

# Buying a hospitality business

## 10 steps to follow to make the process as painless as possible

In most cases, buying an existing business is less risky than starting from scratch. When you buy a business, you take over an operation that's already generating cash flow and profits. You have an established customer base, reputation and employees who are familiar with all aspects of the business and a successful formula for running the business has already been put in place.

On the downside, buying a business is often more costly than starting from scratch. However, it's easier to get financing to buy an existing business than to start a new one. Bankers and investors generally feel more comfortable dealing with a business that already has a proven track record.

Of course, there's no such thing as a sure thing and buying an existing business is no exception. It is vital to define the business you want to buy. Ask yourself the questions: What kind of business do I want to buy? How do I know which business is right for me? Where do I start? When larger corporations do this they call it "acquisition profiling".

### 1 - Research by identifying the business

Even if you already know what business is right for you, it's still a good idea to do some research. Read up on any future legislation that may affect the business sector and know your facts and figures.

At this stage you'll also be considering how much to spend on buying a business. Careful financial planning is crucial as you don't want to overstretch yourself in the purchase only to find you don't have adequate resources to make any changes or implement new plans.

### 2 - Target a business

Once you've defined the parameters of the business you want to buy, (the

market sector, size, location, the price range etc) you'll be in a position to start targeting the right business. There are ways of targeting a business:

- Finding a business that is already for sale.
- Approaching a business not for sale and making an offer.
- Contracting a broker.
- Contracting a consulting firm specialized in the hospitality industry.

### 3 - DIY (Do-It-Yourself) due diligence

This is a chance to dig around and make sure the business is as good as it seems before engaging lawyers and accountants, and starting the official due diligence process.

### 4 - NDA (Non Disclosure Agreements)

Whether you use a broker or got it alone, you will need to sign a NDA in order to have a closer look at the business you're interested in. An NDA is a promise not to reveal sensitive information to a third party.

### 5 - Information

Once the NDA is signed the buyer can have access to the following:

- Inventory. You should know the status of inventory. Also, check the inventory for salability. You don't have to accept the value of this inventory: it is subject to negotiation.
- Furniture, fixtures, equipment and building. Get a list from the seller and determine its present condition, market value when purchased versus present market value, and whether the equipment was purchased or leased. Find out how much the seller has invested in leasehold improvements.
- Copies of all contracts and legal documents. Contracts would include all lease and purchase



agreements, distribution agreements, subcontractor agreements, sales contracts, employment agreements and any other instruments used to legally bind the business.

- Debt disclosure. This includes all outstanding notes, loans and any other debt to which the business has agreed. See, too, if there are any business investments on the books that may have taken place outside of the normal area.

This is the stage where you put together an "acquisition team" (lawyer and accountant) to help you if any loophole exists.

### 6 - Financial records

You should evaluate financial statements for the past five years, if possible including all books and financial records, and compare them to their tax returns, to determine the earning power of the business. The sales and operating ratios should be examined with the help of an accountant or expert, and operating ratios should be compared against industry ratios. This stage will lead you to know the exact value of the business.

### 7 - Valuation

Price is the ultimate reflection of the value of the business. Methods of valuation are:

- Cost approach - value based upon the cost of replacing a property with the same utility.
- Sales comparison approach - estimates the value of a property by comparing it with similar properties recently sold in the open market.
- Income capitalization approach - converts the anticipated future benefits of an investment into an estimate of present value.

### 8 - Negotiation

Once you are satisfied that the business you have targeted is what it

seems to be you can start to talk about buying the business. Between now and when the contract is drawn up you may discover some information about the business that will affect your perceived value of it and you may wish to negotiate further on the price.

### 9 - Heads of Agreements

The purpose of heads of agreement is so that there are no misunderstandings between the buyer and seller when it comes to completing a deal. Essentially it's a document of terms matters that you've both agreed on. Importantly, the document gives you the right to recover costs if the seller suddenly decides to pull out of the deal. The heads of agreement are only partially legally binding.

### 10 - Sale & Purchase Agreement

This legal document will contain the terms and conditions of the acquisition and the rights and obligations of the parties involved. Apart from the price, and when and how the purchase will be financed, it will also contain more detailed clauses.

Congratulations! You've signed all the forms and documents and the business is now yours.

Throughout the process you should always be prepared to walk away. However expensive or painful it might be to do so both the pain and expense will pale into comparison if you go ahead and buy the wrong business. It could be the costliest mistake you'll ever make.

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## The bottom line

- Take your time.

- Be methodical about gathering all the information you can.
- Pay attention to the details.
- Get help when needed and leverage available resources.
- Continue to "test" to see if the business and its demands fit who you are and what you want your business to be.
- If the deal doesn't feel right, keep looking