Due Diligence Red Flags Checklist

Preflight Research
Inspect before you invest.

30 questions to ask before you sign the LOI

Every deal has risks. The difference between a good acquisition and an expensive mistake is knowing which risks matter — and which ones are dealbreakers. This checklist covers the 30 most common red flags we've identified across hundreds of lower-middle-market transactions. Use it as your first-pass screen before committing to full diligence.

FINANCIAL RED FLAGS

- ☐ Revenue concentrated in 1–3 customers (>30% from any single customer)
- ☐ EBITDA add-backs exceed 20% of reported EBITDA
- ☐ Working capital has been systematically underinvested
- ☐ Revenue growth is from price increases, not volume
- ☐ Owner expenses run through the business (cars, travel, family payroll)

CUSTOMER & REVENUE

- ☐ No long-term contracts — all revenue is transactional
- ☐ Customer churn is hidden by new customer acquisition
- ☐ Top 3 customers represent >50% of revenue
- ☐ Revenue quality is poor — one-time projects, not recurring
- ☐ Customer satisfaction is untracked or declining

OPERATIONAL

- ☐ No documented processes — everything lives in the owner's head
- ☐ Key equipment near end-of-life with no replacement plan
- ☐ Single-source suppliers for critical inputs
- ☐ IT systems are outdated, unsupported, or homegrown
- ☐ Inventory is stale — >20% hasn't moved in 12 months

MANAGEMENT & PEOPLE

- ☐ Owner is the only person who can close sales
- ☐ No second layer of management — flat org with owner as bottleneck
- ☐ Key employees have no employment contracts or non-competes
- ☐ Employee turnover is high or concentrated in key roles
- ☐ Owner plans to leave immediately post-close with no transition

MARKET & COMPETITIVE

- ☐ Market is shrinking or flat — no organic growth tailwind
- ☐ New competitors entering with better technology or pricing
- ☐ Business is vulnerable to disintermediation (platforms, direct-to-consumer)
- ☐ No competitive moat — competes on price alone
- ☐ Industry is consolidating and the target is sub-scale

LEGAL & COMPLIANCE

- ☐ Pending or threatened litigation (even if "routine")
- ☐ Environmental liabilities — especially in manufacturing/industrial
- ☐ Regulatory exposure — industry facing new compliance requirements
- ☐ IP is unpatented, unregistered, or poorly documented
- ☐ Customer or vendor contracts are verbal/handshake only

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