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# GUIDE TO BUYING A BUSINESS

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## **Introduction**

Millions of owners of small and growing companies can't be wrong. If you are motivated by personal accomplishments, stimulated by challenge, and want to be your own boss, then business ownership is for you!

My goal is to work with you to understand your needs, motivations, resources, goals, make suggestions and refinements if appropriate and introduce you to businesses including franchises that meet your criteria.

We realize that to find and buy a good business isn't easy. This guide is designed to answer many of your questions and provide valuable information. If you have additional questions, please call me on 916 570-2674.

## Finance

In most small business purchases, there are basically two avenues to finance your purchase. These are a bank loan guaranteed by the SBA or seller finance.

Bank loan guaranteed by SBA	Seller finance
10 year term, maximum 2.75 points above Prime	Usually shorter term of 5 years at fixed rate, usually slightly less than an SBA loan.
Formal approval process taking up to 60 days	Relatively simple process taking less time
Personal guarantee/Outside collateral almost always required by SBA	Personal guarantee/Outside collateral may be requested by Seller.
Average 30% down payment	Down payment can vary between 20% and 50%

## Risk V price

Some Buyers look for the “perfect business (high profits, low risk, great potential, easy to run, no problems, etc.) If they ever find a business like that, the price will be very high. These Buyers will be competing with well-financed industry professionals and corporate Buyers to purchase the business.

Other Buyers look for very cheap businesses, often closed down or failing. These businesses are very risky and may involve significant additional investment to make them profitable. They are usually best left to industry professionals or corporate Buyers who can afford the cost and the risk.

Most of the businesses I sell are in the “Safety Zone”. These businesses are priced lower than the “perfect” business (if it really exists!), but are less risky than the closed or failing business. **The key is to look for a business that is established, but has some problems you can solve.** That way, the business will be affordable, and you can take all the profit from the improvements you make.

## Methods for valuing a business?

There are many methods of pricing a business. The most commonly used are:

- 2 to 3 times Sellers Discretionary Earnings (SDE), but this can vary widely depending on the business.
- Value of equipment and inventory plus goodwill equal to 1 to 2 times SDE.
- 3 to 12 months gross sales, depending on type of business.

### **Note:**

SDE is the net profit of the business adding back any owner's compensation, discretionary expenses, one-time charges, interest expense, and any non-cash charges such as depreciation and amortization. This would represent the available cash flow that a Buyer may have available to pay themselves, reinvest in the business, and service any debt. Of course, cash flow for the Buyer may be more or less than the Sellers depending on how they run the business. For clarification, please consult your Murphy Business and Financial associate.

Price is usually related to earnings, and varies with the financing terms agreed upon. Price will also depend on the type of business, the value of the assets, location and general attractiveness of the business, and future potential, among other factors. True value is what a Buyer agrees to pay and a Seller agrees to accept.

## What's the right price?

The monetary investment you have in the business is the down payment. After that, the business pays for itself out of its earnings.

**So, if you can buy a business...**for the amount you have for a down payment and the business makes the debt payments and you still earn the desired profit...**then, the transaction seems to make sense.**

## **What's an offer?**

An offer is just that – an offer. If it is not accepted by the Seller within the time limit you set, your offer is void. Offers contain contingencies – that is, they become automatically null and void unless certain things happen.

### **All offers are contingent upon:**

Your price and terms being accepted.

### **Most offers can also be contingent upon:**

- Books and records meeting your satisfaction.
- All equipment subject to your inspection and being in working condition.
- Approval of the terms of the lease and successful assignment of the lease.
- The business being sold free and clear of debt.
- Ability to get necessary licenses and permits.
- Ability to get SBA funding.
- Business passing necessary inspections.
- If any of the contingencies in an offer are not met within the time frame you set, the offer is void and your deposit is returned to you.

### **Many offers also have conditions such as:**

- Seller providing a non-compete agreement.
- Seller agreeing to a specified training period.
- Certain representations and warranties about the condition of the business.

## **What it takes to buy a business – the buying process**

### **Commitment**

You should be committed to purchase a business at a price and term consistent with the marketplace.

### **Disclosure**

You sign an agreement promising to maintain confidentiality for all the information provided to you on the businesses we discuss. This is called a Non-Disclosure Agreement or Confidentiality Agreement.

### **Background Information**

You provide us with the information about yourself, such as a resume, financial statement, and credit report. The more we know about you, the more likely we can find a business that you will like and the willingness of the seller to share the business confidential information. And, the more information we provide to the Seller, the better he feels about accepting your offer.

### **Review and Select Businesses.**

We will discuss and review with you various types of businesses and select some that appeal to you and for which you are financially qualified.

### **Site inspection.**

We will show you the businesses you are interested in and discuss the important factors of each. You will be provided with a Confidential Business Review that will allow you to get a better feeling about the business and hopefully provide you with enough information to write an offer.

### **Buyer/Seller Meeting.**

Depending on the circumstances, you will be able to interview with the Seller.

### **Offer to Purchase.**

We will assist you in preparing an offer for the business you like. Remember:

1. An earnest money deposit is required to demonstrate your seriousness to the Seller. (See section on Earnest Money).
2. Most offers are contingent upon your inspection of the books and records of the business, among other contingencies and this is done after the offer has been negotiated and accepted by both parties.

### **Offer Presentation.**

We present your offer to the Seller. We give the Seller your background and financial information, experience, and point of view in arriving at the offering price, terms and conditions. Favorable and complete background information about you, the Buyer will result in favorable consideration of your offer. We carefully explain the terms and conditions of the offer to the Seller.

## **Negotiation and Acceptance.**

The Seller accepts the offer as it is written or writes a counter offer.

## **Mutual Acceptance.**

When you and the Seller agree to all terms and conditions of the sale, the offer becomes a Purchase and Sale Agreement.

## **Inspection.**

You'll meet with the Seller at our office or at the Seller's business to examine the financial records of the business. Any questions you have are resolved. (See section on The Financial Review).

## **Contingency Removal**

Buyers remove all contingencies in the agreement. It is now time to open an escrow.

## **Open Escrow**

We provide all necessary documents and information to the escrow holder so they can prepare the escrow instructions. (See section on transferring the Business).

## **Lien Search**

The escrow holder performs a lien search on the business to identify any secured creditors.

## **Lease Assignment**

We work with the landlord to get an assignment of the current lease or a new lease for the Buyer.

## **Note & Lease Assumptions**

We make arrangements to assign any notes or equipment leases.

## **Inventory**

Arrangements are made for you and the Seller to count and price the inventory (if required).

## **Closing**

All parties meet to sign closing escrow instructions and possession is delivered to you.



## **Getting the best price**

### **What Sellers like to see.**

Buying a business is not easy and you will have questions and concerns. Selling a business creates just as many questions and concerns for the Seller. You can often get significantly better price and terms by being aware of the Seller's needs and removing some of his or her uncertainties.

### **Resume and Financial Statement.**

The more information the Seller has on your past experience, qualifications and financial situation, the more likely he/she will accept an offer you make. By entering into an agreement with you, the Seller is taking their business off the market and needs to feel comfortable that the transaction will indeed close in a timely manner.

### **Fair offer.**

A fair offer is one that realistically satisfies the needs of both Buyer and Seller. Sometimes that results in an offer that is quite different from the listed price and terms. Your broker will try to help develop a win-win offer. A word of caution: What about "low ball" offers? Sometimes they damage your relationship with the Seller. This could result in reducing your chances of getting the business for a fair price.

### **Reasonable Down Payment.**

Every Buyer wants to conserve cash. But, a very low down payment can indicate a Buyer's lack of commitment to the business and harm their chances to obtain financing. If the Seller questions a Buyer's commitment or seriousness about the business, the Seller may not negotiate seriously with that Buyer.

### **Quick Removal of Contingencies.**

It's to everyone's advantage to proceed through the contingency removal phase in a quick but thorough fashion.

## **Earnest money**

Earnest money is evidence of a Buyer's seriousness when making an offer on a business. In return, the Seller takes the business off the market while the Buyer removes the contingencies in the offer. If any of the contingencies are not removed, the earnest money is returned to the Buyer.

Indicates to Sellers you are a serious Buyer.

Is made payable to an escrow company and is held by the broker un-cashed until you sign escrow instructions to open escrow.

Earnest money is returned if your contingencies are not removed in the specified time period – YOU DECIDE IF YOU WISH TO GO FORWARD.

## **Due Diligence**

The due diligence review need not be complicated, but the process does generate questions from Buyers and Sellers. Some typical questions from Buyers are:

### **What is it?**

You have the opportunity to check out the books and records of the business and verify the Sellers representations. You may also have additional questions for the Seller. If you are satisfied with the information you see, you remove the financial contingency and proceed to the next step in your purchase of the business.

### **How long does it take?**

It's up to you. Many businesses can be checked out in one meeting. More complex businesses can take longer.

### **What if I find something I don't like?**

The contingencies in the offer have to be met. If not, you have the right to make a different offer, or cancel your offer and get your earnest money refunded, and look at another business.

## **Why not do the financial review before I make an offer?**

Some Buyers have expressed a desire to perform a detailed financial audit before making an offer. Later they found that the audit didn't replace the need to be comfortable with the business and be truly interested in it. They wasted a lot of time analyzing books, only to find that they couldn't agree with the Seller on price and terms, or that the type of business just didn't suit them. We developed the financial review contingency as a compromise to bridge the gap between the Buyer's concerns and the Seller's needs. We understand the Buyer's need to verify the books before buying the business. We also know that it could damage the Seller to have confidential information released to strangers or potential competitors. By using the financial review contingency, a Buyer can make an offer in perfect safety and the Seller is assured that he is dealing with a serious party.

Contingencies give you the flexibility to negotiate price and terms with the Seller, but not be obligated to proceed with the sale unless certain things happen to your satisfaction.

For example, most offers are contingent upon financial review. If your review of the financial records turned up something you didn't like, you would not remove the contingency. Therefore you would not be obligated to proceed with the sale and earnest money would be returned.

## **Transferring the business**

California laws require the sale of most businesses be processed as a Bulk Sale Transfer to protect the Buyer and creditors of the Seller when transferring the business between Buyer and Seller. All transactions subject to this law are handled through Bulk Sale Escrow with experienced Escrow Companies to assist the Seller and Buyer in transferring ownership of the business. Escrow Companies are specialists in the field of business transfers and perform their services at very competitive rates. Some Buyers and Sellers choose to have their own attorneys review the details of the transaction. We encourage you to consult your attorney if you feel more secure by doing so, however, the escrow company will draw all of the required documents.

### **Escrow company.**

- Is completely neutral. They represent neither the Buyer nor the Seller, and will not represent one party against the other nor represent the broker.
- Prepares all necessary closing documents.
- Performs a lien search on the business to make sure clear title can be conveyed.
- Prorates and pays the rent, deposits, taxes and other expenses if requested.
- Makes sure that secured creditors are satisfied.
- Files and records documents with appropriate authorities.
- Complies with the Bulk Sale provisions of the Uniform Commercial Code. (The Bulk Sale provisions are designed to protect against an owner selling the business and leaving the Buyers to clear up the debts).

## **Frequently asked questions and answers**

### **What is Goodwill and what should I pay for it?**

Goodwill is basically the difference between the total value of a business and the value of inventory, equipment and other "hard" assets. Most businesses have goodwill, unless they are closed or performing poorly. The amount you pay for goodwill will depend on the cash flow of the business and its general attractiveness. Many Buyers believe that goodwill is equal to 1 to 2 years profits. The theory being that it would take that long for a start up business to become profitable. If Buyers didn't pay for goodwill, Sellers might as well sell off their equipment and close down rather than sell as an on-going business.

### **What is Cash Flow or Sellers Discretionary Earnings (SDE)?**

Cash flow is determined for a business to put it on an even footing with every other business, no matter how the owner takes the profits out of the business. Cash Flow is usually defined as profit before income tax, depreciation, interest and owner's compensation and benefits. This is the amount of money the owner has available to pay himself, to invest in additional equipment and to make the note payments on the business and pay taxes. Other economic benefits to owning the business may also be represented in the cash flow.

I hope this information has been helpful to you. If there is any way I can assist you in the purchase of a business, please give me a call on (916) 570-2674.

## **Why Buyers use Andrew Rogerson**

If you're looking for a small business to buy, you probably have a lot of questions.

Questions like...

- How do I get started?
- How do I find a really solid business?
- How do I get financial information from the Seller?
- What is a business really worth?
- What strategy should I use when making an offer?
- What is the best price?
- Who will write the Purchase and Sale Agreement?
- When should I get a lawyer or accountant involved?
- How do I get the lease I want?
- How can I be sure this is the right business for me?

Andrew is a 5-time business owner; two businesses in his native Australia and three in California. Andrew uses his experience and objectivity to answer all your questions and match your needs, abilities, resources, and interests with just the right business.

Andrew is also part of Murphy Business and Financial. This provides the advantage of dealing with the largest and most experienced business brokerage organization in the U.S. We can introduce you to more good business opportunities than anyone.

## Why Sellers use Andrew Rogerson

Sometimes Buyers wonder why a Seller uses a broker to sell a "good" business. Here are some of the reasons smart Sellers engage a professional business broker.

**Integrity.** Both buyers and sellers that have used Andrew's service know that they were and will not knowingly be misrepresented. They also know that he won't mislead them as trust and integrity with what Andrew stands for and how he conducts himself.

**Knowledge.** Andrew holds both the Certified Business Intermediary credential from the International Business Brokers Association and the Certified Business Broker designation from the California Association of Business Brokers. Through experience and results, Andrew knows how to bring a Buyer and Seller together.

**Qualifying.** Owners ask us to introduce only qualified Buyers to their business. Based on our knowledge of Buyers and Sellers' needs, we can match the right Buyer with the right business and not waste anyone's time.

**Confidentiality.** We know how to maintain confidentiality. An owner selling on his own has great difficulty keeping the sale process secret from key employees, customers, suppliers and competitors. Confidentiality must be maintained until the sale is complete.

**Time.** It often takes a business owner several years to sell without a broker. Each prospective Buyer takes a lot of time. If the owner spends most of his or her time trying to sell the business instead of actively managing it, profits can sink.

**Documentation.** We coordinate and obtain the necessary information from the Seller that Buyers need to have to purchase the business.

## About the Author

Andrew Rogerson is a licensed Broker with the California Bureau of Real Estate (License #01861204) and holds the following qualifications:

- Certified Mergers and Acquisition Professional (CM&AP) from the M&A Source, the highest designation awarded by that institution
- Mergers and Acquisition Master Intermediary (M&AMI) from the M&A Source
- Certified Business Intermediary (CBI) from the M&A Source and the International Business Brokers Association (IBBA), the highest designation awarded by those institutions
- Certified Business Broker (CBB) from the California Association of Business Brokers (CABB)
- Certified Machinery and Equipment (CMEA) designation from the NEBB Institute
- Certified Senior Business Analyst with the International Society of Business Analysts (ISBA)
- Certificate of Taxation from Los Rios Community College, Sacramento, CA



Andrew is also the published author of four books on business ownership available from his website <https://www.rogersonbusinessservices.com>.

As the owner Rogerson Business Services, Andrew assists his clients with both selling and buying businesses. For more information, visit [www.RogersonBusinessServices.com](http://www.RogersonBusinessServices.com).

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