AMERICA'S SBDC MAINE

MAINE SMALL BUSINESS DEVELOPMENT CENTERS

So, You Want to Buy a Business!

Presented by:

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Thank you

- A copy of this slideshow & a recording will be made available.

- We invite questions throughout the presentation or in the comments; this is a complicated topic, and we intentionally limited headcount to encourage participation.

- Please mute your connections if you are not asking a question.

What We'll Cover

- Why Buy?
- What are you Buying?
- How are you Buying it?
- What's it Worth?
  - Ability to Support Debt
  - 'Multiples'
- Structuring the Deal
- Next Steps, best practices

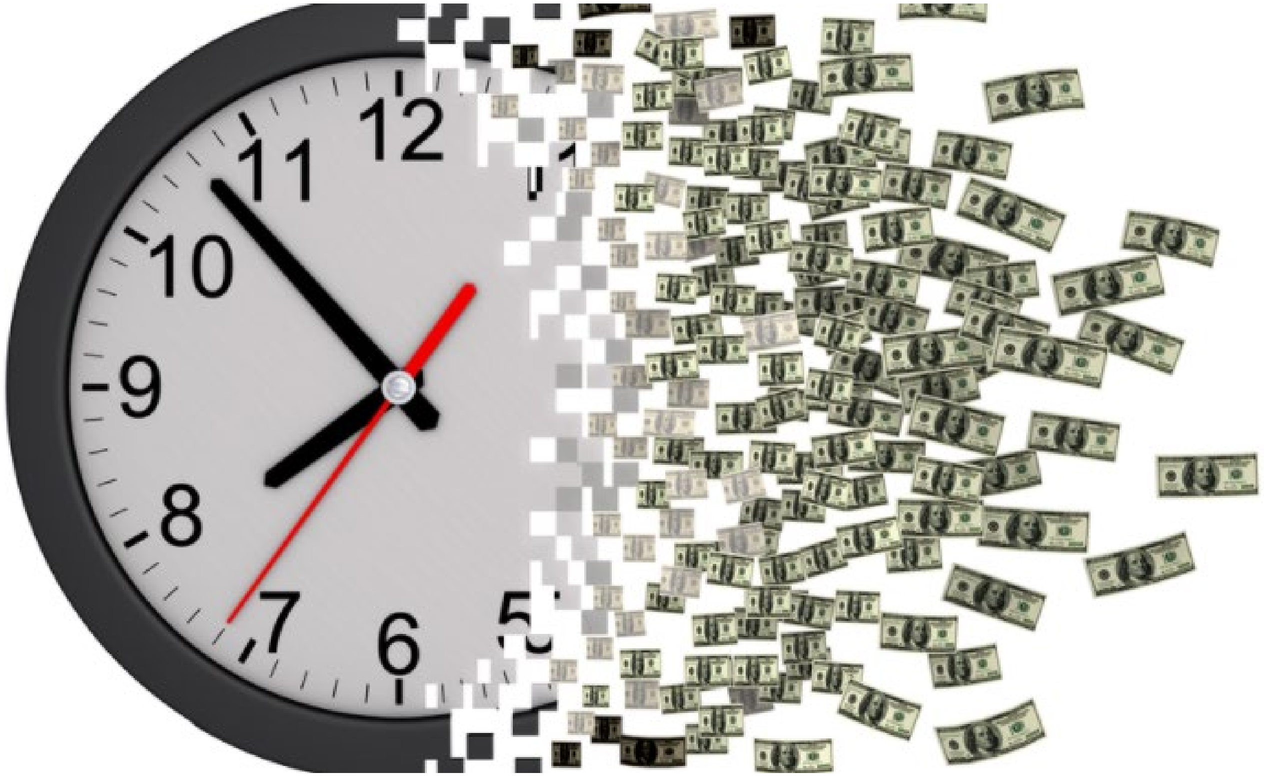
Why Buy?

- Tired of working for others
- “Keep what you kill”
- Don’t re-create the wheel!
- Confirmed market presence
- Existing customer list, employees
- Proof of concept

What's Your Relationship with the Seller?

	Staff / Family	Replacing Seller	*Synergistic Buyer*
What are you Buying?	A Job		*A market share*
How will you pay for it?	Commercial loan / Seller Note **paid for by the cash flow of the business**		*Commercial loan / Seller Note paid for by the cash flow of* ***the businesses – yours and theirs, combined***
Advantages to Structure?	Ease of transition, likelihood of success	Wide range of Options	*Based on gross income* *Leveraged by existing business*
Disadvantages?	May rely heavily on Seller involvement (financial or otherwise) Limited by Cash Flow	Limited by Cash Flow	

What are you *actually* Buying?



The ability of purchased Assets

to reliably generate Cash Flow.

Assets?

Tangible

- Furniture, Fixtures, Equipment
- Inventory
- Real Estate

…

Intangible

- Name, Reputation
- Customer List
- Social Media presence / followers
- Phone number
- Referral network

…

Defining the purchase: Stock vs. Asset Sale

Stock Sale: Buying Ownership stock of existing business (Assets *and Liabilities)*

Asset Sale: NewCo buying predetermined list of assets from OldCo (*Not* Liabilities; assets can include intangible assets)

Other Considerations: AR? AP? Work in Progress?

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Transferrable Assets are *Buyable* Assets

How can you justify the purchase of intangible assets / ‘goodwill’?

- Processes
- SOPs
- Procedures
- Recipes

Or: Is the Business just the Seller?!

When was the last time they took a vacation?

Transferrable Assets should create cash flow

How do you measure ’Goodwill’?

The ability of assets to create reliable excess cash flow.

“Reliable Cash Flow”?

Legal & Demonstrable

(Usually) Tax Returns

Historic Consistency

The Income Statement

- Top Section: **Sales**
- Second Section: **Cost of Goods**
- Third Section: **Expenses (SG&A)**

- Sales – COGs – Expenses =
- **Net Income**

		Jan
TOTAL SALES		
	Ice Cream	12,500
	Hot Dogs	3,130
		15,630
Cost of Goods Sold		
	Ingredients	4,580
	Direct Labor	4,100
TOTAL COGs		**8,680**
GROSS PROFIT		**6,950**
Overhead		
	Advertising	300
	Admin Payroll	3,800
	Rent	3,000
	Interest	190
	Utilities	800
	Insurance	1,000
	Vehicle	300
TOTAL OVERHEAD		**9,390**
NET INCOME		(2,440)

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Revenue? (Sales!)

(**Price** per Item / Service) x (Number Sold in Period)

			20XX	***% Revenue***	
		How many do I expect to Sell?			
			50,000		*Ice Cream Count*
			25,000		*Hot Dog Count*
TOTAL SALES	**Price**				
Price per Ice Cream	$ 4.50		225,000	80.0%	*Ice Cream Sales*
Price per Hot Dog	$ 2.25		56,280	20.0%	*Hot Dog Sales*
			281,280	**100.0%**	

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Cost of Goods?

Direct Labor & Ingredients to create product

				20XX	% Revenue	
			How many do I expect to Sell?			
				50,000		*Ice Cream Count*
				25,000		*Hot Dog Count*
TOTAL SALES	**Price**					
Price per Ice Cream	$ 4.50			225,000	80.0%	*Ice Cream Sales*
Price per Hot Dog	$ 2.25			56,280	20.0%	*Hot Dog Sales*
				281,280	**100.0%**	
Cost of Goods Sold	**Ice Cream**	**Hot Dogs**				
Cost of Ingredients	$ 1.25	$ 0.80		82,500	29.3%	*Ingredients Cost*
Cost of Labor	$ 1.10	$ 0.75		73,740	26.2%	*Labor Cost*
TOTAL COGs	*52.2%*	*68.9%*		**156,240**	**55.5%**	*COGs Margin*

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Revenue – COGs = **Gross Profit**

"Gross Profit" is a measure of the value added

Adding a lot of value to raw ingredients = *High Margin (Low Volume)*

Tweaking or small improvements = *Low Margin (High Volume)*

% Revenue = how much of every dollar sold do you get to "keep"?

			20XX	% Revenue	
		How many do I expect to Sell?			
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TOTAL COGs	*52.2%*	*68.9%*	**156,240**	**55.5%**	*COGs Margin*
GROSS PROFIT			**125,040**	**44.5%**	*Gross Profit Margin*

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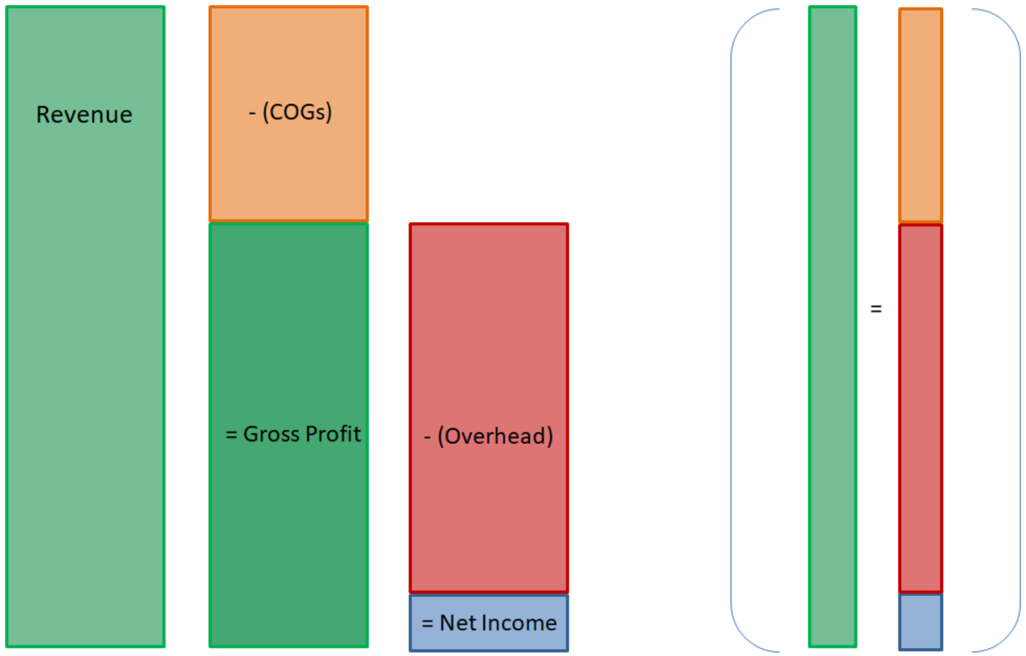
Overhead / Fixed costs

Operational costs don't change with number of sales (too much)

Overhead		
Advertising	$	5,000
Admin Payroll	$	40,000
Rent	$	30,000
Interest		
Utilities	$	15,000
Insurance	$	12,000
Vehicle	$	6,000
TOTAL OVERHEAD		

Breaking Down the Income Statement

	20XX	% Rev
Revenue		
Sales	230,000	*65.7%*
Service	120,000	*34.3%*
Total Revenue	**350,000**	***100.0%***
Cost of Goods		
Materials	90,000	*25.7%*
Direct Labor	85,000	*24.3%*
Total COGs	**175,000**	***50.0%***
Gross Profit	**175,000**	***50.0%***
Overhead		
Rent	45,000	*12.9%*
Insurance	10,000	*2.9%*
Admin Payroll	60,000	*17.1%*
Professional Fees	5,000	*1.4%*
Marketing & Advertising	10,000	*2.9%*
Utilities	12,000	*3.4%*
Meals	3,500	*1.0%*
Total Overhead	**145,500**	***41.6%***
Net Income	**29,500**	***8.4%***



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Understanding Cash Flow

Year-to-year comparison of Tax Returns

Continuity & trends?

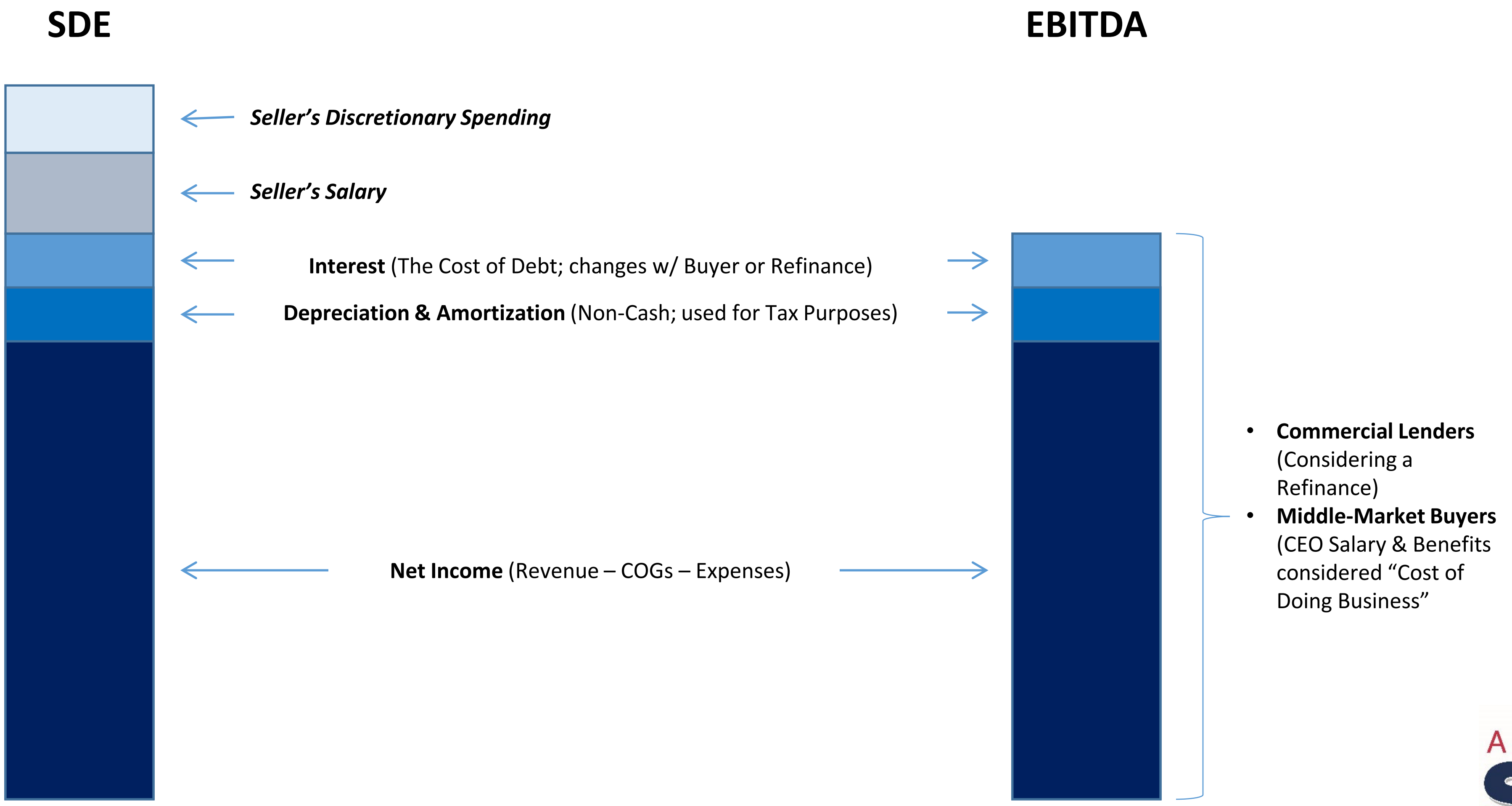
Large jumps?

Large misc. / other?

Compare COGs as a percent of Revenue, overhead as a $.

How much cash remains to pay out to your new Balance Sheet?

IDENTIFYING CASH FLOWS:
Seller's Discretionary Earnings (SDE)
vs.
Equity Before Interest, Taxes, Depreciation, & Amortization (EBITDA)



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2nd Financial Statement: The Balance Sheet

What IS your business?

- Assets
- Liabilities
- Equity
  - (Equity = Assets – Liabilities)

At a specific point in time

BALANCE SHEET

Assets	
Cash	17,152
Inventory	5,000
Equipment	50,000
Total ASSETS	**72,152**
Liabilities	
Loan 1	39,322
Loan 2	-
TOTAL LIABILITIES	**39,322**
Equity	
Initial Investment	25,000
Retained Earnings	7,830
TOTAL EQUITY	**32,830**
Tie out: (A - L - E)	-

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That’s great… what’s the relationship?

The Net Income is Used to Fund the BS

- Can *increase* Assets – and *increase* future sales **(re-invest in the business)**
  - Let cash accumulate
  - Buy new equipment
  - Buy real estate

- Can *reduce* Liabilities
  - This is what a bank wants to see – their Debt Coverage Ratio requirement

- Can *pay out to* Equity
  - Every owner’s dream (but last for a reason)

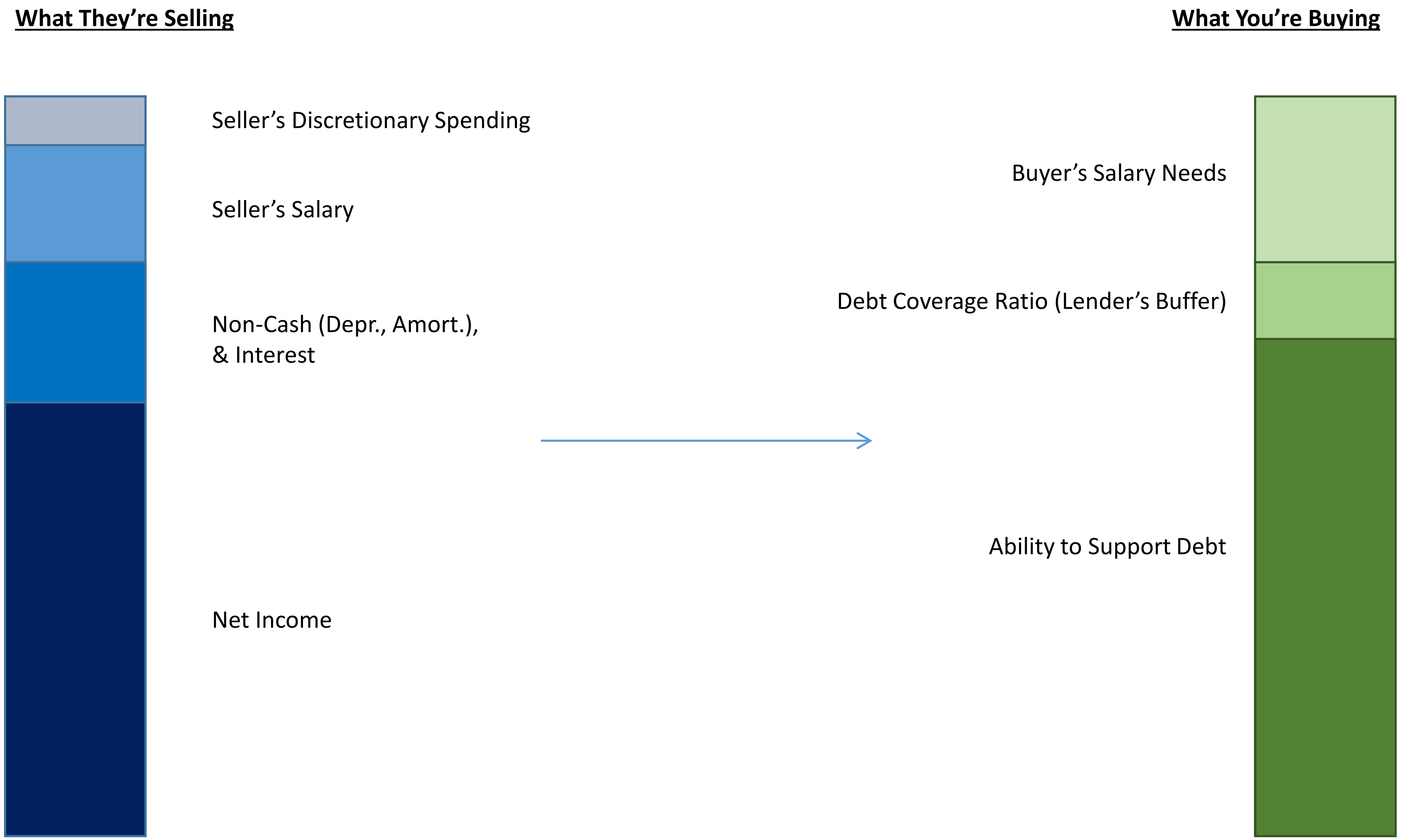
Balance Sheet Considerations: Debt & Equity

To reach your intended **Assets**, you can accept either Debt or Equity

Both require a plan and structure for repayment / return – relying on the ***utilization of the assets to generate excess cash.***

As Assets increase, so does our expectation of Income Statement performance

How Does Seller’s Discretionary Earnings (SDE) Affect a Buyer?



What's that Cash Flow actually Worth?

- Ceiling – Price for you to re-create from scratch. (Buyer's alternative)
- Market Price - If the Cash Flow can support a livable wage for you *and* debt that is equal to or greater than the value of the tangible assets, there might be **Goodwill**. Should be comparable to other businesses of the same size & strength in the industry.
- Floor – Tangible Assets at an Auction

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What are you Buying?

You buy would it could be; you pay for what it is.

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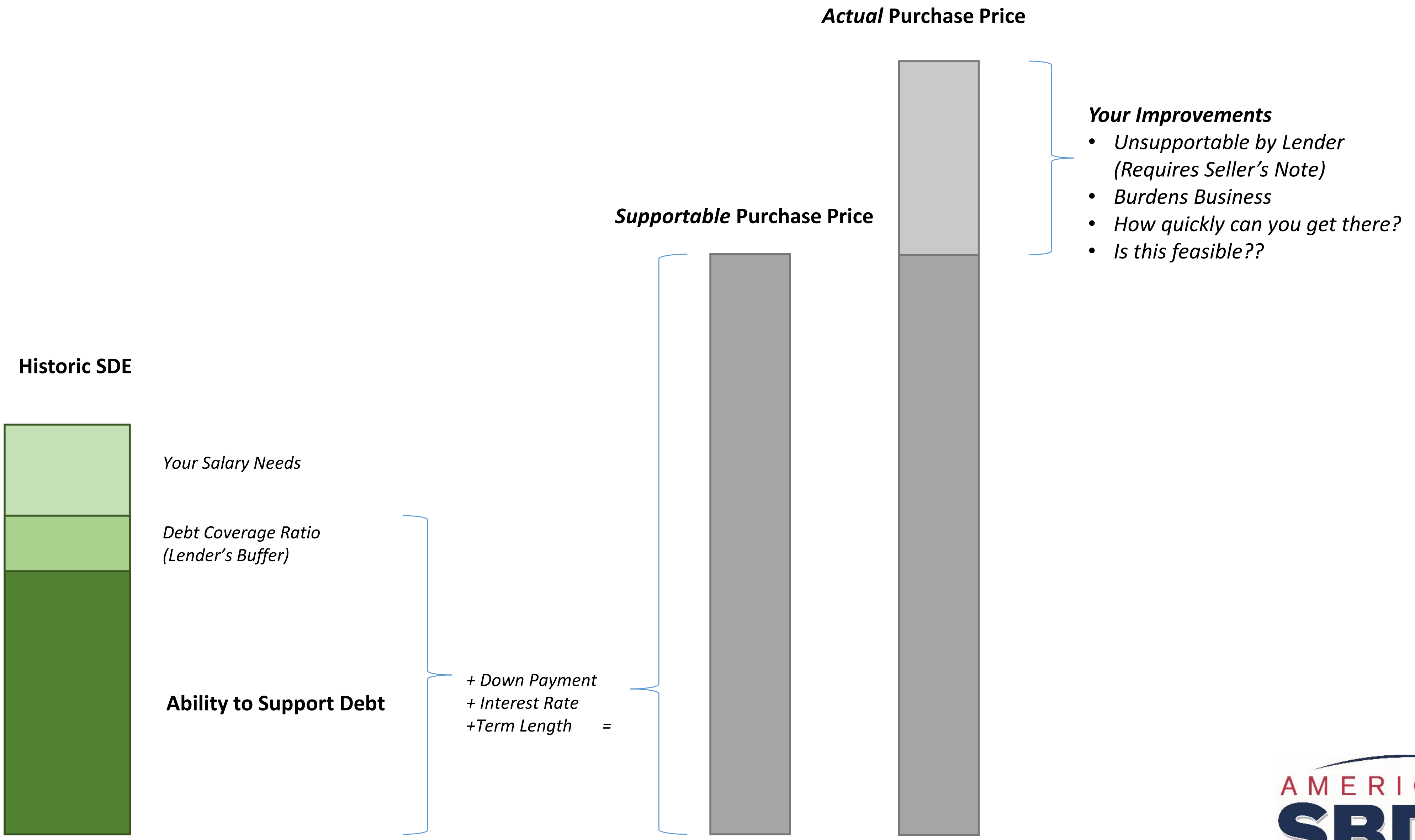
How Does Seller's Discretionary Earnings (SDE) Affect You?



Wait – what about ‘Multiples’?

A good *starting* point.

Lots of room for negotiation and interpretation!

- What cash flow are you using? Weighted historic averages?
- What’s a ‘discretionary / one-time add back’?
- Inventory included or not? How much?
- Quality / age of tangible assets?
- Vendor relationships, contracts, employee turnover…?

Structuring the Deal

A commercial lender considers collateral – physical assets.

- Real Estate?
- FF& E?
- Inventory?
- *Loan-to-Value Ratios*

What if the Seller wants a higher price than the collateral supports?

- Buyer personal guarantee – more collateral
- Seller note – secondary position, uncollateralized
- Consulting contract agreement
- Flexible purchase price with benchmarks
- …? Be creative!

Preparing to Buy – Setting the Table

- Is the current owner replaceable?
  - Standard Operating Procedures? Policies? Transferable knowledge is buyable knowledge!
- What contracts can be assigned? What need to (or can be) renegotiated?
- Is the capital equipment well-kept?
- Good contracts make good partners… identify:
  - When & how they can look over your shoulder
  - Clear lanes of responsibility
  - Worst-case exit strategies
- Do your strengths coincide with identifiable weaknesses?
- Long term customers? Vendors? Employees? Is high turnover a red flag?
- Build your team: **Attorney, Accountant, Broker, Banker**

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Common Timeline

Confirm Interest

Confidentiality Agreement

Letter of Intent outlining Terms

Purchase & Sale Agreement: UNDER CONTRACT

- Due Diligence Contingency Period, Re-Negotiate
- Financing Period

CLOSE

Survives the Close:

- Employee / Consulting Contract?
- Non-Compete?
- Seller Note?
- AR Collection / AP Payoff period?

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Common Due-Diligence Items

- Tax Returns - 3+ years
- Detailed Equipment List – Age, Mileage, Make / Model, etc.
- Organizational Charts - longevity, pay, description, contracts
- Sales by Customer reports by year
- Proposed Schedule of Inventory, AR, and AP at time of Close
- Contracts – Equipment Leases, RE Leases, Vendor Agreements, etc.
- IP – Website, social media, passwords, keys, etc.
- Internal financial documents
- Licenses / Permits
- … Other? Ask your attorney & broker! (Industry-specific items?)

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Need Help – Contact Us:

Maine Small Business Development Centers (Maine SBDC)

Phone: 780-4420

Email: **mainesbdc@maine.edu**

Website: **www.mainesbdc.org**

Finding your SBDC: https://americassbdc.org/small-business-consulting-and-training/find-your-sbdc/