

How to Buy/Sell a Business

by Willem van Reesema

There are many advantages of buying an existing business vs. starting a new business. First, there are often a great reduction in startup costs that can drain time, energy, and unplanned expenditures. Second, cash flow may be immediate because a ready base of customers exists. Third, there is an existing base of inventory and receivables. Fourth, other positive attributes include existing goodwill and easier financing opportunities, assuming the business has a positive track record.

Once you've found a business that you would like to buy, look into every aspect of the business, and try to quickly determine if there are obvious growth opportunities that the current owner has not exploited because they do not have the same creativity and problem solving skills that a new entrepreneur may bring to the table. If the business is flat, can you grow it? If it is in financial trouble, can you turn it around? Often retirement, health, burn-out, etc. of the current owner are opportunities for a more energetic and creative new owner to create immediate value. On the other hand, there may simply be factors that are outside your control and influence that are causing the business to be in financial trouble and you should just walk away and look for the next deal. Below is a check list of steps recommended as you proceed in evaluating if entrepreneurship is for you.

Seek Professional Help

A professional Business Broker or Business Intermediary can assist you as they have experience on a daily basis performing valuations, marketing, and negotiating businesses for sale. The Michigan Business Brokers Association is a great place to start. See their web site at <http://www.mbba.org> Your financial planner can help you determine the risks as they relate to your personal financial position. Your attorney should be enlisted to help review the legal and organizational documents of the business you are planning to purchase. Your accountant can help do a proper evaluation of the financial condition of the business. Your banker can help you qualify for a conventional or SBA business loan.

Confidentiality Agreement

Often required by the seller, a confidentiality agreement indicates that you won't use the information about the seller's business for any purpose other than making the decision to buy.

Financial Statements

Examine the financial statements from the business for at least the past three to five years. Also make sure that the statements are accompanied by an audit letter or review from a reputable CPA firm. Don't accept a simple financial review by the business itself.

Tax Returns

Review the business' tax returns from the past three to five years. This will help you determine the profitability of the business as well as whether any potential tax liability is outstanding.

Determining Price

A realistic business valuation requires more than merely looking at last year's financial statement; it requires a thorough analysis of several years of the business operation and an opinion about the future outlook of the industry, the economy, and how the subject company will compete. The reality is that you should be able to purchase the business and still support your current lifestyle through W-2 wages that you pay yourself through the business. There should be additional positive cash flow at the end of the year to provide you with a return on your cash down payment on the business that is commensurate with a return that you would find if you were to make conservative investments in the public securities market. There are a number of different methods to determine a fair and equitable price for the sale of the business. The following lists a few methods to determine the price:

Capitalized Earning Approach - This method refers to the return on the investment that is expected by an investor.

Cash Flow Method - This method is usually used when attempting to determine how much of a loan the cash flow of the business will support. The adjusted cash flow is used as a benchmark to measure the firm's ability to service debt.

Balance Sheet Method - This method values the business by the tangible assets.

Value of Specific Intangible Assets Method - This method is based upon the buyer's buying a wanted intangible asset versus creating it. This method also takes into consideration valuing the goodwill of the business. Once you have determined the price you are willing to pay for the business, there are several steps on needs to take.

Letter of Intent

A letter of intent usually creates a non-binding offer to purchase the business and is usually needed in order for the seller to provide sensitive information about the business. It should spell out the proposed price, terms, and conditions for the sale of the business. The letter should also state that either side may revise or quit for any reason.

Contracts and Leases

It's important to discover all the obligations that the business is subject to. Also be aware that you may have to work with the current landlord to assume any existing lease on the business premises or negotiate a new lease. If you acquire an existing lease from another lessee, you may have to pay the previous lessee for the privilege. The cost of acquiring your lease may be amortized over the remaining term of the lease.

Important Documents

Numerous documents should be checked during an investigation. They include:

- * Real and personal property documents
- * Bank Accounts
- * Customer Lists
- * Sales Records
- * Supplier/Purchaser List
- * Contracts

- * Advertisement Materials
- * Inventory Receipts/Lists
- * Organization Charts
- * Payroll, benefits, and employee pension/profit sharing information.
- * List of Employees
- * Federal, State or Local Permits, Licenses, Certifications.
- * List of Owners

Sales Agreement

The sales agreement is the key document in buying the business assets or stock of a corporation. It is important to make sure the agreement is accurate and contains all the terms of the purchase. It would be a good idea to have an attorney review this document. It is in this agreement that you should define everything that you intent to purchase of the business, assets, customer lists, intellectual property, and goodwill.

The following is a checklist of items that should be addressed in the agreement:

- * Names of Seller, Buyer, and Business
- * Background information
- * Assets being sold
- * Purchase price and Allocation of Assets
- * Covenant Not to Compete
- * Any adjustments to be made
- * The Terms of the Agreement and payment terms
- * List of inventory included in the sale
- * Compliance with the Bulk Sales laws of the state
- * Any representation and warranties of the seller
- * Any representation and warranties of the buyer
- * Determination as to the access to any business information
- * Determination as to the running of the business prior to closing
- * Contingencies
- * Possibilities of having the seller continue as a consultant
- * Fees, including brokers fees
- * Date of closing

Closing Checklist

It is important during the closing to make sure that you have legal counsel available to review all documentation necessary for the transfer of the business.

The following items should be addressed in a closing:

- * Adjust Purchase Price -This would take care of prorated items such as rent, utilities, and inventory up to the time of closing.
- * Review Documents Required to be Provided by the Seller - These would be a corporate resolution approving the sale, evidence that a corporation is in good standing, or any tax releases that may be been promised by the seller. Check with your local department of corporations or secretary of state.
- * Signing Promissory Note - In some cases, the seller will carry back financing, so have an attorney review any Note documentation.
- * Security Agreements - These documents may be necessary if you are going to finance your purchase. A Security Agreement lists the assets that will be used for security as a promise for payment of the loan.
- * UCC Financing Statements - These documents are recorded with the Secretary of State in the state you have purchased your business. Again, these documents

are necessary if you are going to finance your business.

* Lease - If you have agreed to assume an existing lease, you will be required to execute the assumption. Make sure that you have the landlord's concurrence to assumption of the lease. You may have negotiated a new lease with the landlord instead of assuming the existing lease.

* Vehicles - If the purchase includes vehicles, you may have to execute the transfer documents for the vehicles. You can check with your local Department of Motor Vehicles to determine the correct procedure and necessary forms.

* Bill of Sale - The bill of sale will be proof of the sale of the business and will transfer the ownership of the other tangible business assets not specifically transferred on their own.

* Patents, Trademarks, and Copyrights - May need to execute the necessary forms if part of the transaction.

* Franchise - May have to execute franchise documents if the purchase of the business was a franchise.

* Closing or Settlement Sheet - The closing or settlement sheet will list all financial aspects of the transaction. Everything listed on the settlement should have been negotiated prior to the closing, so there should be no surprises.

* Covenant Not to Compete - It is a good idea to have the seller execute this agreement. This will help add to the success of your operation of the business without any interference from the previous owner.

* Consultation/Employment Agreement - If the seller has agreed to remain on for an amount of time, this documentation would be necessary.

* Complete IRS Form 8594 (PDF file), Asset Acquisition Statement — This document will indicate how the purchase was allocated amount the various assets. Important for your tax return.

In conclusion, there are many good books written on how to buy a business and I would suggest that you venture down to your nearest bookstore or go online. The above information is a good reference guide and starting point, still be forewarned, as the time and effort can be considerable to find a business, perform your due diligence, finance, and eventually close the transaction. But, once you are an entrepreneur, you may find that you have never been happier. Good luck searching.

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