Three Stages in a Buyer's Process

Stage 1

Part 1: FINDING and VALUING a Business - 8 Key Considerations

This information is provided as a **general** guide for the processes in buying an existing business. The steps indicated are placed in a chronological order to indicate procedures that should be completed prior to closing and taking over ownership. Some of the steps are **required by law.** The list is **not all inclusive** and other steps may be necessary.

STAGE 1 (Parts 1, 2 and 3)
Finding and Valuing, Offering, Due Diligence

This is a series of actions that allow you ample time to review all information PRIOR TO BUYING. It is a right of the buyer to obtain information and seek disclosure of facts already presented by the seller. It is your right as a buyer to be informed. Take the necessary time to complete the process to your satisfaction.

STAGE 2
Financing

A separate series of actions is required to obtain the financing. Some of the required information for banks is included in the due diligence processes and will "overlap". Usually the financing steps will take place prior to accomplishment of full due diligence, but remember that obtaining necessary financing is usually a prerequisite before a seller is willing to disclose all operational information. If you cannot finance the business, the seller is not willing to share all the information with you.

STAGE 3 (Parts 1, 2 and 3)
Operational Licensing and Closing

The legal transferring of ownership, title and equity in the business. Includes all of the necessary steps prior to your first day of ownership so that you can operate legally in Idaho. The steps should take place during the financing and due diligence stages and do overlap in both areas. As an example, you must have your federal identification number prior to accepting any SBA loans; therefore, you will need to file for the number early in the process so that you can close on the indicated date of closing. Another example is insurance. It is necessary to obtain insurance information for financial proforma as well as liability protection during ownership.

*This information is provided by **Kip F. Moggridge** of Arthur Berry & Company for general use. For questions you may contact Kip at 208-336-8000. Please consult an attorney or accountant for legal or financial assistance.*

1. Look for Liquidity. Can the assets and/or the operation be sold again? What are the potentials for protecting your purchase through a future sale? Is this business in the mainstream of business segments?

2. Look for Capacity. What is the overall capacity for this business to expand? Markets? Needs? What are the physical limitations for immediate expansion? Is the current income based upon a maximum usage of all available assets?

3. What is a Fair Return on the Assets. Look at the total dollar amount that would be invested in the tangible assets. How much of that total can be converted to working capital within one year (receivables, cash, inventory)? Do these "current assets" turn over according to reasonable expectations? Is there too much inventory? Too little? What is the fair market value for fixed assets? What is an expected return (percentage) for investing your cash in a dollar-for-dollar comparison? A fair return would be to assume that you can get five percent (5%) in a secure investment. But what about risk? Are the assets at risk such as obsolete or poor repair and maintenance? Fair market value (FMV) is not the book value on the balance sheet. FMV is what it would take for you to replace the equipment assuming that the business makes enough money to warrant replacement.

4. Look at a Fair Return on the Cash Down Payment. Because there is some risk in an operational business, you can expect fair return to be somewhere between 20% and 35% of the down payment. That return should be expressed as earnings before taxes (EBT). You simply divide the EBT by your down payment amount—is it between 20-35%?

5. Can You Stand Doing This Type of Business for 3, 7, 10 Years? Although this is not as important as the financial returns, you certainly will put more effort into something you enjoy. Making money is a necessity - - but liking the business is a luxury.

6. Look at Realistic Return and Ratios on the Business. Study the national and regional returns for similar businesses. You will need to know "real" returns, not including an owners' salary, that you should expect as a bare-bones minimum. Most businesses net only about 4.5% after everything, including yourself, were paid a fair wage. What was the internal rate of return over a stated period? Most business cycles last only about seven to eight years.

7. Have an Out Plan as Part of the In Plan. Look at the potential return to you if you were to grow the business, pay into equity, retire some debt, pay yourself a fair salary and sell the business in seven years. Use a net present value (NPV) formula. Then compare the final net(s) to you to the original realistic returns. Did you make better than 20-35% on the initial investment? Did you net more than 4.5% per year? Did you?

8. Working Capital—Do You Have Enough? The majority of business failures are caused by too little capital ($) when it was needed most. How can you determine what you might or should need in the first year? Consider adding up the following amounts in each category and have that much available in outside funds. The following is ideal:

- 3-6 months personal income needs
- One complete inventory turn—If your cost of goods is 33%, then you should turn three inventories a year, so you have the ability to purchase one
- One year's taxes (personal property and sales)
- One year's replacement/repairs
- Loan reserves—sixty days is not too uncommon
- Two times the normal advertising budget.

This is by no means a comprehensive list but can be used to establish some basic criteria for a business investment. Other resources are immediately available for your research. A list of local non-profit resources can be obtained. To begin with, the Small Business Administration offers "free" counsel and advice for investors.