its core, the due diligence process aims to confirm or disprove every assertion the seller parties make to the purchaser.

Due diligence is a transaction's stress test. This comprehensive audit drills into financial statements, legal liabilities, contractual obligations, and human capital. While this list is far from exhaustive, it serves as a primer for the topics most frequently covered by the due diligence process. It ensures pitch decks turn into payouts by exposing obstacles that sink value and confirms whether the transaction truly advances the parties' business objectives.

While many transactions are alike, no two deals are identical. This guide serves as a playbook, not a rulebook, providing a high level, introductory review of the due diligence process.

# The Due Diligence Process: A Step-by-Step Walkthrough

Due diligence refers to the back-and-forth flow of information between buyer and seller between LOI execution and closing. However, setting yourself up for a successful due diligence process starts well before then.

## 1. Assembling the Team

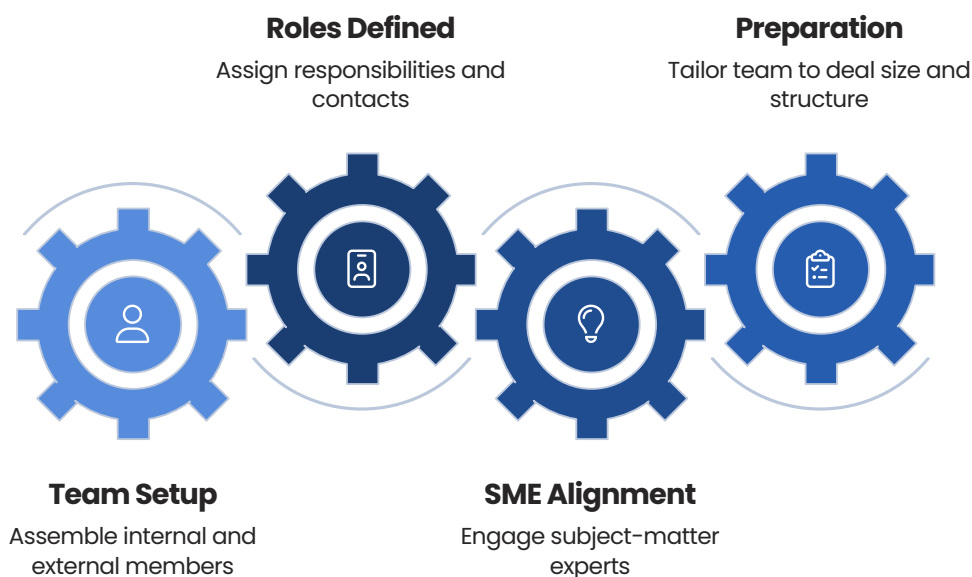
Due diligence begins with assembling the right team members. These team members typically include:

- Internal personnel (executive leadership – CEO, CFO, COO, General Counsel)
- External advisors (investment bankers and specialized consultants)
- Subject-matter experts (accountants, lawyers, and industry specialists)

The composition of your team may vary based on factors such as deal size, structure, and side of the transaction, so identifying the right and relevant team members is critical.

### Key Aspects of Team Assembly:

- **Team Setup:** Assemble internal and external members
- **Roles Defined:** Assign responsibilities and points of contact
- **SME Alignment:** Engage subject-matter experts as needed
- **Preparation:** Tailor team to deal size and structure



## **2. The Due Diligence Request List**

Once you have assembled your team, you will work together to create a comprehensive due diligence request list to send to the other party. This document should outline all information and documentation required from the target company, organized by functional area (financial, legal, operational, etc.).

A well-crafted request list balances precision with practicality, requesting enough information to identify risks without overwhelming the seller parties with excessive or irrelevant documentation

## **3. The Virtual Data Room (VDR)**

Modern due diligence relies heavily on Virtual Data Rooms (VDRs), secure online databases where confidential documents are stored in the cloud for exchange and review. For sell-side due diligence, this means:

- Selecting an appropriate VDR provider.
- Organizing documents according to the request list categories.
- Redacting sensitive information.
- Setting appropriate access controls and permissions.

For buy-side participants, this means learning to navigate the VDR efficiently and tracking document completeness.

## **4. Document Review**

The core of due diligence is the systematic review of all documents provided. Each team examines materials relevant to their area of expertise:

- The financial team reviews tax documents, financial statements, and projections.
- The legal team examines all contracts, litigation risks, and compliance records.
- The operational team assesses facilities, equipment, and supply chain documentation.

Throughout this process, questions will inevitably arise. You should work with your counterparty to establish a formal Q&A process that tracks all inquiries to ensure every question receives a timely response.

## 5. Management Interviews

Conversations with the target company's management team and subject matter experts support document review.

Key interview subjects typically include:

- Executive leadership
- Department heads for critical functions
- Technical specialists for specific areas of concern

These discussions provide context for the documented information and help assess the quality of the management team.

## 6. Reporting and Risk Assessment

As the investigation progresses, findings are compiled into comprehensive reports. These typically include:

- Summary of key findings
- Identified risks and liabilities
- Valuation implications
- Recommended deal adjustments
- Integration considerations

These reports inform the negotiation of definitive terms and support the final decision-making process. In some cases, they lead to termination of the deal. But in either case, accurate and timely review is key.



### **Key Outcomes of Due Diligence Reports**

- Deal Recommendations
- Key Findings
- Risks & Liabilities
- Next Steps





# The Core Areas of M&A Due Diligence

## Financial Due Diligence

This involves digging deep into the target's financial health by analyzing historical and projected performance, verifying financial statements, assessing the quality of earnings, and reviewing the balance sheet. Key focus areas include:

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- Revenue recognition and sustainability
- EBITDA adjustments and normalization
- Working capital requirements
- Debt and liability structure
- Tax positions and potential exposure

Financial due diligence provides the foundation for valuation confirmation and identifies adjustments that may impact the final purchase price.

## Legal Due Diligence

Legal counsel reviews all contracts, litigation history, corporate records, intellectual property ownership, and regulatory compliance to uncover potential legal liabilities. Critical elements include:

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- Corporate governance and ownership structure
- Material contracts and commitments
- Pending or threatened litigation
- Regulatory compliance history
- Intellectual property rights and protections

Legal due diligence is crucial in identifying issues requiring special provisions in the purchase agreement or newly discovered dealbreakers.

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### **Commercial Due Diligence**

Commercial due diligence evaluates the target's market position, competitive landscape, and business model sustainability. This includes:

- Market size and growth trends
- Competitive positioning and advantages
- Customer relationships and concentration
- Sales pipeline and forecast reliability
- Pricing strategies and margin sustainability

This analysis validates the strategic rationale for the transaction and tests growth assumptions.

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### **Operational Due Diligence**

This area examines the target's operational capabilities, efficiency, and scalability. Key components include:

- Manufacturing or service delivery processes
- Supply chain resilience and vendor relationships
- Quality control systems
- Operational KPIs and benchmarking
- Cost structure and optimization opportunities

Operational due diligence identifies synergy opportunities and integration challenges.

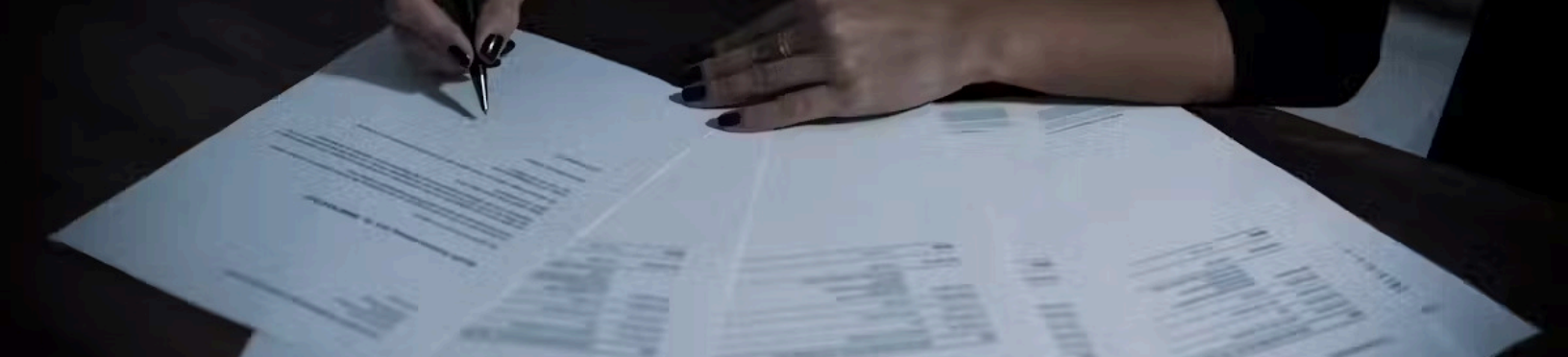
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### **HR Due Diligence**

People are often a key asset in an M&A transaction. HR due diligence examines:

- Organizational structure and reporting lines
- Key employee retention risks
- Compensation and benefits programs
- Employment contracts and policies
- Culture assessment
- Labor relations and compliance

This analysis helps plan for talent retention and cultural integration.



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## Tax Due Diligence

Tax due diligence identifies historical tax compliance issues and future tax optimization opportunities:

- Tax filing history and compliance
- Tax positions and strategies
- Transfer pricing policies
- International tax structures
- Tax credits and incentives
- Potential tax exposures

Findings may impact deal structure and post-closing tax planning.

## Conclusion

Rushing through due diligence or relying on in-house resources to save costs might sound tempting. But the financial impact of overlooked liabilities, unenforceable rights, and regulatory exposure frequently dwarfs the initial “savings” from inadequate legal counsel. A transaction without proper attorney-led due diligence might become your most costly business blunder.

As an M&A lawyer, I’ve witnessed the stark difference between professionally guided transactions involving experienced legal counsel and those where legal corners were cut. I’ve seen deals stall and fail for numerous reasons, including parties being unrepresented or underrepresented (by inexperienced legal counsel), sellers who are unprepared to provide timely and quality responses to due diligence requests, revelations of tax and regulatory compliance issues, misstated financials, quality of earnings issues, and contract issues. In just the last few months, we’ve had transactions under LOI fall apart because the seller lost a major customer (and thus a major portion of their revenue) and because of cultural misalignment. It’s always disappointing when a deal falls apart as a result of due diligence, but it’s better to spend the money to find out where the skeletons are hidden before closing, when you can either (a) address them with special indemnities, escrows, or revised deal terms, or (b) withdraw from the transaction, rather than after the deal has closed.



Don't gamble on your or your company's future by taking shortcuts. Invest in experience and expertise. Contact Dunlap Bennett & Ludwig today to ensure your next transaction is built on a foundation of thorough legal due diligence that protects your investment and maximizes your return.

## Contact us today to schedule your low-cost consultation and turn your innovative vision into a commercial reality.



To learn more about Dunlap Bennett & Ludwig and how we can help you, call today at **888-306-4030** or email us at [clientservices@dbllawyers.com](mailto:clientservices@dbllawyers.com).

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### Disclaimer

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