

SCORE – SERVICE CORP OF RETIRED EXECUTIVES

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EVALUATION GUIDELINES FOR BUYING A SMALL BUSINESS

One of the most often questions asked about buying a business is how much should someone pay for the business. While there are many factors that go into this decision, there are some guidelines that will help the buyer in determining whether to proceed or not. The purpose of Sections 1 and 2 are to bring to your attention all the things you should consider.

1) Ask yourself:

a) What do I know about the business you're buying or industry your going into?

b) What is my experience in:

- * Management
- * Operations
- * Sales & marketing
- * Finances and record keeping

c) Do I understand the meaning of the following terms?

- | | | |
|-----------------------|-----------------------------|----------------------|
| * Gross Margin | * Gross Profit & Net Profit | * Break-even point |
| * Turnover | * P & L Statement | * Cash-flow Analysis |
| * Accounts Receivable | * Accounts Payable | * Terms of Credit |

If I do not know the meaning of these terms, where do I get the information?

d) What do I know of the industry:

- * The competition and their location
- * Where my potential customers or market is

e) What do I know about the business I'm buying:

- * Track record of the business – sales, expenses, profit for the past 3 years.
 - * If decreasing, why?
- * Do they have a lease:
 - * What are the terms of the lease in time and cost?
 - * Do you assume the current owner's lease or do will you have to sign a new one?
- * Are you buying real property as part of the sale? Is it part of the same transaction or will it be separate from the purchase of the business?
- * What is the reason the business is up for sale?
- * What are they asking for the inventory and/or equipment and what is it really worth.
- * What is the potential for improvement
- * What agreements, if any, are in place with suppliers and customers?

f) Where are the sources of money for:

- * Buying the business
- * Sustaining the business
- * Expanding your business

g) Would I be better off putting the money in the bank?

h) Have I received the last 3 years financial records and tax information from the seller?

i) Inventory:

- * Equipment
 - * What is the age and value of any equipment and is it valued at cost, depreciated cost, replacement or salvage value?
 - * What is it worth to me?
 - * Who did the evaluation or does it need to be evaluated by a independent appraiser?
- * Products to use/sell
 - * What is the age and value of finished or unfinished parts or other inventory and is it at cost, replacement cost, selling price, or close-out value?
 - * What is it worth to me?
 - * Who did the evaluation or does it need to be evaluated by a independent appraiser?

2) Is the business dependent on the personality of the current owner(s)?

a) Will the current owner(s) stay on as consultants or still be active in the business?

- * For how long a time?
- * If the current owner(s) leave, will this deter you from making the changes you see as a way to increase sales?
- * Will their leaving the business have a negative effect on sales?

b) The staff

- * Who are the key people that are vital to the continued success of the business?
- * Will they stay on, and/or do you want them to stay on?

c) How much training will the current owner provide?

d) Will the current owners help with a smooth transition with customers and suppliers?

3) Evaluation formula for business acquisition. Rate each category from 0 to 6 (6 = top rating) SCORE

a) Risk – Continuity of income at risk/Steady income likely/Growing income assured _____

b) Competitive – Highly competitive conditions/Normal competitive conditions/Little competitive conditions _____

c) Industry – Declining Industry/Industry growing faster than inflation/Dynamic Industry – rapid growth likely _____

d) Company – Not well established/ Well established with satisfactory environment/ Long Record - well established reputation _____

e) Company – Business has been declining or steady growth slightly faster than inflation/ Dynamic growth rate _____

f) Desirability – No status – rough or dirty work/Respected business in satisfactory environment/Challenging business – attractive environment _____

g) Total Score _____

h) Valuation Rating Factor (divide Total Score by 6 =) _____

4) Determining the average annual income of the business

a) Basic Valuation	Current Year	Last Year	Previous Year
Net Income	\$ _____	\$ _____	\$ _____
+ Adjustment (Owner's salary + entertainment + anything that looks like the owner used for him/herself)	\$ _____	\$ _____	\$ _____
b) Weighted Amount (Benefit accrued to the owner)	\$ _____ (b-1)	\$ _____ (b-2)	\$ _____ (b-3)

c) Weighted Averages	Amount	Weight	Weight Amount
Current Year (b-1)	\$ _____	x 3	\$ _____
Last Year (b-2)	\$ _____	x 2	\$ _____
Previous Year (b-3)	\$ _____	x 1	\$ _____

d) Total Weighted Amount \$ _____

5) Average annual income value *(Total Weighted Amount divided by 6)* \$ _____

6) Valuation of the business

a) Income Value multiplied by the Valuation Rating Factor <i>(See 3h)</i>	\$ _____
+ Accounts receivable	\$ _____
+ Fixed Assets	\$ _____
+ Cash, – accounts payable.	\$ _____

b) VALUE OF THE COMPANY \$ _____

7) Years to recover investment _____
*(determined by dividing Value of the Company - 5b
by Current year's average annual Income – 4a-1)*

Note, A general optimistic guideline is 5 years or 20%/year).

This form for estimating the value of a small business is only one of many different formats used in business and industry. It may be that the business you are interested will call for a different format. In that case, we suggest you contact a business broker or a CPA who does this type of work.