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Buying a Business? Due Diligence Should be Deep

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Anyone thinking about buying or investing in a business needs to do due diligence to make sure it's a viable venture with long-range income potential. But due diligence means more than just reviewing the balance sheets and income statements.

Some other things that warrant close inspection before a buyer signs the final closing documents include:

Client list: A buyer should find out if most of the company's business is done with a few entities or if the business has a diversified, extensive customer base. If clients are limited, the buyer should meet with some of them to determine if they will remain loyal after the sale. Because of the seller's need for confidentiality, any such contacts should occur just before closing and under the seller's scrutiny.

Key employees: If the company relies on key people to perform its services and the buyer doesn't have those skills, the buyer should meet confidentially with employees who do and ask if they plan to stay. Most employees will remain after a sale because a change of ownership isn't as traumatic as a job change.

Books and records: A buyer should obtain tax returns from the company for the past three years to verify income statements. He should also review accounts receivable and payable, any property or equipment leases, pertinent contracts, warranties and copies of the gross receipts tax statements for the past year.

Equipment and inventory: The assets of an asset-intensive businesses warrant an inspection to determine if the inventory is marketable and the equipment is working.

Industry outlook: A prospective buyer should research the industry in which the business operates to determine if it's a healthy and growing area of commerce. The buyer should also discuss with the seller where the business ranks with respect to its market share and what can be done to improve its position.

Chattel and tax lien search: The closing attorney should perform a chattel and tax lien search to uncover any possible encumbrances against the business's assets. Smart buyers ask for searches to be run on both the business and the owners.

Suitable lease: If someone is buying a business with a seven-year promissory note, a three-year lease isn't attractive. The seller's leasehold interests can be transferred to the buyer in a lease assignment, a sublease or a new lease. Any purchase agreement should state that the purchase is contingent upon the buyer's acceptance of a suitable new lease, sublease or lease assignment.

Professional assistance: A buyer should hire a good CPA to review financial records, and an experienced business attorney can advise on legal matters such as contracts, leases and other agreements. Spending a few thousand dollars on professionals before making a major investment is a bargain for peace of mind.

For more information on buying, selling or financing a business, go to www.financenewmexico.org.

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