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ACQUIRING AN EXISTING BUSINESS

A Project
Presented to the
Faculty of
California State University,
San Bernardino

In Partial Fulfillment
of the Requirements for the Degree
Master of Business Administration

by
Teodocio Ramirez

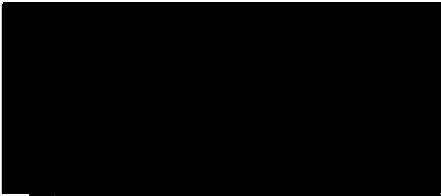
June 2005

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Approved by:


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ABSTRACT

This project reviews how to acquire an existing business and provides an aspiring entrepreneur an insight into how to purchase a small business. The rationale for acquiring an existing business is given versus the notion of looking at a start-up approach. Tips are provided for where to look for businesses for sale, and how to work with a Business Broker. The most common valuation techniques are covered with a valuing example using the Adjusted Cash Flow and Discounted Cash Flow techniques in combination to arrive at a reasonable price for the target business. The topics of how to pay for a business and how to negotiate the purchase are also reviewed. The project ends with recommendations for the new owner to consider during the first 90 days after purchase of the business.

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CHAPTER ONE

INTRODUCTION

Introduction to the Project

The goal of this project is to review the literature on how to buy an existing business and to synthesize the material into a written instructional manual that a regular individual or aspiring entrepreneur can use in understanding the process necessary to buy an existing small business.

This project was selected for the benefit of all aspiring entrepreneurs thinking about acquiring an existing business. In past times, the American dream was found by the well-known route: Through the hallowed halls of college and then up the ranks of a stable career in a blue-chip, white-collar company with a respectable nine-to-five executive hierarchy. But for millions of people across this nation and around the globe, the terrain has dramatically shifted. Technology has redefined job descriptions and macro-economics forces have driven many jobs abroad, resulting in millions of displaced middle-rank managers and employees (Smorenburg, 1998).

In this time of change, owning one's business is a viable basis for individuals to become self-sufficient in

the new world order. Even governing authorities have created tax incentives and loan facilities designed to sustain this business ownership trend (Nunes, 1988).

Ideally, this project adds to the resources available to the aspiring business owner. Although this project was no means intended to be the definitive authority in the subject, the reader will benefit from gaining an insight into how to buy an existing small business, along with having access to additional references on the subject.

For an aspiring entrepreneur, it is recommended that she/he first look at buying an existing business rather than attempting to start up a business. This point is emphasized in the next section with sources provided to find businesses for sell. In addition, a business alternative is covered, which is buying a franchise as an existing business. When the buyer is ready to initiate the search for buying a business, it is advised to follow the recommendation of assembling a professional team to include a competent accountant and lawyer.

This project is organized into five chapters. Chapter One is an introduction to this project and covers the benefits of owning one's business. Chapter Two covers, in some depth, different methods for valuing an existing business. In particular, the Adjusted Cash Flow technique

is presented by an example that will show how to determine a reasonable purchase price. This leads into Chapter Three, which deals with the subject of how to pay for an existing business; it is recommended that the buyer look towards the business seller as the first source of financing.

Chapter Four covers the negotiation phase for making the offer, and how to close the deal. This chapter also covers the mechanics of the all-important and crucial buy phase known as Due Diligence. The due diligence section provides a checklist to assist the Buyer in performing this endeavor. Chapter Four also briefly covers renegotiations if it becomes necessary.

Finally, Chapter Five provides some final thoughts for the new owner, how to plan the first 90 days after the business purchase. The Conclusion and Summary complete Chapter Five by reviewing some highlights of what was covered in this project.

As mentioned previously, the buyer should work closely with her/his professional team (accountant and lawyer). At the same time, the buyer should know enough about the buying process to manage it. The buyer, as an aspiring entrepreneur, should start functioning as a manager during the process of buying a business, as well

as, actually owning it. Her/his professional team should not lead the buyer; the buyer should appreciate and accept advice but always maintain control of the purchasing process.

The next section begins the project by covering the positive aspects of buying an existing business.

Personal Satisfaction

Many rewards and benefits come from owning a business. Although most people believe that money is the most rewarding aspect of business ownership, more buyers report greater satisfaction from the process of achieving success than they do from financial success itself. Personal independence is also considered by many to be a major benefit. The ability to put ideas to work free of the interference or restraint imposed by a boss is very satisfying. For once, each person can do things "his or her own way." Then there's pride of ownership, a powerful reward in itself (Parker, 2003).

Owners of existing business and larger corporations seeking new acquisitions are usually motivated more by financial objectives than by personnel or emotional reasons more common with the first time buyer (Goldstein, 1990).

Most people buy a business to replace an existing salary or generate an income. The primary reason is said to be for the benefits it will deliver and the lifestyle change it will bring. Heading up the "action," building something, contributing to the growth of others, improving a financial situation, meeting challenges and expanding knowledge are usually better reasons for buying a business (Nunes, 1988). While money is an important consideration, it cannot be the most significant reason to buy a business.

Financial Rewards

Business ownership is a way to take personal control of a person's financial and professional destiny. A growing business can provide the opportunity to make more money than the usual employee situation (Goldstein, 1990).

Common Factors for Seller

- Impending retirement of owners
- Resolution of existing or potential estate problems
- Source of capital for expansion
- Access to better management and administration

Common Factors for Buyers

- Attractive investment opportunity

- Desire to achieve economies of scale; integration and cost savings.
- Alternative or supplement to internal growth
- Source of additional management talent
(Goldstein, 1990).

Surprisingly, while there are countless people who want to buy or start their own business, only a very small percentage ultimately achieves it. What holds so many people back? Four major obstacles may block the buying process:

1. The financial obstacle - Lack of money or capital is a challenge to overcome.
2. The self-confidence obstacle - A surprising number of prospective buyers admit that they lack the self-confidence necessary to buy a business.
3. The fear-of-failure obstacle - One may fail in business. In fact, most small businesses do fail although a person will have considerably less chance of failure by buying an existing business than initiating a new start up.
4. The family obstacle - Many buyers are discouraged from fulfilling their ambition by spouses who resist the idea (Goldstein, 1990).

The first time buyer should resolve to overcome obstacles and insecurities that can cause her/him to waiver. Every year people buy thousands of existing small businesses with no prior ownership experience. It is also the premise of this project that buying an existing business can be the preferred course of action for aspiring entrepreneurs who become business owners.

Knowing where to look for businesses for sale is the first step in the acquiring process. The next section will provide sources and ideas where to look.

Sources for Finding Existing Business

The best source is probably a business broker. A broker will provide a listing of available businesses for sale, and will have direct contact with the sellers. This connection with the seller can help with the negotiations during the purchasing process. There are several other sources to find business for sale, as discussed below.

1. The Classified Section

Broker Listings - Brokers advertise their available businesses on a regular basis through various forms. Business brokers maintain a multiple listing database of available businesses for sale. The business broker has an arrangement for a sale commission, as do real estate

brokers. In the case of a business broker the agreement is with the seller, which usually is for commission of 10% of the price of the sale (Goldstein, 1990).

For Sale by Owner (FSBO) - Just like in the real estate market, some business owners will attempt to sell their business directly and bypass the broker, hoping to avoid paying the customary 10% commission.

2. The Internet

There are several websites for finding businesses for sale. Some of the more popular are the following:

<http://www.usabizforsale.com>

<http://www.ibizseller.com>

<http://www.businessforsale.com>

<http://www.bizbuysell.com>

3. Publications and Professionals

There is an incredible amount of publications available to search for businesses. Also, professionals like lawyers and accountants are in constant contact with businesses processing sale transactions, and have many contacts for businesses for sale. Bankers and other lenders can be good source for potential businesses that may be for sale.

Business Brokers

Business brokers work in a similar manner, as do real estate brokers. Their purpose is to bring together buyers and sellers. For aspiring entrepreneurs interested in buying a business, it is highly recommended they work through a broker. A broker maintains listings of businesses for sale. They work with a multiple listing service. Most have simple software programs that can match a buyer's requirements, such as type of business, providing a more focused list for examination.

Brokers work on commission, as mentioned earlier, the commission rate is usually 10% of the total sale price. The seller is responsible for paying the broker's commission. The broker essentially represents the seller. This does not mean that the buyers can not benefit with the broker's services.

After finding a business broker, the buyer will be provided listing sheets with numerous businesses that are for sale. Once businesses of interest are chosen, the broker will forward individual sheets for each business providing more specific information on particular business. The broker usually asks the buyer to sign a non-disclosure agreement on each individual business listing sent to the buyer. This agreement obligates the

buyer to not disclose sensitive information on the target business. See Appendix A for an example of a Confidentiality/Disclosure Statement.

Other Sources

Chambers of Commerce can be a great resource for finding existing businesses for sale. Also friends, family and business contacts can be sources for finding businesses for sale. In other words, the buyer should let everyone know that she/he is in the market for a business.

Sources can be broker listings in the classified section, for sale by owner, the internet, publications and professional, and working directly with business brokers. There is another alternative to business acquiring, and that is purchasing an existing franchise, which is the subject of the next section.

Alternate for Buying an Existing Business

For aspiring entrepreneur, buying an existing franchise is a viable alternate. Over 2,000 franchise systems flourish in the United States (Keup, 2004). Franchises boast over half-million retail and service businesses that generate close to 50 percent of all retail sales. The major advantage of buying an existing franchise is reducing the risk of failure. The master franchise has

developed the blueprint for a successful business, and can provide training for franchise owners along with assistance towards running businesses and providing name recognition that quickly attracts potential customers (Tomzack, 1999).

The downside of buying a franchise is that they are expensive and include the common practice of requiring a royalty payment of 2 to 4 percent of sales. Under the watchful eye of the franchiser, the owner can feel more like an employee than one's own boss. Still, a franchise may be justified when the higher expenses are compensated by higher sales and increased profits of a franchise affiliation (Kluegar, 1988).

In summary, acquiring an existing franchise follows the same process as buying another small business. The same steps apply, such as finding a potential franchise to buy, valuing the business, making an offer to purchase, and the other steps describes throughout this paper. The reader should consider the advantages and disadvantages to buying a franchise. It is recommended that this should be studied in more detail, and also consider discussing the issue with a business consultant.

Hire an Accountant and Lawyer

At the start of the buying process, it is highly recommended that the buyer hire a professional team. This typically includes a lawyer and an accountant. The time to assemble the professional team should be before actively beginning the search for buying a business (Goldstein, 1990).

The professional should be one who has the time and talent to do the job along with the experience to assist throughout the buying process. An accountant should be selected with experience in small business operations since the accountant will be the financial navigator throughout the buying process, as well as, after ownership has been transferred.

Although there are over 600,000 attorneys in this country, finding a good one to handle small business matter is seldom easy. Just because someone is an attorney by no means qualifies him or her to handle buying/selling business transactions. A lawyer is essential to ensure that all contracts and documents to be signed are legal and properly written (Smorenburg, 1998). Also, a competent lawyer can act as a sounding board to explain the protective measures needed through the buying process and contracts with the seller. The buyer should never sign a

contract or offer to purchase without an attorney's approval.

Business Consultants

Why not add a small business consultant to the professional team? For instance, the Small Business Administration's (SBA) SCORE Service Corps of Retired Executives (SCORE) group found through one's local SBA office provides valuable help absolutely free of charge (Nunes, 1998). It is not a bad idea to hire a business consultant who is an expert in the industry of the prospective business.

In summary, Chapter One covered the benefits of owning one's own business. The corporate environment has been changing and life-time employment is a thing of the past. Owning one's business provides the owner an opportunity towards achieving some degree of financial independence, and also as a means to finding personal fulfillment as an owner. Aspiring entrepreneurs were also encouraged to first consider acquiring an existing business versus attempting a start-up. The risk of failure is minimized by buying an existing business with a good income history. Chapter One also covered sources for finding businesses for sale, and to consider a franchise

as an alternative business to acquire. Lastly, the buyer is encouraged to should seek professional help for the acquisition by assembling a professional team consisting primarily of a lawyer and accountant, and business consultant, if is accessible.

The next chapter reviews valuation techniques and an example of how to value an existing small business. Most commonly used valuing techniques are grouped in two broad categories; Asset-based and Cash-flow based. The valuing techniques should be attempted by the buyer with the assistance and advice of her or his professional team. Also, the buyer should not lose sight what is "reasonable" when valuing of an existing business. Buying a business, like most business decisions, can not be done with a mechanical approach but require judgment and creativity.

CHAPTER TWO

VALUING A BUSINESS

Small Business Valuation

Unlike the publicly-owned company whose value can readily be determined by the trading value of its shares, small businesses can be difficult to value. There are no hard set rules for establishing what the owner wants to sell the business for or what the buyer is prepared to pay. David P. Francis, in his 1990 book, *How to Sell your Business without a Broker*, says that the buyer of a business is looking that the adjusted cash flow will allow him to accomplish the following:

- Pay all fixed operating expenses.
- Earn a reasonable salary or allow him to pay a manager at competitive salary commensurate with a manager's duty.
- Adequately service the debt on any newly created financial obligations.
- Operate the business at a profit.
- Earn a return on investment consistent with the risk factor included in his investment in your business.

Internal Revenue Service Ruling 59-60 set forth the general standard and specific criteria that should be covered, where applicable, in every business valuation. An outline of these follows:

1. Nature and History of the business.
2. General economic outlook and specific industry conditions.
3. Book value and financial condition of the company.
4. Earnings record
5. Tangible and intangible asset value, including goodwill.
6. Dividend paying capacity.
7. Other sales of the company stock and size of the block to be sold.
8. Market price of comparable companies traded in the open market (Internal Revenue Service, Rev.Rul.59-60, 1959).

Items 6 and 7 above do not apply for small, closely-held businesses. Some of the most common approaches for business valuing will be covered in this chapter, ending with a valuing example using the widely used valuing technique, "The Adjusted Cash Flow Method."

Asset-Based Valuation

In this method, assets of a business that are used to produce income are given a value, then, totaled to establish the purchase price. While this seems straightforward, however it is not easy to value assets for their current selling price. There are two approaches used to put an estimated value on the assets. These are the "Fair Market Value" (FMV) approach, and the "Liquidation Value" approach. There is a third asset-based valuation known as the "Book Value" technique. Book Value technique is the value that the assets are listed as on the business's Balance Sheet. As previous mentioned, valuing an existing business is not straightforward as illustrated using the Book Value Technique. What follow next are the various valuing techniques discussed in more detail.

Fair Market Value

Fair Market Value (FMV) is considered the "realistic value" at which assets can be sold on the open market. In this technique, assumption is made that there is time to sell the assets and that these assets are not sold in a "fire sale" environment. The situation most appropriate for using FMV technique is when a business considers

selling its assets, such as the following: cash, accounts receivables, inventory, leasehold improvements, furniture and equipment, prepaids and other assets (Gabehart & Brinkley, 2002).

Liquidation Value Approach

This valuation method is different from FMV. The purpose of the LV approach is to determine what the business's assets would sell for, or converted to cash, within 30 days. This technique comes from approximating the liquidation value a owner could get for assets on the open market. For the purpose of valuating an existing business, the LV is valid only used for establishing a "floor" for the overall value of the business.

In the case where the owner is "the business," the liquidation value can be used to purchase a business. In this situation, there is no choice for the seller but to sell the business at liquidation value, hoping to find someone willing to buy the business. As a general rule, except for cash, the guideline to use for liquidation value is 50% of the FMV for each category or item of assets on the Balance Sheet (Gabehart & Brinkley, 2002).

The liabilities of the business have to be deducted from the asset value (FMV or LV). The value placed on any

assets has to be reduced by the taxes, payables or other obligations assumed by the buyer of the business.

Goodwill is "the premium" or the cost over and above the hard assets of the business and the amount obtained when subtracting all of the assets from the selling price. If the sellers did not get a premium for their business, they would simply liquidate all of their assets when they want to sell their company. Goodwill is an intangible asset, but it is relative to the general health and stability, reputation of the business. Also it is brand recognition that can be translated into a "Goodwill Premium" (Gabehart & Brinkley, 2002).

Cash-Flow-Based Valuations

These types of valuations are the most common approaches for valuating a business. The cash flow based valuation focuses on the Income Statement and earnings. There are two popular approaches to establishing cash flow valuation: the "Multiple Method" and the "Discounted Method" (Gabehart & Brinkley, 2002).

Multiple Method for Valuation

This method uses the most recent year's financial statements to establish a cash flow figure and then uses multipliers applied to the cash flow figure by a certain

factor to arrive at the value of the business. The advantages to this approach are that it uses company's financial data for establishing a valuation and most sellers are comfortable with it for its simplicity. The disadvantage to the multiple methods is that it does not consider future earnings, and uses factors for similar businesses for its factor, which makes it somewhat biased (Gabehart & Brinkley, 2002).

Adjusted Cash Flow Method

This is also known as free cash "flow" (FCF) which is the actual, real and available cash that is in the business. To determine the adjusted cash flow or FCF, certain expenses are redefined because they may not necessarily impact the business on a day-to-day basis. The Income Statement is adjusted by adding back adjustments to establish the free cash flow. One line item that needs to be closely reevaluated are the owner's benefits, salary and other extras. As part of the valuing technique, the owner's compensation is reevaluated to consider what could be considered "excess owner compensation." In other words, how much compensation can the new owner do with during the payoff period (Gabehart & Brinkley, 2002) In the example Income Statement in Appendix B, compensation over \$50,000

and the country club membership fees are considered excess owner compensation (excess salary and perks), and are added back to the income earning or "adjusted" back to the cash flow, along with interest and depreciation amounts. The \$50,000 owner salary and other existing perks are subjectively figured by the person doing the business valuation considering the minimum the owner needs during the business purchase pay-off period. The Free Cash Flow (FCF) can also be presented with the following formula:

$$\text{Free Cash Flow} = \text{Net Income} + \text{Excess Owners Compensation} + \text{Interest} + \text{Depreciation}$$

As part of using multiples for valuation, the Free Cash Flow is established and then a multiple is applied. Sellers and brokers sometime rely on a multiple that fits to "similar" businesses and apply a multiple value from as low as 2 to as high as 15 (Goldstein, 1990).

Discounted Cash Flow Approach

The concept behind Discounted Cash Flow is to use future (projected) Cash Flow as the basis for determining a value. The present value of future cash flow is used and sometimes referred to as the "Time Value of Money." The "Discounted Cash Flow" method uses the projected/future cash flow converted back to its present value. This

conversion is the discount. The discount percentage depends on return on assets (ROA), values of return on the investment and the overall risk involved in the business. Other factors for used in determining the discount rate are Return on Equity (ROE), and Return on Debt (ROD), along with others (Goldstein, 1990).

Above, a review was provided of the most common valuation techniques or methods, which are usually grouped in two general categories: Asset-Bases Valuations and Cash Flow Based Valuations. The Asset-Based valuations include techniques like Fair Market Valuation (FMV), "Book Value," and Liquidation Value techniques. These valuations deal with the Balance Sheet aspects of the business, mainly the Assets, in attempting to calculate a value to a particular business. Anything over and above the calculated asset-based value is considered a "goodwill" premium paid to acquire target business. The Cash Flow Bases valuations include techniques like The Multiple Method, Adjusted Cash Flow (Free Cash Flow), and Discounted Cash Flow techniques. These valuations deal with the Income Statement aspects of the business, mainly looking at the Income or Cash Flow generated as a means to calculate the valuation.

The next section will demonstrate a valuation exercise using the Adjusted Cash Flow (Free Cash Flow) technique. The sample Income Statement in Appendix B will be used in this exercise to demonstrate the procedure for arriving at a true valuation that the buyer can use to make an offer.

Valuation Example: The Valuation Calculation

In this section a valuation method example will be presented using mainly the Adjusted Cash Flow technique. This method is also known as the "Free Cash Flow" approach. This valuation adjusts the net income with certain expenses that are added back to arrive at the available or free cash flow. One assumption for this example is that five years be used as a reasonable time frame to payoff the purchase price of a business.

The valuation example will use a Target Company's Income Statement for the past three years and eight months. If it is past the midway points in the company's current fiscal year, include these as well but only the actual figures not "annualized guesses." The Income Statement will be adjusted to arrive at "The Free Cash Flow" for the subject business to be acquired (Copeland, Koller, & Murrin, 2000).

The combined valuation method is called "The True Valuation Calculation" and it has three components (Peterson, 1990). The first is to determine how much money will be available to service the debt. Second, "Business Earning" will factor how many years that the buyer wants to work. The third factor is "Recent Trends." The overly conservative position taken in this valuation is that the business will not experience a single dollar of growth throughout the entire payoff period or after the buyer owns the business. Figures from the most recent years will be used as these are the most realistic numbers to use to establish the business earnings trend.

Step 1 - Debt Service

(From the Free Cash Flow in the Income Statement, presented in Appendix B). The illustrated Income Statement shows 44 months or 3.75 years of free cash flow numbers. Add all of the years together to get the 44 months or 3.75 years of free cash flows:

$$\$51,640 + \$31,277 + \$30,574 + \$44,647 = \$153,138.$$

Divide \$153,138 by 3.75 = \$42,170 (Average)

Annual Free Cash Flow. In the example provided, assume the buyer will borrow money to purchase the business, the business cannot afford to spend more than \$42,170 (round-off to \$42,000) per year on the debt

without having to put in more money or reduce the owner's salary. Assuming the buyer will finance the debt through seller finance or another source and the debt financed for 5 years at 8%, the buyer will need \$25,000 per year to service each \$100,000 of debt. This figure can be arrived at using a loan amortization program, which would show that a loan for 5 years at 8% would require \$25,000 paid per year for every \$100,000 borrowed. A simple formula can be derived using a factor of .25. With this formula, the total available free cash flow is divided by .25 to arrive at the total amount that the business can service which is \$168,000:

$$\$42,170 / .25 = \underline{\$168,000}$$

The \$168,000 is called the "Debt Service Amount." The 8% interest rate is used as a basis to calculate the Debt Service Amount, a different interest rate and year of debt service will change the outcome of the result. To visually illustrate the above numerical result (\$168,000), see Table 1.

Table 1. Calculation for Sustainable Business Debt

Debt Service Amount: Calculation	
Available FCF per yr.	\$42,000
Loan period	5 years
Loan interest	8%
Amount of debt that can be covered under the above conditions (FCF=\$42,000, 5 years, at 8%)	\$168,000

Source: Author's Calculations.

The "Debt Service Amount" is a way to back-calculate the amount of debt the business can cover during the pay-off period given the available free cash flow and the loan terms.

Step 2 - Business Earnings

Next determine the number of years that the buyer plans to keep the business. An example can be that the potential buyer is 40 years old and plans to retire at 55, which is 15 years to contribute to the business.

The objective of this step is to calculate how much money this business can potentially generate for the new buyer/owner; direct benefit (salary and other perks) over the 15 year period. Using the sample Income Statement (Appendix B) we can see the \$50,000 per year owner's salary (after adjustment for excess owner compensation).

Assume the new owner successfully paid off the business purchase loan in five years, and was then able to increase owner total compensation to \$92,000 per years for the remaining 10 years. In other words, after 5 years once the original debt service is satisfied, the \$42,000 previously used to service the debt can be added to increase owner compensation to \$92,000 per year for the remaining ten years of ownership, the cumulative 15 year benefit to the owner would provides the following:

Table 2. Total Benefit to New Owner

<u>Year</u>	<u>Salary</u>	<u>Total</u>
1 - 5	\$50,000/year	\$250,000
6 -15	\$92,000/year	\$920,000
Total Owner's Benefit	Projected over 15 years	\$1,170,000

The \$1,170,000 is the potential "business earnings" over the planned life of ownership, and it is calculated based upon a figure that is reasonable and represents a sound investment derived from the purchase of this particular business. The question now becomes what this \$1,170,000 is worth to the buyer today. Using a percent of 20 of the total would be "reasonable" to pay today

provides the following valuation:

$$\$1,170,000 \times .2 \text{ (20\%)} = \underline{\$234,000}$$

The \$234,000 would be a "reasonable" price to pay for this business considering the projected future earning (Free Cash Flow) over the 15 years and not forgetting the total allowable "Debt Service Amount" of \$168,000 for the first five years.

Another method to check for reasonableness of the \$234,000 value is to apply the Discounted Cash Flow approach on the projected cash benefit to the new owner. This approach discounts the future cash flows using a present value interest factor. The trick is knowing what discount interest factor to use. In the present example the loan debt has an 8% interest rate for 5 years. The new owner should expect to have a reasonable return on her or his investment enough to cover the debt interest with some spread to justify the buy in the first place. According to the authors in *Valuation: Measuring and Managing the Value of Companies*, companies with a cost of capital within 9% to 13% should see a spread of 2% to 6% as a minimum in order to be creating some value. Using 11% as the discount interest for our example will leave a 3% spread during the debt service period.

Applying the Discount Cash Flow technique would look like as follows: multiple the business earnings of \$1,170,000 by net present value of .209 (11% for 15 years, obtained from Present Value Interest Factor per Table A-3, (Groppelli & Nikbakht, 1995))

$$= \$1,170,000 \times .209 = \$244,530.$$

This value looks very similar to the \$234,000 obtained using the 20% reasonable discount. Let's stay with the \$234,000 value to continue with the valuing exercise.

The total calculated valuation of \$234,000 figure and considering the \$168,000 debt service amount provides the following for a possible down payment:

$$\begin{aligned}\$ \text{Down payment} &= \$ \text{Sell Price} - \$ \text{Debt Amount.} \\ \$ \text{Down Payment} &= \$234,000 - \$165,000 \\ &= \underline{\$66,000}\end{aligned}$$

Step 3 - Recent Trends

A third factor is considered to gage the most recent activity and get at an indication of where the business is going. Take the owner's benefits *less Excess Compensation plus Pre Tax Income* over the course of the last two periods. In this case, use the current year's 8 months (75% of the year) plus the previous years.

Last Year's Owner Benefits:

\$66,000 - \$14,000 ("Excess") = \$52,000 + Current
Owner's Benefit.

Current Owner's Benefit:

\$49,575 - \$10,575 ("Excess") =	\$39,000 +
Last Year's Pre Tax Income	\$42,950 +
Current Year Pre Tax Income	\$40,691
Total	\$174,641

Take the total (round up to) \$175,000 to calculate this
figure for one year: Divide \$175,000 by 1.75 = \$100,000
Using the 15 year rationale and the 20% factor used in
Step # 2:

\$100,000 x 15 years = \$1,500,000

\$1,500,000 x .2 (20%) = \$300,000

"Recent Trends" figure is \$300,000

Step 4 - The True Valuation Calculation

Obtain the average of the factors by adding all three
components and then divide the three:

The True Valuation Calculation Formula is:

(Debt Service + Business Earnings + Recent Trends)
3

(168,000 + \$234,000 + \$300,000 = \$234,000.

Buyer's Offering Price

Given all the considerations that are critical in determining a small business value, this particular example yields a price of \$234,000. In this case, the down payment would be \$66,000 as previously calculated in Step 2. Changing the assumptions based on what the steps 1 -3 will change the outcome and \$234,000 value or price figure (Parker, 2003). Nevertheless, the buyer now has a good idea what should be a price to offer for the sample business. The offer should make an offer around \$234,000 and be prepared to have \$66,000 for the down payment under similar loan terms. This arrangement will provide enough of the free cash flow to cover the debt service while compensating the owner with a reasonable salary during the pay-off period.

The Small Business Administration (SBA) and the Department of Commerce maintain statistics and a reference book on ratios for comparison of buying prices. The Institute of Business Appraisers Publication MO-9 states that "when buying a small business, the buyer should consider the following:

Sufficient cash should be available to repay the loan to the seller with the following criteria:

- Sufficient cash to support the operations of the business.
- A reasonable return on the buyer's down payment.
- A fair salary for the owner's work in the business" (Peterson, 1990).

Regarding price, in its simplest form, the market value of a business is what it owns, what it earns, or what a willing qualified buyer will pay a motivated seller, with a reasonable amount of time to consummate the sale (Francis, 1990).

Another important factor in the business pricing strategy is determining the proper capitalization rate for the new owner. The cap rate represents what a buyer could expect to earn by investing funds in other businesses or projects with a similar risk factor. This approach takes the Adjusted Cash Flow Statement and dividing by a desired capitalization rate to obtain the market value of the particular business (Francis, 1990).

Thus, once the buyer has found a potential business to buy, a valuation is needed to arrive at a reasonable price to offer. Although there is no standard method to value a small business there are several accepted techniques a buyer can use. The most common technique for valuing a small business is using the Adjusted Cash Flow

Technique; also know as the Free Cash Flow Technique. An example of how to value a business was provided in this chapter with a three-step approach to arrive at a reasonable price. The valuing example was performed primarily using the adjusted cash flow method; the discounted cash flow approach was also incorporated in the example to assist in valuing future earnings.

The next chapter will cover how to arrive a price to offer for a small business. The buyer will be asked to consider cash requirements after buying the business, along with the initial purchase needs. Also, the next chapter will cover sources the buyer can consider to finance the business purchase. The recommendation for the first-time buyer is to consider the seller as the first source for financing. Seller financing is a common practice, which has many advantages over all methods of financing for acquiring an existing business.

CHAPTER THREE

HOW TO PAY FOR A BUSINESS

Buyer Should Consider Available Cash Flow

The price paid for an existing business will depend on its value, and affordability by the buyer. As previously mentioned, valuing existing businesses can be done with methods ranging from crude rules of thumb to exotic and intricate mathematical models (Peterson, 1990). In Chapter Two, the financial information in Appendix B, provided an opportunity to demonstrate the Adjusted Cash Flow Technique to calculate a business valuation for a "reasonable" price for the sample business. In the example, the Adjusted Owner's Cash Flow was the cash available to an owner after adjusting expenses to a level that is actually required for the business to service its purchase debt, and afterwards allowing an appropriate salary for the owner's effort in the business. This adjusted owner's cash flow is calculated with no allowance for interest or depreciation, that is, any interest or depreciation is added back as a plus to cash flow (Peterson, 1990).

The resultant cash, also known as the free cash flow, is and available to the owner or the buyer for investment,

principle interest payments or dividends. The remaining cash flow calculated in the Chapter Two example was used to service the purchase debt.

Pricing Of Loans

The price of loan money will vary from bank to bank, such as the points, loan origination fees, and other charges. Also, banks differ in the security interest they require. One bank may be willing to release part of the security when part of the loan has been repaid. Some banks may require that personal assets (such as the buyer's house) also be collateralize or secure the loan; other banks may not (Kluegar, 1988).

Formulating a sound approach to financing the acquisition is critical to both the seller and buyer. For the buyer, it must mean considerable more than the ability to buy the business. More businesses fail because of improperly structured financing than any other factor (Goldstein, 1990). Improper financing can also restrict growth, create adverse tax consequences, and needlessly increase personal liability. The future of the business is influenced, if not controlled, by the initial financing (Goldstein, 1990). This is the time that the buyer should involve his/her professional team.

Dealing with Banks

Dealing with banks, Kluegar (1998) states "Banks can make money only by lending money. Banks usually specialize, both as to the type and size of loan business they do. The banks that do make loans for businesses acquisitions tend to lend only under very strict conditions and depending on the size businesses (p.159)." The key is to find what is right for the buyer. The right bank is one that will assist the buyer during the purchase transaction, and will continue to assist the buyer in hers or his business financial needs.

Finding the right bank is similar to shopping for a house or a car. The buyer should shop around for the loan deal, and a good banker for the long haul. Once in business, a good banker can become a valuable of the buyers team, along with the buyers lawyer and accountant (Kluegar, 1988).

Measure One's Financing Needs

Determining the acquisition financial needs goes beyond calculating the amount required to buy a business. The buyer should also forecast the capital needed to operate properly and build the newly acquired enterprise.

It is common for buyers to err in approaching financing as a two-step process. Purchasing a business usually exhausts available capital or borrowing power to finance the acquisition afterwards; later, the owner attempts to find additional financing necessary to operate the newly acquired firm properly and this become difficult since the buyer usually has exhausted his or hers available credit (Goldstein, 1990). Approval for additional line of credit is typically unsuccessful because available collateral has been previously pledged and it is usually not feasible to restructure the original financing arrangements to accommodate additional financing.

Therefore, it is wise to anticipate and incorporate working capital requirements into initial financing package. When projecting the financing requirements for the acquisition, capital needs need to be considered for such items as:

- Sufficient inventory to achieve sales projected in the business plan
- Renovate and modernize the physical plant
- Add or replace fixtures and equipment
- Finance accounts receivable

- Finance planned advertising or promotional programs
- Maintain adequate working capital (Goldstein, 1990)

Financing Methods

There are several ways to finance the purchase of an existing business other than the buyer paying outright for the total amount. Most buyers do not have the total purchase amount and must resort to some form of financing of which be can be viewed as follows:

1. Internal Financing
2. External Financing
3. Equity

Internal financing -- is the portion of the sales price financed by the seller financing, or the assumption of debt or similar financing opportunity existing within the business and made available to the buyer.

External financing -- includes funds borrowed from external sources, such as banks, small business investment companies, and other third party lenders.

Equity -- is the amount invested by the buyer's own funds or from business partners, if any, and thus not scheduled for repayment (Goldstein, 1990).

The Preferred Method

The buyer is encouraged to look first to the availability of internal financing or seller financing. For only then can the buyer determine the additional capital needed from external sources or personal funds. Seller financing is exceptionally common in business acquisitions. The majority of small business acquisitions include some form of seller financing to bridge the difference between the agreed price, the buyer's down payment and the other sources of external financing available to the buyer. Nor is it unusual to find seller financing 80 percent or more of the price (Goldstein, 1990).

How Much Does the Business Need?

The business can never have too much money to fund a business. The more capital available, more that can be done to build the business or meet future needs under new ownership. The new owner should consider what the business would need to use as Working Capital, which can be defined as "the amount remaining after subtracting the Current Liabilities from Current Assets. Current Assets can be converted into cash within 12 months and Current Liabilities have to be paid within 12 months" (Goldstein,

1990). The Working Capital is what is used to fund the day-to-day business activities. If the buyer arranges just enough financing to pay for the acquisition, funds could be lacking to devote to the immediate needs of the business.

The Buyer of an existing small business should always consider financing the purchase price plus Working Capital requirements. Another important factor to consider by the buyer is the possibility that the business might experience a drop in revenues when a new owner assumes ownership of the small business. A good-rule-thumb for the new buyer is to secure enough capital to cover three months of expenses assuming a 50 percent decrease in revenues as the new owner (Staff Study, American Institute of Certified Public Accountants, 1967).

Goldstein (1990) states, "assumption of a 50% revenue decrease is an extremely conservative safety precaution." This does not necessarily mean that extra money should be borrowed. If additional amount is required for this need, a viable alternative would be to have it available through a line of credit with a bank and that usually requires a Pledge of Assets or personal guarantee by the new owner. The projected budgets and forecasts in conjunction with the purchase price will dictate total requirements (Bunn,

1969). This is a reason why a buyer of an existing business should obtain seller financing and attempt to negotiate the smallest down payment possible so that more of the buyer's money can be devoted to the business. This is also the reason behind the strategy of negotiating a line of credit by new owner. A buyer of a small business obtaining a home equity line of credit may be a viable approach prior to the purchase of the business (Goldstein, 1990).

Where to Go for Money

There are a number of financing resources available to a potential buyer. Financing is available from various sources:

- The Seller
- Small Business Administration (SBA)
- Banks
- Asset Based Lenders
- Factoring Companies
- Leasing Companies
- Friends and Family Member
- Angel Investors
- Suppliers
- Customers

- Equipment Lenders
- Private Investors

Most of these lenders require very detailed information from the buyer, and a potential financing source needs to be located before proceeding with the financing process. The buyer should begin investigation for financing sources, and initiate a process for obtaining financing early enough in the acquisition process to have time to evaluate all of the options available (Francis, 1990).

Seller Financing

As previously recommended, the author strongly suggests looking towards seller financing as the primary source to purchase an existing small business. As a general rule, most small businesses purchases involve seller financing, and it should be the first choice of financing to be sought. The opportunity to negotiate a favorable loan will be best served when the buyer can obtain financing from the current owner as he or she may be more willing to provide the buyer with favorable terms. The recommendation to the buyer is that initial search for businesses to buy should be limited to those businesses where seller financing or SBA approval is available

(Goldstein, 1990). Seller financing is by far and always the best financing option because of the following advantages:

- The buyer can negotiate the best possible loan terms
- The seller has the incentive to finance the buyer since other financing sources are usually difficult to obtain for first time buyers
- The buyer will be capable of leveraging the assets since the seller has already valued them at the highest price
- The seller knows that this can save the deal
- If the seller does not provide financing, the seller may be making a statement about the viability of the business
- If problems are discovered in the business, the buyer may be able to renegotiate with the seller
- Sellers realize that offering a balance of sale is "normal" in these transactions (Parker, 2000)

Reviewing in more detail each of the above mentioned advantages of seller financing provides the following:

(i) *Terms*

The terms with seller financing are all negotiable. Payments could be spread at over 5, 10

or 20 years. The seller may accept a low down payment and payments that are comfortably affordable by the business. When dealing with a bank or any other financial institution, there may not much that can be negotiated.

(ii) *Incentive*

Why would a seller finance a buyer? Unless the buyer has somehow convinced the seller that she or he is not capable of running the business, the seller should have every incentive to make the purchase deal work. One exception might occur when the seller is in such a terrible financial situation and needs to make an all cash sell. In the event the seller is not motivated to finance the sale, and the buyer needs to seek alternate financing, the buyer can use this as leverage during negotiations with the seller. The buyer, with a secure loan on hand, can pressure the seller to offer better terms on the sale. If the buyer must go elsewhere for financing other than the seller, the buyer should evaluate the seller's motivation for selling (Parker, 2000).

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(iii) *Leverage the Assets*

No one knows the true value of the Assets better than the seller. When and if the seller and buyer negotiate the assets as collateral, it becomes obvious the value of the assets is a double-edged sword. During the purchase negotiations, the seller tries to overvalue the Assets. Later during financing negotiations, the value of the Assets as collateral will need to be upheld. The Buyer, on the other hand, has attempted to lower the value of the business during the purchase negotiations, and then tries to leverage the same assets as guarantees for future financing (Parker, 2000).

(iv) *Saving the Deal*

A seller does not want the buyer to walk away from the table because of the financing. Seller financing the purchase of a small business is a common practice, and usually an integral part of the deal.

(v) *The Viability of the Business*

If the Seller is not willing to finance a large part of the deal, the message could question the viability of the business itself. It is very much a "put your money where your mouth is" situation.

Unless there are extraordinary circumstances, the buyer has to believe that the business may not be what the Seller claims if the seller is not willing to participate in the finance.

(vi) *Problems*

Although rare, what if the representations that the Seller made were not accurate and only come to light after closing? What if the business goes through an unexpected slow period and runs into trouble? Having a good relationship with the seller helps to renegotiate a seller-financed deal in case the business gets into trouble, and the seller needs to be persuaded to reschedule the balance of payments. Without seller financing, the buyer usually does not have the same recourse from other lending sources.

In case the business runs into trouble, the Buyer has little change of rescheduling payment terms when owing or borrowing money from banks. On the other hand, seller financed businesses have a better change of rescheduling payments. The seller wants the buyer and business to succeed and she or he (seller) does not want to take the business back. The buyer is more likely to get some relief

from the seller. Also, the seller knows the business better than anyone does and can pitch in a bit to provide assistance versus watching the money disappear in the form of the debt service.

(vii) Seller Financing is Common

Seller financing is used in the vast majority of small business purchases. It is usually the job of the broker to explain this to the seller as a way to greatly improve their chances of selling the business (Parker, 2003).

Small Business Administration Lenders

The Small Business Administration (SBA) makes loans to business buyers. SBA financing is used extensively and is great for business buyers and owners to be familiar with. The SBA website has the following address:

<http://www.sbaonline.sba.gov>

The SBA was established to help grow the economy through loans to small businesses for acquisition as well as expansion. There are numerous lenders who handle SBA loans and the SBA website will provide a listing of local lenders or they can also be reached at 1-800-U-ASKABA.

To obtain an SBA loan, both the buyer and the business must qualify. After seller financing, this may be

the best alternative for financing an acquisition of a small business. When an SBA lender looks at a business, the lender makes a determination as to whether or not the cash flow can service the debt. Then, the lender evaluates the assets to be sure that they can adequately collateralize the loan. The bad news is that both the business and the buyer personally must guarantee the loan and usually with the buyer's house. The SBA will finance up to 70% of the purchase over 10 years. They will even provide funding for use as Working Capital. The SBA even has separate programs to fund machinery purchases as well as real estate (Small Business Administration Home Page, 2005).

Dealing with Banks

Although banks are in the business of making loans, they want the minimum risk possible. Obtaining a loan for buying a business may be very difficult without a lot of collateral. The financing terms are usually less favorable than through the Seller and/or the SBA.

It is still a good idea to establish a small line of credit once the business purchase has been made. Doing this will help the buyer to establish a line of credit with a bank in the event she or he has future capital needs, and a bank is the only source of financing.

Therefore, the aspiring entrepreneur should concentrate on finding businesses for sale with a seller willing to finance the buyer. This chapter concerned considering the financing the purchase of the target business. The buyer should consider the total financing requirements of acquiring a business and cash needs after the purchase. The cash consideration should include possible revenue losses under new ownership, and Working Capital requirements of the business. The preferred source of financing is the seller of the business. Although other financing sources may be available, the seller offers many advantages to the buyer, and new owner.

The next chapter delves further into the purchasing process dealing with the Offer, negotiations, Due Diligence and the Purchase Agreement. Chapter Four will remind the buyer to continue working closely with her or his professional as the process into the final purchase agreement.

CHAPTER FOUR

NEGOTIATIONS AND CLOSING

Steps for Making an Offer

The buying process continues with the buyer making an offer to the seller. It is not the end of the process. In fact, it may take more time to go from the offer to the closing than it took to make the offer (Peterson, 1990). The remaining steps between an offer and the closing can vary somewhat, but these steps are representative:

- The offer or letter of intent
- Negotiations
- Acceptance of the Offer
- Due Diligence
- Final Negotiations
- Drawing Contracts
- Closing

The Offer:

The centerpiece for the negotiations is the Offer followed by a letter of intent (Peterson, 1990). The buyer's attorney should draw up the letter of intent. The letter of intent should contain at least these elements:

- The names of the Buyer and Seller
 - A description of what the Buyer intends to purchase
 - The date of the offer and the date the offer expires
 - The price
 - The terms
 - The interest rate, if any
 - The repayment schedule, if any
 - A date for closing
 - The contingencies attached to the offer
- (Smorenburg, 1998)

Letter of Intent

After the buyer has taken all of the necessary steps to gather information, review the financials, determine the value and price that is willing to be offered and has discussed the situation with the broker, and the professional team (i.e., lawyer and accountant), it is now time to prepare an offer. Before drawing up an official offer to purchase, it would be advisable to consider a Letter of Intent instead of going through submitting an Offer to Purchase (Smorenburg, 1998). The Letter of Intent is being offered to demonstrate the Buyer's good faith,

and as a foundation to begin formalized negotiations. Again, a lawyer will draft the Letter of Intent and the buyer should ensure that his/her lawyer is the one to provide this document.

The Letter of Intent obligates the buyers to purchase the targeted business. The Letter of Intent has two provisions that are legally binding. First, the buyer is obligated not to disclose to others sensitive information about the business. The second binding provision prevents the seller from going to others in the hopes of getting a better deal.

The Offer: Negotiation Strategy

Even though the valuation process was completed, the question remains about how much to offer, and what the down payment should be. There are basically two options when making an offer: 1) offer a price close to the valuation, or 2) offer an amount quite a bit less than the valuation price. The Seller will respond in one of following three possibilities: 1) acceptance, 2) total rejection, or 3) a counter offer (Nunes, 1988).

Purchase Agreement

The final objective of the negotiation process is a written Purchase Agreement covering the details of the

proposed buy-sell transaction (Bunn, 1969). See Appendix C. The Buyer's attorney should write the Purchase Agreement once the Seller and Buyer have agreed to the price for the business. A very provisional item to include in the Purchase Agreement is the statement of Due Diligence. The terms for allowing the Buyer to perform Due Diligence should be clearly written into the Purchase Agreement (Peterson, 1990). Once an agreement has been reached in principle to buy a business either by Letter of Intent or in a formal Offer via a Purchase Agreement, the next phase of the buying an existing business is the all important Due Diligence (Goldstein, 1990).

Crucial Step in Buying: Due Diligence

This step of the buying process is probably the most crucial step. At this point, the targeted company will be "inspected" in-depth to verify the company's financial statement in an effort to understand the state of the business (Bunn, 1969). The Buyer, along with her/his professional team, will carefully review the business to determine several things, as follows:

- Are the financial statements accurate?
- Is the Inventory in "Good and Resalable" condition?

- What is the condition and value of the assets?
- How effective and committed are the employees?
- What is the overall picture of industry and competition?
- What has the company done to market itself?
- How strong is the sales team?
- Will the company's contracts continue under new ownership?
- Are there potential opportunities to increase the revenues and profits?
- Based on the available information, does the business have a viable future?
- Is this a "Good" business? (Nunes, 1988)

There are checklists on every aspect of this process for any business of interest. The accountant should have a Due Diligence checklist for common areas of most businesses (Nunes, 1998).

Discounted Cash Flow Approach

The Due Diligence period is the time to check out everything, not just the financials. The agreement should allow for 20 working days or one month for a small business that is not overly complicated (Kluegar, 1988).

Areas Due Diligence that need investigation and its required documents, include the following:

Systems

Required Materials

- Contracts for any equipment leases, maintenance contracts
- Software manuals (where available)
- Company website access, passwords (at close of sale)
- Copies of all reports currently being provided

Competition

Required Material

- All competitive material available
- Listing of all major competitors' phone numbers and website address, profiles

Customers

Required Materials

- Sales catalog (if available)
- Reports with sales by customer for current year and previous year.

Contracts

Required Materials

- Copies of all contracts in each category
- Listing of all contracts terms, expiry date.

Legal and Corporate Issues

Required Materials

- Copy of company minute books
- Incorporation documents
- Copies of all documents related to any ongoing or potential legal proceeding

Financials

Required Materials

- Income Statements
- The company statements, five years at a minimum
- Company tax returns going back 3 years at a minimum
- Comparative report outlining a revenue and expenses item from one year to the next
- Projected operating financial provided by the Seller

- Projected revenue and expense statement to be done by the seller
- The chart of accounts
- Agreed Trial Balance of each report as listed
- Copies of Customer invoices, deposit books, and bank statements
- The Balance Sheet going back several fiscal periods.

Inventory

Required Materials

- Inventory report by item.
- Sales report by item for the past few months.

Furniture and Equipment

Required Materials

- Listing of all items
- Valuation Report
- Depreciation Schedule indicating accumulated and remaining debt
- Lease Contracts
- Maintenance Contracts
- List of all equipment

Liabilities

Required Materials

- Accounts Payable Listing
- Supplier Statements
- Letter/documentation from all parties that the Buyer will be obligated financially.

Banking

Required Materials

- Copies of all bank statements for the past 3 years
- Documentation on any existing loans
- Listing of all company bank accounts, numbers, institution and signers.

Sales

Required Materials

- List of top customers that contribute at least 75% of total sales.
- List of each salesperson's top five accounts broken down by sales rep w/sales terms and commentary.
- Sales Policies
- Discount/pricing structure.

- Sales reps to provide suggestions to increase the business
- Sales Report by sales rep and what has been their performance to date.

Marketing

Required Materials

- Copy of current marketing plan, if available
- Detailed report on MP-results
- Copy of all company marketing materials
- Report from sales/marketing employees on marketing activity.

Employees

Required Materials

- Organizational chart
- Job descriptions, compensation, and commentary regarding any promises made by Seller to any of the employees
- Copies of any Employee Agreements
- Copies of any Consulting Agreements
- Employee files with memos for reprimands or any other disciplinary action or warning

- Listing of any labor disputes, work stoppage, and union certification (pending or otherwise)
- Copy of Employee Benefit Program
- Summary of company incentive plans, including Profit Sharing
- Confidentiality Agreement, if any (Goldstein, 1990; Nunes, 1998; & Parker, 2000).

Due Diligence Summary

Due Diligence is an opportunity for a buyer to answer some essential key questions. With help of the buyer's professional teams, Due Diligence strive to answer the following (Goldstein, 1990):

- Are the financial statements accurate?
- Is the inventory in "good & resalable" condition?
- What is the conditional value of the assets?
- How effective and committed are the employees?
- What is the overall picture of industry and the competition?
- What has the company done to market itself?

- How strong is the sales team?
- Will the company's contracts continue under new ownership?
- What can you do to increase the revenues and profits?
- As part of Due Diligence the process, does the business have a viable future?
- Is it a "good" business?

The exercise of Due Diligence is an important step in the buying process. This is the point the buyer has the opportunity to review the validity of the state of the business. The process allows the buyer an in-depth look as well as all aspects of the inner workings of the business. The buyer should confirm the financials and other important documents, but just as important, the buyer should take this opportunity to learn all she or he can about how the business works. This will help the buyer start off running when she or he becomes the new owner.

The buyer is reminded that this is a crucial time and should work closely with his or her professional team. The buyer should consult with his or her accountant to review financial and related information. It is also important to have the buyer's lawyer review all aspects of the Due

Diligence, and prepare to renegotiate purchase, if it becomes necessary. This point will be covered in more detail in the next section.

Attorney Review

After the Due Diligence, certain points may need to be renegotiated by the Buyer. The outstanding issues shall be turned over to the attorney to be included as part of the Purchase Agreement. If the seller does not agree to mediate the outstanding issues and depending on the severity of the issues discovered by the Due Diligence, the Buyer must decide whether to proceed or not with the purchase.

Final Agreement: The Purchase Agreement

Once the buyer has completed the Due Diligence and is ready to proceed with the final agreement, the Buyer's lawyer should now draw up the Purchase Agreement. It is the Purchase Agreement that obligates the buyer to purchase and the seller to sell his/her interest in the target business.

The buyer's attorney should be conversant with the issues surrounding the purchase of any business and should draft the purchase agreement slightly advantageous to the client, the buyer, without causing rejection from the

seller and/or the seller's attorney (Goldstein, 1990). See sample of Purchase Agreement in Appendix C.

Pre-Closing

There is a lot to do for the buyer and her or his attorney prior to closing. One of the first things to be done after signing the Purchase Agreement is to meet with the key employees of the target business. This will be a time of great uncertainty, and the future new owner should allay the employees' fears and anxieties about the future (Kluegar, 1988).

This is also the time for the buyer's attorney to file documents for the appropriate business structure. The buyer's attorney will be checking all the contracts, leases, and financial schedules provided by the seller. As well, the attorney will have the responsibility to send out notices to the major creditors.

The buyer should take this time to contact the business' principal customers and suppliers prior to signing the Purchase Agreement. The buyer will also need to visit the business and physically count the assets and the inventory prior to signing the Purchase Agreement.

The attorneys for both sides may wish to meet to conduct a pre-closing session. This will provide an

opportunity for both sides to exchange and review all the documents required to be signed at the actual closing (Smorenburg, 1998).

CHAPTER FIVE

SUMMARY AND CONCLUSION

A Plan for the New Owner

Once the deal is closed, now it is time to take ownership of the existing business. The author recommends that the new owner develop a 90-day plan to take over her or his business. The author outlines some suggestions to be considered, which are by no means complete but are offered to the buyer as a guide.

Top 10 items for the first 90-days:

1. Many small businesses typically see a sales decline in the first three months after a new owner takes over. The new owner should have a plan to deal with this situation, and attempt to minimize the decline in revenues during this transition period. The new owner should have planned up front when first considering the financial needs of acquiring the business. At this time, the new owner should implement the plan for getting the business through this period.
2. The new owner should next clean up the premises and get everything and everyone organized. Make

the place feel new and make the employees renewed. The new owner should make her or his presence felt and attempt to re-invigorate the place. It is likely that sales will decline at the beginning of the new ownership. The new owner should not get overly excited if this happen, but should have anticipated for this scenario by creating a supportive environment to spur the business and its employees into regaining momentum.

3. The new owner needs to compile a detailed list of everything to be accomplished for each area of the business. This task should be in conjunction with developing a business strategy. This should be done with cooperation of all employees. The new owner should meet with all key individuals. The desired outcome is to develop goals and create a sense of a common purpose.
4. The new owner should determine which assets are not part of the core business and develop a strategy to sell these for the best price without wasting too much time. This is a time to evaluate the core competency of the business,

and to look for opportunities to disinvest in areas not consistent with the core business. This could also be an opportunity to sell unproductive assets to provide needed cash for core activities.

5. Next, the new owner needs to develop a 30/60/90 day plan for each department and employee. Involve the staff in determining the first quarter goals. Develop and communicate clear expectations for performance. The business should have clear and concise metrics to guide the business and employees in day-to-day activities.
6. The owner needs to get each employee to commit to completing the agreed upon tasks as per the schedule. Every employee should strive to support the business and the new owner in maximizing performance. The new owner should take this time to evaluate the employees' commitment to supporting the new business ownership. Some employees may have difficulty making the transition to having a new owner and may need to "let go."

7. The business needs next to develop the Marketing Plan. The new owner should involve all employees to participate and buy into the plan. Obtain assistance from business consultants or other experts. The Marketing Plan is essential for the viability of the business and the new owner should not hesitate in its completion.
8. It is recommended that the new owner hold a company lunch/dinner/picnic once some of the scheduled goals have been met. Have employees bring their families to this event. It is going to take considerable hard work from every employee to get the business back on track.
9. Now it is time to update the Business Plan, or develop it with the help of key employees. As with the Marketing Plan, the new owner should also seek professional help in this endeavor. The professional team formed during the business acquisition phase can continue to be consulted. Along with having an accountant and lawyer in the professional team, an experienced business executive (SCORE member) can be of tremendous help.

10. The new buyer can not change the world in 90 days, she or he can definitely influence it. The first 90 days is not only the time to get things done, but this is also the time for the new buyer to set the tone for the recently acquired business. This is her or his business now. For a new entrepreneur, it is now the moment so long dreamt and planned for.

Summary

There are several milestones in the process of buying an existing business. In general they will likely follow this order:

- Finding an existing business for sale
- Finding a business broker and assembling a professional team
- Letter of Intent Agreement
- Negotiation to Purchase
- Agreement in Principle
- Offer to Purchase Agreement
- Exercise of Due Diligence
- Renegotiation (if necessary)
- Final Agreement

- Closing

Due Diligence is probably the most important step during the buying process. Many key questions were answered during this step about the state of the business and what might be its future potential and answer the question, "Is it a Good business"?

After the Due Diligence, certain issues may need to be renegotiated by the Buyer. The outstanding issues shall be turned over to the attorney to be included as part of the Purchase Agreement. If the seller does not agree to mediate the outstanding issues and depending on the severity of issues discovered by the Due Diligence, the buyer must decide whether to proceed with the acquisition.

The buyer will need help from an accountant to review the financial statement, a lawyer to prepare the purchase Agreement and a helper to assist in data/document gathering. In order to successfully proceed, there are some things to know in advance:

- The buyer work should closely with his or her professional team and the business broker to make sure that all of the documents required are prepared prior to the start date.
- The Due Diligence checklist will comprise each section the materials required to conduct the

audit of the particular aspect of the business.

These required documents should be included in the Offer to Purchase Agreement.

The accountant should have a Due Diligence checklist for common areas for most businesses. The buyer should work closely with her or his professional team to progress throughout the acquisition process.

Conclusion

In 1988, there were 15 million individuals in this country running their own businesses. These entrepreneurs are proud of their business ownership, and are fulfilling their dream of being their own "boss." Although most people desperately want to improve their current life style and are tired of the corporate pecking order, they also need a dependable source of income to meet the financial obligations of housing, food and other living expenses. Owning a business has become the most popular method for achieving independence (Smorenburg, 1998).

The author has suggested that acquiring an existing business is better than attempting a start-up business. The main reason for buying an existing business is the lower risk of failure for the entrepreneur. An existing business has a stream of income with an established

customer base, it has trained employees and a business with established operations, and it has assets that are producing a return. Also, an existing business has formulated a successful formula; a product or service that is wanted by the its customers, and is generating profit. A start-up may be gambling on a new idea or new market, untested and full of risk for a new entrepreneur.

A start-up can fail due to a host of reasons that cannot be imagined ahead of time, especially by a new entrepreneur not experience in business ownership. Experts estimate that start-up business generally take eight to 15 months before they turn a profit. This means that during this time the start-up business owner will face expenses without any income. In dollar terms this could be anywhere from \$20,000 and \$150,000 that must be invested over and above capitalization and operating capital (Smorenburg, 1988). Another advantage to buying an existing business is that having an income history allows for valuing the business to arrive at a purchase price

There are numerous business valuation methods or techniques available to the entrepreneur. Some of these techniques were described in this paper; the two main techniques presented were the asset-based techniques and cash flow techniques. For a small business valuation, the

recommended method is the Adjusted Cash Flow (ACF) technique. ACF is the most commonly applied measure of cash used in valuing privately held companies. Most professional business brokers use this figure as an important component of their valuation analysis (Gabeheart & Brinkley, 2002). The ACF is defined as the pretax, cash-equivalent benefits accruing to a single owner working the business full-time" (Gobehart & Brinkley, 2002)

Although the ACF technique is the method applied to small, privately-held companies, this is usually combined with the Discounted Cash Flow (DCF) analysis technique. The DCF measures the time of value of money. In other words, what future cash earnings will be worth now? In combination, using the ACF to analyze history earnings and the DCF to measure future earnings provides a complete value a business. These various cash flow concepts are interrelated (Gabeheart & Brinkley, 2002). For the purpose of providing a practical valuing approach, the Adjusted Cash Flow technique is recommended when looking at what price a business should be placed for sale.

Buying as business is more than just about the numbers and earnings; it is more about a change of life style for the aspiring entrepreneur and business owner.

Finding a business that can provide the new owner a reasonable salary and rate of return, but most importantly, it provide the opportunity the owner a greater control of her or his own destiny. Economic and technological trends have forced big businesses to shed staff. This situation has in turn made job security an antiquated fable from another time and generation.

Consequently, many individual employees have opted for getting into business for themselves in the effort to become self-sufficient, which has increased the ranks of the of small-business owners (Smorenburg, 1998).

This paper had the objective of providing the reader, especially an aspiring entrepreneur, with an insight into the process of buying an existing business. The author hopes that the intent has been met, and the reader now has an understanding of how to approach the task of acquiring an existing small business. Along with providing the reader with the stated objective, the author was as equally benefited from this endeavor. What started as a thesis project has turned in a great educational experience. The author has benefited from the exercise of writing this paper. For the author, the buying process has been demystified, and is looking forward to applying the

concepts presented in this project to acquire an existing
business in near future.

APPENDIX A
CONFIDENTIALITY/DISCLOSURE STATEMENT

**STANDARD CONFIDENTIALITY/DISCLOSURE STATEMENT
NONREPRESENTATION BROKER
EXAMPLE ONLY**

This document is for use as a reference only. You must not, under any conditions whatsoever, use this agreement without prior review by your attorney. Be sure to add the clauses on Non Compete and Due Diligence [REPRINTED FROM #, pg. #]..

(Your name, address, & el., etc), herein known as PROSPECT, acknowledges and agrees that PROSPECT approached _____ Business Brokers, Inc. Who is a NONREPRESENTATION BROKER (BROKER), and that BROKER was the first to advise PROSPECT of the availability of and details concerning the following business opportunities and real properties:

	LISTING #	TYPE
1)	_____	_____
2)	_____	_____

-- PROSPECT understands and agrees that all dealings concerning said business opportunity will be handled through BROKER and that BROKER HAS ENTERED INTO AN AGREEMENT FOR PAYMENT OF A COMMISSION WITH THE SELLER. PROSPECT further agrees that information received with respect to the above-mentioned opportunity will be kept in strict confidence, will not be used to compete with the SELLER and that PROSPECT shall not disclose this information to any person, excluding those parties specifically involved in the transaction itself and the PROSPECTS'S sole purpose in seeking information about the business is to purchase a business. In the event that PROSPECT violates this confidentiality covenant or any other covenant herein and/or with respect to SELLER, then BROKER, Listing BROKER and SELLER shall be entitled to all remedies provided by law, including but not limited to injunctive relief and damages. The same remedies shall be afforded and available to the BROKER. BROKER shall be deemed to include all and any other BROKERS with whom BROKER is co-operating.

-- All data on business opportunities are provided for information purposes only. No representation is made by BROKER as to the accuracy of the data provided. BROKER encourages PROSPECT to thoroughly review and independently verify to PROSPECT'S own satisfaction that the data provided are substantially representative of the business activity of the SELLER and can be relied upon when considering the purchase of said business opportunity of SELLER and can be relied upon when considering the purchase of said business opportunity of SELLER. PROSPECT acknowledges that Prospect has been advised to seek the independent counsel of an attorney and/or an accountant to verify the information supplied to BROKER by SELLER and to examine any and all applicable documentation relevant to the transaction hereinabove, will also be responsible for the payment of BROKER'S

compensation which would have been payable on the listed selling price or minimum compensation, whichever is greater.

-- PROSPECT agrees that he will not within two years from this date deal directly or indirectly with the SELLER without the BROKER'S written consent and should the PROSPECT do directly or indirectly a sale, management agreement, lease or other financial arrangement, including leasing the SELLER'S premises from the SELLER or Landlord is consummated, the PROSPECT shall be liable for all and any damages which the BROKER may suffer, including but not limited to the compensation, whichever is greater and PROSPECT further agrees in terms of Section _____, the BROKER at BUYER'S expense shall have the right to place any appropriate lien and encumbrance on the business and real estate or both, necessary to collect any compensation and this shall be the necessary authorization and consent as is required by the Statute. BUYER further grants BROKER a security interest under the _____ in and to all furniture, fixtures, inventory, accounts receivable and general tangibles of the BUSINESS as security for such commissions due in the future arising out of any portions which a BUYER may subsequently exercise and authorizes BROKER to file this Agreement as a financing statement to perfect such security interest for the purpose hereof the prospect shall include any corporation which the BUYER may use to purchase the said business. This Contract shall be governed by the laws of the State of _____. The parties agree that prior to the institution of Arbitration as hereinafter set out, they will have the option of attempting to settle any dispute or claim between them arising out of this document, the breach, or interpretation thereof, to non-binding Mediation in terms of the _____. All cost of Mediation shall be equally borne by the parties. The parties and the Broker specifically agree, subject to the provision of Mediation referred to above, to submit any controversy or claim arising out of or relating to the Contract, or the breach thereof, either to a Court of Competent Jurisdiction to file a suit at law and/or in equity, with venue in

_____, or to resolution by Arbitration in accordance with the commercial arbitration rules of the American Arbitration Association (AAA). The prevailing party in any litigation over this contract shall be entitled to an award of reasonable attorney's fees, paralegal fees, expert witness fees, costs and expense (whether or not taxable as court costs). A judgment upon any award rendered by the arbitrators shall be entered by a court having subject matter jurisdiction therein. The parties hereto agree that jurisdiction and venue for the entry of judgment upon said arbitration award shall be in _____ County. The arbitrators costs, the costs and charges of the American Arbitration Association, all reasonable attorney's fees and costs, to the prevailing party in the arbitration. No action shall be entertained if filed more than two years subsequent to the date the cause(s) of action actually occurred regardless of whether damages were otherwise as of said time calculable. The Broker shall be entitled to all information and copies of all documents relating to the arbitration from both the Arbitrator and the parties. In the event the parties take the controversy or claim to a Court of Competent

Jurisdiction, the Broker shall be entitle to a copy of all filings, pleading and rulings within 5 days after such papers are issued.

-- The seller is the intended beneficiary of all covenants of Prospect, which benefit the SELLER, including without limitation, the covenants concerning the use of information disclosed to Prospect, and may bring an appropriate action to enforce such covenants. The Prospect acknowledges receiving a copy of this document. A facsimile copy of this document and any signatures shall be considered for all purposes as originals.

SIGNATURE LINES BELOW

END

APPENDIX B

INCOME STATEMENT: EXAMPLE

INCOME STATEMENT: EXAMPLE
Target Business for Acquisition

	<u>Last Yr</u>	<u>2 Yrs Ago</u>	<u>3 Yrs Ago</u>	<u>CY 8 months</u>
Total Revenues	355,700	311,915	309,86	279,750
Cost of Goods Sold (COGS)	<u>132,050</u>	<u>118,408</u>	<u>117,648</u>	<u>103,415</u>
Gross Profit	223,650	193,507	192,214	176,335
Expenses				
Rent	25,200	25,200	24,000	18,900
Salaries & Benefits	49,200	47,300	46,100	36,900
Utilities	16,500	15,700	15,500	12,045
Usage Fees	9,100	8,900	8,800	6,776
Depreciation	7,500	7,500	5,000	5,625
Training	2,000	2,300	2,970	1,600
Shipping	750	780	660	565
Supplies	3,100	2,800	4,000	2,475
Uniforms	600	570	1,480	540
Subscriptions	250	320	490	250
Association Dues	500	470	660	393
*Owners Benefits:				
Salary	60,000	55,000	55,000	45,000
Life Insurance	2,000	2,000	2,000	1,500
Country Club Membership	4,000	3,800	3,700	3,075
Total Expenses	<u>180,700</u>	<u>172,640</u>	<u>170,360</u>	<u>135,644</u>
Pre Tax Income	42,950	20,867	21,854	40,691
Less:				
Tax	(12,810)	(5,990)	(4,980)	(12,207)**
Interest	(1,860)	(1,640)	(1,520)	(1,392)
Net Income	<u>28,280</u>	<u>13,337</u>	<u>15,354</u>	<u>27,092</u>
Add Backs:				
Interest	1,860	1,640	1,520	1,392
*Excess Owner's Compensation	14,000	8,800	8,700	10,575
Depreciation	<u>7,500</u>	<u>7,500</u>	<u>5,000</u>	<u>5,625</u>
Free Cash Flow	51,640	31,277	30,574	44,684
*Owners Benefit Deduction Rationale				
Salary	\$10,000	\$5,000	\$5,000	\$7,500
Life Insurance				
Country Club	4,000	3,800	3,700	3,075
Owners Benefit in Excess of What is needed	\$14,000	\$8,800	\$8,700	\$10,575

**denotes items that are estimates only using Last Year percentages

Source: (Parker, 2003)

APPENDIX C
PURCHASE AGREEMENT - EXAMPLE

PURCHASE AGREEMENT

EXAMPLE ONLY

This document is for use as a reference only. You must not, under any conditions whatsoever, use this agreement without prior review by your attorney. Be sure to add the clauses on Non Compete and Due Diligence [REPRINTED FROM #, pg. #].

This Agreement is made and entered into by: _____, (hereinafter referred to as PURCHASER") AND _____ (hereinafter referred to as "SELLER").

1. PURCHASE AND SALE OF ASSETS: SELLER agrees to sell PURCHASER, and PURCHASER agrees it will purchase all of the SELLER'S assets and properties pertaining to the business known as _____, located at _____, a corporation the shares of which are owned fully by the SELLER. The assets to be conveyed to the PURCHASER by SELLER at closing include all inventory, customer records, materials, supplies, website address and pass code, equipment, leasehold improvements, furniture, furnishings, fixtures, transferable licenses, name, telephone number, and all other assets used in the business.

This sale does not include the books and records of SELLER, accounts receivable, cash on hand of SELLER

2. PURCHASE PRICE: The total Purchase Price for all of the assets as listed in section 1 shall be \$ _____

3. PAYMENT OF PURCHASE PRICE

3.01 \$ _____ Deposit paid by PURCHASER to the escrow account of _____

3.02 \$ _____ Additional Deposit after completion of Due Diligence by PURCHASER to be paid to escrow account of _____

3.03 \$ _____ Represents the Balance of the Down payment (subject to adjustments) due at closing by certified check

3.04 \$ _____ **TOTAL DOWN PAYMENT**

3.05 \$ _____ of the Purchase Price shall be paid by the PURCHASER to the SELLER as a Balance of Sale at ___ per month for ___ months at an interest rate of ___ per annum

3.06 \$ _____ **TOTAL PURCHASE PRICE**

All notes assumed or executed by PURCHASER for the benefit of SELLER shall be secured by security agreement and chattel mortgage on all of the assets of the business being transferred to PURCHASER. In the event PURCHASER is a corporation, all promissory notes executed/assumed by the PURCHASER shall be personally guaranteed by all stockholders of PURCHASER. All promissory notes executed by PURCHASER to SELLER shall provide for a grace period of ten (10) days.

4. CLOSING. This transaction shall close on/about 15 to 45 days from the completion of due diligence (unless extended at the request of the lender for the SBA loan or any other financing entity)

5. LEASE. SELLER presently possesses a lease for the premises of the business being sold to PURCHASER. Such lease is a valid lease, is current and in good standing, and SELLER has the right, subject to any consent required to be obtained by the lessor under the terms of the lease, to assign the lease to PURCHASER. Such lease shall be assigned to PURCHASER at the closing. The present term of the lease extends _____. The current monthly rent payable under the terms of the lease is \$ _____

6 **LIABILITIES**. PURCHASER shall assume:

6.01 If applicable, principal and interest on the Note specified on Paragraph 3.04 and 3.05 falling due after the closing.

6.02 All obligations under the terms of the lease for the business being sold falling due after the closing.

6.03 Cost for _____ and other utility services arising after the closing.

6.04 _____.

Except for such obligations, PURCHASER shall not be obligated and will not assume or become liable for any obligations or liabilities of SELLER. At the closing, all of Seller's accounts payable, liens, liabilities of any type and other encumbrances of SELLER affecting the business being transferred which are existing on or arise prior to the closing shall be paid from the proceeds of the sale contemplated herein. The parties intend PURCHASER shall acquire ownership of the assets being purchased free and clear of all claims, liens and other encumbrances, except as set forth herein.

SELLER warrants and represents that at the closing, all sales taxes, interest and penalties which may be owing to the _____ Department of Revenue will have been paid and satisfied in full. Following the closing, SELLER agrees to indemnify the PURCHASER and hold the PURCHASER harmless from any and all sales taxes, interest and penalties that may be asserted against the PURCHASER as a result of the activities of SELLER prior to the closing.

7. **PRORATIONS, DEPOSITS AND UTILITIES AND ADJUSTMENTS**.

7.01 **Utilities**. SELLER and PURCHASER shall arrange to notify all utility companies to take final readings as of the date of closing, and PURCHASER shall have the obligation to advise such utilities to provide services in Purchaser's name.

7.02 **Deposits and Prepayments**. SELLER shall be entitled to be reimbursed for all deposits and prepayments which are held by depositors for the benefit of PURCHASER.

7.03 **Proratable Items**. All proratable items shall be prorated at the closing.

7.04 **Inventory-Adjustment to Purchase Price**. The purchase price provided for herein includes current and saleable inventory to be transferred to the PURCHASER at the closing at Seller's wholesale cost of _____ DOLLARS \$ _____. In the event the amount of inventory transferred to PURCHASER is more than or less than such figure, the purchase price shall be increased or decreased, as the case may be.

All adjustments provided for by the terms of this Paragraph 7 shall increase or decrease the cash payable by PURCHASER to SELLER at the closing under the terms of Section 3 above.

8. **CONDITIONS OF ASSETS**. All assets of Seller's business being transferred to PURCHASER shall be in good working order at the closing. SELLER shall be responsible for repairing any items found defective prior to the closing.

9. **REPRESENTATIONS OF SELLER**. SELLER represents to PURCHASER that:

9.01 SELLER is in good standing and has the power to sell its assets as provided for herein.

9.02 SELLER is the owner of and has good and marketable title to all of the assets, free and clear of any liens, encumbrances or claims whatsoever, except as set forth in Section 6 above with respect to the existing obligations (if any) to be assumed by PURCHASER.

9.03 SELLER possesses all licenses necessary to operate the business being transferred to PURCHASER.

9.04 There are no judgments, liens, actions or proceedings pending or threatened by or against SELLER.

9.05 The business of SELLER will be conducted up to the date of closing in accordance with all laws, rules and regulations, and SELLER will operate and maintain the business in regular course and not violate the terms of any contracts with third parties.

10. **CONDITIONS TO CLOSING.** On or prior to the closing, SELLER shall obtain any necessary consents from third parties required for the transfer of the assets to PURCHASER, including, but not limited to, consent from the landlord, if applicable, and consent from any holders of mortgages against the assets of the business being assumed by PURCHASER.

11. **AGREEMENT NOT TO COMPETE.** SELLER and all stockholders and/or partners of SELLER shall agree at the closing in writing not to compete with the business being sold to PURCHASER hereunder for a period of _____ months following the closing date within the area of _____ miles _____

12. **INSPECTION OF PROPERTY, BOOKS AND RECORDS.** Notwithstanding anything in this agreement or any addendum, for a period of twenty (20) business days following the receipt of the _____ financial statements (list all of the different statements here) (the "Inspection Period"), PURCHASER shall have in its sole right and absolute discretion, right at mutually agreeable times to inspect the assets and records of SELLER. If PURCHASER is not satisfied with such review in its sole right and absolute discretion, PURCHASER shall have the right to cancel this Agreement for any reason and receive a return of the deposits paid if written notice of PURCHASER's objection is sent to SELLER or the BROKER within twenty (20) business days of the date after receipt of the _____ financial statements. Upon any such cancellation, all deposits paid shall be returned to PURCHASER, without any deductions, and each of the parties shall have no further obligation to each other.

In order to assist PURCHASER, SELLER shall, within one week of execution of this agreement, provide Purchaser:

1. The (company name) _____ (period) Income Statements and Balance Sheets.
2. A listing of all liabilities contingent or otherwise.
3. A detailed listing of all assets included in sale.
4. A complete breakdown of owner's compensation and benefits.
5. A listing of all employees, job descriptions, terms of employment and any other contracts in place, or implied, between Seller and employees
6. Anything else that you may need

13. **MANAGEMENT ASSISTANCE.** SELLER agrees to provide assistance to PURCHASER to transfer management and operation of the business during normal business hours at the location of the business for a period of _____ days following the closing, all without additional consideration payable by PURCHASER to SELLER. _____ agrees to stay on up to _____ after closing with a compensation of \$_____/week. _____ will have paid health insurance, and will have use of a vehicle during business hours. **Add in all other conditions here for employment, training, consultation, etc.**

14. **FURTHER COOPERATION.** Each of the parties agrees to take whatever actions as may be necessary to carry out the terms of this Agreement following the closing.

15. **DATE OF AGREEMENT.** The date of this Agreement shall be the last date this Agreement is signed by both SELLER and PURCHASER.

16. **DISPUTES WITH BROKER.** In the event any dispute arises under this Agreement between SELLER and PURCHASER resulting in BROKER being made a party to any lawsuit or action, SELLER and PURCHASER, severally and jointly, agree to indemnify BROKER for all costs and legal expenses incurred as a result of BROKER having been made a party to such proceeding, providing a judgment is not rendered that BROKER acted improperly regarding such dispute under this Agreement. All costs of Broker's legal expenses shall be shared equally between SELLER and PURCHASER, unless it is determined the BROKER was improperly or needlessly made a party solely as a result of the actions of one party, in which case that party shall satisfy the legal cost of BROKER.

The parties acknowledge all financial information concerning the business of SELLER was supplied by SELLER and BROKER makes no warranties or representations as to the genuineness of any financial information of the business.

17. **DEFAULT.** In the event SELLER refuses or is unable to consummate the sale of the assets provided for herein, the earnest money deposit received by the BROKER shall be returned to PURCHASER upon demand. In the event such default of SELLER is intentional, PURCHASER shall be entitled to receive an additional amount equal to _____ percent of the deposit, as liquidated damages.

In the event PURCHASER fails to complete the purchase after all terms and conditions have been met by SELLER, _____ % of the deposits paid by PURCHASER shall be retained by BROKER as liquidated damages, and the remaining _____ % shall be paid to SELLER as liquidated damages.

18. **LEGAL ADVICE.** The parties acknowledge BROKER has advised both parties to employ legal counsel prior to execution of this Agreement, and each party has had ample opportunity to retain the same. The failure of any party to obtain legal counsel shall relieve BROKER and its associates of all claims for the failure of any party to retain legal counsel.

19. **FEES TO BROKER.** SELLER acknowledges that BROKER has earned a commission as provided for in a separate listing agreement between SELLER and BROKER, which shall be satisfied at the closing. In the event SELLER refuses or is unable to close this transaction by reason of a default of SELLER, SELLER shall be liable for and agrees to pay the full-agreed commission to BROKER. In the event of the failure to close this transaction because of a default of PURCHASER, BROKER shall be entitled to retain _____ % of the amount of PURCHASER'S DEPOSIT.

20. **SURVIVAL OF REPRESENTATIONS.** All representations, warranties and agreements of the parties contained in this Agreement shall survive the closing.

21. **AMENDMENT.** This Agreement may be amended at any time in writing executed by SELLER and PURCHASER; however, no such amendment shall affect the BROKER unless the BROKER joins in the execution of any such amendment.

22. **CONTRACT REVIEW.** From the date of execution of this contract, Buyer and Seller shall have _____ business days to have this contract, which includes any addenda or amendments to it, reviewed by their respective attorneys to verify that the forms and Language only used herein adequately protects their respective clients and to have the necessary changes made within such time, so long as the substance of and material terms in this contract shall remain unchanged.

23. **ATTORNEYS' FEES.** In the event any party shall be forced to retain the services of legal counsel to enforce the terms of this Agreement whether suit be brought or not, the prevailing party shall be entitled to be reimbursed for all attorneys' fees and court costs incurred.

24. **EFFECT OF OFFER.** The offer by PURCHASER hereunder shall be in effect for _____ () hours after execution by PURCHASER. If SELLER has not accepted this Agreement by such time, the deposit paid shall be returned to PURCHASER on demand and all rights of PURCHASER under this Agreement terminated.

25. **GOVERNING LAW:** This contract shall be governed by the Laws of the State of _____ and the parties specifically agree as a matter of substance and express their intention to submit any post-closing controversy or claim arising out of or relating to this Contract, or the breach thereof, to resolution by arbitration in accordance with the commercial arbitration rules of the American Arbitration Association (A.A.A.). A judgment upon any award rendered by a single arbitrator may be entered by a court having subject matter jurisdiction therein, and all parties expressly waive any challenge to the use of arbitration in accordance with this paragraph. The parties hereto agree that jurisdiction and venue for the entry of judgment upon said arbitration award shall be in _____. The arbitrators are directed to award the expenses of the arbitration, including required travel and other expenses or the arbitrators and any representatives of the arbitrator's costs, the costs and charges of the American Arbitration Association, all reasonable attorneys' fees and costs, to the prevailing party in the arbitration. The decision of the

arbitrator shall be binding. If the parties cannot agree on the name of a sole arbitrator then the said arbitrator shall be appointed by a representative of the A.A.A

26. OTHER

SIGNATURE PAGE AND ANY SCHEDULES FOLLOW

END

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