

Part 18 of 32

## Due Diligence from the Target's Side: What PE Buyers Actually Examine

What PE buyers examine most intensively, data room preparation from the seller's perspective, quality of earnings from the seller's side, the management presentation, and managing diligence while running the business

## WHAT YOU WILL LEARN AND WHY IT MATTERS

---

A sale process — whether a PE acquisition, a strategic sale, or an IPO — is the financial governance event that most directly tests the quality of the CFO's work over the prior several years. Every accounting decision, every financial statement, every cap table entry, every revenue recognition judgment becomes evidence in the buyer's due diligence review. The CFO whose financial governance has been rigorous, consistent, and well-documented will find the due diligence process efficient, manageable, and confidence-building for both parties. The CFO whose financial governance has accumulated compromises, deferred decisions, and undocumented judgments will find the due diligence process grueling, damaging, and often value-destructive.

Understanding what PE buyers examine most intensively — and preparing accordingly in the months before a sale process begins — is one of the highest-return investments available to a CFO of a company that is likely to be acquired by a PE fund. This part covers the financial due diligence process from the seller's perspective: what to expect, how to prepare, how to manage the process efficiently, and how to present the company's financial story in a way that builds buyer confidence rather than raising buyer concerns.

## WHAT PE BUYERS EXAMINE MOST INTENSIVELY

---

PE financial due diligence is more intensive, more systematic, and more focused on financial risk identification than the due diligence conducted by most strategic acquirers. PE funds typically engage specialized due diligence firms — quality of earnings providers, accounting consultants, and tax advisors — in addition to the M&A; team's own financial analysts, creating a multi-front analytical assault on the target's financial information.

**QUALITY OF EARNINGS:** As introduced in Part Fourteen from the buy-side perspective, the quality of earnings analysis is the centerpiece of PE financial due diligence. The QoE provider — typically one of the large accounting advisory firms — will attempt to independently verify every adjustment management has made to the reported EBITDA and to identify any additional adjustments that management has not made. The QoE provider's adjusted EBITDA — which becomes the "agreed EBITDA" for the acquisition multiple calculation — is almost always lower than the management's adjusted EBITDA, because the QoE provider applies more conservative adjustment criteria than the management team.

From the seller's side, the most important preparation for the QoE process is the pre-sale QoE review — a self-assessment of the company's adjusted EBITDA that identifies every potential adjustment before the buyer's QoE provider does. The CFO who has conducted a thorough pre-sale QoE review knows exactly what adjustments the QoE provider will propose, can prepare supporting documentation for each adjustment the company intends to defend, and can identify in advance the adjustments that the buyer's QoE provider will likely disallow. This preparation converts the QoE negotiation from a discovery exercise (in which the buyer's QoE provider is identifying issues the seller has not previously analyzed) to a well-prepared negotiation (in which the seller has a documented position on each adjustment).

**REVENUE QUALITY:** PE buyers scrutinize revenue quality intensively, because the revenue run-rate at closing becomes the baseline from which the post-acquisition growth is measured. The revenue quality analysis examines: the concentration of revenue by customer (what percentage comes from the top five or ten customers, and how contractually secure is that revenue?), the recurring versus non-recurring composition (what percentage of revenue is contracted, subscription-based, or otherwise recurring, and what percentage is episodic or project-based?), the revenue recognition appropriateness (has the company been recognizing revenue in accordance with GAAP, or are there aggressive recognition practices that will be corrected post-closing?), and the revenue trajectory (is the revenue growing, flat, or declining in the months immediately before the sale process, and why?).

**WORKING CAPITAL AND CASH CONVERSION:** The PE buyer's working capital analysis establishes the normalized working capital — the level of working capital required for the business to operate normally — which becomes the target for the working capital adjustment mechanism in the purchase agreement. The analysis examines the historical working capital components month by month for at least twelve to twenty-four months to identify seasonal patterns, unusual items, and the appropriate normalization for the working capital target.

## **DATA ROOM PREPARATION: THE SELLER'S PERSPECTIVE**

---

A well-prepared data room is the single most important determinant of the efficiency and quality of the due diligence process. From the seller's perspective, the data room has three goals: to provide the buyer with the information required to complete due diligence and make an informed acquisition decision, to present the company's financial history and performance in the most favorable accurate light, and to minimize the number of follow-up information requests that consume management time during the diligence period.

**THE PRE-SALE DATA ROOM AUDIT:** The most effective data room preparation begins six to nine months before the anticipated sale process launch with a pre-sale data room audit: the CFO reviews every document that will be included in the financial section of the data room against the standard that a sophisticated PE buyer will apply. The audit identifies documents that are missing, documents that contain errors or inconsistencies that need to be corrected, and accounting issues that need to be resolved before the due diligence process begins.

**THE FINANCIAL SECTION ARCHITECTURE:** The financial section of the data room should be organized around six categories. Historical audited financials: three years of audited financial statements with auditor reports, including all notes to the financial statements and any restatements or corrections. Management accounts: monthly financial statements for the current and prior fiscal year with detail sufficient to support the QoE analysis. The management adjusted EBITDA bridge: a clearly formatted bridge from reported EBITDA to management adjusted EBITDA with documentation supporting each adjustment. The financial model: the company's forward-looking financial projections with the underlying assumptions clearly documented. The revenue detail: a customer-level revenue analysis showing the revenue by customer for at least three years, the contract terms for significant customers, and the customer retention history. Working capital analysis: the monthly working capital components for twenty-four months with the

company's proposed normalization methodology.

**THE QUALITY OF DATA:** The quality of the data room reflects directly on the CFO's professional credibility. Data rooms that contain inconsistent financial figures across different documents (the revenue figure in the management accounts does not agree to the revenue figure in the audited financial statements for the same period), documents that are mislabeled or incomplete, or working papers that show calculation errors create an immediate impression of financial management weakness that cannot be fully recovered in the subsequent due diligence interactions.

## **THE MANAGEMENT PRESENTATION**

---

The management presentation — the formal presentation of the company's business, financial performance, and strategic plan to the PE buyer's investment team — is the most important single event in the sale process from the CFO's perspective. It is the event at which the buyer makes their most important assessment of the management team's analytical capability, and the CFO's contribution to the financial sections of the management presentation is a primary driver of that assessment.

**THE FINANCIAL SECTIONS OF THE MANAGEMENT PRESENTATION:** The CFO is typically responsible for four sections of the management presentation. The financial performance overview: three to five years of historical financial performance with trend analysis, highlighting the metrics most relevant to the investment thesis (EBITDA growth, gross margin expansion, customer retention, and revenue quality). The adjusted EBITDA bridge: the management's adjusted EBITDA for each historical period, with the adjustments clearly explained and documented. The financial projections: the company's forward-looking financial plan for the next three to five years, with the underlying assumptions clearly articulated and the connection between the strategic initiatives and the financial projections explicit. The balance sheet and capital structure: the current balance sheet, the existing debt structure, and the anticipated purchase price allocation that the PE buyer will implement at closing.

**PREPARING FOR FINANCIAL QUESTIONS:** The due diligence session that follows the management presentation will include an intensive financial Q&A; in which the buyer's team probes the assumptions behind the financial projections, challenges the adjustments in the management EBITDA bridge, and tests the CFO's knowledge of every significant financial item in the data room. The CFO must be prepared to answer questions about every line item in the financial statements, every adjustment in the EBITDA bridge, and every assumption in the financial projections — and must be able to do so with precision and confidence, without deflecting to the investment banker or the financial advisor for information that the CFO should know firsthand.

## MANAGING DILIGENCE WHILE RUNNING THE BUSINESS

---

The due diligence process for a significant PE acquisition typically takes eight to twelve weeks and consumes an enormous amount of management time — particularly the CFO's time, which is the most demanded of any member of the finance team. The CFO must design a due diligence management process that provides the buyer with the information they need while protecting the management team from a diligence burden that prevents them from running the business effectively.

**THE DUE DILIGENCE COORDINATOR:** The most effective approach to diligence management is the designation of a dedicated due diligence coordinator — typically a senior member of the FP&A; team or a hired diligence advisor — who owns the due diligence tracker, manages the information request queue, and provides the first-line response to information requests that do not require the CFO's personal involvement. This coordinator function protects the CFO's time for the highest-value interactions — the management presentation, the financial Q&A; sessions, and the negotiations over the purchase agreement financial terms — while ensuring that the information flow to the buyer is efficient and uninterrupted.

**THE INFORMATION REQUEST PROTOCOL:** The CFO should establish an information request protocol that specifies the turnaround time for different categories of information requests (standard requests within forty-eight hours, complex analysis within five business days, legally sensitive information requiring review within twenty-four hours after legal counsel approval), the approval process for providing sensitive information (all information posted to the data room should be reviewed by the CFO or the designated coordinator before posting), and the documentation discipline (every document posted to the data room should be logged in the due diligence tracker with the date, the requester, and the CFO's review status).

## ACTIONS TO TAKE BEFORE PART NINETEEN

---

Conduct the pre-sale QoE self-assessment: build the management adjusted EBITDA bridge from reported GAAP EBITDA to management adjusted EBITDA for each of the last three years, with the specific adjustment categories and supporting documentation assembled for each. For each adjustment, assess the likelihood that a PE buyer's QoE provider would accept the adjustment, partially accept it, or disallow it — and quantify the potential EBITDA impact if the adjustment is disallowed. This pre-sale QoE creates the financial preparation required to defend the management adjusted EBITDA in the due diligence negotiation.

Begin the data room assembly now, even if a sale process is not imminent. The financial section of the data room — three years of audited financial statements, monthly management accounts, the financial model, the customer revenue analysis, and the working capital history — should be assembled and reviewed for accuracy before the sale process is launched. Having the data room substantially complete at the time of process launch reduces the due diligence timeline and the management distraction, and creates a positive impression of financial management readiness that benefits the company in the buyer's overall assessment.



## CLOSING PERSPECTIVE

---

*The due diligence process is the final exam on the quality of the CFO's financial governance over the years preceding the sale. The CFO who has maintained rigorous, GAAP-compliant, well-documented financial governance will find the exam manageable and confidence-building; the CFO who has deferred difficult accounting decisions, allowed inconsistencies to accumulate, and avoided the hard governance conversations will find the exam revealing in ways that are damaging to the sale process and to the CFO's personal credibility. The preparation described in this part converts the due diligence from a reactive test to a proactive demonstration of financial management excellence.*

## COMING NEXT IN THE SERIES

---

### **Part 19 — The 100-Day Plan: Financial Priorities in the First Quarter of PE Ownership**

Part Nineteen covers the financial management agenda for the first hundred days under PE ownership — the immediate financial governance upgrades required, the debt facility onboarding, the baseline financial model for the holding period, the value creation initiative prioritization, and the relationship building with the PE sponsor's operating partners.