

Buying a Business

"Buyer Beware" is an old adage, however very true. When buying a business you can believe only what you see not what you hear. Whether dealing with an owner or a real estate salesman you can only believe official documents you can see and understand not what you are being told.

It is also incumbent upon the buyer to determine the REAL reason the seller wants to sell. The given reason may not be the real reason. There may be hidden facts known only to the seller, not revealed to the buyer that could impact upon future sales. Economic trends, future road construction, other demographic changes could all impact sales and profits.

Generally a business is purchased for a multiple of cash flow. Cash flow being defined as Earnings Before Interest, Depreciation, Taxes and Amortization, (EBIDTA)

The only way to determine cash flow is to see the Business Federal Tax Return, or the individual owners schedule C from his/her tax return. You want to see as many years as possible. In addition you want to see the Sales Tax Returns. You want as many years as possible to see the trend of sales up, down or static.

The accountants report may be interesting as to the details of some of the expenses, however, YOU MUST SEE THE FEDERAL & STATE TAX RETURNS.

Should the seller not be willing to disclose the tax returns - WALK AWAY.

You may be told that there are more sales that are being shown. That means nothing, you are buying only what is being reported to the government.

Should the tax returns not show any cash flow, walk away. Do not buy somebody else's problems. There is always another deal to be had.

Once you have all the information you must run a Pro Forma P & L, plugging in the information from the seller and your own information to determine whether this is a deal that makes sense. You will probably need an accountant or financial advisor to assist you.

Should the results of the Pro Forma P&L indicate that you are able to recover your cash investment within 3 - 4 years and your results match or exceed the present cash flow then the selling price should be in the area of 3 to 4 times the yearly cash flow. This price would be for the business only, excluding any real estate

This is not a foolproof method of determining sales price. Sales trends, local economic trends, and other variables must be taken into consideration.

In addition you need a written inventory of furniture, fixtures and equipment, which you must personally verify. This inventory will be an exhibit to the sales documents. In this way

there will be no confusion of what you are purchasing. You must determine that all equipment is in working order at the time of the sale and secure a warranty to that effect.

Generally merchandise, food and liquor inventories are purchased for their dollar value and are in addition to the purchase price of the business,

The length and expense of the existing lease is very important. Total Occupancy (Rent, Real Estate Taxes and Insurance if paid by the lessee, Common Area Maintenance, Sales Tax on the Lease) should not exceed 6% to 8% of sales. The lease should be at least ten years including options.

Lease

When you sign a lease for a business premise you will have to sign personally on the lease even though you may be operating as a corporation. I know of NO landlord that would not demand personal guarantees.

Lease Definitions

1. Gross lease - A property [lease](#) in which the [landlord](#) agrees to pay all expenses which are normally associated with ownership, such as utilities, repairs, [insurance](#), and (sometimes) [taxes](#).
2. Net lease - A property [lease](#) in which the [lessee](#) agrees to pay all expenses which are normally associated with ownership, such as utilities, repairs, [insurance](#) and [taxes](#). **also called** closed-end lease.
3. Double Net Lease - A [lease](#) in which the [lessee](#) pays rent to the [lessor](#), as well as all taxes and insurance expenses that arise from the use of the property. The lessor pays maintenance expenses.
4. Triple Net Lease - A [lease](#) in which the [lessee](#) pays rent to the [lessor](#), as well as all taxes, insurance, and maintenance expenses that arise from the use of the property

Which lease is negotiated will impact the total occupancy cost on the P&L. **It is imperative that the lowest possible occupancy factor be negotiated up front without a commitment so that the Pro Forma P&L can be run to determine viability.**

Lease Term and Options

It is to your advantage to negotiate a lease with the shortest initial term and several short to medium options. In the event that the project does not do well you will not be stuck with a lengthy lease obligation. Examples of a ten-year lease term - 1-year lease with three 3-year options or a 2-year lease with two 4-year options.

It is important that the lease contain a provision for assignment so that you are in a position to sell the business should you desire. Some, but not all leases have the right to assign with the landlord's permission. However the assignment paragraph must read, in part, as follows: "the lessee shall have the right to assign the lease with landlord's (lessor's) permission which shall not be unreasonably withheld" This means that were you to want to sell to a homeless person with no visible means of support who had never run a business the landlord could refuse the assignment. However, should you want to sell to an experienced business person with a financial profile as good or better than your own the landlord could not deny the assignment.

Ask for a Landlord's construction allowance with new construction. Ask for rent abatement.

In starting a new business. Always negotiate with determination; never assume that you won't get what you want.