FAQ for Potential Business Buyers

1. I Want to Buy a Business. Where do I start?

You may want to start with lining up professional assistance to help you avoid the pitfalls of doing it yourself. If you have been "looking," you may have seen some sort of general listing information posted by the Business Listing Broker, on a website or in the newspaper. You may then see a one or two-page presentation that provides a minimal amount of specific information, which is often provided by the broker or the seller to let buyers know what type & size of business is available without disclosing to the general public financial & proprietary information that any business owner would not want to make common knowledge. Even the fact that a given business is for sale can be extremely detrimental to the business if that information is made available to competitors, vendors, and employees.

After seeing this "blind" profile, a buyer may decide this is something they want to know more about. Contact with the selling or listing broker will then result in some communication via phone, e-mail, fax, or in person. The broker will want to know some more about the buyer to determine if this business, or perhaps some other business, is a good fit. Most brokers will ask for some basic background information to assess your financial and experiential qualifications.

The buyer will also be asked to execute a Confidentiality Agreement, also called a non-disclosure form, before he will be allowed to meet with a seller or see any proprietary information. This information may sometimes include "small" things like the location. With some businesses, knowing what they do, and their location can easily give away their identity. It is (generally) the Broker's job to handle the marketing of the business for the seller, and this includes obtaining the required paperwork to protect the seller's livelihood and interests.

After the Buyer has signed a Confidentiality Agreement, and if the buyer is a fit for the business, the broker will work with the buyer to provide all of the information he needs to make an informed decision on a given business opportunity.

Tips on working with a professional Broker:

We hear from many buyers who are frustrated that they can't get some business brokers to return their calls. They assume these brokers must be either unprofessional or don't really want to sell the business. It is unacceptable for brokers not to return calls. However, it is important for buyers to understand business brokers in order to work with them effectively.

Business brokers do want to sell businesses, and generally spend their time with the buyers who they think are most likely to close a sale. Brokers receive many calls every day from buyers who are interested in buying a business, but many of these calls are from people who do not have the resources, experience, or risk profile to actually buy a company. Therefore, brokers spend a lot of their time screening out the "tire kickers" from those who are motivated buyers who are ready to make a decision.

There are things you can do to make sure business brokers treat you as a serious buyer. First, define your criteria so that you know what you are looking for. Some buyers make the mistake of telling a broker that they are "wide open" to anything. This really means they have no idea what they are looking for and want to "kick some tires" on a few (or MANY) businesses in order to narrow it down. Brokers see this as a waste of their time and their client's time. Others make the mistake of inquiring about a business that is not a good fit with their background. Some businesses don't require experience in the industry, but many do. If a buyer is inquiring about a machine shop and doesn't have manufacturing experience, many brokers will see the buyer as a "tire kicker," even if the buyer honestly believes he is serious.

Second, be willing to sign a non disclosure agreement (NDA) also known as a Confidentiality Agreement, and to provide personal financial information. Clients require brokers to get a CA or NDA and financial information prior to sharing the company's confidential information. If the buyer won't disclose financial information, the broker can't tell if the buyer is able to complete the sale. Therefore, it is unlikely that most brokers will provide him with any information. Remember that the listing broker has an obligation to protect the seller client's interests and cannot disclose information to unqualified buyers. Signing a NDA and providing financial information is the standard process for buying a company and you should be willing to follow it if you are a serious buyer.

Third, be easy to do business with. Some buyers want to spend a lot of time re-negotiating the non disclosure agreement, or want to control the process rather than follow the broker's process. They incorrectly assume that because they are the buyer, they can dictate the process or the agreement. If something is very important to the buyer then he should stick to his request, but if you are too demanding then some brokers may not be as responsive to you. This can be especially true if the broker has other buyers who are easier to work with.

Fourth, show the broker that you are able to make a decision and are ready to make an offer on the right business. Some buyers want to analyze everything and will request too much information before making an offer. The broker may see this as being difficult to work with or being afraid to make an offer. It is important for buyers to get the information they need, but it is also important to require it at the right time. Due diligence is the time when buyers verify the information provided by the company and confirm through the details that there are no red flags. Don't try to do all your due diligence before making an offer. You should attempt to arrive at an agreement in principal, assuming that the information you have been given is accurate. Your offer should have contingencies allowing you to verify the information, so that if it is not substantially as presented, you **can** walk away with a return of your earnest money.

If buyers will make the effort to work effectively with brokers, they will stand out among a large group of buyers and get the attention and assistance they need. Brokers will know these buyers are serious about working within an established system, and listening to those with expertise. Brokers will want to show these buyers the businesses they represent, as well as any other business that may be a fit that are listed with other brokers with whom there are co-operative agreements.

2. When buying a business, what are some basic questions to ask?

Most professional Business Brokers will have an information package available to you after you have signed a Non-Disclosure or Confidentiality Agreement, which protects the seller and new buyer's interests from damage done when proprietary information is made available to the wrong parties.

These types of questions, at a minimum, should be answered in the initial information package, and/or at the first meeting.

1. **Why are you selling your business?**
2. **How many years have you been in business?**
3. **How many years have you been in business at the present location?**
4. **Did you create the business or did you buy it from someone else?**
5. **Are you a sole proprietorship, partnership, or S or C corporation?**
6. **Do you have tax returns and financial statements that my CPA can look at?**
7. **Which bank do you do business with?**
8. **What types of insurance must your business carry?**
9. **What licenses are necessary to own and/or run this business?**
10. **How many hours did you work per week in your business?**
11. **How many employees do you have?**
12. **Do family members work in your business?**
13. **Will the family members stay after the sale?**
14. **Are you willing to take a note and be paid over time instead of all at once?**
15. **Will you stay and work for a while after the business is sold?**
16. **How is inventory controlled**?

3. What is Due Diligence and when do I do it?

- After you have met with the seller of the business, and analyzed the initial material made available to you by the broker, you will make a decision concerning your commitment to proceed with the purchase of the business. If you are serious, you will need to make an Offer to Purchase or proffer a Letter of Intent, stating the terms of the intended transaction.

The Business Broker can assist you with the preparation of this document, based on your terms. You can prepare an Offer or LOI all by yourself, or with the assistance of a trusted advisor. Offers can be legally binding, or NOT, depending upon the wording of the document, so you should be fully aware of the content, and consult an Attorney if you see fit. The Broker will present your Offer to the Seller. If the seller agrees, accepts your terms, you will continue the systematic process that will lead to a closing.

- Due Diligence is the necessary investigation on the part of both the buyer and the seller to verify that each party understands what they are getting in the transaction. No one wants to be surprised at or after Closing. The parties will often have their CPAs participate in this process.
- The buyer will want to verify that the business information he has received is accurate. This will entail, at a minimum, a review of the books & records of the business, counting any inventory, and surveying the equipment. Due diligence can be complicated with larger businesses, so there is no standardized list of usual items. The seller will want to verify the claims of the buyer regarding his business experience, creditworthiness, and available liquid cash for the business down payment. This is especially critical when the seller is considering financing the buyer for some portion of the Purchase Price. This may entail checking references, running a credit check, and reviewing copies of certain account summaries.

4. Am I responsible for the prior businesses debts after I buy the business?

Laws vary from state to state. Successor liability laws transfer responsibility for payment of certain business debts to the new owner when a business is sold. In the majority of small business transactions, the sale will be an "asset sale," and the seller will pay liabilities and keep current assets. Unless you buy the actual Corporation, a "stock sale," you would not be responsible for liabilities, unless they are specifically agreed to in the Closing Documents. You should check for possible back taxes, liens, penalties and fines that may transfer to you upon purchase of the new business. Your CPA or Attorney, or the Closing Attorney will generally handle that task, so that you are assured you are receiving a clear title.

5. Are some business locations better than others?

For many businesses that depend upon drive-by business and/or easy consumer access, "YES!" You can have the best business in the world, but if it is located in a dead-end cul-de-sac in a dangerous part of town, your business will probably fail. Time and effort devoted to selecting your business location can mean the difference between success and failure. The kind of business you are in, the potential market, the availability of employees, and the number of competitive businesses should all be determining factors in your choice of location.

On the other hand, many businesses do not depend upon a high visibility location, and you can reduce your overhead costs dramatically, and make more profit, if you choose a location for its access to cheap labor, the loading dock you may need, easy truck turn-around, low taxes, commute time, etc.

If you are buying an existing business, the prior owner has already resolved many of these issues. If the business is doing well where it is, and growing as it should, moving it may not be a wise idea, and you can be happy that someone else did all that location work for you!

6. What about the Company Name?

The right to use the business name is part of the sale, nearly always. You may not be buying the Corporation, but you are buying the DBA, or Doing Business As name. This is generally a very important part of the goodwill if you are purchasing an existing business. Customers turn to this company for their products & services, and the company makes money. That is one of the reasons you may want to buy the business. You may want to think long and hard before changing that name, and risking the loss of customers and revenue.

If you do want a new name, you can request a report from a search company that will check records in the US Patent and Trademark Office, state registers and various other business sources. There usually is a fee for this service. Some companies are: CSC, The US Corporation Company, 1090 Vermont Ave NW, Washington DC 20005, 800 241-6518. Thomson and Thomson, 500 Victory Road, North Quincy MA 02171-3145, 800-692-8833.

7. How much is the business worth?

There is no simple answer or formula for evaluating the value of a business. The price that the business can command in the market will actually change for the same business depending upon the terms of the sale. There are appraisers that specialize in valuing a business. Professional business brokers can give a range of prices that will be fairly accurate for many small businesses, based on experience with the market, rules of thumb, and an analysis of financial statements and cash flow.

Some brokers believe that cash flow is the most important factor to consider in a small business sale, as the business must be purchased with that available cash flow for an owner-operator buyer to be able to survive after the sale.

Other important factors to consider include:

- competition,

- industry trends, and like-size comparison with other companies in the industry
- balance sheet ratios,
- income statement analysis and trends,
- gross and net margins,
- type and condition of equipment, and future capital requirements
- customer base: target, size, quality, diversification, location,
- avenues of growth for the company under new ownership,
- owner's role, now and after the sale
- financial needs and goals of the buyer and the seller,
- difficulty of someone else learning the business, and
- potential for growth in this business and in the industry as a whole.

A professional Business Broker can assist you with this.

8. How can I get a business valuation?

The Business Broker, or possibly your CPA, can help you with valuation. If a professional intermediary is marketing the business, ask them if a third party valuation has already been done. Only specialists certified to appraise businesses should be doing true business valuations. Many small businesses are not actually valued, but rather priced using market information, rules of thumb, and experience. Ask the broker how the business was priced.

9. When I buy a business, how is Goodwill determined?

Goodwill is the difference between the selling price and the estimated values assigned to all the assets, not including the goodwill. The seller's asking price will be broken down into its various components such as equipment, inventory, furniture, accounts receivable, (if being purchased) miscellaneous assets, assumed liabilities (if agreed upon), and possibly real estate.

The mathematical difference between the sum of all these other assets and the selling price by definition equals the intangible assets, most of which will be goodwill, by the broadest definition. Goodwill is a highly valued asset in any on-going business. Think of Goodwill as the "profit-generating intangible" that makes that business worth more than a start-up with no current customers, no employees, no name recognition, no established vendors, no distribution system, no lessons-learned, no mentor to help with the transition, etc. etc. It is the "going concern value." Fixed assets without the goodwill are just non-productive equipment and furnishings.

10. What is the correct sequence, order of the assets, when allocating the sales price in a business acquisition?

This is one of the many areas in which you should consult your tax consultant and/or CPA.IRS Form 8594 is used to allocate the sales price over the purchased assets. The buyer and seller must each file this form, and they must agree. On Form 8594 are 5 classes. The assets are allocated from class 1 through class 5. Class 1 = cash type assets such as bank accounts. Class 2 = assets such as CD's US government securities, foreign currency and readily marketable securities or stock. Class 3 = all tangible and intangible assets that are not class 1,2,4 or 5 such as furniture and fixtures, land, buildings, equipment, and accounts receivable. Class 4 = all intangibles except goodwill and going concern values. Class 5 = the goodwill and going concern value.

11. How do I deduct the cost of Goodwill I purchased with the business?

The Tax code is always changing; so consult a professional on these matters. Currently, the cost of business intangibles such as Goodwill, covenants not to compete amounts, and trademarks are amortized over a 15-year period for the buyer at this time.

12. How do I deduct the value of the customer list I purchased?

The Tax code is constantly changing; so always consult a professional on these matters. Currently, customer lists cannot be deducted in full at the date of the purchase. Generally, the fair market value of the customer list must be amortized over 15 years.

13. How do the parties allocate the purchase price of a business to various assets?

The CPA of the buyer & seller are usually involved with the allocation of the assets to the purchase price. When a business is acquired, the business being purchased can include various assets including machinery, inventory, fixtures and intangible assets. The breakdown of these assets is important because certain assets can be depreciated or written off faster than others. Often one allocation will tend to favor the seller or the buyer.

In many instances, especially with the intangible assets, this allocation is somewhat negotiable, and is sometimes used as a bargaining tool. The IRS will verify that the seller and buyer have done an identical allocation, so the parties must agree it upon. You should work with your CPA to be sure you understand the tax implications of the final allocation.

14. What should I know about accounting and bookkeeping?

The importance of keeping adequate, legible, complete records cannot be stressed enough. Without records, you cannot see how well your business is doing and where it is going. This is your feedback mechanism and "report card."

All business transactions should be documented with checks or credit cards. Undocumented cash transactions should be avoided if possible. At a minimum, records are needed to substantiate your tax returns under federal and state laws, including income tax and social security and sales tax laws. It also is necessary to substantiate your request for credit from vendors or loans from lending institutions.

If you ever plan to sell your business, you will need to substantiate your representations and claims about the business. Speak to your local CPA to set you up on a good bookkeeping system. There are many good software programs that allow small business owners to keep their own books without being an accountant themselves.

The IRS also has a wealth of information on their web site that helps small business owners to understand their record-keeping and tax obligations. http://www.irs.treas.gov/

15.Can I make a tax free like kind exchange of the Goodwill I purchased with my new business?

No. You cannot make a tax free “like kind” exchange of goodwill from one business to another.

16. When I buy a business, do I sign personally?

You may not want to sign personally to guarantee payment on a business purchase. It will be very rare if you don’t have to. The seller or the bank will usually request your personal guarantee on any note. The more money down and the more collateral at risk, the less likely your personal signature will be required. A good CPA can negotiate and work with your lawyer to minimize your personalexposure.

17. When buying my business, what form do I file to apply for an Employer Identification Number (EIN) ?

File Form SS-4. Ask your local CPA for a copy of the form, or you may download the form from the IRS web site http://www.irs.treas.gov/ You may also call the IRS and apply over the phone.1-800-829-1040

18. Can I defer the Gains on the Sale of My Business by Buying Another One?

You should consult a tax consultant specializing in these transactions before considering this option. There is a possibility of deferral of gains on sales of certain types of corporate stock under Section§1045.Section§1045 essentially works like the old capital gains rules for the sale of a primary residence.Specifically,§1045 allows non-corporate taxpayers to defer (elect to rollover) the gain on the sale of Qualifying Small Business ("QSB") stock if the gain is invested in another business. Similar to the old law that applied to the sale of personal residences, the basis of the replacement QSB stock purchased must be reduced by the amount of gain that has been deferred.

This is a very brief overview of the complex rules under §1045. You should consult a CPA before thinking about this possibility.

NOTE: A Business Broker is not authorized to give you actual legal or accounting advice.

Be sure to consult an attorney and/or CPA or your choice for advice in any business purchase or sale transaction.

Before you consider buying or selling a business, be sure to ConsultKAP!

CONTACT us today for a Free No-Obligation Consultation on your unique situation.

You have nothing to lose except some of your questions.

Offices in Atlanta Metro and Savannah. Main Office: 770-918-9390

E-mail us!