9 Financial Factors to a Successful Business Purchase

You are in the process of buying a business - what should you look for?

Every business is unique and value is different to different people

It is much better to spend your time, some money and energy now than either paying too much or buying a business that doesn't meet your needs and expectations.

We share the 9 financial factors to a successful business purchase.

1. Understand profitability
2. What are the profit drivers for the business
3. Identify the key risk areas
4. Financial information to request from seller
5. Complete a Due Diligence
6. Get the right business structure
7. Estimate add back and owners wages
8. Stock and inventory considerations
9. Prepare a post-acquisition budget & cashflow

Understand Profitability

You should have access to the financial statements for the business you are looking to buy, being the:

Profit and Loss Statement
Balance Sheet

If you understand financial reports then these documents are fine to interpret, however if you are not used to reading financials, the data can be confusing.

It is critical to focus on the key areas that you need to review in relation to the business to identify the key numbers and value drivers

1. Sales and Sales trends
2. Gross Margin and Gross Profit %
3. Key overheads and how these impact on profits and cashflow
    a. Rent
    b. Wages and Labour Costs

Use the most recent or current year figures (this is the business now – more crucial than how it was trading two years ago). Get these broken down by month, so that you can check against trends and prior years for consistency. Most financial software will enable to vendor to provide this data to you.

Industry benchmarks are available for many industries which will help you assess both the performance of the business you are looking and also perhaps the accuracy of the data

If you would like to receive the report for your industry, please feel free to call or email and we can provide.

Look for consistency in performance

- If you see an increase in sales or ongoing sales growth, it is important to understand the reasons for this growth
  - Do the reasons make sense?
- Are sales growing while maintaining margin?

What are the profit drivers for the business?

What are the 2 to 5 drivers that make this business a success and are these at risk in the future or are they a sustainable advantage?

The drivers could be:

- the market the business is in
- supply chain or exclusivity
- technology
- Location
- Branding
- Consider consumer trends

Who is the target customer for this business and is this market likely to be sustainable?

Big question – if you are the target customer - would you buy from this business?

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Identify the key risk areas?

All businesses have risk attached to their future and future earnings, this is why the return on investment is so much higher than for passive investments.

The key is to be able to identify risk areas so you can manage around them or in some cases undertake steps to eliminate these from future business performance or at least ensure that the purchase price appropriately reflects this risk. Consider:

- Does the business have healthy cash flow?
- By reviewing sales can you tell where the revenue is coming from?
- How reliable are the projections and what multiple is the price placing on those earnings?
- Are profits going up or down?
- How big is the market for the company's products or services?
- Is the market growing, shrinking or stagnant?
- Are there any major new competitors coming into the area that could negatively impact earnings?
- What kind of online presence does the business have, and how does it compare to its competitors?
- If the company has physical assets, are they valued correctly and fairly?
- Could there be there any hidden liabilities?
- Is the business up to date on its taxes and employee entitlements?
- Review the lease and key clauses?
- Review the employee summary including salary and benefits and roles?

Financial information to request from seller

Further information you should request after you have entered a contract

- 3 years accountant prepared Financial statements
- Forward budgets and cashflows (if they have)
- Critical numbers or KPI's the current owners track
- Management accounts – current year
- 3 Years Income Tax returns
- Asset and depreciation ledger
- Tax Portals - 2 years
- Profit and Loss monthly – to let you see seasonality (in excel)
- Sales by Customer (if relevant)
- Suppliers – agreements and breakdown of volume.
- Leases on premises
- Payroll Report and entitlements
- Details of functions of owners – this is what you need to cover after takeover

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Complete a Due Diligence processes

There are numerous due diligence processes that can be undertaken to ensure that you are buying the business that is being marketed to you.

The processes will be determined based on a combination of:

- Assessed Risk
- Purchase Price
- Your experience in the industry
- Budget you are prepared to spend
- Time allowed
- Access to and quality of data

The specialist in our Business Purchase Division have vast experience in carrying out due diligence for business purchase.

If you would like to know how we can help you or the services we provide, please feel free to call or email and we would be happy to provide it to you

Get the right business structure

Usually you will need to establish your business structure before you enter into a contract to buy a business so this needs addressed quite early in the process.

There is no best business structure for all scenarios, the key factors that will help determine the appropriate structure are:

1. Expected level of profitability in the Business
2. Number of business owners
3. Industry the business operates in
4. Intention in the future to bring on other business owners or raise capital
5. Expected growth of the business
6. Your existing assets and structures
7. Likelihood for there to be related party loans as time goes by

Frequently after knowing the above factors a company is determined to be the most appropriate operating structure. Ideally with a family trust owning the shares in the company to provide maximum tax flexibility for future dividend flow or to access to the small Business CGT concessions on a future sale

There are many different structures that could be considered.

We have prepared a paper on Structuring and Asset Protection. If you would like a copy of the paper, please feel free to call or email and we would be happy to provide it to you.

Should you have any questions or require any assistance, contact our Business Purchase Specialists Division today:

07 5592 3644 **info@walshaccountants.com** **www.walshaccountants.com**

WALSH BUSINESS PURCHASE SPECIALISTS

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Estimate add back and owners wages

Business owners structure their remuneration and dividend mix to suit their own unique circumstances. Most commonly this generates the need to adjust the reported profit of the business to account for the method or amounts that are being paid to the owner as opposed to what the commercial or post acquisition amounts to replace these resources will be.

Review Owner roles and estimate of time spent managing the business

- Understand the key functions that will be lost and consider your plan to replace these;
- Do you have the same skills as the vendor;
- Will you employ someone to do what they do and do other things (get this into your budget assumptions)
- Key is to understand how and what the vendor does as this will give you insight into how your day might look in the business as well as what time you will need to allow
- Consider which tasks or items you will to either outsource or have an employee do.

There are also various other profit adjustments, referred to as 'add backs' that need to be taken into account to arrive at the underlying profitability of the business.

When you are considering the validity and reasonableness of the add backs think deeply about the way you will operate the business – which may not be the same as the current owners. After all you are buying a business to suit your needs.

Common add backs include

- Owner wages - what are they paying themselves, will this suit you?
- Depreciation – should this be added back or does it represent the required annual capital spend in the business?
- Replacement of owners time that is not expensed
- One off Marketing or capital expense
- Interest
- Private vehicle usage
- Owner superannuation contributions

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Stock and Inventory Considerations

Stock will usually be in addition to the business price as it will fluctuate based on seasonality as well as direction that you might give the vendor.

We see many buyers try and ensure that the stock is kept low on purchase, whilst this has some advantages:

- Less outlay on purchase price;
- Easier stock take
- Possibly less risk of dead stock

However the disadvantages can include

- Loss of sales from stock outs
- Not being able to service customers just as you take over
- You may need to restock

Unless you are changing the stock mix, you will likely have to order up to replace it all and spend the same funds while you may have had a negative impact on sales (as you didn't have the stock), staff and the customers you have just paid for.

A better approach is to gain an understanding of how the current owner manages the stock levels and why as well as form your own view on the stock requirements to arrive at a figure or plan to ensure when you take over the correct amount of stock is on hand for how you intend the operate the business.

Prepare a Post-Acquisition Budget and Cashflow

This is possibly the most powerful process to help you understand if the business will deliver to you the profitability and cashflow you are expecting from the investment you are making.

A post acquisition budget is your forward looking budget using a combination of:

1. Financial information from the vendor
2. Adjustments you will make to the business cost base
3. Removal of valid add backs
4. Finance and Interest costs
5. Funds/Wages you intend draw from the business

If you are looking to prepare a post-acquisition Budget and Cashflow, we have a simple 12 month template which can be used for manufacturing, trading, and service entities.

Please feel free to call or email and we would be happy to provide it to you

How can Walsh Accountants help?

Choosing to purchase a business is one of your most important financial decisions you could make so it is important to partner with a team who understand this and are focused on supporting you through the process.

We pride ourselves on offering a complete package service through the entire acquisition process. So, if you're looking to purchase a business, you can rely upon our team to help you every step of the way.

If you would like to partner with a team who will support you through the purchase process… and beyond, look no further than Walsh Accountants.

You can contact our Business Purchase Specialist team today for a complimentary and obligation free discussion on 5592 3644 or email info@walshaccountants.com