LAW OFFICES OF
DONALD W. HUDSPETH, P.C.
"The Business of our Firm is Business"

Checklist for Business Acquisition or Start Up
Stage Two: Strategic Considerations

After your initial work up of a new business idea, acquisition or merger, and perhaps after or as part of your due diligence it is important to consider the following as “Stage Two” of your analysis:[1]

1. Why is the business for sale? Assume the stated reason is not the real reason and look deeply. For example the pending loss of a key government or private company contract is a common reason for sale.
2. What is so great about the business or idea; what makes it special? Everyone you deal with, from customers, bankers, and investors will be asking this question. Here are some considerations:
    a. Reputation. How is the company considered in the marketplace, avant-garde or stodgy? It is almost impossible to become something the company isn’t and the change may cost the customers the business has.
    b. Industry and Market.[2] On the upswing, stable or fading?
    c. Market share
    d. Niche market that works?
    e. Can you expand sales to existing customers or expand customer base by sales and marketing?
    f. Potential new market or customer base, e.g. adding online sales to wholesale and retail distribution.
    g. Competition. Strong, weak, upcoming or fading?
    h. Products and services. State of the art, stable or fading?
    i. What is the “secret sauce?” Unique intellectual property? The product, invention, idea, production method, or marketing method that makes the business or its products and services unique.
    j. Other unique aspects of the business, e.g. minority owned, woman owned or disabled veteran owned? If not so certified can the business qualify?
    k. New products or services available?
    l. Facilities. State of the art, adequate or need improvement. New facilities needed or planned?
    m. Superior production methods?
    n. Production costs. Low for the product or service, average or high?
    o. Established distribution channels.
    p. What about distribution channels for intended new product or service?

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[1] For our purposes here we are defining “due diligence” as a comprehensive appraisal of a business undertaken by a prospective buyer to determine its assets, liabilities, profitability and cash flow and evaluate its commercial potential. This includes review of the industry, market, company clientele, financial statements and tax return, and for retail stores and some other businesses, the cash register “Z tapes,” i.e. end of the day print out.

[2] By “industry” I mean the general area of business, like computers, medical services or law. By “market"’ I mean a particular group of potential customers defined by demographics, product price, and place and manner of purchase, e.g. wholesale versus retail, online versus bricks & mortar, or Nordstrom versus Walgreens.

q. Location for type of business:
   (i) In general near prime market,
   (ii) In particular logistics, e.g. near railroad yard or airport,
   (iii) Key suppliers, resources nearby, or
   (iv) Marketing, strategic location
r. Vendors. Good relations, competitive cost or terms?
s. Purchasing power. Competing with someone who can sell retail cheaper than you can buy wholesale due to their purchasing power and distribution channels?
t. How do you compete if you are not the low cost producer or low cost seller?
u. Specialized market – too small for "big box" operations?
v. Integration. Vertical to buy supplier or distributor or horizontal to add locations?
w. New expertise
x. Timing. Is now the time for this business, this investment?
y. Synergy.

3. What's ***not*** so great about the business? What hurdles will you need to overcome? Is it realistic to think you can overcome them? How?
4. What's so great about you? Do you bring something special or new to the business? What do you think you can accomplish when assets and aspects of the business may be relatively fixed or expensive to change? Will anything you can do make a material difference?
5. Does the price make sense?
   A. Fair market value as pre-tax cash flow (not income) times industry multiple. This multiple should be available online and ranges from 2 to 7 for most businesses, or
   B. Mergers & Acquisitions model as after tax cash flow divided by "cap rate," usually 10 to 20%.[3] [4]

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[3] A capitalization rate, the "cap rate," is the ratio of Net Operating Income (NOI) to price or asset value. For example, if a business or property was listed for $1,000,000 and generated an NOI of $100,000, then the **cap rate** would be $100,000/$1,000,000, or 10%. But, the cap rate is also and for our purposes here used as the minimum return on investment an investor requires considering the risk. For example, if one can earn 7% return in bonds or other fixed return investments with relatively little risk, one is not likely to invest in a start up for less than a 15% return – and the required cap rate could be as high as 25%. High cap rates can greatly diminish the perceived investment value of a property or business to a third party investor. You as an investor and operator may want to consider whether the investment is the best use of capital from a risk/reward perspective. This is one reason why the above listed strategic considerations are so important.

[4] The above formulas for determining fair market value or acquisition value are more like rules of thumb and not as accurate or as complete as the methods used by a professional business appraiser which can be quite complicated.