

# DUE DILIGENCE WORKBOOK

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## **Exhibit C: Rapid Interest Checklist**

### Preliminary Questions Clarifying Potential Investment Interest

- 1) What assertions has the company made?
- 2) Are there any claims that cannot be verified?
- 3) What is the need? What is the customer problem being solved?
- 4) Who has the need? How compelling is their need? Who is the target buyer? Does the customer need really exist? Does the company have data to prove this? How good is their data?
- 5) Is there at least \$1billion being spent today in this sector? Could \$1billion be spent in this sector? How has the company sized the market? Do we agree? Can we size it ourselves? How difficult are the buyers to find and sell to?
- 6) Is the company's strategy clear from both the presentation and business plan?
- 7) What is your analysis of the Balance sheet?
- 8) Did the company address Sources and Uses of Funds for the upcoming round?
- 9) How many investors does the company have already and who are they scheduled to meet? Already met?
- 10) What is the timetable for funding?
- 11) Are there any outstanding leadership characteristics immediately visit from founder's previous work experience or bio?
- 12) What is the EXIT?

Documents Required: Executive Summary, Slide Deck (?)

# Exhibit D: Due Diligence Report Generator

## A. Market Competition and Analysis

### 1. Business Plan/ Presentation review

- 1) What assertions has the company made?
- 2) Are there any claims that cannot be verified?
- 3) Are there any claims that the company is not willing to substantiate that they've made in presentations?
- 4) Has the company used the information provided in a true but unfair manner?
- 5) What claims might an investor rely on (Big Picture)?

### 2. Market Analysis

Here we examine the market for the product

- 1) What is the need?
- 2) Who has the need? How compelling is their need? Who is the target buyer?
- 3) How does the product meet the need? How is the product different from and better than its competitors? Features? Is this a big customer play (Large Company X) or a common consumer play (Cell phone)? In what ways is the competitor's product better? Performance? Do they intend to compete on price? How are potential customers meeting the need today?

### Validation of the market opportunity

- 1) Does the customer need really exist? Does the company have data to prove this? How good is their data?
- 2) Are there enough customers? Is there at least \$1billion being spent today in this sector? Could \$1billion be spent in this sector? How has the company sized the market? Do we agree? Can we size it ourselves? How difficult are the buyers to find and sell to?
- 3) What competition is out there- either real or potential? Does the company know their competitor(s)? Have they made an evaluation of, and can they articulate their competitive advantage? Is this a race to be the first mover in the market and build consumer recognition?
- 4) What does the competitive landscape look like from the overall perspective (saturated)? (Refer to tips on main guide for methods of exploration)

### Competition

- 1) How are these other competitors competing? (Price, Quality, Features, manufacturing store brands, products sold through distributors)
- 2) Is the company's strategy clear from both the presentation and business plan?
- 3) What comes up when you search for this area of industry? What is your overall feel of the market? Examine various sources. (I.e. Internet searches and professional publications/analysis)

## **B. Company Financial Analysis**

- 1) Examine the company's QuickBooks file. How does the record keeping appear?
- 2) Request the company's tax statements. Were they filed on time? Do the profits and losses match up with the numbers presented in the materials?
- 3) What are the basic conditions of the business plan financials? Examine the income statement, balance sheet, and cash flow statement. What do these suggest about the overall health of the enterprise?
- 4) What does the information found in the financial statement (presented at board meetings/ sent to investors periodically) say about the health of the company?
- 5) Do the forward-looking budgets seem reasonable given the knowledge about the company and market?

After receiving the above documents, perform basic financial analysis. This task will likely include basic financial modeling

- 1) What does your cash-flow analysis tell you (static, historically, next 12 months projected vs burn rate)? Is cash from a debt or equity raise?
- 2) What was the burn rate for the past three-months average current and how does it compare to the last year's average monthly burn rate in the same period. Provide a graph indicating the trajectory of the latter.
- 3) Examining the income statement, what can you deduce and determine about the company? (This is deal for startups/early stage companies, a 12-month trended monthly presentation of the income statement is ideal)
- 4) What is your analysis of the Balance sheet?
- 5) How is the Cap table situated? Are there any irregularities or red flags?
- 6) Graph the items that stand out (revenue, gross income, operating costs, and operating income)
- 7) What does revenue, profit/loss, and burn rate look like? Monthly? Quarterly? Yearly?
- 8) How do the financials presented at each shareholder and board meeting compare to the information you've been given?
- 9) Do the Capital Accounts of funds paid in equity agree with the QuickBooks cap table, which was given to the DD team? (QB link)

## **Funds**

- 1) Have you requested a Sources and Uses of Funds for the upcoming round?
- 2) Request a forward looking Excel spreadsheet with historical data previously obtained but now with the intention going forward. (A "best guess" scenario completed by founders)
- 3) Does the company's intended "Sources" and "Uses of Funds" from the business plan match up with how funds have been spent thus far? Were they aligned historically? Were the funds used to take the company in an entirely new direction or the original purposed direction? If there was a divergence, what was the cause?
- 4) After verification and extrapolation, do the numbers align with the intended uses of funds and does the math actually back that up?
- 5) After calculating the next year's going forward average burn rate by extrapolating from past burn rates and use of funds, does the trajectory match the funds to be taken in?
- 6) What are the top three reasons for change?
- 7) Should the company be able to raise 100% of the planned funds, how many months will the company be able to operate if we add the current round plus the funds that are currently in the bank account if all

management/founder assumptions for this raise come to fruition? What does the monthly picture look like? (This is called the company's forward looking runway)

- 8) What is the worst case scenario if all the funds are raised, but certain events do not occur? What are the effects on the timelines and the consequence of extending? What are the best and worst case scenarios (timing, and amount if possible) on the next raise, or future raises affecting exit?
- 9) Is there less than 3 months of runway left?
- 10) Are there excessive liabilities and will my money principally be used to pay other investors?

### **C. Founders, Management and Board:**

- 1) Are you able to tell that the founders exhibit good character, subject matter expertise, a willingness to learn or bring in others when required to succeed, and the skill set required to run and grow a company (which is different from the skill set required to create the product)? Personal Experience?

### **2. Background Verification**

- 1) How were the interviews (customers, board members, management team, purchasers, and experts? Use a grid to keep track of meetings and interviews. (Refer to Corresponding section of DD report.)
- 2) Do the resumes of the management (if a company is very small all employees) convey that the company has the skills to bring their claims and projections into fruition?
- 3) Was there any unsettling body language from the CEO and Team whenever "Exit" and "Liquidity Event" is mentioned (and unwilling to consider protecting me from the venture's developing into a "Built To Keep" or lifestyle company via a redemption trigger)
- 4) Does the Founder refuse to imbed the IP in the capital raise?

### **3. Relationship Analysis**

- 1) How many investors are there and when did each initially become an investor (date and size).
- 2) How many shareholders paid for their shares? How many shares were given to shareholders? For what reasons?
- 3) How should this look? A running cap table provides the most easily visible method for determining the life of each round.

### **Cap Tables: Table A**

- 1) What is the true ownership representation of the company versus the influence?
- 2) Which shareholders and/or board member were given shares rather than a check for compensation?
- 3) Which shareholder participated in each round?

**Refer to corresponding report section in order to complete other mentioned objectives.**

## **Relationship Influence Analysis**

- 1) How do the voting members know each other, and what are the relationships between the different entities comprising ownership? Who introduced owners? Is anyone related to another or to people who work at the firm? Request relationships intersections from management and map them. Is there anything peculiar?

## **Negative Covenants**

- 1) Are you able to determine outsized influence through the existing negative covenants? (Right of first refusal for decisions made by the board, such as hiring anyone with a salary over a certain amount, or having prior approval for any new financing round or dilution requests. This is likely a company inquiry or a request of absence submission)

## **Side Letters**

- 1) Are there any agreements that the CEO or other management has made to bind the company without anyone else's knowledge? (These include reimbursements for costs of a particular board member, paying the legal fees for an investor in a given round who won't invest unless a company agrees to this.) Request all board members, advisory positions, founders and management to indicate in writing that there are no known side letter agreements. If there were some previously, are they still in effect?
- 2) Double check to see if any shareholders received stock without writing a check. How much and Why?
- 3) Request that each board member, founder, management and shareholder sign an agreement saying there are no side deals, no side "letters" made with anyone at the company for anything not already specified in the documents provided. Due diligence is about what has been done and is verifiable, and requesting written agreement that there has been nothing overlooked by the company's due diligence team, to the best of managements' knowledge (think estoppels in real estate financings).

## **D. Document Verification and Review**

- 1) **Follow DD report instructions for this section**

## **E. Board Analysis**

### **Board Meetings**

- 1) Examining the minutes of all board meetings, did you find any interesting conversations that might have occurred?



- 2) Using a grid, when were meetings held and who attended? What were the meeting's consistencies and inconsistencies (times, meeting places, actual participants and attendees)?
- 3) Were any motions taken, seconded, and implemented?

### **Relationships**

- 1) Are you able to detail the relationship between each party? (This is information typically not found in the business plan or other documents)
- 2) After having interviewed founders/management, and all board members, board advisory participants, on how they met and know each other and if any is/was related to anyone else in the company, detail said information in a chart.

Organization. An organizational chart provided by the company permits several levels of inquiry. However, in order to get some of this information additional information may have to be requested.

- 1) What was the start date and salary history for each current employee?
- 2) Read DD report and complete the instruction therein.

### 3. Legal Analysis

- 1) Follow instructions listed in the DD report
- 2) Use Excel chart accompanying DD report to score company according to its current status

### **F. Company Specific Risks**

- 3) Legal and Regulatory risk
  - a. Are there any lawsuits or is there pending litigation? (These are found in documents such as PACER record, state court records, and in legal documents provided by the company)
  - b. What is the current state of regulatory approval and filings? (Filings should be provided by the company)
  - c. Is the company registered and able to do business in all locations?(These documents can be obtained by the Secretary of State in the respective business location)
- 4) Industry specific legal and regulatory risk (healthcare)
  - a. Is FDA approval required for the company to be successful?(Evaluation of this should be offered by company's legal counsel)
  - b. At what stage is the company in the FDA approval process?
- 5) Contractual risk
  - a. What are the statuses of the contracts with key vendors?
  - b. What are the statuses of the contracts with key customers?
  - c. What are the statuses of contracts with key employees?

d. Are there any debt financing agreements on the table?

6) IP Risk

- a. What are the statuses of the patents? (Docs filed with Patent Office)
- b. What are the statuses of the trademarks? (Docs filed with Trademark Office)
- c. What are the statuses of the copyrights? (Docs filed with the Register of Copyrights)
- d. Are the patents defined broadly or narrowly? (Docs filed with Patent and Trademark Office)
- e. What are the times to patent expirations?
- f. What are the statuses of the trade secrets?

7) Industry Specific IP risk (healthcare)

- a. What type of patent does the company hold?
- b. Is there any confidential information? (HIPPA Protected) (Doc describing IT, information segregation, encryption)
- c. Are there other protections on confidential information? (IT Related) (Docs describing IT, information segregation, encryption)

**G. Investor specific risks**

**Company Failure Scenario**

- 1) What is the priority of the investment instrument in Bankruptcy?
- 2) Am I expected to sign an NDA?
- 3) Am I allowed run personal background check on Management/Founder/CEO?
- 4) Does Management/Founders/CEO have zero skin in the game but expect(s) a market wage?
- 5) Does the current CEO lack the “Passion, Presence, and Conviction” necessary to present well to other funding sources (yet still expects to be the CEO)?
- 6) Would the CEO rather be CEO than to have his/her venture prosper under another’s leadership?
- 11) Is my level of trust increasing with each interaction /meeting with this CEO & team? Is there too much capital needed from here to the planned Liquidity Event? Am I being exposed to too much dilution and control by other individuals I’ve yet to meet
- 12) Are there too many family members on the payroll? (They will likely lose their jobs under a new owner?)

**Successful Exit Scenario**

- 1) What dilution protection is available?
- 2) Is there a right to participate in additional rounds?
- 3) What is the liquidity preference?
- 4) What are the registration rights?
- 5) What types of participation in decision making/ voting rights are available?
- 6) Are there Pre-existing agreements that might cloud the exit as in a right of first refusal by partners

## **Growing Concern Scenario**

- 1) What ability is there to force a sale?
- 2) What ability is there to redeem capital?
- 3) What ability is there to transfer shares?

## **Successful Exit Characteristics**

- 1) Is it likely that the share's value will not only correspond with company value but has the potential to outperform the company's growth rate?
- 2) Is growth stretched over too long of a time period?
- 3) Subscribers, customers, users of said technology are looking for this type of technology or approaching customers doesn't require an extensive amount of capital
- 4) Customers are large companies as opposed to independent consumers
- 5) Willingness to accept outside guidance, direction and changes

### **Documents requested:**

#### **Corporate Documents**

1. Articles of Incorporation
2. Bylaws
3. Minutes of Board of Directors, Committee, and Shareholder meetings (including actions by unanimous written consent, written notices or waivers thereof and all written materials provided to directors, since incorporation—from inception)
4. Documents furnished to shareholders and directors over the last two years
5. Executive Summary
6. Pitch Info
7. List of states or countries in which the Company has qualified to do business
8. List of states or countries in which the Company has offices, employees, and a significant consumer or otherwise transacts business
9. List of subsidiaries

#### **Securities Issuance**

10. Sample of stock certificates, warrants and options
11. Copies of Shareholder agreements
12. Stockholder information, including dates of issuance, number of outstanding shares and percent ownership (Capitalization Table)
13. Detail of any outstanding preferred stock, including covenants

14. Detail of any outstanding options, warrants or convertible securities
15. Information on stock option, stock purchase or other employee stock benefit programs
16. Copy of prior and current term sheets
17. Investor Questionnaires from prior and current round(s)
18. Copies of Private Placemen memoranda, business plans, projection and other documents provided to previous investors in prior offerings
19. Equity investment documents, including an preferred stock agreements, convertible debt agreements, etc.
20. Founder's Stock purchase agreements

### **Financial Information**

21. Audited financial statements since inception of the company (including Income Statements, Balance Sheets, Statements of Cash Flow and Changes in Equity Position)
22. Detail of accounting methods and practices
23. Letters to and from any auditors
24. Internal monthly or quarterly statements
25. Budgets and financial projections
26. Full Business Plan
27. Accounts Receivable
28. Accounts Payable
29. Detail of pricing plans and policies
30. A breakdown of revenue and gross margins by product line or service
31. Analysis of any extraordinary income or expenses
32. Analysis of any material write-downs or write-offs
33. A summary of any bad debt experience
34. Detail of any outstanding contingent liabilities
35. Any reports from outside consultants or accountants on the Company's financial condition
36. Three month average burn rate compared to three month average burn rate last year this time
37. Sources and Use of Funds from round with itemized costs
38. Best/Worse case scenario with missed benchmarks factored in the financial analysis
39. Documents listing all federal, state funding applied for by the Company

### **Operations**

40. Documents of title for major assets
41. Equipment purchase or lease agreements
42. Loan agreements, lines of credit, promissory notes, guarantees etc.
43. All documents purporting to create liens, mortgages, security interests, pledges, charges or other encumbrances on real or personal property owned by the Company
44. Financing (UCC) statements filed
45. Insurance, including litigation tendered to and accepted by insurance companies in defense, and title insurance policies
46. Material contracts
47. Standard forms of ordinary contracts

48. Summary of any government contracts; copied of standard form contracts
49. Permits, licenses, franchises, certificates and consents
50. Documents relating to possible environmental pollution including, without limitation, correspondence with governmental agencies and internal and consultant reports regarding same
51. Real estate leases, contracts
52. Distribution, OEM, Reseller and other similar agreement

### **Tax Status**

53. Federal and state income tax returns for the last five years

### **Contracts and Agreements**

54. List of Bank and non-Bank lenders
55. Join Venture and partnership agreements
56. License Agreements
57. Purchase agreements
58. Any additional agreements or contracts relevant to the business of the Company including contracts with suppliers, vendors and customers
59. List of all current and prior law firms, accounting firms, and consultants

### **Government Regulations**

60. Copies of any permits and licenses
61. Copies of reports made to government agencies
62. Detail of any enquiries made by any local, state or federal agencies including OSHA, EPA, EEO, SEC and CFTC

### **Litigation**

63. List of all pending or threatened litigation relating to or arising out of the operation or management of the Company since incorporation, including, without limitation, parties, remedies sought, and nature of actions. (Actual pleading may be required after examination of list)
64. Material documents and filings in above-mentioned litigation
65. Attorney's letters to auditors since incorporation
66. List of, and principal documents relating to, all pending or threatened inquiries or investigations by governmental agencies, including, without limitation, tax authorities
67. Any decrees, orders or judgments of courts or governmental agencies
68. List of all current and prior law firms, accounting firms and other consultants
69. Warrant and returns policy

## **Marketing**

70. List competitors and details of market share
71. List of major clients
72. List of pending clients
73. Analysis of pricing strategy
74. Current brochures and marketing materials
75. Sales commission structure
76. Sales projections by product line
77. Any pertinent marketing studies conducted by outside partners
78. Complimentary goods and inputs
79. Strengths and weaknesses of product
80. Benchmark against nearest competitor
81. Competition percentage of the market (include stage, market share, funding and strategic outlook)

## **Directors, Management, and Personnel**

82. List of Company's Directors
83. Management organization chart and bios of senior personnel
84. Detail of any labor disputes
85. Detail of various employee compensation plans including pension, option, profit sharing, deferred compensation and retirement
86. Detail of various management incentive plans including pension, options, profit sharing, deferred compensation, and any non-cash compensation
87. Confidentiality Agreements with employees
88. Consulting Agreements
89. Relatives, spouses, friends working at Company
90. List of salaries and bonuses, including accrued but unpaid salaries and bonuses for officers, directors, and key employees
91. Management employment agreements
92. Offer letters to employees
93. Personnel policies and procedures manuals
94. Pension and retirement plans
95. Labor/collective bargaining agreements and details of labor organizing efforts
96. Details of grievances, terminations, etc.
97. Noncompetition agreements
98. Employee confidentiality and invention assignment agreements
99. All other material agreements with any employee, consultant or agent past or present
100. List of employees and job descriptions with organization chart.
101. Summaries of oral arguments or promises of future benefits

## **INTELLECTUAL PROPERTY**

102. Agreements between shareholders or employees of the Company and other former employers (including employment agreements, termination agreements, non-disclosure agreements, patent assignments, and correspondence relating to intellectual property matters)
103. List of all foreign and domestic patents and patent applications held by the company
104. List of any copyrights, trademarks, trade names or service marks. (Copies of applications may be requested in follow-up requests)
105. Copies of all agreements for licensing of technology from third parties.
106. Copies of all material agreements for licensing of Company technology to third parties, including cross licenses and all exclusive licenses whether or not otherwise material
107. Summary of any claims of infringement or misappropriation of intellectual property rights, including relevant litigation documents, if any
108. Documents pertaining to or describing the Company's policies regarding trade secrets and proprietary information.
109. Copies of all agreements under which the Company developed, acquired or divested any Intellectual Property
110. List of all royalty or other payment obligations of the company to third parties for Intellectual Property
111. Nondisclosure and confidentiality agreements
112. List of persons to whom intellectual property has been disclosed and the date of disclosure
113. Government grant agreements or other agreements for funding of research or development

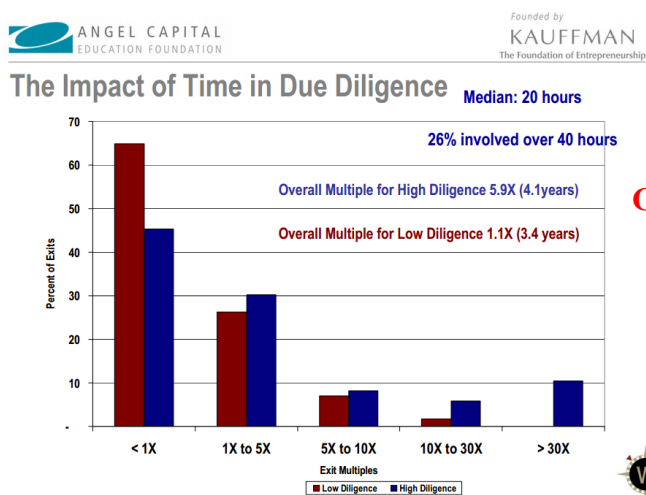
Company Specific Risk	Source Documents	Green (low risk)	Yellow (some risk/mitigatable risk)	Red (high risk)	Black (unacceptable)
<b>Legal and Regulatory Risk</b>					
Lawsuits or pending litigation	PACER Records, state court records, legal documents provided by the company	None outstanding	Awareness of risk of minor lawsuits or unpaid but settled minor litigation	Currently subject to active litigation claims	Currently subject to large active litigation claims
Regulatory approval and filings (list below)	Filings provided by the company	Current			
Registered and able to do business in all locations	Filings with each relevant Secretary of State	Properly filed documents in every state			
<b>Industry specific legal and regulatory risk (healthcare)</b>					
FDA approval required?	Evaluation offered by company's legal counsel	No	yes (if medical device)	yes (if drug)	
FDA approval stage?	Communication between company and FDA	Class I device that has been filed; Class II device with a reasonable predicate		Unfiled; Class III Device; Early stage Drug	
<b>Contractual risk</b>					
Contracts with key vendors					
Contracts with key customers	Employment agreements; any documents used in employment negotiations	Employees w/ non-competition and non-solicitation agreements	independent contractors w/ disclosure agreements, invention assignment agreements	Independent contractors w/ very few, if any, auxiliary contracts	
Contracts with key employees					
Debt financing agreement					
<b>IP risk</b>					
Status of patents	Documents filed with the Patent and Trademark Office	Patent has been issued	Patent has been filed but not granted	No patent; application has already been patented in another country	A competitor has already patented a core element
Status of Trademarks	Documents filed with the Patent and Trademark Office	Registration with the USPTO; Considered an "inherently distinctive mark" and has been used in interstate commerce; if "descriptive mark," has been used in commerce and has developed a secondary meaning	if "descriptive mark," has been used in commerce but hasn't developed a secondary meaning	Hasn't been used in commerce, isn't registered with state or federal PTO, very similar to extant trademarks	Copyrighted works made by contracted employees who didn't specifically cede their interest in the work
Status of copyrights	Documents filed with the Register of Copyrights	Claims are differentiated both in scope and class	2-5 years till expiration	Very broad patent claims	Have not evaluated whether
Narrowness/ broadness of patent	Documents filed with the Patent and Trademark Office	> 5 years till expiration	Have identified trade secrets and haven't exposed them to outsiders, but don't have a comprehensive protection plan	< 2 years till expiration	any of the company's IP would have implemented trade secret protections and have exposed trade secrets beyond a point where protection could be expected
Time to patent expiration					
Trade Secrets?		Fully implemented trade secret policy			



Industry specific IP risk (healthcare)	Design or utility patent	provisional patent	No patent
Type of patent	Documents describing IT, information segregation, encryption		
Confidential Information (HIPAA protected)	Documents describing IT, information segregation, encryption		
Protections on Confidential Information (IT related)			
<b>Investor Specific Risk</b>	<b>Source Documents</b>	<b>Green (Investor Favorable)</b>	<b>Yellow (Neutral)</b>
Company Failure Scenario	Convertible preferred note		<b>Red (Company Favorable)</b>
Priority of instrument in Bankruptcy	Term Sheet	Debt or Preferred equity	<b>Black (Unacceptable)</b>
Successful Exit Scenario	Term Sheet	Common Equity	Subordinate debt without equity upside
Dilution protection	Term Sheet	Full Ratchet Antidilution	Entrepreneur/Company is non-dilutable
Right to participate in additional rounds	Term Sheet; Certificate of Incorporation	Super pro-rata participation right	Company and earlier investors are non-dilutable
Liquidity preference	Term Sheet; Certificate of Incorporation	Participating preferred stock Demand Rights beginning within 2 years; Piggy-back rights	No participating rights nonparticipating preferred stock; Company retains call rights
Registration Rights	Term Sheet; Certificate of Incorporation	Voting preferred shares; exclusive control over some number of board seats, class veto power over some types of amendments	No registration rights
Participation in decision making/ voting rights	Term Sheet; Certificate of Incorporation	voting preferred shares w/ no domains of exclusive control	non-voting preferred shares
<b>Going Concern Scenario</b>			
Ability to force sale	Term Sheet	Ability to force auction sale	2/3 voting shares required to approve any sale
Ability to redeem capital	Term Sheet	Mandatory redemption	2-4 year tranche redemption option after 5 years at small premium
Ability to transfer shares	Share purchase agreement;	Co-sale agreement	Buy-Sell Agreement (depending on terms)
Participation in decision making/ voting rights	Term Sheet		Right of First Refusal Does company have second class of non-equity voting shares?

## I. Introduction

Due diligence is used to avoid costly investment mistakes, minimize risk, choose investments for committee approval, and facilitate negotiations with entrepreneurs/founders. The value of conducting due diligence positively correlates to investment returns.<sup>1</sup> A Kauffman Foundation study based on the number of hours spent on due diligence prior to investing suggests the importance of conducting due diligence (Graphic A). Angel investors may not have the time, inclination or resources to perform sufficient due diligence for the purposes of reducing investment risk. This handbook is a tool kit for conducting due diligence efficiently and thoroughly to the benefit of those angel investors considering companies wishing to be included in the new healthcare portal by Dabney Financial, Inc.



**Graphic A: The Impact of Time in Due Diligence**

Due diligence is an attempt to mitigate the risks associated with investing generally, in private companies, and for the purposes of this tool kit, companies in early- to mid-growth stage in the medical and healthcare arenas. Though not exhaustive, below is a list of risks associated with private investment in medical companies:<sup>2</sup>

Regulatory risk:	FDA approval, length of time to approval.
Funding risk:	Timeline to next funding; funding requirements to FDA approval
Liquidity risk:	Risk to return of shareholder capital: IPO market, Pharma industry
Execution risk:	Management mistakes; recruitment and personnel issues
Reimbursement risk:	Reimbursement codes from Medicare are not obtainable
Idiosyncratic risk:	Negative individual patient results
Unknown risks:	Political changes, global circumstances

<sup>1</sup> (Kauffman, 2015)

<sup>2</sup> (Forbes, 2011)

While the above risks cannot generally be reduced by conducting due diligence, many other risks associated with private equity investments can be mitigated with proper due diligence. They generally include those risks that are discernible through research and document review:

Management:	Verification of credentials (degree verification, credit scores, addresses)
Market:	Current industry market conditions
Model:	Review of business model proffered
Financials:	Do the numbers add up both historically and projected
Money:	Money on hand; burn rate; cash necessary to next round

## II. The Due Diligence Report.

A due diligence report is the best efforts of a due diligence team to identify (and thereby minimize) risk and summarize opportunity for a qualified investor, termed “accredited investor” by SEC rules, which are defined by Regulation D (or “reg D”).<sup>3</sup> If an investor is accredited, and interested in early stage investment, they are likely to have some experience regarding investment in general. Angel investing, or investing in higher risk/higher yield private entities directly, using one’s own funds, usually follows a traditional investment history, where yield correlates with risk.

*Note of caution:* Unless retained as an expert in your field, a due diligence report done for a third party investor or investors is *not* the following:

1. Your opinion
2. War and Peace
3. Conclusive

Often in due diligence it is more important to identify the questions than the answers. This paper will give you a framework to use in analyzing companies, questions to ask and hints on methods to use for gathering and analyzing information.

**A. Format:** All due diligence starts with a business plan review and ends with a final report for investors. The format for the final due diligence report should be as follows:

1. Cover page
2. Table of contents
3. One or two-page executive summary with visual metrics in a chart on all subjects (Exhibit D)
4. Larger discussion of each section of the due diligence completed
5. Discussion of that which was not done; alerts to investors about risks, both known and unknown
6. Addendums with charts for documents acquired and reviewed
7. Footnotes and sources used for the due diligence

No two due diligence reports will require the same exact methodology. Therefore, this DD “toolkit” is a framework for companies presented as having gone through this independent process as a condition for being accepted for inclusion in an on-line funding portal for mid-stage healthcare companies through Dabney Financial, Inc.

<sup>3</sup> (U.S. Government Publishing Office, 2015)

**B. Components:** There are four general components of due diligence for post revenue startups, generally done in the following order:

- 1. Market and Competitive Analysis:** Due diligence should determine the business environment and competitive landscape for the product or service being offered by the target company. Many times this analysis is the most important. Without a market, there is no exit and no return on investment. (However, there may be room to *create* a market)
- 2. Company financial analysis:** The company-provided financials, including timelines and assumptions, are analyzed. If the figures do not convey confidence that the company has made correct assumptions the investment will either fail, or worse, it will linger (what many in the industry call “dead deals walking” because they don’t thrive). Financials not only verify information, they provide a basis for valuing a company. Everything is a negotiation. Every round. With every investor.
- 3. Management and Founder Analysis:** A clear summary of the participants past, current and future is integral to allowing the investor to determine, in his or her own opinion, if the current team can take the investment to an exit. It can indicate what further expertise is required or may be lacking.
- 4. Document Review and Legal Analysis:** Critical for the lawyer in each of us is to review, verify, and research all documents signed and executed by the company, as well as those documents that should be in the files, and those that were signed and have expired. Keeping track of everything that you do during the due diligence process is integral to the integrity of the final product and will be included in the report. Though somewhat pedantic, this due diligence workbook includes explanations for the manner in which those requests, interviews and document reviews are kept, including examples of methods for inclusion in the final report.

## II. Due Diligence Process:

### A. Market and Competitive Analysis

#### 1. Business Plan/Presentation Review

Read all presentation materials and the business plan for statements made by management. All marketing, management and financial assumptions should derive from the business plan, so start by giving it a thorough read.

- Highlight all assertions made.
- Follow up and verify all footnotes are provided.
- Request backup for every important claim made.
- To save time, require the management to provide this backup. They made the claim. Do not waste your time looking up resources where the basis was not supplied.
- Indicate in your copy of the business plan where back-up was not obtained or provided.
- In reviewing the footnotes, indicate where a reading of the back-up was cherry picked or incorrectly applied to the assertions made.

## 2. Market Analysis

- a. **Market opportunity.** This might be the most important single piece of research to get right. It can also provide a quick go/no go moment if the market is not sufficiently large enough to coincide with the risk of investment. For example, a company may have a great solution for its customer's problems, but there are only 10,000 potential customers worldwide that need the product. This may be OK if the product is a big-ticket item (like an airplane) but if each product only net's the company \$10 and each customer only uses ten per year, that means each customer is worth \$100 and the potential market size is only \$1,000,000 (\$100 x 10,000 customers), a very small market.

An investment may also be a no-go if the market analysis cannot corroborate a demonstrated need for the product among the potential customers and a basis on which the company will compete.

Here are some questions to determine whether there is a significant market opportunity for this product.

- **What** is the need? What is the customer problem being solved?
  - **Who** has the need? How compelling is their need? Who is the target buyer?
  - **How** does the product meet the need? How is this product better and different from its competitors? Is the company competing on price? Features? Performance? How are potential customers meeting the need today?
- b. **Validation of Market Opportunity** Research needs to answer the following questions:
- **What:** Does the customer need really exist? Does the company have data to prove this? How good is their data?
  - **Who:** Are there enough customers? Is there at least \$1billion being spent today in this sector? How has the company sized the market? Do we agree? Can we size it ourselves? How difficult are the buyers to find and sell to?
  - **How:** What competition is out there - either real today or potential competition? Does the company know their competitors? Have they made an evaluation of, and can they articulate, their competitive advantage? <sup>4</sup>

## 3. Competition.

Identify the company's competitive advantage. Validate the company's competitive advantage. Is the company competing on price (cost) or differentiation, or both? It should be clear which strategy the company is pursuing from its presentation and business plan.

The goal is to identify not only the immediate competitors, but the competitive environment. Understanding the competitive environment requires knowing not only the competitive companies, but also how they are competing. Do some sell on price? Quality? Features ("superior

SpermCheck® offers home male fertility test products that discreetly and accurately indicate if a man's sperm are healthy for reproduction. *What is SpermCheck's competitive advantage? Competitive environment? Differentiation?*

<sup>4</sup> (Seeds, 2009)

breathability” is a Band-Aid claim, others include cartoon characters or waterproof adhesives). Do some garner market share by manufacturing the store brands? Do some make larger quantity deals with hospitals? Are there alternatives to bandages for wound care (i.e. sprays/liquids)? Are there technologies that threaten to displace the current technology (is there an app for that)? Are any of the competing products protected by patents or other intellectual property? Is the competitive product sold through distributors? Are there any controlling laws, or licenses or approvals required to enter the market?

Competition is against the landscape that the target company will compete. Does the company have a strategy that directly addresses the question: why will a customer choose our product over our competitor’s?

Furthermore, and often more important, how does the company plan to reach that customer? By asking this question, we cross the line into marketing and selling, but marketing and selling strategies derive directly from understanding the competitive landscape and are vital to each company’s go-to-market plan.

Here are some tips and techniques for researching the competitive environment:

- Competitive market analysis is an art, not a science.
- Be creative with search terms, follow co-branded industries; develop your own sense of the market and strategies for verifying the environment for the product/device.
- Review and verify management’s assertions as to its market then find markets that may affect the competitive environment.
- Once you’ve determined the space, or spaces as the case may be, that the company will compete in, call industry leaders and request an expert. For instance, the closest university may have an expert in the field at hand. Check LinkedIn at your own alma mater to find credible industry experts, including but not limited to those that invest at the next level through funds. Try to get opinions both positive and negative to allow the investor to choose which statistic they believe, and to mitigate your risk of becoming biased.
- Interview medical personnel as to the value of the concept or their perception of the industry and trends.
- Interview buyers, users, and the individual(s) responsible for purchasing the product for an organization.
- Provide an industry competitors’ features analysis grid (Graphic B).

*Search for similar products or needs. For example, search for “male infertility” and “at-home diagnostics.” Use Google Scholar to find research articles on new and existing technologies in the pipeline for this market. Sometimes barriers to success are simply educating the market to an entirely new technology, making SpermCheck a marketing play first.*

## Graphic B: Vidrunner Features Competitive Analysis Matrix

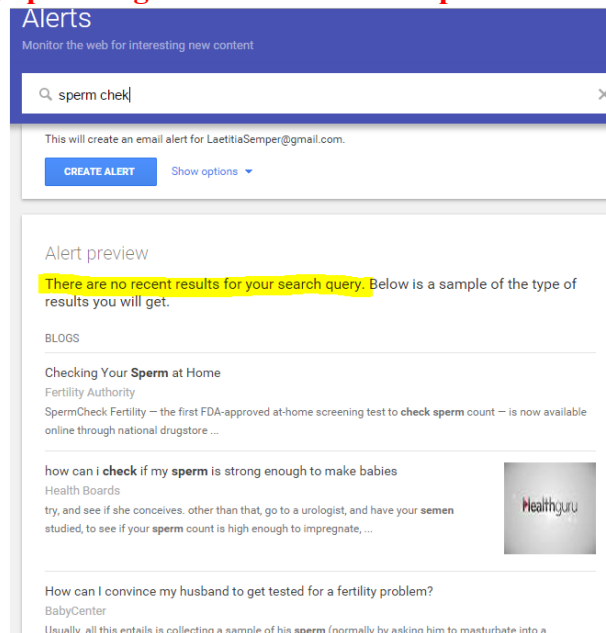
<u>Metric</u>	<u>Vidrunner</u>	<u>AT&amp;T</u>	<u>Livecast</u>	<u>Qik</u>	<u>Fring</u>
<u>Peer to Peer Streaming</u>	√	-	-	-	√
<u>Mobile to Mobile</u>	√	√	√ (website)	√ (website)	√
<u>True Live Streaming</u>	√	√	(>30 sec delay)	(>30 sec)	√
<u>One to Many</u>	√	-	√ (web)	√ (web)	
<u>IM: Buddy List</u>	√	-	-	-	√
<u>Standalone without other products</u>	√	√	√	√	
<u>Scalable at Low Cost</u>	√	-	-	-	√
<u>Sense of Presence</u>	√	-	-	-	√
<u>Content Private/No Content Liability</u>	√	√	-	-	√
<u>GPS Location-Sender/Video</u>	√	-	√	-	-
<u>GPS Location--Viewers</u>	√	-	-	-	-
<u>Opt-In Viewing</u>	√	-	√	√	
<u>Device Independent</u>	√	-	√	√	√
<u>Network Independent</u>	√	-	√	√	√

Here are a few methods for scanning the market during the due diligence time frame to collect information (using at-home diagnostic SpermCheck® as an example):

Google Alerts: For information on the market, set up several Google Alerts for daily delivery to your Gmail.

- Terms:
- The name of the product or device (“SpermCheck”)
- Industry buzz words (e.g. home diagnostic tests; male infertility; sperm count)
- Words or phrases with co-located with the competition (e.g. E.P.T.)

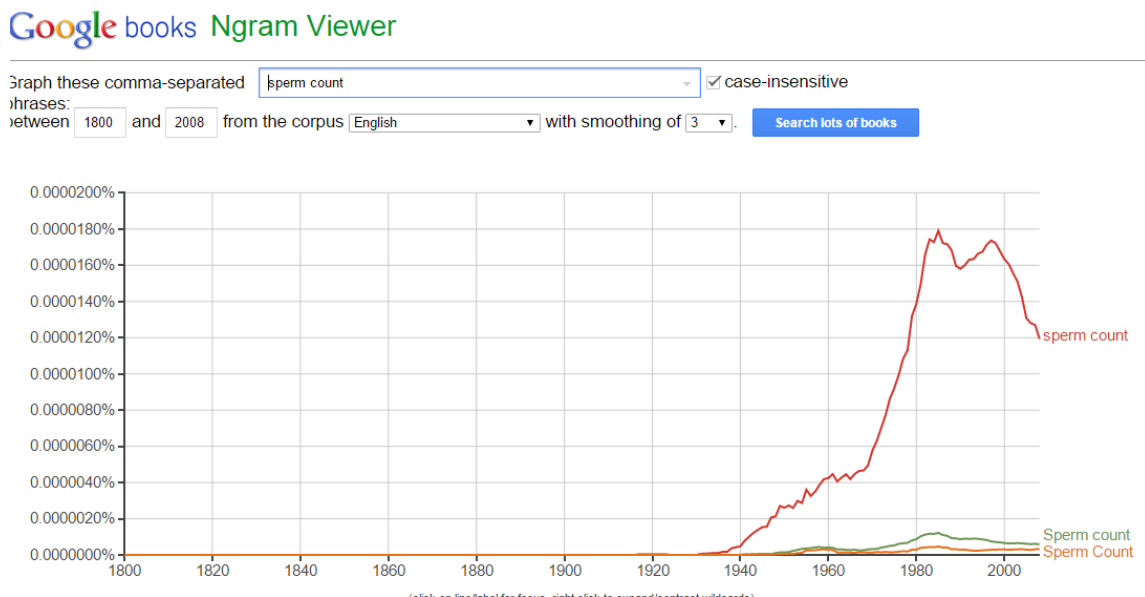
### Graphic C: Setting up a Google Alert for Terms “Sperm Chek” and “SpermCheck”



Ngram Viewer: For products reliant on interest in the subject, use Google’s Ngram Viewer.

Using “sperm count” on Ngram reveals the following changes in books and periodicals discussing the term (Graphic E).

### Graphic D: Ngram Viewer Results for “sperm count”



**Website Usage:** Google the name of the company and the industry and determine website traffic to sites like WebMD or others that may have statistics indicating how many people over a period of relevant time (last 3 years perhaps) have “Googled” male infertility. How big a subject is it? Review any and all articles written for freshness, paid articles and other areas where the indications might be that current information for online marketing is not up-to-date.



## Graphic E: Using Google Alert - Stale interview



### B. Company Financial Analysis: Company financial analysis derives from the following:

- QuickBooks file
- Tax Returns
- Business plan financials (income statement, balance sheet, cash flow statement)
- Financial statements (presented at board meetings/sent to investors periodically)
- Forward-looking budgets

After obtaining the above documents, perform basic financial analysis:

- **Cash-flow analysis** (static, historically, next 12 month projected vs burn rate). Is cash from a debt or equity raise?
- **Income statement** (for startups/early stage companies, a 12-month trended monthly presentation of the income statement is ideal).
- **Balance Sheet analysis**
- **Cap table analysis**

*It is in its forensic analysis of the thinking behind the model where an early-stage investor really gets a feel for how the founder thinks and how he/she wants to direct the company in the near future. Next, it is in how his/her cash will be used efficiently to accomplish the mutually agreed goals.*  
(Eduardo, 2012)

Next, graph the above information that looks interesting. For instance, graph major line items such as revenue, gross income, operating costs, and operating income, if any. When the business has no income, developing a trend of burning cash will determine how it is burning cash, and how long it has until it runs out. It will also provide the basis for a determination if the forward-looking budget, which underpins the need for the cash being raised, is realistic *based on past performance*.

- Develop percentages for categories, look at trends over quarters and years, high light large changes.

- Look at revenue, profit/loss, and burn rate: by year, quarter, and by month.
- Review all the financials presented at each shareholder and board meeting and compare to the information you've been given.
- For a certain number of shareholders, do the capital accounts of funds paid in as equity agree with the cap table in QuickBooks and that which is given to the DD team?
- Review the company's intended "Sources and Uses of Funds" from the business plan against how funds have been spent thus far. Are they aligned historically? Were the funds be used to take the company in an entirely new direction, or the original proposed direction?
- Determine the last three-month average current burn rate and compare it to the past year's average monthly burn rate. Provide a graph indicating the trajectory of the latter.

**Funds:**

- Request a Sources and Uses of Funds for the upcoming round.
- Request a forward looking Excel spreadsheet with the historical data previously obtained but now with the intention going forward. A "best guess" scenario by the founders.
- Verify and extrapolate if their numbers align with the intended uses of funds and if the math actually backs that up.
- Calculate the next year going forward's average burn rate from the extrapolated numbers provided in the 2<sup>nd</sup> Excel spreadsheet. Determine if the trajectory matches the funds to be taken in.
- Indicate the top three reasons for the change.
- Based on a 100% raise in the time period allotted plus the funds currently in the bank account at the moment the due diligence report is almost finished, determine how many months the current raise will last if all management/founder assumptions for this raise come to fruition.
- Plot the above by month.
- Recreate a worst case scenario if the funds are raised, but certain events do not occur. Show any effect on timelines; consequences of extending them and therefore. Project best and worst case scenario (timing, and amount if possible) on next raise, or future raises affecting exit.

**Table A: Cap Table – PathSensors, Inc. (provided by company)**

**Table 2** may be more easily followed by investors. Unfortunately, both **Table 1** and **Table 2** lack dates above the rounds and indications of where a check was written, or if shares were issued to the investor for some other reason. **Table 2** cap table indicates that J. Pallag participated in each of these first three rounds, including founders' shares.<sup>5</sup>

PathSensors, Capitalization Table (Current Financing and Option Pool Reserve)													
Last Name	Series A Preferred	Series A %	Series B Preferred	Series B %	Common Stock	Common %	Total Shares	Total Current %	Convertible to Common		Fully Diluted	Fully Diluted %	
									Options	Warrants			Debt
Innovative Biosensors, Inc.	1,250,000	100.00%	0	0.00%	0	0.00%	1,250,000	46.13%	0	317,500	0	1,562,500	34.63%
Blu Venture	0	0.00%	390,000	59.09%	0	0.00%	390,000	14.39%	0	97,500	0	487,500	10.80%
Ted Olsen <sup>2</sup>	0	0.00%	110,000	16.67%	665,000	83.13%	775,000	28.60%	0	27,500	0	802,500	17.78%
Chesapeake Emerging	0	0.00%	85,000	12.88%	0	0.00%	85,000	3.14%	0	21,250	0	106,250	2.35%
Evergreen Capital	0	0.00%	25,000	3.79%	135,000	16.88%	160,000	5.90%	0	6,250	0	166,250	3.68%
Richard C. Faint, Jr.	0	0.00%	25,000	3.79%	0	0.00%	25,000	0.92%	0	6,250	0	31,250	0.69%
DBED	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	25,000	100,000	125,000	2.77%
Empower Baltimore	0	0.00%	0	0.00%	0	0.00%	0	0.00%	0	0	750,000	750,000	16.62%
Ed Harrell	0	0.00%	25,000	3.79%	0	0.00%	25,000	0.92%	0	6,250	0	31,250	0.69%
<b>Totals</b>	<b>1,250,000</b>	<b>100.00%</b>	<b>660,000</b>	<b>100.00%</b>	<b>800,000</b>	<b>100.00%</b>	<b>2,710,000</b>	<b>100.00%</b>	<b>0</b>	<b>502,500</b>	<b>850,000</b>	<b>4,062,500</b>	
Unissued Options										450,000		450,000	9.97%
Fully Diluted Total												4,512,500	100.00%
Unissued Warrants -												187,500	4.16%

Footnote: <sup>1</sup> EMC Warrant is issued if Corporation prepays the loan before conversion for 187,500 Common Shares on terms to be negotiated at the time of prepayment.

<sup>2</sup> This warrant would be in lieu of the shares to be issued upon the note conversion by EMC prior to repayment.

<sup>3</sup> 265,000 Common Shares held by Ted Olsen are subject to vesting and forfeiture.

<sup>5</sup> (Kauffman Foundation, 2006)

**Table B: Cap Table: Luka Bloom (by financing rounds)<sup>6</sup>**

Shareholder Name	Founders Common			Preferred A Round (Angels)			Strategic Acquisition Stock Option Pool			Preferred Round B (Angels)			Venture Capital Round				
	Date of Issue	Number of Shares	% of Total	Date of Issue	Investment @ \$0.10/Share	Number of Shares	% of Total	Date of Issue	Number of Shares	% of Total	Investment @ \$0.30/Share	Number of Shares	% of Total	Date of Issue	Investment @ \$0.25/Share	Number of Shares	% of Total
R. Luka	8/4/98	5,100,000	88.00%														18.25%
J. Bloom	8/4/98	2,100,000	28.00%														7.51%
J. Pallag	8/4/98	300,000	4.00%														1.07%
Hanson Tech								2/4/99	1,000,000	7.87%							3.88%
Employee & Director Options								3/5/99	1,700,000	13.99%							6.08%
Subtotal: Common		7,500,000	100.00%					10,200,000	80.31%		10,200,000	63.39%				10,200,000	36.49%
C. Doerr				9/17/98	\$25,000	250,000	2.50%										0.88%
A. Fritz				9/17/98	\$25,000	250,000	2.50%										0.88%
D. Ohson				9/17/98	\$25,000	250,000	2.50%							2/4/00	\$62,500	250,000	1.79%
C. Sroafer				9/17/98	\$25,000	250,000	2.50%										0.88%
Z. Assaf				9/17/98	\$50,000	500,000	5.00%										1.79%
B. Ujm				9/17/98	\$50,000	500,000	5.00%										1.79%
J. Pallag				9/17/98	\$50,000	500,000	5.00%										1.79%
Subtotal: Pref. A					\$250,000	2,500,000	25.00%		2,500,000	19.69%		2,500,000	17.01%			2,750,000	9.84%
D. Ohson														4/18/99	\$100,000	200,000	1.36%
J. Pallag														4/18/99	\$250,000	500,000	3.58%
A. Slattery														4/18/99	\$100,000	200,000	1.36%
D. Kearley														4/18/99	\$75,000	150,000	1.02%
D. McCure														4/18/99	\$125,000	250,000	1.70%
L. Kruber														4/18/99	\$100,000	200,000	1.36%
J. Jon														4/18/99	\$150,000	300,000	2.04%
D. Grover														4/18/99	\$100,000	200,000	1.36%
Subtotal: Pref. B															\$1,000,000	2,000,000	13.61%
Ruby Venture Group																	
Subtotal: Venture Round		0	0.00%											2/4/00	\$3,000,000	12,000,000	42.99%
Subtotal: Preferred						2,500,000	25.00%	2,500,000	19.69%		4,500,000	36.61%				17,750,000	63.51%
TOTAL SHARES		7,500,000	100.00%			10,000,000	100.00%	12,700,000	100.00%		14,700,000	100.00%				27,950,000	100.00%
Pre-money Valuation						\$750,000					\$6,350,000					\$3,675,000	
Post-money Valuation						\$1,000,000					\$7,350,000					\$6,987,500	

<sup>6</sup> (Kauffman Foundation, 2006)

### C. Founders, Management and Board Analysis:

The single most important part of a successful company is its founders and management (may be the same people). They are the ones that should have the experience to understand their market and how to compete. They are the ones that are responsible for executing the strategies and business plan to make the company a success.

We are looking for good character, veracity, subject matter expertise, a willingness to learn or bring in others when required to succeed, and the skill set required to run and grow a company (which is different from the skill set required to create the product).

Like other parts of due diligence, there is some art involved in assessing management and sniffing out BS. Here are some tips and techniques:

#### 1. Background Verification:

**Interviews:** Interviews (for anything from customers, to board members, management team, purchasers and experts) are important. Use a grid (Graphic F) to keep track of meetings and interviews.

### Graphic F: Example: Interview Grid for DD Report

#### Diligence Meetings/Reference Calls

<b>April 10, 2007</b>	Richard Crawford met with all four owners of NexGenVS (Peter Lazar, Jeff Handy, Bob Slocum, and Joseph Balac) at Manassas Facility of Fulcrum IT
<b>May 4, 2007</b>	Richard Crawford met with Peter Lazar and Rick Morrow in Charlottesville
<b>May 8, 2007</b>	Richard Crawford discussed patent status with Tom LaBreque of NextSteps Research in Northern Virginia
<b>May 18, 2007</b>	Richard Crawford met with Peter Lazar in Charlottesville
<b>May 30, 2007</b>	RC met with Peter Lazar and Rick Morrow (potential new CEO) in Charlottesville
<b>June 8, 2007</b>	RC met with NGVS owners (see above) and Rick Morrow, Tyson's Corner, VA
<b>June 16, 2007</b>	RC met with Peter Lazar in Charlottesville
<b>June 25, 2007</b>	RC met with Peter Lazar in Blacksburg
<b>June 26, 2007</b>	RC met with Peter Lazar and Will Stacey (Project hire as Operations Mgt), Blacksburg, VA
<b>June 26, 2007</b>	RC met with Peter Lazar and Andre Muelenaer, Medical Director, Carilion Biomedical Institute in Roanoke, VA re telemedicine value for VidRunner technology
<b>July 13, 2007</b>	RC met with Peter Lazar and Doug Juanarena, Blacksburg, VA
<b>July 16, 2007</b>	RC & Letitia Green met with David Martin, President, M*CAM, Charlottesville to review validity of independent patent report by NextSteps Research.
<b>Aug 1, 2007</b>	RC met with Peter Lazar and Isaac Simantov, Manassas, VA to discuss the technology.
<b>Aug 14, 2007</b>	RC, LG and Mike Drzal, attorney for Vidrunner, met with Rick Morrow, potential new CEO

Numerous additional reference calls were made in the four months between April 1 and August 15<sup>th</sup>. The details obtained from these calls and meetings have been incorporated in the text of the due diligence report.

**Resumes:** Request resumes and/or CVs on all management, and if a small company, all personnel. CVs provide a chronological indication as well as jobs and may help to determine multiple moves between companies and to different addresses.

**Education verification:** If the investment looks imminent, the final part should be to request that all college transcripts that are relevant to the future of the investment be requested to be sent by each individual from their institution (just like for a security position). For instance, if indicating a degree in CS from MIT and the product is a medical device requiring no coding, it may not be entirely necessary to get more than the CV.?

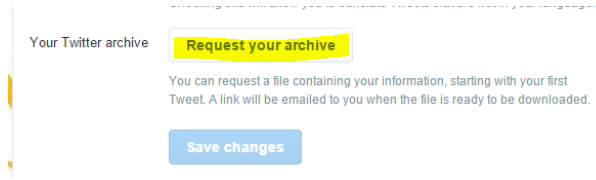
**Google:** Just Google the names, home addresses, spouse’s name, and Zillow for value and ownership of homes. Do not include this in the DD report, but keep it for back-up and for indicating any issues that may arise from these searches.

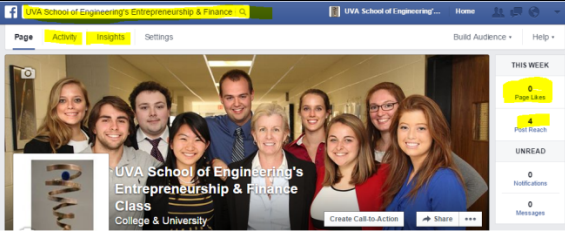
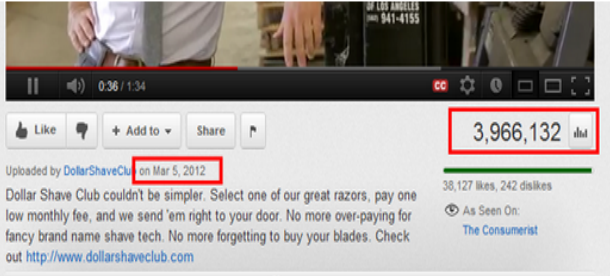
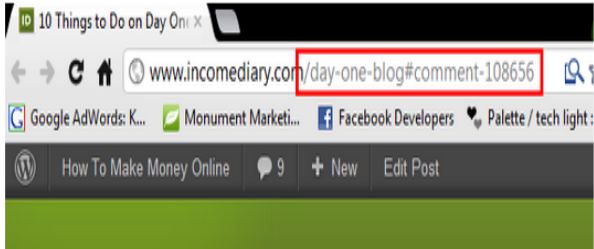
**Security Check:** If the founders or management intend to sell to a government market or any market requiring security clearances for personnel and the company, a thorough background check through a reputable service should be performed and the summary included in the DD report.

**Ancestry:** If there appears to be no good information (individuals have somehow achieved a way to mask regularly available online information on them), join Ancestry.com for a month and put in their names and dates of birth, known locations lived and perhaps family members (particularly parents) and build a mini tree. Ancestry is an unknown but amazing resource for individual research as it has addresses, criminal records, telephone numbers, children and parents.

2. **Social Networking Analysis:** Below are some ideas for assessing social media as it relates to the company:

**Table C: Social Networking Analysis**

Accounts	Check using	
Twitter accounts (personal & professional) <ul style="list-style-type: none"> <li>a. Employees</li> <li>b. Company</li> <li>c. Management</li> </ul>	Determine all the twitter accounts. Review the postings, who they belong to by going to each of the accounts and following them. Ask them to follow you also. Company comments, ill-advised comments, negative commentaries, are red flags. Review their history. If twitter followers matter to the investment, use/request management to sign up for twittercounter or twitteraudit and have weekly stats of users, and verified accounts sent to your email. Request management get an archive and send it to you for review.	

<p>Facebook pages</p> <ol style="list-style-type: none"> <li>Employees</li> <li>Company</li> <li>Management</li> </ol>	<p>If FB figures into the investment analysis, and the company has a FB page, request weekly stats on the company page. FB <b>Insights</b> provide information about a Page's performance and are available after at least 30 people like a Page. Historical stats are available using Insights.</p>	
<p>YouTube/Vimeo Video</p> <ol style="list-style-type: none"> <li>Employees</li> <li>Company</li> <li>Management</li> </ol>	<p>If a website has a YouTube or Vimeo video embedded on the homepage, click to "Watch on YouTube." If the video is public, both YouTube and Vimeo will show the view counts. Also check the upload date to estimate how many people view it per month.<sup>7</sup></p>	
<p>Blogs:</p> <ol style="list-style-type: none"> <li>Employees</li> <li>Company</li> <li>Management</li> </ol>	<p>Gauge the popularity of a blog: look at how many comments it gets per post. ....an average of 1 out of every 200 readers leaves a comment. So a post with 20 non-Nicholas comments was viewed about 4,000 times. This changes with every post and every blog, but again, it gives you a general idea. Immediately after you comment on a WordPress blog, your browser redirects you to where your comment will show up. If you look at the URL, you'll see something that looks like this (see graphic). The second half of the URL tells you that you left the 108,656<sup>th</sup> comment on IncomeDiary.com. This number includes spam comments. Assume that 75-90% of the comments are spam and you can get an idea of how many comments a site has had since day one.<sup>8</sup></p>	
<p>Website(s)</p>	<p><a href="#">Google Trends for Websites</a> is another tool that's similar to Alexa and Compete, except, it's a Google tool, so it's more accurate.<sup>9</sup></p>	
<p>LinkedIn</p>	<p>Review and printout each persons' LinkedIn and determine intersections of people, if the LinkedIn matches the resume, if the connections in the target market industry are extensive or limited, and any other determination.</p>	

<sup>7</sup> (How Much Traffic Websites Get, 2015)

<sup>8</sup> (How Much Traffic Websites Get, 2015)

<sup>9</sup> (How Much Traffic Websites Get, 2015)

- 3. Relationship Analysis.** Probably one of the most undervalued due diligence tricks to determine how a company is run, uses and used its previous raises, and who holds the deciding votes (or negative votes) for future decisions. Many turned over rocks in this area can reveal historical issues that boards try to minimize when the company is in need of funds and the board's own shares and investment are at risk.

Request a tranche formatted cap table, as well as a regular cap table. A tranche-formatted cap table lists investors by the date of the raise, indicating quickly and visually which investors joined new rounds, showing support, or lack thereof for various rounds.

- How many investors are there and when did each first become investors (date and size).
- How many shareholders paid for their shares? How many shares were given to shareholders? For what reason(s)?
- A running cap table provides the most easily visible method for determining the life of each round.

**Cap Tables: Table A** (page 13) was provided by the CEO of PathSensors, Inc., prior to a 2015 round. It indicates shareholders' percentage ownership. However, it lacks several key pieces of information necessary to provide potential investors with a potentially interesting historical understanding of the company.

- True ownership percentages versus influence
- Which shareholders and/or board members were given shares, rather than writing a check
- Which shareholders participated in each round

Using the spreadsheet information from the document review and analysis of signatures (outlined in the next section), build your own cap table, separate from the one in the business plan. You can either attempt this, or go back and verify that the documents actually signed and executed by both parties match with the provided cap table.

Regardless of what is provided, develop a detailed cap table by tranche, such as that in **Table B** (page 14), permitting investors to easily see the progress and results of raises.

**Relationship Influence Analysis:** In order to determine outsized voting influence among shareholders, the relationship between the tax ID entities is important to unravel. Essentially, how do these people know each other? Who introduced them? Are any related to each other or to people who work at the firm? Request relationship intersections from management (how people met each other) and map them in a grid (see **Graphic K** for an example).

**Negative Covenants:** Another way to determine outsized influence is to determine if any board member enjoys negative covenants such as rights of refusal for decisions made by the board (such as hiring anyone with a salary over a certain amount, or having prior approval for any new financing rounds or dilution requests).

**Side Letters:** Side letters are agreements in writing that CEOs are permitted to bind the company to without anyone else's knowledge. Many are agreements to provide reimbursement for costs for a particular board member, or to pay the legal fees in a round for one investor who won't invest unless the company agrees to this. There are many other types of side letters but suffice it to say they are similar to the CEOs right to bind its company to a vendor contract. It is important to finish due



diligence with a request that all board members, advisory positions, founders and management indicate *in writing* that there are *no known side letter agreements* with anyone. Determine if there were previous side letters/agreements that are no longer in effect.

Again, and for emphasis, determine if any of the shareholders received stock without writing a check. And, how much and why.

Request that each board member, founder, management and shareholder sign an agreement saying there are no side deals, no side “letters” made with anyone at the company for anything not already specified in the documents provided. Due diligence is about what has been done and is verifiable, and requesting written agreement that there has been nothing overlooked by the company’s due diligence team, to the best of managements’ knowledge (think estoppels in real estate financings).

## D. Document Verification and Review

This is by far the most verifiable part of any due diligence. Obtain executed documents, including any documents previously signed and no longer relevant, and any documents currently in negotiation with any party.

### Repository:

- Set up a “drop box” for the company to deposit documents.
- Invite the responsible party to the drop box via email with a link or “share” the link.
- Ask them to make category folders that match those found in Addendum A.
- Request that documents be uploaded to the box and put in the correct folder per Addendum A.
- Keep your own separate documents, periodically downloading and dating the spreadsheet for each “iteration” of updates provided by the company when documents are uploaded/added to sheet.

### 1. Request/arrival: Use Addendum A, in Excel format, to request documents and manage their arrival.

- Use either a shared Excel workbook *with tracking changes on*, or use a Google spreadsheet to identify changes made by either party.
- Fill in the “date of request” at the top, left hand of the document to indicate date of request.
- Request management to fill in the date for received documents and provide instructions that they are required to keep that up-to-date. *(Note: seeing the left hand column with request dates associated with the day it was uploaded (therefore the request for documents was made), tends to make management provide the documents in a more timely manner as the date the document is provided (or indicated N/A) benefits the impression of the management team as organized and focused. It also is used to show the opposite and keep track of who’s at fault if DD slows down.*
- Request that links TO the documents from each Dropbox folder be added to the spreadsheet in the correct location by management. Each document can be “shared” from Dropbox, or most box depositories.

## 2. Signatories:

- First, review each document for signatures by adding one name to each column running out to the right of your downloaded private document.
- Fill in the date of signature of document in the correct column.
- Consider whether in this deal there is value in having two columns for document dates: The date on the first page of the document, and the date of the last signature.
- Add the signatories to all documents in separate columns to the right of the date.
- Indicate if any required signatories lines are missing signatures. (**Note:** this exercise does not replace a reading of the document to determine proper execution but does permit a visualization of the number of signatories, and easy comparison against other documents)

By indicating both the number of signatories and then columns for the signatures of each party (regardless of how far out you must go in columns), it is possible to quickly assess complicated situations, increases in shareholders, decreases in shareholders, missing signatures, etc. Though time consuming in many ways at the beginning, a metric analysis of signatures to complex documents can be very enlightening.

## Graphic G: Excel Document Management System (partial)

(Excel document available)

	A	B	C	D	E	F
1		Requested Items	Items We Have	Document name on dropbox	Delivery Date	Notes
2	1)	<b>Corporate Documents of the Company and Subsidiaries</b>				
3	a)	Articles of Incorporation or equivalent, Bylaws (if any), Operating Agreement (if any) and all amendments thereto.	1. Bylaws; Original Certificate of Incorporation; Articles & Certificate of Merger for Virginia; Certificate of Amendment; 5. Certificate of Authority; 6. Certificate of Incorporation;		02/14/11	
4	b)	Minutes of all Board of Directors, committee and shareholder meetings and all consents to actions without meeting.			To follow	
5	c)	Documents furnished to shareholders and directors from date of incorporation.			02/08/11	All such documents found / filed in 2) K) and 3) C)
6	d)	List of subsidiaries, if any, and place of incorporation.				None
7	e)	List of states and jurisdictions in which qualified to do business and in which the Company has offices, holds property or conducts	1. List of Locations		02/08/11	
8	f)	Documents related to all Federal, State and local government related funding sources applied for, regardless if funding received or not.			02/08/11	Only 1 application which was granted. Grant found / filed in 7) K)
9	2)	<b>Previous Issuances of Securities</b>				
10	a)	Stock transfer books and records.				N/A
11	b)	Summary of the ownership of the Company ("capitalization table"). Securities authorized and outstanding, by class and series. Stockholder information indicating number of shares held, dates of issuance, and consideration paid.	1. Cap Table - Current; 2. Cap Table - Post Series A; 3. Cap Table - Pre Series A		02/14/11	Uploaded into the file - Corporate Documents of the Company and Subsidiaries
12	c)	All applications and permits for issuance/transfer of securities.			TBD	
13	d)	Sample copy of stock certificates, warrants and options.	1. Sample Series A Preferred Stock Certificate		02/14/11	
14	e)	All stock option, stock purchase and other employee benefit plans and forms of agreements.	1. Proforma Advisory Board Agreement with Stock Option		02/14/11	
15	f)	List of any outstanding stock options and warrants, including date of grant, exercise price, vesting periods, exercises to date and expiration dates.			To follow	
16	g)	Agreements and other documents relating to the purchase, sale, issuance, transfer, voting or registration of securities (including any voting trust agreements, buy/sell agreements, stockholder agreements, warrant agreements, proxies, or right of first ref	1. Warrant agreement for Cato BioVentures		02/14/11	Warrant agreement for Cato BioVentures
17	h)	Equity investment documents, including any preferred stock agreements, convertible debt agreements, Founders' stock purchase agreements, etc.			02/14/11	Found / filed in 2) K)
18	i)	Other contracts, arrangements, or public or private documents or commitments relating to the stock of the Company.				None
19	j)	Any debt arrangements, guarantees or indemnification agreements between officers, directors or the shareholder and the Company.				None
20	k)	Copies of private placement memoranda, business plans	1. Current Business Plan		02/14/11	Uploaded into the file - Corporate

- **Drop box name reconciliation.** Confusion on the various names of different documents in the above drop box DD checklist can create delays in the process. Therefore, if the documents aren't listed with a link to the document IN the Dropbox, then a name reconciliation should be instructed to management to avoid later confusion. The name of the requested document is not always the name with which the company saved it, nor the name of the actual document on its first page, of which everyone will be referring.
  - Request the names of the deposited documents be reconciled. For example, the document requested might be "Articles of Incorporation." The company may have saved it as "State Certificate." When you open the document, the State may title it "Certificate of Formation." Ask management to list the name of the document with which they saved it. Not just a yes/no answer that it has been uploaded to the drop box.

**Purpose of the Dropbox/spreadsheet Document Analysis:** Listing documents on a spreadsheet during DD review allows for any patterns to emerge visually as it relates to how documents were actually constructed, negotiated and signed:

- **Management assessment:** Cataloguing all documents, dates and signatories provides the opportunity to assess the *management* in ways that are not evident by a simple reading of those documents:
  - Ensures that the *presentation* of the business is indeed structured as proffered in both writing and during presentations.
  - Ensures that documents are *legally* executed in compliance with all requirements of current law (legal team must review, but also must know the legal requirements)
  - Permits evidence of whether the company/management is organized. Compare dates of request for documents with when they are uploaded to Dropbox by management. Properly executed by all parties?
  
- **Listing the name of the document,** the date it was negotiated, the date of signing or execution, and signatories can indicate several things:
  - The first signature is a relatively long time until the final shareholder/ party signs, indicates potential issues not seen IN documents (hard to reach parties, parties are consistently reluctant to sign)
  - Short periods between documents may show a willingness of the relevant parties to transactions on a consistent or inconsistent basis.
  - Sometimes it shows nothing.
  - Date order of documents can give a quick snap shot of activity and changing scenarios. Coupled with the name of the document, it can signal many changes quickly, requiring further review of the situation of the company in each “instance.” (E.g. Does the founder/do the founders wait until the last minute to raise funds? Are they always raising funds?)
  
- **Listing the signatories** to any and all documents indicates how many are necessary to execute which documents. This number should be added up on a column and the names given their own columns:
  - Can show who has signed each document versus who *should* have signed each document. Also can show quickly which documents were not signed by the relevant individual, or at least show an alert to go back and check documents where every individual who signed other documents actually signed all documents. Find out why or why not.
  - Listing documents in date order (or reordered to show date order), increasing numbers of signatories can indicate rapidly expanding parties to the company, potentially increasing complexity in changing deals, cramming down, reaching parties, and convincing shareholders to consider signing deals down the road.

## Additional Verifications

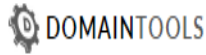
- **Leases:**
  - Review the leases and terms for any offices.
  - Determine if employees are meeting out of their own homes, and if so, claiming tax deductions for said use or being reimbursed for any space.
  - Provide a short synopsis of the situ arrangements for all employees and any leases, along with clauses indicating flexibility for growth, constraints, upcoming deadlines and penalties for such things as “going dark.”
- **Legal Name Analysis:** Do WHOIS search to determine who owns the domain name, expiration, and paid up-to-date. Determine if the name is owned by the corporation or an individual. Match records against state incorporation documents.

**Graphic H: Domain Name Verification**

DOMAINTOOLS   Products ▾

Domain Name: GREENVOYAGE.COM  
Registry Domain ID: 97782661\_DOMAIN\_COM-VRSN  
Registrar WHOIS Server: whois.domainpeople.com  
Registrar URL: www.domainpeople.com  
Updated Date: 2014-04-13T00:16:00.00Z  
Creation Date: 2003-05-12T04:46:06.00Z  
Registrar Registration Expiration Date: 2015-05-12T04:46:06.00Z  
Registrar: DOMAINPEOPLE, INC.  
Registrar IANA ID: 65  
Registrar Abuse Contact Email: [abuse@domainpeople.com](mailto:abuse@domainpeople.com)  
Registrar Abuse Contact Phone: +1.6046391680  
Domain Status: clientTransferProhibited  
Registry Registrant ID:  
Registrant Name: INC. ECorp MANAGEMENT ASSOCIATES  
Registrant Organization: ECorp MANAGEMENT ASSOCIATES, INC.  
Registrant Street: 109 ROBINSON WOODS  
Registrant City: CHARLOTTESVILLE  
Registrant State/Province: VA  
Registrant Postal Code: 22903  
Registrant Country: US  
Registrant Phone: +1.4344093313  
Registrant Phone Ext:  
Registrant Fax:  
Registrant Fax Ext:  
Registrant Email: [markg@ecorp-real-estate.com](mailto:markg@ecorp-real-estate.com)  
Registry Admin ID:  
Admin Name: INC. ECorp MANAGEMENT ASSOCIATES  
Admin Organization: ECorp MANAGEMENT ASSOCIATES, INC.  
Admin Street: 109 ROBINSON WOODS  
Admin City: CHARLOTTESVILLE  
Admin State/Province: VA  
Admin Postal Code: 22903  
Admin Country: US  
Admin Phone: +1.4344093313  
Admin Phone Ext:  
Admin Fax:  
Admin Fax Ext:  
Admin Email: [markg@ecorp-real-estate.com](mailto:markg@ecorp-real-estate.com)  
Registry Tech ID:

# Graphic I: Domain Name Tools (con't)



greenvoyage.com

Products Solutions Pricing Support About

WHOIS RECORD for GreenVoyage.com

## Whois & Quick Stats

Email	abuse@domainpeople.com is associated with ~327,232 domains markg@corp-real-estate.com domaintech@valuweb.net is associated with ~15,609 domains
Registrar	DOMAINPEOPLE, INC.
Registrar Status	clientTransferProhibited
Dates	Created on 2003-05-12 - Expires on 2015-05-12 - Updated on 2014-04-27
Name Server(s)	NS.VALUEWEB.NET (has 8,350 domains) NS2.VALUEWEB.NET (has 8,350 domains)
IP Address	64.71.33.93 - 101 other sites hosted on this server
IP Location	Illinois - Chicago - Affinity Internet Inc
ASN	AS20401 HOSTWAY-1 - Hostway Corporation (registered May 03, 2001)
Domain Status	Registered And Active Website
Whois History	40 records have been archived since 2005-01-29
IP History	5 changes on 3 unique IP addresses over 10 years
Registrar History	3 registrars with 2 drops
Hosting History	1 change on 2 unique name servers over 12 years
Whois Server	whois.domainpeople.com

Preview the Full Domain Report

## Tools

Whois History Hosting History

Monitor Domain Properties

Reverse Whois Lookup

Reverse IP Address Lookup

Reverse Name Server Lookup

Network Tools

Buy This Domain

Visit Website



View Screenshot History

Available TLDs

- **Taxes:** Using tax returns printed by the management team, or even copied from the signed and sent IRS form is not proof of filing. Only the IRS can verify filing and provide a copy of each tax return.

When it is determined that all tax returns have been filed, and the investment looks promising, request this form <http://www.irs.gov/pub/irs-pdf/f4506t.pdf> be filled out, signed by the CEO and delivered to you for sending. This should be done for every year that a tax return was filed with the IRS. The third party receipt sent directly to you.

### Graphic J: Request for Transcript of Tax Returns

Form <b>4506-T</b> <small>(Rev. August 2014)          Department of the Treasury          Internal Revenue Service</small>	<b>Request for Transcript of Tax Return</b> ▶ Request may be rejected if the form is incomplete or illegible. ▶ For more information about Form 4506-T, visit <a href="http://www.irs.gov/form4506t">www.irs.gov/form4506t</a> .	OMB No. 1545-1872
<p><b>Tip.</b> Use Form 4506-T to order a transcript or other return information free of charge. See the product list below. You can quickly request transcripts by using our automated self-help service tools. Please visit us at <a href="http://IRS.gov">IRS.gov</a> and click on "Get Transcript of Your Tax Records" under "Tools" or call 1-800-908-9946. If you need a copy of your return, use <b>Form 4506, Request for Copy of Tax Return</b>. There is a fee to get a copy of your return.</p>		
<b>1a</b> Name shown on tax return. If a joint return, enter the name shown first.	<b>1b</b> First social security number on tax return, individual taxpayer identification number, or employer identification number (see instructions)	
<b>2a</b> If a joint return, enter spouse's name shown on tax return.	<b>2b</b> Second social security number or individual taxpayer identification number if joint tax return	
<b>3</b> Current name, address (including apt., room, or suite no.), city, state, and ZIP code (see instructions)		
<b>4</b> Previous address shown on the last return filed if different from line 3 (see instructions)		
<b>5</b> If the transcript or tax information is to be mailed to a third party (such as a mortgage company), enter the third party's name, address, and telephone number.		
<p><b>Caution.</b> If the tax transcript is being mailed to a third party, ensure that you have filled in lines 6 through 9 before signing. Sign and date the form once you have filled in these lines. Completing these steps helps to protect your privacy. Once the IRS discloses your tax transcript to the third party listed on line 5, the IRS has no control over what the third party does with the information. If you would like to limit the third party's authority to disclose your transcript information, you can specify this limitation in your written agreement with the third party.</p>		

**Board Analysis:**

- **Board Meetings:**

- Read copies of all board meetings
- Flag any interesting conversations that might have been had.
- Develop a grid analysis with the dates of the meetings, dates held and who attended. Look for consistency as well as inconsistencies in meetings, times, and meeting places, along with who actually participates and attends.
- Include in the grid, where possible, any motions taken, seconded, and implemented.

- **Relationships:**

- Produce grid indicating the relationship between each party. This information is not typically included in the documents or the business plan.
- Interview with founders and management, and all board members, as well as board advisory participants, on how they met, how they know each other and if anyone is related or was previously related to anyone else at the company.

**Graphic K: Board & Investor Relationship Analysis Matrix**

VIRGINIA ACTIVE ANGEL NETWORK (VAAN) DUE DILIGENCE SHEET

Name	Produced CEOC due diligence report	Position(s) with PSI, if any	Board position with PSI	Affiliations/overlaps	Investments Made	Warrants Issued	Percent ownership, fully diluted basis	Notes/Comments
<b>Rick Kohr</b>	<b>YES</b>	Contact CFO – through Evergreen @ \$5K month	<b>YES</b> <b>Represents Evergreen Capital, LLC board seat</b>	Works for Evergreen Capital, LLC, who has a consulting agreement for CFO services.	<b>\$25,000</b>  By Evergreen	6,250	<b>3.68%</b>  25K series B shares  135K common stock	Investment made by Evergreen Capital, LLC
<b>Rick Faint</b>	<b>YES</b>		<b>YES as management board</b>	Member of Chesapeake Emerging Opportunity Fund	<b>\$25,000</b>  personally	6,250	<b>0.69%</b>	Was previously with Evergreen. Now CEO of a new IT company
<b>Paul Silber</b>	<b>YES</b>	None	<b>YES on behalf of Blue Venture Investors</b>	Member of Blue Venture Investors; Chesapeake Emerging Opportunity Fund	<b>\$390,000</b>	97,500	<b>10.80%</b>	Paul Silber is a biotech PhD. Acumen for board highly relevant.

No compensation, stock or otherwise, has been paid to, offered to, or promised to, any of the board members of PSI.



## Graphic L: Example: Analysis of the board relationships at PathSensors, Inc. (by VAAN).

**Discussion of authors of the CEOF due diligence report dated September 2010.** The above Board seats and overlap issues appear to VAAN to be common and not extraordinary. While there is always cause for concern when Due Diligence is created by [Chesapeake Emerging Opportunities Club (CEOC)] three people who currently have board positions, and therefore a stake in the outcome of the subsequent funding, several factors give VAAN comfort in its review of the relationships above and how they came about. First, VAAN is investing on par with the current board members (Series B), save for the Common Stock awarded separately to Evergreen Capital, LLC for its initial services in facilitating the round. Second, all of the board members appear to be qualified to be board members and bring something extraordinary to the table on behalf of all investors. Third, all members of the board have either a quasi-fiduciary to the investors they represent (Evergreen Capital and BVI) and/or bring significant abilities to the company at a time of management building and high growth. NOTE: There is one remaining board seat available and PathSensor's CEO, Ted Olsen seeks someone with industry experience, particularly in the area of government contracting in PSI's areas of expertise.

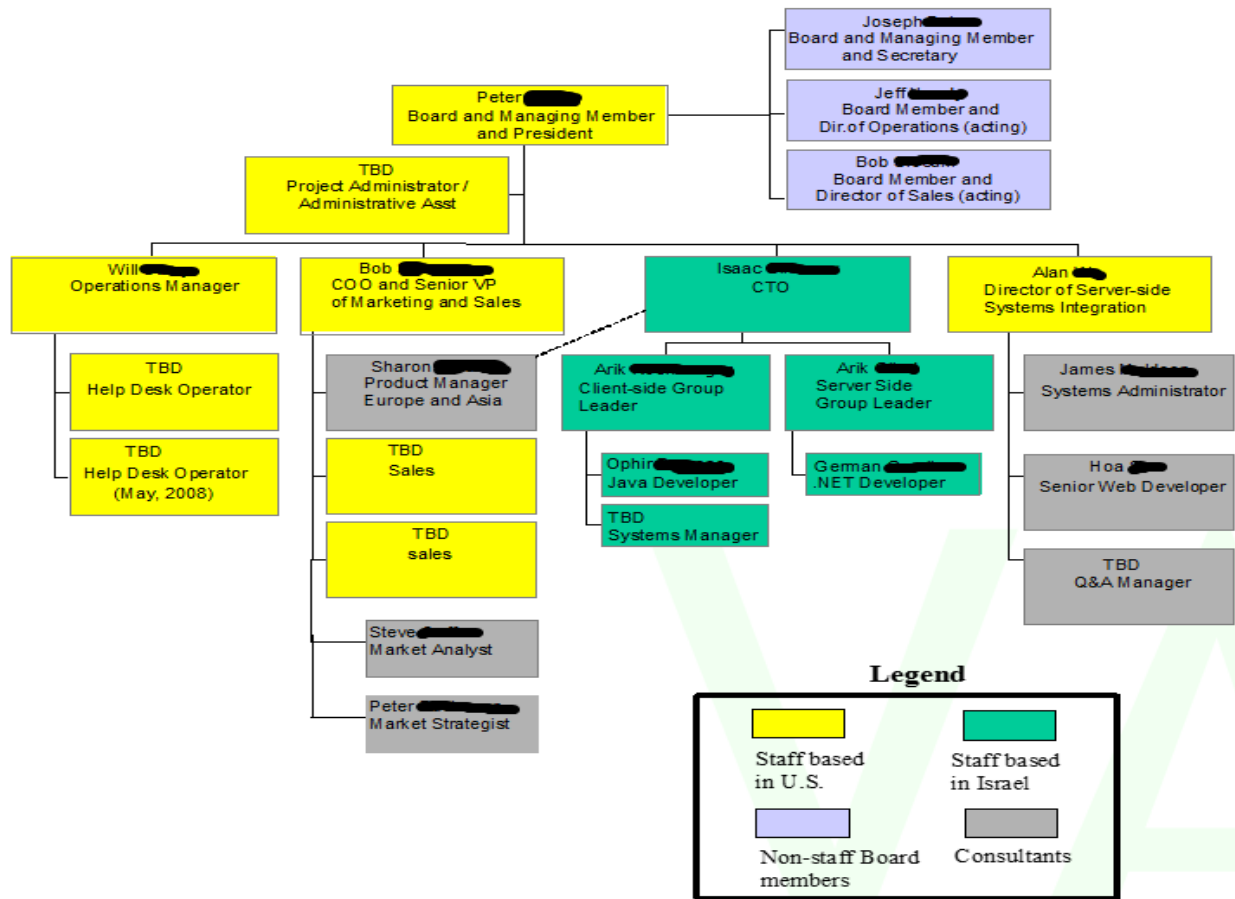
**Summary:** While VAAN cannot rule out collusion among the authors of the CEOF due diligence document, it finds comfort in the fact that each represents sufficient interests, either their own investment or that of their company, and has the acumen and experience to guide the company towards an exit that is investor palatable. Additionally, there is no doubt that the early investor-friendly terms of the deal (including the requirement to sell the company within 5 years, the 1.5 x liquidation preference, the 8% accrued non-cumulative coupon, 25% warrant coverage and preferred shareholder voting rights on par with common) are the direct result of a negotiation by and between the CEO, Ted Olsen, and Evergreen Capital, LLC, an investor and investment bank. All indications are that those principal players sought friendly investor and VC-friendly terms, a rapid growth strategy and anticipate a substantial exit, sooner rather than later.

### Organization. An organizational chart provided by the company permits several levels of inquiry.

- Get a start date and salary history for each current member.
- Request information on how each person currently working at the company knows each other, was referred, and how the hire decision was made.
- Request information on a personnel manual, asking if they have been given to employees with employees having signed that they have received the rules.
- Review/request employment contracts, stock option agreements and grants, and confidentiality contracts with each employee.
- Build a grid indicating hiring and job titles. If job title changes, indicate the change. Ask why the change. (review LinkedIn pages for confirmation of updated changes)
- Request information on all terminated employees, their current stock option status, and all prior documents.
- Review the organization chart against payroll records to verify current employment.
- Request copies of all job descriptions used to hire, particularly paying attention to any currently out in the public domain.
- Ask who determines payroll each period, who pays it and who pays all taxes and liabilities.
- Build, annotate, change the company-supplied information with reviewed information for the investor.

**Graphic M: Organizational Chart (supplied by company)**

**Organization Chart**



**3. Legal Analysis**

Using all the relevant gathered documents, a score should be assigned to allow investors to quickly identify areas where the company is most at risk. Exhibit E provides an example of a risk scorecard. Like many other components of a due diligence report, each specific risk category and contributing factors will vary based on the company being analyzed. The attached scorecard is only meant to indicate potential risks to consider rather than serve as a comprehensive list.

The scorecard is meant to serve two purposes: it will help provide structure and sufficient detail to the document inquiry while also providing an easily accessible visual guide for potential investors.

- Cite directly to the documents used to evaluate each metric so that subsequent readers can find the exact text.
- By noting the investor friendly components and some company friendly components of each relevant metric, an overall picture of relevant documents will arise.
- Be particularly critical of any projected timelines regarding regulators, and ask the company what potential problems they foresee with regulatory approval

## FDA APPROVAL OVERVIEW

- FDA approvals generally fall into one of four major categories: drugs, medical devices, radiation-emitting products, and vaccines, blood & biologics. The FDA uses a different set of criteria within each of these categories to review and approve the application, and each of these criteria can have a substantive effect on the viability of an investment. The most commonly used categories are drugs and medical devices.

### 1. Drugs:

On average, it takes 12 years and \$350 million for a drug to make it from laboratory to pharmacy, though those numbers are often estimated to be much higher. Before anything is filed with the FDA, the drug begins in pre-clinical research in animals (approximately 3.5 years).<sup>10</sup> After receiving and approving an Investigational New Drug Application (IND), the FDA will allow the first of three phases of human testing. Phase 1 typically takes 1 year, Phase 2 takes 2 years, and Phase 3 takes approximately 3 years. If the compound is successful at every level of testing, the company can submit a New Drug Application (NDA), which includes results from all human and animal testing. Review of this application takes, on average, two and a half years. After the NDA is approved, the company can begin to produce product for sale.

### 2. Medical Devices:

Medical Device approval is divided into Class I devices, Class II devices, and Class III devices. For many devices, the primary filing is a 510(k) submission to the FDA. A 510(k) is filed 90 days before the company intends to begin marketing their product, and is an attempt to “piggyback” on a previously successful filing with the FDA; that is, the previously approved device is substantially similar to the device attempting to be marketed with this filing. A 510(k) is only filed after all required performance and testing data has been gathered and reviewed. When conducting due diligence of the company’s FDA filings, pay particular attention to their “predicate” selection. The most likely reasons for a 510(k) to be denied is that the new product isn’t sufficiently similar to the predicate to forego full review.

Class III medical devices are those that sustain or support life, are implanted, or present potential unreasonable risk of illness or injury. They are subject to the toughest regulatory scrutiny, the premarket approval (PMA). Unlike the 510(k), which relies on a predicate, the PMA requires extensive documentation of safety and effectiveness. The review period is nominally only 90 days longer for a PMA, but in practice, the path to regulatory approval is far longer and riskier.

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<sup>10</sup> Failure rate during this stage: only 1 out of every 1000 compounds that enter lab testing will make it to human testing (phase 1)

# Exhibit A: Excel: Managing Requests for & Tracking of Due Diligence Documents (VAAN)

Spreadsheet to request documents, track delivery, analyze signatures/execution dates etc.

VAAN Due Diligence Checklist - TEMPLATE blank.xls

Addendum A for entire DD checklist		Columns to be filled out by management			
		Requested Items	Items We Have	Delivery Date	Notes
<b>I</b>	<b>Corporate Documents of the Company and Subsidiaries</b>				
I.1	Articles of Incorporation or equivalent, Bylaws (if any), Operating Agreement (if any) and all amendments thereto.				
I.2	Minutes of all Board of Directors, committee and shareholder meetings and all consents to actions without meeting.				
I.3	Documents furnished to shareholders and directors from date of incorporation.				
I.4	List of subsidiaries, if any, and place of incorporation.				
I.5	List of states and jurisdictions in which qualified to do business and in which the Company has offices, holds property or conducts business.				
I.6	Documents related to all Federal, State and local government related funding sources applied for, regardless if funding received or not.				
<b>II</b>	<b>Previous Issuances of Securities</b>				
II.1	Stock transfer books and records.				
II.2	Summary of the ownership of the Company ("capitalization table"). Securities authorized and outstanding, by class and series. Stockholder information indicating number of shares held, dates of issuance, and consideration paid.				
II.3	All applications and permits for issuance/transfer of securities.				
II.4	Sample copy of stock certificates, warrants and options.				
II.5	All stock option, stock purchase and other employee benefit plans and forms of agreements.				
II.6	List of any outstanding stock options and warrants, including date of grant, exercise price, vesting periods, exercises to date and expiration dates.				
II.7	Agreements and other documents relating to the purchase, sale, issuance, transfer, voting or registration of securities (including any voting trust agreements, buy/sell agreements, stockholder agreements, warrant agreements, proxies, or right of first refusal agreements, registration rights or preemptive rights agreements).				
II.8	Equity investment documents, including any preferred stock agreements, convertible debt agreements, Founders' stock purchase agreements, etc.				
II.9	Other contracts, arrangements, or public or private documents or commitments relating to the stock of the Company.				
II.10	Any debt arrangements, guarantees or indemnification agreements between officers, directors or the shareholder and the Company.				
II.11	Copies of private placement memoranda, business plans, projections and other documents provided to investors in this and prior securities offerings.				
<b>III</b>	<b>Material Contracts and Agreements</b>				
III.1	List of banks or other lenders with whom Company has a financial relationship (briefly describe nature of relationship - lines of credit, equipment lessor, etc.).				
III.2	Credit agreements, debt instruments, security agreements, mortgages, financial or performance guarantees, indemnifications, liens, equipment leases or other agreements evidencing outstanding obligations to which the Company is a party or was a party (including lines of credit, source, and amount drawn to date).				
III.3	All material correspondence with lenders, investors and shareholders during the last three years, including all compliance reports submitted by the Company or its accountants.				
III.4	List of major customers/clients, their locations, contact information and copies of their contracts.				
III.5	Distribution, OEM, Reseller and other similar agreements.				
III.6	Documents pertaining to potential acquisitions, divestitures, alliances, joint ventures, partnerships or other corporate affiliations, if any.				
III.7	Descriptions and/or contracts/agreements of all materially related 3rd party transactions which have occurred during the last three years (and any currently proposed transactions).				

## Exhibit A: Excel: Managing Requests for & Tracking of Due Diligence Documents (VAAN) (con't)

	Requested Items	Items We Have	Delivery Date	Notes
<b>IV</b>	<b>Litigation</b>			
	Copies of any pleadings or correspondence for pending or prior lawsuits involving the Company, the Founders or the Company's Officers.			
	Summary of disputes with suppliers, competitors, or customers.			
	Correspondence with auditor or accountant regarding threatened or pending litigation, assessment or claims or other litigation contacts.			
	Decrees, orders or judgments of courts or governmental agencies.			
	Settlement documentation.			
	List of all current and prior law firms, accounting firms and other consultants.			
<b>V</b>	<b>Financial Information</b>			
V.1	Audited financial statements (including balance sheet, statement of profit and loss (P&L), and cash flow statement) since inception (unaudited if audited financials are unavailable).			
V.2	Quarterly income and expense statements for the last three years and the current year (to date).			
V.3	Financial or operating budgets or projections for the next five years, with monthly projections for at least the next year, including detailed assumptions.			
V.4	A description of accounting method used (for example, accrual or cash) and of all changes in accounting methods or principles during the last three fiscal years.			
V.5	Any documents relating to material write-downs or write-offs other than in the ordinary course of business.			
V.6	Revenue, gross margin and average selling price by product or service.			
V.7	Management letters or special reports by auditors and any responses thereto for the last three fiscal years.			
V.8	Letters/Reports of counsel to the Company delivered to/from auditors.			
V.9	Aging schedules for accounts receivable for the last two years.			
V.10	Current aging schedule showing all accounts and notes payable.			
V.11	Breakdown of General and Administrative (G&A) expenses for the last two years.			
V.12	Copies of any valuations of the Company's stock.			
V.13	Description of all contingent liabilities.			
V.14	Detail of pricing plans and policies.			
V.15	Analysis of any extraordinary income or expenses.			
V.16	A summary of any bad debt.			
<b>VI</b>	<b>Property and Operations</b>			
VI.1	List of all real property and material personal property owned by the Company.			
VI.2	Documents of title, mortgages, deeds of trust and security agreements pertaining to the properties listed above.			
VI.3	Detail of any easements or other encumbrances.			
VI.4	An appraisal, including age, of all equipment and fixed assets			
VI.5	Recent appraisals and property surveys			
VI.6	Loan agreements, lines of credit, promissory notes, guarantees, etc.			
VI.7	All documents purporting to create liens, mortgages, security interests, pledges, charges or other encumbrances on real or personal property owned by the Company.			
VI.8	Financing (UCC) statements filed.			
VI.9	Insurance, including litigation tendered to and accepted by insurance companies in defense, and title insurance policies.			
VI.10	All outstanding lease/sub-lease/purchase agreements with an original term greater than one year for real and personal property to which the Company is either a lessor/purchaser or lessee/seller.			
VI.11	Expansion plans.			

## Exhibit A: Excel: Managing Requests for & Tracking of Due Diligence Documents (VAAN) (con't)

	Requested Items	Items We Have	Delivery Date	Notes
<b>VI</b>	<b>Intellectual</b>			
VII.1	Agreements between shareholders or employees of the Company and other former employers (including employment agreements, termination agreements, non-disclosure agreements, patent assignments, and correspondence relating to intellectual property matters).			
VII.2	List of all foreign and domestic patents and patent applications held by the Company.			
VII.3	List of any copyrights, trademarks, trade names, or service marks.			
VII.4	Copies of all agreements for licensing of technology, including cross licensing, to/from third parties.			
VII.5	Summary of any claims of infringement or misappropriation of intellectual property rights, including relevant litigation documents, if any.			
VII.6	Documents pertaining to or describing the Company's policies regarding trade secrets and proprietary information.			
VII.7	Copies of all agreements under with the Company developed, acquired or divested any Intellectual Property.			
VII.8	List of all royalty or other payment obligations of the Company to third parties for Intellectual Property.			
VII.9	Company nondisclosure and confidentiality agreements.			
VII.10	List of persons/entities to whom intellectual property has been disclosed and the date of disclosure.			
VII.11	Government grant agreements or other agreements for funding of research or development.			
<b>VIII</b>	<b>Taxation</b>			
VIII.1	Any notice of assessment, revenue agents' reports, etc. from federal, state or local authorities with respect to any currently "open" years.			
VIII.2	Federal, state and local income and/or other tax returns for the last three years.			
VIII.3	Evidence of Company being current on sales and use, franchise, unemployment, social security, and other tax payments.			
<b>IX</b>	<b>Insurance and Liability</b>			
IX.1	Schedule or copies of all material insurance policies of the Company covering property, liabilities and operations, including product liabilities.			
IX.2	Schedule of any other insurance policies in force such as "key man" policies or director and officer indemnification policies.			
IX.3	All other relevant documents pertaining to the Company's insurance and liability exposure, including special reserve funds and accounts.			
IX.4	Evidence of workers compensation audits and payments.			
<b>X</b>	<b>Government Regulations and Filings</b>			
X.1	Summary of OSHA inquiries for past three years.			
X.2	Summary of federal and state EPA, EEO, or other governmental agency inquiries during the past three years.			
X.3	Material reports to government agencies for past three years (e.g., OSHA, EPA). Documents relating to possible environmental pollution, including, without limitation, correspondence with governmental agencies and internal and external consultant reports regarding same.			
X.4	Copies of all permits and licenses necessary to conduct the Company's business.			
X.5	Copies of all correspondence between the Company and the FDA, including any filings with the FDA, and a summary of the status of the Company's products/services with respect to FDA applicability and regulatory process.			

## Exhibit A: Excel: Managing Requests for & Tracking of Due Diligence Documents (VAAN) (con't)

	Requested Items	Items We Have	Delivery Date	Notes
<b>XI</b>	<b>Directors, Management and Personnel</b>			
XI.1	A current management organization chart			
XI.2	List of all employees and job descriptions			
XI.3	Full resumes for all officers, key employees and founders, including home addresses, phone numbers, email addresses, social security numbers, and dates and place of birth. We will need an authorization from each to perform background checks.			
XI.4	List of company Directors, a summary biography and contact information for them.			
XI.5	References (including former employers) for all officers, key employees and founders with permission to contact them and contact information.			
XI.6	All employment and consulting agreements, loan agreements, guarantees and documents relating to other transactions with officers, directors, key employees and related parties.			
XI.7	Schedule of all compensation paid to officers, directors and key employees for most recent fiscal year showing separately salary, bonuses and non-cash compensation (i.e. use of cars, property, etc.) including accrued but unpaid salaries and bonuses.			
XI.8	Documents outlining any management incentive or bonus plans, as well as other non-cash forms of compensation.			
XI.9	Summary of employee benefits, oral agreements or promises of future benefits. Copies of any healthcare, dental, life, retirement, pension, profit sharing, management incentive, deferred compensation and retirement plans.			
XI.10	Offer letters to all employees.			
XI.11	Confidentiality, work-for-hire, patent rights, invention assignment, non-disclosure, and non-compete agreements with employees.			
XI.12	Personnel policies and procedures manuals.			
XI.13	Details of any labor disputes, grievances, terminations, etc.			
<b>VII</b>	<b>Products, Services and Markets</b>			
VII.2	Business plans outlining current and future markets and products.			
VII.3	Detail of product offering including potential market share by product line.			
VII.4	List of all major suppliers including dollar amount purchased per year.			
VII.5	Warranty and returns policy.			
VII.6	List of competitors and detail of market share.			
VII.7	List of major current and/or future customers.			
VII.8	Analysis of pricing strategy.			
VII.9	Current brochures and marketing materials.			
VII.10	Sales commission structure.			
VII.11	Sales projections by product line.			
VII.12	Any pertinent marketing studies conducted by outside parties.			
VII.13	Company press releases.			
VII.14	Articles relating to the Company or its industry.			
VII.15	Company newsletters.			
VII.16	Major research in progress.			

