

Preparing for Due Diligence

This document is designed to provide an outline of information and tips to entrepreneurs about how to maximize their potential for success during the due diligence process.

1. An estimate of the timeline for a typical Keiretsu Forum DD process
2. Possible legal and other DD expenses that the company will have to incur as part of preparing investor documents and closing a financing
3. The DD processes.
4. The value and importance of proactively communicating with potential investors.
5. Access to information for the recording of the Q&A conference calls.
6. The importance of recording both the initial Q&A conference calls and the Deep Dive session for the benefit of both members with busy schedules and members of other chapters or angel investment groups that join the DD process later in a multi-chapter or syndicated financing.
7. The recommended structure for the Q&A call.
8. What kinds of materials they should begin to gather, compile, and post in their deal room.

Document Request Sequence

Appendix I (referring to the Document Binder) cover a list of many of the documents that should be reviewed in an exhaustive DD process. However, all companies that present to The Keiretsu Forum are at different stages of development. The DD Team may not want to review every document on that list.

The DD Leader should ask someone from the DD Team to address both the full scope and the targeted scope of documents that the DD Team will want to review. First, that member should direct the entrepreneur to both this Appendix and Appendix I regarding the due diligence binder, both of which outline what documents a DD Team should review at different stages of an exhaustive DD process. Second, that person should provide guidance to the entrepreneur on which documents the DD Team will likely want to review, given the company's specific stage of development. And, third, that person should outline types and categories of documents, thereby reminding the entrepreneur to consider what else, in addition to what is being requested, will also help him or her make his case for receiving an investment.

Invariably, the DD Team's members will want to see more material and documents as the DD process progresses and their understanding of the company evolves. To keep the pace moving and respect the entrepreneur's schedule, the DD Team should do its best to anticipate what additional or supplemental documents it might want to review and make those requests as soon as possible.

This Appendix serves as a high-level summary and general outline for the sequence of requesting documents. Generally speaking, documents should be requested and provided in groups as the DD process progresses. This will save the entrepreneur time by preventing him or her from taking the time to gather and upload documents if the DD process is not going to progress further.

Please be alert for references in this Appendix that highlight or emphasize what to look for in some of the specified documents.

The stage numbers below reference the documents that should be uploaded just before that stage begins. This assumes that the DD Leader has indicated ... just as the prior stage is ending ... that investor interest remains sufficient to continue the DD process.

Just before Stage 1: Organization

The company should upload ... whether or not the DD Team specifically requests it ... documents related to understanding the company's historical progress, launch plans, and growth plans, along with all other documents the management team feels will help bridge the gap between what was covered in the initial presentation and what will be covered in the Deep Dive session. The entrepreneur should consider

the questions that came up in the Mindshare session, as relayed by The Keiretsu Team.

Among other things, this should include the filled in Keiretsu Forum overview, general executive summary, PowerPoint investor presentation and handouts, business plan or business model canvas, financial model, assumptions underlying the financial model, technological overview, marketing plan, competitive analysis and comparison to competitors' products or services, market and industry explanations or whitepapers, writings by the management team explaining the industry that might help investors better understand both the team and the industry, market analysis, sales pipeline, and so on.

Proposed deal terms and draft financing documents should also be uploaded, because the DD Leader will be assessing, as a prerequisite for continuing the DD process, whether or not the proposed terms will be generally acceptable to members on the interest list.

Just before Stage 2: Key Questions and Verifications

The company should provide the names of all personal references and customer references. The company should upload all documents that confirm what its leadership has said it has achieved with regard to customer acquisition, strategic partnerships, and so on. The company should also upload its capitalization table and shareholder list and provide the DD Team with the contact information of the lead investors from previous financings.

The company should also upload and the DD Team review all the documents specified in Appendix I's sections on corporate documents and on litigation and regulatory compliance. For real estate investments, the company should upload and the DD Team review all the documents specified in Appendix I's section subtitled property.

And, the company should upload for review all financial statements and all the documents that the DD Team said it will want to review from Appendix I's sections on intellectual property and employee relations.

When patents are involved, it is critical to assure that all documents required to assign rights from the people who created the claimed technology or features to the company have been signed and are in place. Therefore, all signed assignment of inventions agreements should be uploaded as soon as possible. The DD Team should specifically cross-reference and look for assignment provisions in the employment agreements to make sure there is no inconsistency in the employment agreements (or agreements among the co-founders) that might override or undermine the provisions within the assignment of inventions agreements.

Just before Stage 3: Questions Addressed/Deep Dive

The company should upload whatever documents the entrepreneur feels that the DD Team should review before the Deep Dive session in order for investors to be prepared for that session. In the case of companies involving technology, this should include enough of an overview for people without an engineering background to be ready to track the conversation at the Deep Dive session (though the company may prefer to only provide detailed technology architecture explanations directly to the person on the DD Team handling that part of the DD process).

Additionally, the company should upload for review any documents that the DD Team tells the entrepreneur it wants to review in preparation for the Deep Dive session.

Just before Stage 4: Reports and Commitments

The company should upload for review at this point the documents that the DD Team said it will want to review from Appendix I's sections on contracts and commitments, finances, taxes, insurance, and government licenses, permits, and filings.

It might seem like these documents should also have been provided just before stage two, before the verification process commenced. Yet, by deferring this deeper review until just before stage 4, two things can be accomplished.

First, the essential information is less likely to be missed or overlooked. And, second, if something fundamental or critical stops the DD process from progressing, the entrepreneur will not have had to spend unnecessary time sorting through and providing extra documents. The documents provided at this stage, generally speaking, involve matters that can be successfully addressed once they have been identified.

Just before Stage 5: Deal Closure

The company should upload and the DD Team review all documents related to the proposed terms (or existing terms on which other investors have been investing), along with all documents required to complete the current financing and all documents that had been used in previous financings (which will lay out the precise terms granted to those investors).

Company Overview

Corporate Structure/Organization

1. Founding information: date, founder(s)
2. Legal structure: type of corporation, certificate(s) of incorporation, list of states/countries in which the Company is authorized to do business
3. Current By-laws (including all amendments)
4. Agreements related to significant acquisition(s) or disposition(s) made by the Company in the last 3 years.
5. Company organization: Organization chart, FTEs; consultants/ service providers (including legal); outsourced functions and relevant contracts

Funding/Ownership

6. Funding raised: Capitalization table including capital raised to date, form/structure(s) including bridge loan(s) valuation, funding sources and relationship/commitments to the Company, contact information

Proposed Deal

7. Current round of financing: amount expected, timeframe, expected use of funds, expected milestones, shortfall contingency plan
8. Planned next round of financing: targeted capital sources, amount required, expected use of funds, expected milestones
9. Company valuation: current valuation, basis for valuation, industry comparable for both valuations and exit multiples, and company's financial model and underlying assumptions as they related to future valuation

Financial Structure

10. 3 years Historic financial statements: Balance Sheet, Income Statement, Cash-flow (audited if available)
11. Schedule of all liens and encumbrances against assets/stock
12. Schedule of all the Company's investments
13. Copies of all federal, state, local and foreign tax returns for the current year

and past three years

Financial Model

14. Historical and current financial model: debt, cash-flow, burn rate, income, balance sheet
15. Margin: gross, operating, net each product/service; expected trend over time & product cycle
16. Projected financials: cash-flow and income projections for next 3-5 years
17. Assumptions driving projected financials: market share/penetration; price; revenue model; sale and payment cycles; cost of goods/services; overhead; ...etc.

Product/Service

18. Expected time frame and milestones to reach commercialization
19. Product marketing materials, including product, pricing & customer list(s), marketing collateral
20. Status of product(s)/service(s) development cycle (pre- α , α , β , commercial trial or launch...)

Customers

21. Existing customer(s) and nature of relationship: names, contacts & their position; targeted sales volumes & revenues for top 10 customers
22. Customers' pipeline
23. Letter(s) of intent from potential customer(s)

Suppliers

24. All suppliers critical to development, procurement, deployment & servicing of product(s)/ service(s)

Marketing

25. Most relevant & recent press releases; coverage of Company, target market, competitors & customer

Tax Matters

26. Suitability for taxable or retirement investment based on risk profile (subjective)
27. Is this income or capital appreciation type of investment
28. Capital gains should be disclosed to the extent projectable
29. Tax credits should also be relatively certain depending on the investment
30. UBTI (Unrelated Business Income Tax) should be fairly cut and dry but we should request an outside tax firm's opinion from the sponsor

Appendix I - Document Binder

The list of items below does not reflect a complete list. Items should be added based on the Company in question and the analysis of the DD Team. This list is intended to save the entrepreneur and DD Team time by providing the entrepreneur up front guidance as to what documents should be gathered.

There is no need to attach these documents to a Final DD Report. These should be uploaded by the entrepreneur to the Deal Room component of the Gust Group for the company to which the entrepreneur has access. One member of the DD Team should be assigned to review all of the documents.

Corporate

Certificate of Incorporation and all related documents:

1. Certificate of Incorporation and related documents
2. Articles of Incorporation
3. By Laws
4. Shareholder Agreement
5. Schedule of all business entities, which comprise, or are affiliated with the Company
6. Stockholder Agreements
7. Options Plan, rights of first refusal
8. Voting trust Agreements
9. Warrants Agreements
10. Any other agreements with respect to ownership of the Company or relating to purchase the capital stock and/or assets of the Company
11. Agreements, documents or closing volumes related to any significant acquisitions or dispositions made by the company during the last three years or which are currently proposed
12. List of current officers and directors of the company and all employees and consultants of the company

13. Internal operation manuals, all policy manuals, including those related to hiring, regulatory compliance, internal controls and internal policy statements of the company
14. Closing volumes and any other agreements or documents relating to any secured or unsecured borrowings of the company, including any debt instruments, debt/equity exchanges, letters of credit, sale and leaseback transactions, guarantees, pledges, security agreements and any other documents relating to liens and security interests
15. Bonds or other government financing programs.
16. All material correspondence with lenders including correspondence related to refinancing of any the company debt. Need to review and summarize any loan agreements

Finance

A summary of any loans, guarantees, performance bonds, and/or cash infusions of any officer, director or stockholder of the company or any other related party and amounts and terms of such loans or transactions

Financing for specific facilities of the company, including documents and agreements evidencing equipment and vehicle financing arrangements.

Schedule of all liens and encumbrances against any of the Company's assets or stock

Any correspondence with creditors or Companies during the last two years not in the ordinary course of business

Schedule and documents supporting loans and loan guarantees

Schedule of all investments related to the business of the company

Schedule of all bank accounts and safe deposit boxes of the company

Audited financial statements for the past three years

List of all current inventories including location of inventory

Detail list of all tangible property and equipment including location

Detail list of current Accounts Payable and Accounts Receivable aging

Description of financial and management information systems and related contracts with outside vendors if applicable

List of all products and services offered and their pricing

Current and future years Budget and strategic plans

Taxes

Copies of all federal, state, local and foreign tax returns for the current year and past three years

Copies of memoranda and other documentation relating to the company's income or other tax liability or prepared in connection with any tax problems affecting the business of the company since inception or which may rise in the future

Copies of all state sales and use tax reports and returns of the company for the current and past three years

A schedule describing any ongoing tax disputes with copies of documentation with respect to pending federal, state, local or foreign tax proceedings with regard to open items.

Employee Relations

Management compensation plans and agreements including bonus and deferred agreements

Employee stock option plans

Documents assigning the rights to patents from the creators to the company

Employment, consulting and advisory contracts

Summary of employees including wages/salaries and job description

Employee background investigations and degree verification documents

Pension and retirement plans and all related plan documents

Management & consulting agreements, agreements not to compete, agent agreements, confidentiality agreements with employees, & agreements with employees covering inventions

Key man life insurance plans or other death benefits compensation

All correspondence and documents received from and filed in the last three years with relevant employee relations, occupational safety and civil rights organizations

Schedule and brief description of all pending legal or arbitration proceedings

All employee manuals, handbooks, policy statements, payroll practices and personnel practices

Acquisition or divestiture agreements affecting any Qualified Plans

Any other material agreements or documents relating to employees, consultants or agents of the company

Insurance Policies including product liability, E & O, D & O, liability limits etc.

Name of broker _____

Contracts and Commitments

Material &/or long-term contracts and purchase orders w/customers & suppliers

All government contracts

Material and/or long-term equipment, automobile or other leasing contracts

All management or service contracts for the sale of services related to the business of the company

Agreements requiring the company to indemnify or hold harmless any other person

Agreements related to waste disposal and environmental services

Any other material and/or long-term contract related to the products, services or business of the company

Provided Information services and data processing agreements, including lists of software and licensing status

All requirements or take-or-pay contracts

All warranties and service contracts

All license agreements

All distribution and distributorship agreements

Property

Deeds held by the company and options to sell or purchase real property

Original real property leases and all amendments thereto

Easements, licenses and restrictions on use relating to real property related to the

business of the company.

Title insurance policies & surveys relating to real property related to the company

Maps and blueprints of all buildings and property of the company

Appraisals on any owned real property

Schedule of material personal property owned & related to the business of the company

Governmental Licenses, Permits and Filing

Federal licenses, permits or clearances related to the business of the company if applicable

State, county, and city licenses, certificate of occupancy, and environmental-related permits related to the business of the company

All other licenses, certificates and letters of accreditation

Policies related to the treatment, storage and disposal of hazardous waste and other waste products

Intellectual Property

Schedule of patents, trademarks, service marks, trade names, copyrights and other agreements used or held in the name of the company

Documents regarding any claim of infringement of the intellectual property rights of Companies and any claims against the company alleging any such infringement

Any other material intellectual property rights or claims

Insurance

Schedule and description of all insurance policies now in effect

Copies of all insurance policies in effect and certificate of insurance for each policy

Loss and/or claims history for all such insurance coverage's maintained for company, past five years

Litigation and Regulatory Compliance

Copies of all material correspondence or notices concerning compliance with occupational safety, civil rights, labor or environmental laws

Consent decrees, judgments, settlement agreements and other agreements to which the company is bound, requiring, regulating or prohibiting any future activities

Schedule and brief description of all pending legal or arbitration proceedings to which the company is a party and the names of the court or agency in which the proceedings are pending

Schedule of potential or threatened government investigations and legal proceedings and any other contingent liabilities of the company

All material correspondence with respect to any administrative or regulatory body, which regulates the business of the company

Audit response letters from all outside legal counsel to the company, past three years

The material in this Appendix was initially created by members of The Keiretsu Forum's Founding Chapter in the East Bay of the San Francisco Bay area during the first two years after The Keiretsu Forum was founded in 2000.