

Five Tips for Decreasing Risks in Business Purchases

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When the economy is uncertain, buying a business becomes more risky. Before you consider buying a business in these economic times, you should be aware of the risks that you face. Here to give you five tips to decrease those risks is Melinda Davis Lux. Melinda is a corporate attorney with Wyche Burgess Freeman & Parham in Greenville. Melinda has represented buyers and sellers in sales and acquisitions valued at over \$1 billion.

How has the economic downturn affected merger and acquisition activity?

M&A activity dropped of in 2009, and it hasn't yet picked back up in any significant way. The primary reason for that slowdown is that the credit markets are so tight that it is extremely difficult for a buyer to obtain financing for an acquisition. The good news is that it's a buyer's market. Buyers that have cash or availability in their lending arrangements have the opportunity to purchase businesses at favorable valuations. Seller financing is also more likely to be available to a buyer today than it has been in the past.

Why is buying a business more risky in an economic downturn?

Buying a business is more risky in an economic downturn for the same reasons that operating a business is more risky in an economic downturn. When the economy is volatile and unpredictable, it's just harder to run a business. Many business costs, such as energy and transportation costs, have been fluctuating significantly, which makes it difficult for businesses. In addition, financing is so tight that businesses don't have as much "cushion" as they've had in the past. They can't obtain bank loans as easily as they have in the past to help them through rough patches when business slows down. And when a business goes bankrupt, that bankruptcy has a ripple effect on other businesses. With all of that uncertainty, evaluating whether to buy a business becomes more risky.

So if you're going to buy a business, what are the top five things you can do to decrease that risk?

Number one is to increase your due diligence investigation of the customers of the business. After you buy the business, you will depend on sales to those customers, and you want to make sure, as best you can, that those customers aren't in financial trouble and that they will be there after the closing.

Number two is to thoroughly investigate the accounts receivable of the business. Many businesses are collecting their accounts receivable more slowly and collecting fewer of their accounts receivable. If you are acquiring accounts receivable as part of the acquisition of the business, you want to make sure that the accounts receivable will be collected, and you don't want to pay for old accounts receivable or for accounts receivable that aren't likely to be collected.

Number three is to adjust your purchase price to reflect the uncertainty in the economy. Buyers often value a business by taking the historical earnings of that business over some period of time and applying a multiple. When the economy is deteriorating, however, that approach is more risky because the business may be losing customers and the future revenues of the business are not as certain. For that reason, your valuation and your purchase price should be lower than it would be if the economy were more stable.

Number four is to make sure that the seller pays off all of its bank loans at closing. If the seller has a bank loan that is not paid off at closing and the bank loan was secured by the assets of the business, and then the seller defaults on the loan after the closing, the bank can probably foreclose on the assets that you've purchased. You need to make sure that you acquire the business assets free and clear of all liens at closing, which generally means that the seller needs to pay off all of its loans at closing.

Number five is to insist that part of the purchase price be placed in escrow for a period of time following the closing. It's typical in most acquisitions for the seller to be responsible for liabilities of the business that relate to the period of time prior to the closing. However, after the closing, if the seller is no longer operating the business, the buyer can end up paying for those liabilities. If that happens, you want to make sure that you have access to funds in an escrow account to reimburse you. You can also address that risk in other ways but in any case, you want to make sure that you feel comfortable that you have access to funds after the closing for claims that you may have against the seller.

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