

## ▶ WHAT'S A HAIR BALL ANALYSIS<sup>SM</sup> ANYWAY?

Once in a while, we come up with cheeky expressions to describe a service, or a group of services, that we provide to our clients. In this case, the phrase we have coined is "Hair Ball Analysis<sup>SM</sup>". While this service does not exactly sound like one that a certified public accounting firm would routinely provide, it is a service that KBA Group's Transaction Advisory Service practice provides as a part of its buy-side due diligence engagements. If we have sufficiently stirred up your curiosity, then here is some more detailed information about our Hair Ball Analysis<sup>SM</sup>.

In these uncertain times, acquirers of businesses and their capital partners are approaching deals with a renewed sense of caution. With all the talk about recession and the reality of a tight credit market, it is more critical now than ever to gain a solid pre-acquisition understanding of the target business -- beyond what traditional financial due diligence provides. Let's face it, nobody wants to make a bad investment.

With this said, due diligence is not something to be overlooked. The due diligence phase of each deal should be viewed as a one-time opportunity to take an in-depth look at the target business and confirm the validity of the investment opportunity. Depending on the structure, industry and process-maturity of the target, an in-depth look into the people, processes and procedures involved in the business can add value in a number of ways. Two must do items include a solid quality of earnings assessment and a verification of the productive assets of the business. A tax position evaluation is also a must in a stock deal. There is just no substitute for these basic financial due diligence analyses. However, KBA Group's Transaction Advisory Service professionals encourage clients dig even deeper on the front end of the transaction. This is where the Hair Ball Analysis<sup>SM</sup> comes into play.

KBA Group's Hair Ball Analysis<sup>SM</sup> typically requires about one day, requires our team to gain an understanding of the intended deal from the buyer's perspective and requires that we have a receptive audience with key management personnel of the target company. The process generally involves an analysis of deal documents, historical financial and operating data and a series of carefully thought out "stupid" questions intended to identify the weaknesses and risks associated with the business. Following are some of the "hair ball" items to consider:

- ▶ In a strategic buy or when adding to a platform investment, what are the expected synergies and how long will it take to realize them?
- ▶ If the target is a carve-out of a larger entity, can you be sure that core costs and processes have not historically been supported by another part of the seller's business?
- ▶ How solid are information and productive equipment systems within the target? Do they suffer from deferred maintenance that may require a substantial future investment to repair?
- ▶ Is the target's management capable of implementing your plans to integrate the business, or will they need additional resources?
- ▶ Are the processes for key business cycles documented, or is the day-to-day business at risk if certain key people terminated their employment?
- ▶ Cash and working capital are key. What are the future working capital requirements and seasonal cycles going into the future?
- ▶ Is the company in compliance with permits and licenses required to conduct business?

This list of questions is not intended to be comprehensive, but it is meant to give you a rough idea of what the "hair ball" may look like. Depending on the deal, obtaining straight answers to many other questions may also be appropriate.

**What is the Final Outcome of KBA Group's Hair Ball Analysis<sup>SM</sup> ?** The Hair Ball Analysis<sup>SM</sup> generates a short list of the key financial and operational areas of concern. Most quality acquisition targets end up having three to five critical risk areas, or ones that require a better understanding. From the buyer's perspective, the identification of any more than five critical risk areas should be cause for concern.

With this list in hand, KBA Group's Transaction Advisory Service professionals can prepare a targeted project plan with meaningful cost estimates. Moreover, our client can make a decision on which areas require further analysis and who on the deal team should cover those items.

In closing, we want to leave you with a formal definition for our newly coined term.

**Hair Ball Analysis<sup>SM</sup>** – {hâr bôl ə-nă'l'ī-sīs} - noun - A Hair Ball Analysis<sup>SM</sup> is defined as a wise investment made at the beginning of a deal that has the ability to steer the deal's evaluation towards its risks and has the effect of providing a road map to a targeted, cost effective evaluation of the investment opportunity.

Whether it's analyzing a potential merger or acquisition, preparing information for a sale or financing, or minimizing the tax implications of a purchase or sale, finding the right financial professional to assist with the transaction can be a difficult task. Contact KBA Group today.

**About the Author.** David has almost 20 years of industry accounting and finance experience with roots in Big 4 audit and a progressive series of management responsibilities in corporate accounting, financial planning and analysis, controllership, general management and VP Finance roles in both public and private company environments. David's background is diversified to include expertise in both domestic and international business with industry depth to include consumer products, manufacturing, distribution, software, information services and high tech industries. For more information, contact David McCully, Principal, Transaction Advisory Services, at 469.341.0786 or via email at [dmccully@kbagroupllp.com](mailto:dmccully@kbagroupllp.com).



14241 Dallas Parkway  
Suite 200  
Dallas, TX 75254  
972.702.8262 Phone  
972.702.0673 Fax