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CAPITAL ADVISORY

INVESTOR GUIDE

How Due Diligence Works

What institutional investors examine in financial, commercial, and legal diligence, and how to prepare.

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Due diligence is the process by which investors validate the investment thesis, identify risks, and build conviction for pricing and structure. Preparation quality directly affects timeline, re-trade risk, and ultimate terms. Companies that treat diligence as an audit to be survived consistently leave value on the table; companies that treat it as the operational proof of their narrative consistently close faster and on the terms they signed.

The economics of preparation are asymmetric and worth stating plainly. Every material issue has two prices: the price of fixing it before launch, and the price of the investor finding it first. A gap surfaced in week two of preparation is a task; the same gap surfaced during exclusivity is a re-trade, because by then the company has lost its alternatives and the buyer knows it. Most valuation erosion in private processes happens not at the term sheet but in the quiet weeks after it, one discovered issue at a time.

KEY FINDINGS

01 Preparation quality directly affects timeline, re-trade risk, and final terms.

02 Quality-of-earnings work is standard; expect scrutiny on revenue quality and concentration.

03 Management credibility in live Q&A matters as much as the data room itself.

SECTION 01 OF 04

Financial Diligence

Investors examine revenue quality, margin durability, working capital seasonality, customer concentration, and normalized EBITDA bridges. Quality-of-earnings work is standard in middle-market processes, and management should assume every adjustment will be rebuilt independently by the buyer's accountants. The goal of preparation is simple to state: when the investor's rebuild of your numbers is complete, it should match yours.

Revenue quality receives the deepest scrutiny because it anchors every multiple. Expect analysis of contracted versus reorder revenue, cohort behavior by acquisition vintage, churn definitions tested against raw data, and any quarter-end revenue patterns that suggest pull-forward. The EBITDA bridge attracts equal attention: each addback needs documentation, a rationale, and internal consistency, because one indefensible adjustment licenses the buyer's advisors to discount the entire schedule.

Working capital is the sleeper issue that surprises otherwise prepared teams. The peg negotiated at closing is set from the trailing profile, so seasonality, receivable aging, and any customer prepayment dynamics should be analyzed and explained before the buyer does the work. A company that presents its own working capital analysis controls that negotiation; a company that waits inherits the buyer's version of it.

SECTION 02 OF 04

Commercial Diligence

Market size, competitive positioning, retention metrics, and pricing power receive significant attention, frequently through third-party commercial diligence firms who will interview your customers directly. Management should know what those calls will surface before commissioning-side advisors do: run informal win-loss and reference conversations in advance, and address the recurring criticism in the narrative rather than hoping it stays unspoken.

Management's ability to discuss these topics credibly in Q&A often matters as much as the data room. Partners build conviction in unscripted exchanges, watching whether the CEO can defend the market thesis against a skeptical rebuild, whether the CFO knows which cohorts are weakening and why, and whether the team's answers stay consistent across meetings. Rehearsed fluency with the deck is table stakes; the differentiating signal is fluency without it.

SECTION 03 OF 04

Legal and Governance

Cap tables, material contracts, IP ownership, litigation, and regulatory exposure are reviewed in parallel with the financial and commercial workstreams. Legal diligence rarely changes price directly, but it is the workstream most capable of destroying a timeline, because legal issues tend to be binary: an unsigned IP assignment from a departed co-founder is not discounted, it is fixed or the deal waits.

The recurring offenders are remarkably consistent across processes: option grants never approved by the board, missing assignment agreements from early contractors who touched core IP, material contracts with unflagged change-of-control clauses, and side letters nobody catalogued. Every one of these is inexpensive to cure months before a process and expensive to cure inside one. A pre-launch legal audit by transaction counsel, not company counsel reviewing its own work, is among the highest-return preparation spends available.

Clean documentation and proactive disclosure reduce friction in final documentation, and disclosure strategy deserves genuine thought. Issues disclosed early, with context and a remediation plan, become priced-in facts; issues discovered late become trust problems that contaminate unrelated workstreams. The disclosure schedule is not the place investors learn about a problem for the first time, it is the place they confirm what management already told them.

SECTION 04 OF 04

Running the Process

Diligence is also an operational load on a company that still has a business to run, and processes fail from exhaustion as often as from findings. Assign a single internal owner for the data room and Q&A flow, route every investor question through one channel with a forty-eight-hour response standard, and maintain a living FAQ so the tenth investor receives the same answer as the first in the same words. Inconsistent answers across parallel conversations are how careless companies manufacture diligence issues out of nothing.

Finally, protect the operating rhythm. Ring-fence the deal team, keep the wider company on quarterly execution, and remember that the strongest diligence artifact of all is a business that hits its numbers during the process. Nothing re-prices a deal downward faster than a company missing its own forecast in the exact quarter it asked to be underwritten on it.

NEXT STEP

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Keningford Partners is a New York-based, principal-led capital advisory and M&A firm advising companies from Series A through the pre-IPO stage, alongside institutional investors, on equity, debt, and strategic transactions. Every mandate is led directly by senior bankers from origination through close.

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