Buying a Business

BEAL
Business Brokers & Advisors

BEAL
Business Brokers & Advisors

Buying a Business

Finding, financing, and buying a business

We provide expert advice to help you buy the business of your dreams.

Beal Business Brokers & Advisors
Phone: 204-478-7266 1-800-669-4295
bealbusinessbrokers.ca

BEAL
Business Brokers & Advisors

The decision to purchase an existing business is an enormous step in your career. While there is merit and a certain sense of accomplishment in starting your own business, buying a business mitigates a great deal of risk, helping to eliminate many of the potential pitfalls, stressors, and financial obstacles of a start-up. If your expertise or passion lies in optimization, growing what already exists, and building upon a business' current operations, then the following information is essential for you as an entrepreneur.

The following guide will walk you through the steps of acquiring a business, from evaluating your own credentials as a business owner (financial situation, area of expertise, passions, etc.) to searching for a business, selecting the one that is right for you, making an offer, financing, due diligence, and closing. The process is long and quite complex, and it will require a significant amount of patience and many hours of legwork, but when the right opportunity comes along, you'll be more than ready to take full advantage.

Buying a business is an exciting and challenging endeavour, and Beal Business Brokers & Advisors is pleased to provide you with this guide. Should you require any assistance throughout the process, please do not hesitate to contact us for help.

Steven Beal,
MBA, CPA, CGA, CFA, CBV, CBI — Principal

WE ARE HIGHLY ACCREDITED, EDUCATED, AND QUALIFIED

The information included in this book is intended as general information only and not as legal financial, or tax advice. Every business situation is different, and a professional advisor should be consulted for your specific needs. The information herein should not be regarded as a complete analysis of the topics discussed, and though presented as current and factual, total accuracy is not guaranteed. All subject matter is the opinion of the author and subject to change.

About Us

Beal Business Brokers & Advisors is a full-service brokerage and consulting firm, offering business owners and entrepreneurs assistance with everything from buying and selling businesses to strategic planning for future growth and/or eventual transition and exit. Our expert team is adept at providing people with valuable business advice in order to improve their businesses in competitive and innovative ways.

WE'VE ASSISTED 100'S OF SMALL AND MEDIUM-SIZED BUSINESSES

BEAL
Business Brokers & Advisors

Buying vs. Starting a Business

Cheaper, Faster, and Safer

Buying an existing business can be a great way to avoid the up-front costs, initial marketing, training, and start-up losses associated with starting a new business from scratch. You may also be able to inherit pre-negotiated contracts with existing suppliers and avoid buying new equipment that is needed to operate the business.

Buying an existing business can also be faster, since the initial waiting period for permits, agreements, contracts, and other aspects of a business start-up have already been taken care of by the founder.

Finally, it can be safer to buy an existing business with an established client base and proven positive cash flow as opposed to starting a new business and spending months or even years building your business towards profitability.

Profits from Day One

For some businesses it can take years before they begin to generate profits. Buying an existing business with an established track record of profitability allows you to skip this risky and time consuming stage and allows you to focus on growing the business and creating efficiencies from day one. Moreover, when you buy an established business, you will be able to analyze performance from previous years, which can give you a sense of your business' expected profitability.

Established Market Presence

An existing business comes with an established market presence, which will allow you to capitalize immediately. An established brand will be complete with all names, copyrights, and websites associated with it. This gives clients, suppliers, lenders, and other contacts confidence in your business that they are unlikely to have with an unknown start-up.

Trained Staff and Established Processes

Perhaps one of the greatest benefits of buying an existing business is the experienced staff and proven processes that you will inherit. Often when starting a business, entrepreneurs will need to go through a trial and error period in order to find the right employees and appropriate business processes, which can be stressful and costly. When you buy an existing business, you will be able to skip the majority of this process. Experienced staff members can also help you transition into your own business, while preventing any dip in activity associated with the ownership changeover.

No Added Competition

Buying a business is a fantastic way to enter into an industry without adding to the competition. Instead of struggling to secure clients, purchasing an existing business allows you to also purchase market share. This can be especially beneficial when entering into a highly competitive industry.

Financing

Financing a start-up can be one of the biggest hurdles for those looking to go into business on their own. Banks may be more open, however, to financing an existing business, as they have a proven track record and existing cash flow. Furthermore, it may be possible to receive financing from the seller of the business, further increasing your ability to finance an acquisition.

The Business Buying Process

Buying a business can be a long and complex process. Knowing the many steps involved can ensure that when it comes time to make the purchase, the process will go smoothly.

The first step is to focus on you:

- Why are you interested in buying a business?
- Are you looking for freedom?
- Cash flow?
- Growth?
- Independence?
- Immense wealth?
- All of the above?

Understanding your motivation helps you to understand what to look for in a business.
A couple of questions to ask yourself:

“What would your ideal business look like?”

“If money were no object, what would you spend your time doing?”

Now that you have had a chance to dream, let’s turn to more practical matters.

BEAL Business Brokers & Advisors

The Business Buying Process

Assessing Your Qualifications

Skills

Understanding what types of businesses you are capable of buying and operating is the second step of the business buying process and a good way to narrow down your search criteria. Understand that many businesses require a certain level of expertise, and while you may be able to hire the right employees to handle the technical aspects, some businesses require a hands-on owner with a specific skill set. For example, you will need an accounting designation to run an accounting practice, or you may need experience in plumbing to manage a plumbing business. Acknowledging your own skill set and understanding your own limitations will save you time and energy in your search process.

Financial Capability

Determining your financial capabilities and credit worthiness is also an important step when it comes to defining your search parameters. Some of the benefits of understanding your financial capabilities include:

- Saving you time by eliminating businesses that are out of your price range
- Allowing you to be more precise when it comes time to make an offer
- Putting you in a better negotiating position

As a rule of thumb, most banks require 30-50% of the value of the business as a cash down payment before they will consider financing your endeavour. Make sure you understand your own financial limitations. While a seller may finance a portion of the business, it is best to estimate your financial capabilities conservatively to avoid financing problems in the closing stage of the process. It is also important to factor in other costs associated with the purchase of the business. Some typical costs to consider when determining your budget include:

- Legal fees
- Accounting fees
- PST on assets purchased
- Land transfer fees (if real estate is included)
- Working capital (if not included)
- Loan application fees

The Business Search Process

ALIGN YOUR SEARCH PROCESS WITH YOUR SKILLS AND ATTRIBUTES

Determining Fit

Once you have determined your skill set and financial capabilities, it is important to determine what you want in a business. Ask yourself some basic questions in order to get a better idea of the type of business that is right for you:

- What do you enjoy?
- What are you passionate about?
- What are your strengths — operations, sales, supervision?
- Are you an introvert or an extrovert?
- What is your background and experience?
- What do your past successes include?
- Where have you failed?
- Do you want employees? If so, how many?
- How much do you want to make from your business?
- How many hours per week do you want to work?
- Are you willing to relocate? Does location matter to you?

Asking yourself all these questions and thinking through them honestly will help you determine what type of business is right for you and eliminate those that aren't.

Once you have narrowed down your financial capabilities, skill set, and preferred type of business, you can begin your search.

How to Qualify Yourself for a Specific Business

As you begin your business search, ask yourself the following questions every time you come across a business you think you would like to purchase:

- Do you have the financial capabilities for this business (30-50% as a down payment)?
- Is it in your preferred location?
- Do you have the skill set necessary to manage this business?
- Will this business generate enough income for you?

Once you have qualified for a business and reviewed a one-page summary, you will be asked to fill out a non-disclosure agreement, and your broker will provide you with a full business profile. In the business profile, you will find:

- Name and location of the business
- Operational information, including number of employees, job titles, operating hours, and any other business-specific information
- A summary of financials with standard normalizations applied

BEAL
Business Brokers & Advisors

The Business Search Process (continued)

As you review the information package, there is certain terminology to understand. (A full glossary of business analysis terms can be found at the end of this book).

Earnings Before, Interest, Taxes, Depreciation, and Amortization (EBITDA):

EBITDA is a measurement used to quantify a business' earning performance. It is more commonly used in businesses without a hands-on owner/operator or in larger companies with less discretion for personal expenditures. It is calculated by taking net income and adding back Interest, Taxes, Amortization, and Depreciation.

Discretionary Earnings (DE):

DE is another method of calculating the earnings of a business and is often used in businesses with an active owner. It measures the total economic benefit to the owner and is calculated by taking net income and adding back all non-cash expenses, all non-recurring expenses, and all expenses that the owner has personal discretion over. Examples of commonly seen add-backs include:

- Owner's salary
- Interest
- Personal travel
- Depreciation

- Donations
- Meals
- Entertainment

- Spouse's salary
- One-time expenses
- Cell phones

Goodwill:

Goodwill is the net difference between the purchase price of the business and the value of the identifiable tangible and intangible assets acquired, minus the liabilities that were assumed. Beyond the accounting definition, goodwill is often described as the value of the business' brand, processes, customer base, and reputation.

Drafting an Offer

Once you have researched the business, met with the owner, visited the premises, and had all your questions sufficiently answered, it is time to draft up your offer.

When drafting your initial offer there are a few things to consider:

Assets vs. Share

There are two primary ways to buy a business: either as an Asset Purchase or a Share Purchase. Knowing the difference will help you make a better offer. It is also important to note that an Asset Sale and a Share Sale will have different tax implications for both the buyer and seller. As each business transaction is unique, you may want to contact an accountant to walk you through the specific tax implications of each.

Asset Purchase

In an Asset Purchase, you are buying all of the assets the business owns. Assets can be tangible or intangible. If the business you are looking to purchase is not incorporated, then an Asset Sale is your only option. The business profile you will be provided with will have an exact schedule of what assets are being sold.

Share Purchase

Share Purchases are often done when the business that is for sale is incorporated. In a Share Sale, you simply buy shares of the corporation from the existing owner. All assets (and sometimes liabilities) are included in the purchase (unless explicitly excluded in the profile).

APPROACH THE OFFER PROCESS WITH A "WIN-WIN" MENTALITY

BEAL
Business Brokers & Advisors

Drafting an Offer (continued)

Making an Offer

Letter of Intent (LOI)
A Letter of Intent is a non-binding agreement that serves as the preliminary step in the negotiation process. It is essentially "an agreement to agree." It is not uncommon for one party to present an LOI and the other party to come back with a counter or a new set of conditions. LOIs are important tools, as they illustrate a roadmap for how the next steps of the purchase process will proceed. You may feel more comfortable having a lawyer draft up your LOI; however, because LOIs are non-binding, you may opt to save money and do it yourself or have your broker assist you with it.

Some things to consider when drafting your LOI:

- What is the asking price and what price will you offer?
- When would you like to take full possession of the business (closing date)?
- What conditions need to be met and when must they be satisfied?

Some common conditions include:

- Accountant review
- Lawyer review
- Non-compete clause (location and time)
- Financing approval
- Lease transfer
- Training provided
- Franchisor approval (if the business in question is a franchise)
- Equipment inspection

One of three things will happen after you submit your LOI:
1) The seller accepts your offer
2) The seller accepts a competing offer
3) The seller counters (or declines your offer).

In the event of 1), the next step will be to proceed to due diligence.
In the event of 2), your broker will inform you that the seller has declined or has entered into due diligence with a competing offer and will keep you informed should the business fail to close. **In the event of 3),** the seller will draft up a list of revisions, which may include price, closing date, change of conditions, or a combination of these. You will then have the opportunity to review the revisions and decide whether to accept, decline, or submit a counter.

Due Diligence

Once the Letter of Intent has been accepted, it is time for the due diligence stage. In this stage you may choose to have your lawyer, accountant, or advisors help you analyze all aspects of the business before buying it.

Some common items you may want to investigate include:

- The business operation
- Legal and tax compliance
- State of equipment and other assets
- A verification of client lists
- An analysis of historic financial performance
- Other business-specific details

The due diligence period will have a finite timeline, so it is important to start as soon as the LOI has been agreed.

Removal of Conditions

Beyond standard due diligence and investigation of the business, you should also use this time to work on removing all conditions that you have control over. You may need to meet with a landlord if the business is in a leased premises, attain franchisor approval, attain the necessary permits and licenses, and any other conditions that you and the seller had agreed upon.

WE OFFER BUSINESS ADVICE FOR THE MOST COMPLEX SITUATIONS

Financing

Financing an acquisition in Canada can be extremely difficult. Canadian banks are notoriously conservative and are considered “asset lenders” — that is, they will only lend against the hard assets of a business. They typically won’t lend against the “goodwill” or intangible aspect of a business (unless you are putting up separate collateral for that). The issue is, any business worth buying has strong cash flow and thus positive goodwill.

There are specialized lenders that will finance the goodwill portion of the business, but their rates are higher and some of their terms are more strict than the big banks. Consult with your accountant and broker on how to best finance the deal. While vendor financing is always a possibility, a vendor will typically be reluctant to put more at risk than you are — that is, if you are hoping to buy the business with 10% down, don’t expect the vendor to make up the remaining 90%.

Typical transactions have a mix of:

1. Buyer cash (unencumbered*)	15-35%
2. Buyer asset-backed loan (e.g. second mortgage on house)	15-35%
3. Bank – fixed assets and/or mortgage (on real property)	30%
4. Bank – line of credit	10%
5. Vendor – if necessary	10%

Also note the “line of credit” financing item. Make sure you understand the working capital requirements of the business before you buy it. The price of the business may be $1,000,000, but you may need an additional $100,000 or more in “working capital” to actually run the business. Depending on structure, that may or may not be included.

** Unencumbered means there are no preset principal and interest re-payment obligations on the money.*

Closing

Closing and Post-closing Adjustments

Just because it's closing day doesn't mean the closing process is over. The legal documents should all be signed and the money transferred, but items that remain to be sorted out are "post-closing adjustments." These include net working capital adjustments, tax filings, final legal documentation, and training.

Prior to closing, you need to ensure you have set up your legal entity, bank account, POS system (if applicable), tax accounts, and supplier relationships.

Training and Transition

Once all conditions have been removed and it is clear that the sale will be closed, the next step is to arrange training between you and the previous owner. Depending on the agreement between you and the previous owner, this may be an intensive training schedule, or you may be working on a more consultative basis. In some cases, you may even hire the previous owner to work for you.

Beyond using this time and the previous owner's expertise to learn the business, it is a good idea to have them introduce you to the business' key suppliers, clients, and staff.

To Do After the Purchase

If you have come this far, congratulations! You are now the proud owner of a new (to you) business. Business ownership is a wonderful way to create job satisfaction, create wealth, and even have legitimate tax deductions (business use of home, mileage, etc.). Learn carefully from the previous owner and don't make too many changes too quickly. While the urge is to remake the business in your image and to improve it as fast as possible, try not to change any of the core aspects of the business too soon. Give yourself 6 to 12 months to understand the flow of the business before you try to change anything significant.

BEAL
Business Brokers & Advisors

Conclusion

If the business buying process seems daunting to you at first, you're right — it's an enormous undertaking. But don't let that discourage you from following your dreams of financial success. Instead, focus on each stage of the buying process individually, learn all you can about it, and execute on it with maximum effort. Putting in that work throughout the entirety of the process will yield the greatest results when it comes time for that final handshake and the actual purchase transaction.

The most crucial thing you can do, from start to finish, is be open-minded. When the lightbulb of your idea to buy a business first lit up, you may have had an ideal situation built out in your head, which probably gave you a feeling of tremendous excitement followed by immediate trepidation. Let that feeling motivate you throughout the buying process, but don't let it colour your judgement if things don't turn out quite the way you had envisioned them originally. Be open to opportunities and changes in direction — they may prove better for you, the business, and your long-term financial goals.

Contact Us Today

Selling a business can be a daunting and complex process, but Beal Business Brokers & Advisors is ready and able to assist you throughout the entire experience. Contact a consultant today to learn more about how we can help you succeed in your transition or any other endeavours you have planned.

Please call us at: 204-478-7266 1-800-669-4295

OR

E-mail us at inquiries@bealbusinessbrokers.ca today.

We look forward to helping you.

Appendix - Glossary of Terms

Adjusted Book Value (see Book Value)
Value of tangible assets adjusted up or down as necessary. For example, land and buildings may be written up.

Asset Sale (see Share Sale)
The buyer acquires all or part of the company's assets, while the seller retains the ownership of the corporate entity (shares).

Book Value (see Adjusted Book Value)
Value of the assets as recorded on the balance sheet, after depreciation. Equal to net book value. Underlying assumption is that financial statements are prepared using Canadian GAAP, which is on historical cost basis. Book value for sale excludes cash and redundant assets.

Capital Expenditure (CAPEX)
Funds used by a company to acquire or upgrade physical assets such as property, plant, or equipment. This outlay is made by companies to maintain or increase the scope of their operations.

Cash Flow from Operation (CFO)
CFO represents the cash generated from the operations of a company. Cash flow is also often used to identify the company's earnings.

Discretionary Earnings (DE)
Discretionary Earnings is a commonly used valuation term for small businesses where the buyer would most likely be an individual who would take a hands-on approach to working in the business. It is typically normalized EBITDA plus one owner's salary, benefits, and perks paid by the business.

Earnings
Earnings are synonymous with the profit of the business and are different from revenue.

EBIT (see EBITDA, DE)
Earnings before Interest and Taxes. It is the net profit of the business, plus interest on long-term debt, plus taxes.

EBITDA (see also EBIT, DE)
Earnings before Interest, Taxes, Depreciation, and Amortization. EBITDA is an indicator of a company's financial performance. Could be normalized or not. When normalized, it is the net of any discretionary, non-recurring, and non-operational expenses or income. In essence, it is the net profit of the business, plus interest on long-term debt, plus taxes, plus depreciation and amortization. This is similar to cash flow from operations (CFO), but not identical.

BEAL
Business Brokers & Advisors

Appendix - Glossary of Terms

Fair Market Value (FMV)
"Fair Market Value" can be defined as the highest price that a business would fetch in an open and unrestricted market between informed and prudent parties, acting at arm's length, neither party being under any compulsion to buy or sell, calculated in financial terms.
However, the price you settle at can be significantly higher or lower than a theoretical "fair market value" due to the following issues:

1. Buyers and sellers rarely have access to the same information, finances, and negotiating abilities.
2. There are emotional considerations for both the buyer and the seller. The buyer may be willing to pay a premium just to "buy a job." The seller may be reluctant to sell for "fair market value" because the business may hold strong emotional attachments.
3. There may be legal and/or contractual restrictions that limit the flexibility of the vendor and hamper the realization of true value.
4. The buyer or the seller may be forced to act due to health or other concerns.
5. Value is calculated assuming a 100% cash sale. The terms may not be 100% cash, so price adjustments would have to be made.

Free Cash Flow (FCF) (see Free Cash Flow to Equity)
FCF represents the cash that a company is able to generate after meeting its reinvestment needs in the form of working capital and capital expenditures.

Free Cash Flow to Equity (FCFE) (see Free Cash Flow)
FCFE represents the cash available to be distributed to equity holders (owners) of the company after meeting all debt obligations and required capital expenditures.

Goodwill
The collection of intangible assets, represented in dollars by the difference between the total purchase price for the business and the net value of the tangible assets being purchased.

Gross Margin
A company's total sales revenue, minus cost of goods sold, divided by the total sales revenue, expressed as a percentage. Gross margin is an important measure of a company's profitability.

Intrinsic Value
The value of a business on a "standalone" basis, without consideration for a premium that may be paid by a synergistic buyer. It is calculated based on the required rate of return to investors and current operating performance of the company, with no assumption of synergies upon acquisition.

Liquidation Value
Liquidation Value is the value of assets if sold as assets rather than as a going concern. It is typically assumed to be an orderly liquidation, as opposed to a fire sale.

NAICS Code
North American Industry Classification System code. The NAICS is used by statistics agencies in the collection, analysis, and publication of statistical data related to the economy.

Appendix - Glossary of Terms

Net Book Value (NBV)
NBV is the value at which an asset is carried on a balance sheet. It is the historical cost of an asset, minus accumulated depreciation.

Net Realizable Value
Net proceeds after the sale of an asset, after providing all disposition costs, including income taxes.

Normalized Financial Statements
Normalized Financial Statements are financial statements that have been adjusted to eliminate non-recurring and non-business-related items.

Pro Forma
A projected financial result.

Replacement Value
The current cost of replacing an asset with a similar quality asset.

SIC Code
Standard Industrial Classification Code. A code given to a business in order to classify its industry.

Share Sale (see Asset Sale)
The buyer acquires all or part of the company's shares and the ownership of the company, or specific shares are transferred to the buyer. Since the assets of the business are owned by the company, and the company is an independent entity and its ownership is represented by the shares, purchasing the shares includes all of the assets and liabilities of the company unless otherwise specifically excluded.

Value to Owner
Value to Owner measures the value of the company in the hands of the owner. This can differ from other types of valuation measures for a number of reasons:

1. Benefits of ownership of a business
   - Emotional benefits: The owner may have an emotional and/or sentimental attachment to their business that would be impossible to value in monetary terms.
   - Financial benefits: The value of the ability to determine salary, bonus, and benefit mix.
2. Operating benefits
   - The owner may have specific knowledge, contacts, or abilities that are not transferable, causing the business to have a greater value in their hands than in anyone else's. This is referred to as personal goodwill and is typically non-transferable and non-commercial.
3. Corporate structure
   - The owner may have different classes of voting and non-voting or common or preferred shares that would have different value in the hands of the owner versus any buyer.

Working Capital
Also called net working capital. There are a number of methods for calculating this, though it is traditionally calculated as total current assets minus total current liabilities.