

OUT ON YOUR OWN

Buying someone's business

Buying a business can give budding entrepreneurs a head-start, but the risks are as big as the rewards

For those lucky enough to have the cash to invest, acquiring an established venture can be a valuable route to future revenues.

"It puts you well ahead of the game, since the start-up phase is the most common time for a business to fail," said Cormac Mohan, head of the Business Advisory and Corporate Recovery Team at FM Auditors, Tax & Business Advisers.

By buying a business, Mohan said, entrepreneurs could avoid some of the pitfalls and difficulties associated with getting an all-new venture off the ground.

"For a start-up, 'time to profitability' – either months or years – is unpredictable," he said. "It is largely not under the control of the business owner, but rather under the control of the potential customers. During this period, the owner is not well compensated, if at all, and the business operates under a high level of stress."

Barry Kieran, managing partner of Amalino Partners, said that established ventures could offer new owners several benefits, including an established customer base, a proven product or service and the goodwill created by the previous owner.

"Such a purchase gives more certainty in terms of repayment capacity or return on in-



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vestment than in a start-up scenario, but right now there is a very depressed level of activity largely arising from the availability of finance," said Kieran.

"The majority of deals are distressed sales with larger companies, in particular, looking for value among their smaller competitors."

Profitable history

Kieran advised purchasers to look for ventures with a solid history of profitability, sustainable cashflow, an established reputation and growth potential.

"Purchasing a distressed business can offer value, but only if you have the expertise and the means to make it work," he said. "Firstly, you must understand why the business is currently in trouble."

"Typical problems may include strategic misdirection, poor management or lack of capital. You must then consider your ability to solve the problem. Assuming the underlying product or service is good, you must think about whether



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the strength of customer base," said Kieran.

It is crucial that you do your research before committing to an acquisition. At the very least, Kieran recommended a thorough analysis of the company's management accounts and a review of financial statements going back three years.

"Look at the company's top ten customers and suppliers and be wary of over-reliance," he said. "Look at the strengths and weaknesses of the current management team and research the market, trading en-

vironment, legal or regulatory issues and potential changes. Also review competitors, as this will give a good initial indication of the stability of the business prior to entering into full due diligence."

Warning signs

Before you sign on the dotted line, carry out a thorough financial review to assess the company's commercial viability. "Warning signs that something may be amiss will include unexplained trends in the financial performance, which may be contrary to market trends, or erratic financial performance," said Kieran.

"Look out for over-reliance on a single – or small numbers of – customers, contracts or suppliers, issues with Revenue, over-reliance on short-term finance or debt judgments registered against the business in the past."

Limited companies with a poor history of filing with the CRO should also be avoided, and Kieran also advised purchasers to assess the compa-

ny's culture and the potential for hidden problems.

"You may inherit certain issues such as potential claims or an undesirable staff culture," he said. "Small businesses tend to be identified with their original owner and the purchaser may struggle to rebrand or retain customer loyalty. You could also face the possibility of future competition from the previous owner, their family or current staff."

Due diligence

The due diligence process should give you a realistic picture of how the business is performing and what its future prospects are.

"There are traditionally three types of due diligence you should do and you might need different advisers for each," said Mohan. "Legal due diligence is part of a sales and purchase contract. This is where the solicitors check that the business has legal title to sell, ownership of all the assets and that regulatory and litigation issues are fully addressed."

"Financial due diligence involves checking the numbers and making sure there are no black holes or hidden financial issues. "Commercial due diligence is about finding out the business's place in the market, checking competitors and the regulatory environment. Finally, you should review the business plan and track it against the company's latest audited financial results."

Handover

As part of the deal, you should agree a handover period with the outgoing owner during which they can introduce you to existing staff, customers and suppliers and deal with any historical issues that may arise.

"The most successful business owners have an innate understanding of risk and how to manage it," Mohan said. "Ensure there is an agreed exit strategy with a transition phase so the business can be transferred in an orderly manner."

"The seller may require – under the purchase agreement – to remain in the business for a period of time. This will facilitate the learning curve for the new buyer."

"The purchase price can also be conditional upon the performance of the business for a period of time after the sale. These are factors which can be agreed at negotiation and when finalising the transaction."

Should you buy?

Your first step should be to determine if you are truly a motivated buyer, writes Cormac Mohan.

- Ask yourself:
- Do you know what kind of business you want to buy?
 - Are you experienced enough to run the business?
 - Do you have the

attention to detail that most businesses demand?

- Can you deal with uncertainty without losing sleep?
- Are you a good 'people person' who can handle customers and employees?
- Can you accept the financial shortfall that may result from investing in a business?

Valuing the business

Businesses are generally valued at a multiple of relevant earnings plus, if applicable, a sum for the business assets purchased as part of the transaction.

"Relevant earnings are normally calculated as an average cashflow over the last three years with adjustments for items such as expenses directly attributable to the previous owner," Kieran said. "The multiplier used will be determined by the results of the due diligence and the return on investment required."

Price determinants include the company's profitability or repayment capacity and the certainty of income or cashflows.

"Other determinants include the growth or cost-saving potential for the new owner, the degree to which the business is reliant on the current owner for its financial performance, ownership of patents or proprietary knowledge and

A good deal

Barry Kieran has these tips for buyers on negotiating the best possible deal:

- Carry out a thorough and professional due diligence.
- Gain a full understanding of the business drivers and structure the deal to protect

- these.
- Understand the taxation implications and the various options available when structuring the purchase.
- Obtain comprehensive legal warranties from the previous owner.
- Have an earn-out period whereby the payment part

of the price is deferred and subject to performance targets post-purchase.

- Enter into a non-compete agreement with the previous owner.
- Ensure key staff are on board and under contract.

For more on Amalino, see www.amalino.ie