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Insight Solutions Success



# Buying and Selling a Business

## For Sellers

You've worked long and hard to build up a good business. Maybe the business is hugely profitable or maybe from a financial perspective the business may have paid you a modest salary over the years, but maybe not more. You may be ready to retire, move onto another challenge, or perhaps you are burned out. You are wondering if you can and should sell the business. Will you be able to get some return for your investment? How do you come up with a price? How to market the business? How to negotiate with potential buyers? What steps do you take to close the deal? Where are the hidden traps?

Selling your business can be financially rewarding as well as give you the personal satisfaction that what you created will continue after you. Your customers will be happy, and the jobs your business provides will continue. Plus you'll give someone else a chance to be a small business owner. Our tips on selling your business can help you achieve your goals. Through this process your SBDC advisor can be a valuable resource.

### What do I need to do to get my business ready to sell?

Ideally, entrepreneurs should plan ahead if they are going to sell their business. This may take a 1-2 year look ahead. To get the best price and ensure continued success of the business you are selling usually involves specific activities from perhaps getting the business to be more profitable to writing documentation that will assist a buyer—an employee manual or technical manual, for example. Some key areas are:

#### Initial questions to ask yourself

Why are you selling your business? Most buyers will ask you this question. Are you retiring? Looking for a new challenge? Burned out? Having financial difficulties?

Why should they buy your business? Why should someone buy your business rather than starting from scratch or buying something else? Your assets might include a sound reputation, a loyal customer base, industry knowledge, established suppliers, and good employees. In addition to those possible assets, consider how much cash the business will generate for a new owner. We discuss that factor under valuation.

Is this the right time to sell? How is the economy doing? How is the industry outlook for your business? Have you been able to show profit for the past several years? Are there similar businesses on the market?

#### Get your books in order

Buyers evaluating your business will generally require at least three years' worth of financial information including tax returns and a current balance sheet. Have the most recent twelve months' financial statements by month as buyers will want to see any seasonal fluctuation. Have a list of the assets for sale and either the current book value or a supportable value of each. Other information that might be valuable for a buyer can be: permits, licensing, leases, customer and vendor contracts, supplier lists and marketing materials.

#### Get a business valuation

Placing a dollar value on the worth of a business is a complex process involving many factors. One of the things you should do is get a realistic idea of what your business is worth. A professional valuation will give you the basis for evaluating buyer offers and help you set your asking price. It will also tell you if there are weak areas that, hopefully, you can correct before you put the business on the market. Sellers often overprice their business — they have put their hard work into the business and have a difficult time realizing if profitability is low, the business may not be worth as much as they think it is. Being aware of the factors that go into valuing a business can be of help. Valuations can be obtained from a number of sources, ranging from local accounting firms to regional business brokers and investment banking firms. Your SBDC counselor can explain to you, using your financial data, the most commonly used valuation techniques. See our discussion on valuation.

To locate your local SBDC advisor please visit [wsbdc.org/contact-an-advisor](http://wsbdc.org/contact-an-advisor)

# Advice you need to grow your business at no cost to you



## *Buying and Selling a Business Continued ...*

### **Get your advisory team in place**

Your advisory team includes your attorney, your accountant, possibly a business broker or realtor, your banker, and your SBDC Advisor.

### **Marketing:**

Determine your strategy, prepare the marketing package, and implement your action plan.

One question you should determine early on is: do you plan to use an agent or broker to help with the deal? If not, are you comfortable negotiating with potential buyers? If you have emotional attachment to the business, it may be helpful to have an intermediary for the transaction.

### **Be prepared for prospects**

Make sure you will be available to answer prospective buyers' questions and meet with them. Keep your business ready to be shown at any time. Keep in mind also that prospective buyers may contact your business as potential customers.

### **What are other tips for selling my business?**

#### **Tips on sharing information with potential buyers**

When a potential buyer contacts you to buy your business, they will need to see the financial statements for at least the last three years, including tax returns, profit and loss statements by month for the most recent twelve months and a current balance sheet in order to evaluate the opportunity. Often the seller is reluctant to give out business tax returns to "just anybody who asks for it." You don't want your financial information known all over town (or perhaps given to the competition). You can meet the buyer's need for information and your need for confidentiality by doing the following:

- First interview the potential buyer. Ask about their background in the industry. Get a sense of whether or not the buyer seems to have the skills and experience to run your business.
- Next explain that in exchange for giving the potential buyer your financials you will want the following from him or her:
  - A signed nondisclosure or confidentiality agreement. This should clearly state that the potential buyer's intent is to evaluate purchasing the business and not for the purposes of gaining any information for business competitors or for any other reason
  - A resume
  - A personal financial statement

### **Evaluating an offer**

What is the proposed purchase price? What are the terms? Will you be asked to finance all or part of the purchase? Many times a lender will want the seller to finance part of the sale to ensure that the seller has an interest in helping the business continue to be a successful one.

Will you be available after the sale to help train the new owner or answer questions? How will the transition period be handled? What are the qualifications of the buyer? Does he or she have experience in owning or managing a small business? Any experience in this industry?

How will the buyer finance the deal? Does it seem reasonable that he or she will be able to secure the financing they need? What will be used for collateral? Does the buyer have sufficient cash for a down payment and perhaps for working capital? How good is the buyer's credit?

### **Next Steps**

See our list below, Next Steps: a list of things to do for the buyer and seller

### **For Buyers**

Perhaps you have considered starting your own business, but you realize there is good competition in the area. Perhaps you also know yourself and know that you are an excellent manager, but starting something from scratch is not one of your strengths. Whatever your reasons, you've become aware of a business for sale and are not sure how to proceed. How do you evaluate the price? What about financing? What contingencies will you need? What about training, and learning about the business? Buying a business can be an excellent way to be a small business owner. It may also be less risky since you should be buying a "successful formula". Our tips on buying a business can help guide you in the initial steps of considering buying a business. They will prepare you to meet with an SBDC Advisor who can guide you further in this area.

### **Where do I start?**

Some initial questions to ask yourself: Is this the right business for you?

What will owning this business be like?

Talk to the current owner about what your day will be like. Spend a day or two in the business to see what you would be doing. Do you have experience in this industry?

If not, how will you get it?

Have you owned a business before?

If not, see our section on:

"What does it take to run a small business?" I don't know if I am "entrepreneurial?"

# Advice you need to grow your business at no cost to you



## *Buying and Selling a Business Continued ...*

### **Why should you buy an established business?**

Why should you buy an established business rather than start one from scratch? Assets of an established business can include their customer base, industry goodwill, established suppliers, and good employees. In addition, you are buying an identified cash flow. Other advantages of buying a business are time saving and reduced risk. Cons include reduced reward (perhaps), and higher cost (the cost of buying a business is usually greater than starting one yourself).

### **Why is the business for sale?**

Don't depend solely on what the owner tells you. Probe. Ask around town. What kind of reputation does the business have? Have there been legal or financial problems? Visit the business unannounced, as a customer.

### **What are you actually buying?**

Ask the owner for the business records. You'll want to see their financial statements for at least three years including tax returns, a current balance sheet and the most recent twelve months' financial statements by month to determine any seasonal fluctuation and a current balance sheet. What are the terms of the lease? Do the statements appear to be accurate? Have they been prepared by an accountant? Are they audited statements? Request a specific list of all the assets you will be buying and what they are worth. Is property included? Inventory? Equipment? Generally you will be buying only the assets and good will and not liabilities.

**How do I evaluate buying a particular business? See our section on valuation.**

### **What are some other tips for buying a business?**

#### **Information the seller wants**

The seller will most likely want some information from you before they release their financial statements. Typical information is: signing a nondisclosure or confidentiality agreement, a copy of your resume and a copy of your personal financial statement. The seller will want to know that you are a serious buyer and are in good financial shape to buy this business. Remember that you may be competing with other potential buyers.

#### **Get your advisory team in place**

Your advisory team includes your attorney, your accountant, your banker, and your SBDC Advisor.

### **Financing buying the business**

First you will need to determine how much cash you have and how much you will need to borrow. Will the seller finance all or part of the deal? How is your credit? Can you get a bank loan? What will you use for collateral? Are the business assets sufficient collateral or will you need additional collateral, such as equity in your home?

### **Making the offer**

The offer is usually made in the form of a purchase agreement or a letter of intent. A letter of intent is a nonbonding agreement that allows the buyer to take a closer look at a business and its records before committing to a formal contract. The letter of intent lets the seller know that you are serious and that the two parties are in agreement on the basic terms of the transaction, such as price, terms, conditions, and timing. An alternative to a letter of intent is a standard purchase agreement that states specific contingencies that must be released before the offer becomes binding, such as financing. Keep a written record of meetings, conversations, and agreements with the seller or seller's agent.

- Some things to consider in your offer are:

What is the proposed purchase price? What are the terms? Will you ask the seller to finance all or part of the purchase? Many times a lender will want the seller to finance part of the sale to ensure that the seller has an interest in helping the business continue to be a successful one. Will the seller be available after the sale to help train you or answer questions? How will the transition period be handled? How likely is it that key employees will stay with the business? Should you ask for them to sign an employment contract as a condition of sale?

Your SBDC Advisor can assist you in determining other issues to be included in the offer letter. You may also want to get your attorney involved in the drafting of the offer.

### **My offer has been accepted! Congratulations! What's next?**

See our next section on:

**Next steps: a list of things to do for buyer and seller**



## *Buying and Selling a Business Continued ...*

### For Both Sellers and Buyers

#### Valuation

Placing a dollar value on the worth of a business is a complex process involving many factors. If you are the seller you will need to determine an asking price. Valuations can be obtained from a number of sources, ranging from local accounting firms to regional business brokers and investment banking firms. Your SBDC Advisor can explain to you, using your financial data, the most commonly used valuation techniques. There are a lot of ways to value a business. There is no “right” way. Ultimately, a business is worth whatever you think it is worth, based on your criteria. You can make your estimation by analyzing several ways to value a business. Let’s review some basics to help you get started.

- **Asset Value.** You can start by looking at the value of the business’ assets. What does the business own? What equipment? What inventory? Any assets such as a building? This rationale says that a business is at least worth its liquidation value. If you were starting a business you’d need to buy similar assets, so the business is worth at least the replacement cost of the assets. The balance sheet can give you a good indication of the value of a company’s assets.
- **Revenues.** Revenue is probably the crudest approximation of a business’ value. Often, businesses are valued as a multiple of their annual revenue. The multiples depend on the industry. For example a business might typically sell for “two times sales.” While a professional may be able to find out typical multiples for your industry, revenue doesn’t mean profit. While revenues can sometimes give a buyer an indication of potential if the business is poorly managed now, it is not a reliable indicator of value.
- **Earnings or Discretionary Cash Flow.** Using earnings or what we call “adjusted or discretionary cash flow” may be a better way to think about valuation than revenues. Basically, this technique determines how much cash a business will generate for a new owner to take for him or herself as compensation and for any debt acquired in buying the business. The more cash a business generates, the more valuable it is. Here are the steps in determining discretionary cash flow:
  1. Take net profit for the most recent year.
  2. Add to that figure any non-cash expenses, such as depreciation.
  3. Add to that any expenses that a new owner will not have or are discretionary. The most common ones might be charitable contributions, perhaps

some travel or expenses for conferences, interest on any debt (a new owner will have their own debt and will have a different interest expense figure).

4. Add to that the any wages that the owner has taken during the year. A new owner might have different income needs.
5. Subtract from that any known expense, other than new debt and a new owner’s compensation, a new owner will have. An example of this is if the seller is a couple with both working in the business and the buyer is an individual, the buyer will need to add another employee to replace one of the sellers. Another example would be if the seller owns the building where the business is located and will lease it to the new owner. A buyer then needs to subtract from the net profit figure what the new rent payment would be on an annual basis.
6. You now have how much cash this business currently generates for a new owner. If the financial statements you are using for this analysis are several months old and the most recent year is already proving to be different from last, you will want to adjust your analysis for that recent evaluation.
7. Have your SBDC Advisor help you with this analysis or review your figures.

**Applying a multiple to DCF:** Multiples are usually applied to the discretionary cash flow figure to arrive at a valuation for the business. Factors that determine a multiple can be:

- Type of business—service versus retail or manufacturing, for example. Also whether the business has significant assets.
- Whether special managerial skills or industry expertise is needed.
- Stability of historical profits.
- Business and industry growth.
- Location and facilities.
- Stability and skills of employees Competition.
- Diversification of products, services and geographic markets.

# Advice you need to grow your business at no cost to you



## *Buying and Selling a Business Continued ...*

**Feasibility:** Whatever the asking price of a business is, whether you are the seller and used one of the valuation techniques to arrive at a specific asking price and/or a range that seems acceptable to you, or you are a potential buyer trying to evaluate an opportunity to purchase a business, you should look at the feasibility of someone buying this business at this price. If you are the potential buyer, you can apply your specific situation to this feasibility analysis. If you are the seller, you might want to first look at feasibility for yourself and then look at what the situation might be for a “typical” buyer. For feasibility for the seller, the question is “can you afford to sell the business for this price?” Do you have business debt that needs to be paid off out of the proceeds of the sale? The steps for feasibility for the buyer are: take a specific price for the business, whether it is the asking price or one of the values in a range of prices; to that that add the working capital a buyer would need to start as well as any other initial costs (perhaps there are some needed renovations or equipment that needs replacing etc.); this gives you the total amount a buyer will need to buy and begin to operate this business. With that figure:

- Subtract the amount a buyer will have of his or her own funds. That leaves you with the amount of debt the buyer will have to incur.
- Figure out what the annual loan payment would be on the debt. Subtract that from the discretionary cash flow figure you arrived at in step 6 above. Subtract the minimum amount the buyer will need to take out of the business for his or her own compensation. If there is not enough for the buyer, or if you are at a negative figure, the sale as outlined above is not feasible.
- Look at the deal and see what, if anything can be changed to make it feasible. Can the seller finance all or part of it at a lower interest rate or longer term? Can the buyer come up with more cash? Is it feasible for the seller to reduce the price? Your SBDC Advisor can assist you in looking at the feasibility of various scenarios.

### **Next steps: a list of things to do for buyer and seller**

This list includes some of the activities after the offer has been accepted and any contingencies have been removed, but prior to closing. We recommend that both the buyer and seller consult with both their accountant and their attorney in the transaction of buying/selling. These professionals should

be different for each party. Your SBDC advisor can assist you in determining any additional steps.

- The seller continues to run the business in a sound and responsible manner until closing.
- The lease: if applicable, the buyer confirms the details of a new lease with the landlord.
- Business License: The buyer needs to get a state business license ([www.wa.gov/dol](http://www.wa.gov/dol)); and a city business license if necessary.
- If the buyer is going to be a corporation, he or she will need to file incorporation papers as well (buyer’s attorney can do this).
- Seller will indicate that the business has been sold on the last B&O report that is filed.
- Buyer needs to get an EIN (employee identification number) from the IRS to be able to employ people or if the business will be a corporation ([www.irs.gov](http://www.irs.gov)).
- Buyer needs to get insurance prior to taking over the business (liability, property, fire, theft, vehicle, business interruption and the lender may require life insurance on the new owner.)
- Buyer is to inspect and approve the equipment list. Prepare allocation of purchase price forms that are for equipment (your accountant will have this IRS form).
- Inventory: determine who will take inventory and when. Estimate inventory level for closing documents.
- Contact utility companies to have accounts transferred.
- Contact phone company and web hosting firm, if applicable, to have accounts transferred and web site changed to reflect new owner (if applicable). Examine all marketing materials for any needed changes (such as owner’s name).
- Clarify training period and activities.
- Contact all suppliers and transfer accounts. Buyer to find out if suppliers will give terms and what they will be.
- Contact merchant’s credit card company and arrange for transfer or new account.
- Buyer to set up business checking account.
- Seller to close business checking account.
- Prepare joint press release to be sent out after the closing.
- Seller to turn over all records for the business to buyer at closing

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