

PROBUS BUSINESS SALES

**SURVIVOR'S GUIDE TO
BUYING A BUSINESS**



**If you are considering buying a business,
there will be many questions that will
need to be answered before you begin.**

**This booklet will give you some basic
guidelines to help you answer these**

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A SURVIVOR'S GUIDE

BUYING A BUSINESS

GUIDE TO BUYING A BUSINESS

Buying a business is a big step for the first time buyer. Purchasing an existing business is can be very complex, and a buyer must be very careful to navigate through many possible hazards. A successful purchase involves:

- Selecting an acquisition team
- Developing goals and plans
- Identifying and locating candidates for purchase
- Evaluating selected companies
- Obtaining required funds
- Formulating a purchase proposal
- Negotiating and closing the purchase
- Integrating operations after closing

Working with a professional Business Broker to guide you through this maze will help you avoid many costly mistakes.

SELECT AN ACQUISITION TEAM

Working with experienced professionals is essential for buyers, particularly for the first time buyers. Sellers have the advantage of being intimately familiar with their businesses. Buyers, on the other hand, might simply accept many of the sellers' assertions without the assistance of experienced advisors to guide the buyer through a complete investigation.

Who should be members of your acquisition team? Begin with an experienced professional Business Broker. Your broker will guide you through the process and make sure you receive all the information you need to make an informed decision

In addition, you will want to involve your accountant, your attorney and your banker. It is important to have your accountant review all financial statements and tax returns. Your attorney will help you if you decide to set up a corporation or need a partnership agreement. In addition, your attorney should review all contract, including the premises lease.

EVALUATE YOURSELF

Before rushing into buying a business, evaluate yourself and your skills objectively.

1. What types of business experiences have you had?
2. Do you have the money and credit to acquire the business you want?
3. Are you willing to make the time and energy commitment necessary to learn to run the business successfully?
4. Do you have the full support of your family?
5. Do you understand financing and the time value of money?
6. Do you have the skills to successfully operate the business?
7. Are you willing to work long hours?
8. Are you a risk-taker?

FIND THE RIGHT COMPANY TO BUY

After choosing the industry, you must decide what you want from a business -- the "acquisition criteria." These are guidelines you set for yourself in deciding which businesses merit investigation. Among some of the criteria to explore are:

1. Type of industry
2. Specific level of gross sales and net profits.
3. Geographical locations.
4. The amount you are willing to pay.
5. Terms of financing.
6. Strength and stability of the company.

LOCATION

When assessing the location of a particular business, it is necessary to first determine where the business is *location sensitive* or not. A retail business or a restaurant is particularly location sensitive. A move of only one mile or a move to a different shopping center can have a profound effect on this type of business, either positive or negative. Another consideration that is very important, particularly in the Bay Area, is the distance one must travel to and from a business. As the owner you may have to go to your business several times a day or on days that you are not scheduled to be in the business in order to solve problems or take care of emergencies.

MAKE THE PRE-PURCHASE INVESTIGATION

Many businesses can be rejected immediately. Sales or income may be too low, their reputations may not be acceptable, or the owners may not be serious about selling. Do not reject a candidate simply because the asking price is unreasonably high compared to the value of the company. The price may fall quickly when the seller realizes that the potential buyer is a serious prospect.

The following are some areas that should be investigated in a detailed analysis:

Selling price and considerations -- Find out the seller's actual reason for the sale in order to determine your best negotiating position.

Organization and management -- Assess the strengths and weaknesses of the seller's leadership.

Owner's role -- What is the owner's contribution to the operation of the company?

Products, marketing and channels of distribution -- Define the nature of the business and its potential.

Competition -- Analyze the company's position within its industry.

Historical financial information -- Assess the quality of financial reporting and track the progress of the operations.

Projected financial information -- Forecast future gross income and profitability under several different conditions, including the current owner no longer being involved with the business.

Analysis of inventory -- Define the condition of the inventory.

Description of plant and equipment -- Review these for condition and for compliance with governmental regulations. (Remember: It is rare that there is any warranty on equipment after the transfer of possession of the business. The prudent buyer will hire an expert to assess the condition of the equipment.)

Analysis of intangible assets -- Identify the nature and the value of such assets.

PROTECT YOURSELF

1. Satisfy yourself about the seller's motives for selling. Do the reason seem plausible, or is the seller hiding the real reasons? If you suspect the seller's motives, you and your broker can add contingencies, conditions and covenants to the sales contract to protect you.
2. If the business is a corporation, you will probably want to structure the acquisition as an asset sale, rather than a stock sale. In an asset sale you will be liable only for those liabilities that are specifically assumed by you. In a stock sale you automatically acquire all the obligations of the business. IN addition, in a stock sale you acquire the balance sheet as it currently is. This means if all the equipment has been depreciated for tax purposes, you will not get the benefit of future tax write-offs. There may be other considerations in determining the way in which you will take possession. Contact your attorney and your accountant.

3. Consider an employment contract, consulting agreement or earn-out to secure the seller's services during the transition period. Give the seller a stake in your success, at least for a short-term period.
4. Strive for a "win-win situation." Make a fair deal. Do not intimidate or antagonize the seller during negotiations. You will need his or her cooperation after the sale.

ENTERING INTO NEGOTIATIONS

Find out what issues are important to the seller. Does the seller need a maximum amount of immediate cash, or is the concern with a continuing income? Is the seller concerned about employees? Is continued service to customers paramount? The essence of a "win-win negotiating" is to find out what the seller really wants, and compromise so that both parties are satisfied.

Let the personality of the seller guide your negotiating style. Build rapport. Indicate your respect for the seller's achievements and your interest in the business.

Price and terms will be more reasonable if the seller trusts the buyer. When the seller feels he or she is leaving the business in good hands, there will be more of willingness to compromise.

Demonstrate your eagerness to begin negotiations. Your enthusiasm will be interpreted as evidence that you are serious. It will not, as many buyers fear, work to increase the price of the transaction. In fact, many deals are lost when the buyer is too cautious. This can be viewed as indifference and may cause the seller to lose interest.

SOURCES OF FUNDS

When buying a business, most buyers would prefer to leverage their personal funds as much as possible. This means that the seller must agree to carry a note from the buyer, or the buyer must find an outside source for funds.

Seller Carryback Many times a business owner will be willing to act as a lender to the buyer and finance part of the purchase price. Factors that will influence a seller to carry a note include

- 1) the seller's confidence in the business,
- 2) the seller's confidence in the ability of the buyer,
- 3) the financial strength of the buyer, and
- 4) the collateral for the note.

Generally the seller will require a substantial down payment, from a minimum of 33% up to as much as 75% of the purchase price. The note will usually have a term of no more than 5 years, and often shorter. The interest rate will be between 7% and 9%. Part of the collateral will always be the business itself, but the seller may also require that the collateral also include additional real estate or other property. The seller will always look to the buyer to personally guarantee the note, regardless of collateral.

Small Business Administration Another source of funding is the SBA. The SBA works through lending institutions to fund the acquisition of businesses. The SBA guarantees 80% of the loan, which means that the lending institution can take a bigger risk in making the loan. SBA loans will usually fund 80% of the purchase price, closing costs and working capital. The terms of the loan are usually:

- 1) real estate collateral as well as the business as collateral
- 2) interest rate of 2.75% over prime (current rate)
- 3) 10 year, fully amortized loan, and
- 4) guarantee fees and other fees usually amounting to about 2% - 2.5% of the loan.

The criteria the SBA lenders use are

- 1) the financial strength and historical cash flow of the business,
- 2) the collateral that will secure the note,
- 3) the credit history of the borrower, and
- 4) the experience and expertise of the buyer.

Ask your broker to help guide you through the process. By creatively financing your business acquisition, you can increase the size of the business you can purchase, increase your cash flow, and reduce your taxes.

TAX CONSEQUENCES

There are a great many tax implications involved in the purchase and ownership of a business. If the purchase is structured properly, if the allocation of the purchase price is carefully assessed, and if the various methods of taking possession are carefully reviewed, an owner could experience a minimum of tax liability both during ownership and upon sale.

The method of taking ownership can also have tax consequences. There are four ways to take possession of a business in California.

1. Sole Proprietorship
2. Partnership
3. Corporation (This can either be an "S" corporation or a "C" corporation.)
4. Limited Liability Company

Check with you accountant and attorney to determine which one is best for you.

SOME FINAL WORDS

Once you and the seller have reached an agreement, you will have the opportunity to verify the information that the seller has provided. This will include access to bank records, accountant's files, check registers, federal tax information, sales tax returns, employment tax records, and any other documents or files you may need.

If there is a lease involved, your broker will work with you and the landlord to complete the assignment and to negotiate any changes or additions you may want to try to include.

When escrow is opened, the escrow agent will insure that the transaction complies with all applicable California laws. This includes notice of Bulk Sales and filing of UCC 1, if applicable, as well as completing a lien search and verifying that all taxes have been paid. The escrow office will also help you file your fictitious business name.

With all this completed, you are ready to embark on one of the most exciting, rewarding steps in your professional life. Once you have had the experience of running your own business, reaping the rewards of your achievements, and suffering the consequences of your failures, you will never want to earn a living any other way. Owning your own business is truly the American Dream.