

[Home](#)

[Our Firm](#)

[Our Services](#)

[Knowledge Bank](#)

[Careers](#)

[Contact Us](#)

Would you buy this business?

We're often asked by clients whether a business is worth buying. Let's look at the features that make a business an attractive proposition:

Profitability/Price relativity

What are you getting for the price you are paying? Not only is profit necessary to repay borrowings or provide a return on investment it needs to be there to provide cover against the risk of a private business.

Key measures include:

- *Return on Investment in the range of 25%-50%* - Profit (after owner's wages) as a percentage of the investment required in the business across a time period.
- *Payback period <5 years (ideally <3 years)* – Another way to assess price and risk is to look at how long it will take to pay back the initial capital investment from the profit in the business. The payback period is calculated by dividing the purchase price and any associated additional capital investment by the annualised profits. The shorter the payback period the lower the risk in the investment and the more attractive it will be.
- *Profits in top quartile for sector* – Averages are unreliable but top quartile performance demonstrates how the best businesses in a particular sector perform.
- *Earnings to revenue between 10% and 20%* - This measure will vary significantly depending on the type of business. Service businesses should be able to achieve higher returns (between 15% - 20%) than retail or manufacturing (7.5% - 15%).
- *Interest cover 3 times plus* – Many businesses are funded on debt. Where there is debt funding, profits need to be greater than three times the interest cost of the loan. This not only allows a return beyond funding cost but provides a buffer if interest rates rise.

Growth capability

Where a business has evidence of a sustained history of growth the benefit is that the business you buy today has an implicit revenue increase built in and is also likely to be able to sustain a downturn.

To assess growth capability, we normally look at both the industry sector and also the business itself to determine what stage they are both in; growth, maturity or decline. A growth history of 10% is ideal.

Other key factors include the capacity within the business to accommodate further growth without substantial investment; and the extent to which growth can be managed as a variable cost rather than

fixed cost. Managing growth as a variable cost lowers the risk.

When assessing a business's growth capability, the existing client base and product range are also important factors. You need to be able to identify the business's point of differentiation and sustainable competitive advantage. Where these exist, growth is more likely to be sustained.

Resource availability

The availability of resources such as product, labour, capital, and technology are important to any business. A scarcity of resources impinges on growth and a limited number of suppliers makes the business unreasonably dependant. Ideally, the resources required by the business will be in ready supply from a choice of suppliers, there will be an opportunity to achieve economies of scale where volume purchases are made, and resource supply is scalable as the business grows.

Manageable risk

Increasingly businesses are risk assessed by purchasers. The bigger the investment and the greater the proportion of the purchase price that is attributable to goodwill and intangibles, the more risk is an issue.

When assessing risk we look for evidence of both a compliance history and the existence of operational risk management systems. In addition to the risk management systems of the business, we also consider the risk profile of the business generally and the risks attached to the products or services supplied by the business.

Ownership demands

A business that is highly dependant on its owners might be performing at a high level but this might be a result of the input of the owners. Where this input is substantially in excess of normal parameters and where a buyer is not prepared to maintain this level of input, there will be a financial effect. We look to ensure that the business has a reasonable level of infrastructure support, and can return a viable result when the owners are working reasonable hours, are not unduly stressed, and are able to take leave.

Talk to us today to help you assess the viability of a new business venture or franchise, or prepare your business for sale.

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