

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.

Corporate gifts that make a difference

Christmas is a time to demonstrate to your key customers how much their business is appreciated. Normally, this symbol of appreciation is in the form of cards, lunches, hampers and more. While all of these are appreciated, they don't always continue to make an impact into the New Year when the excesses of Christmas have been forgotten.

Why not introduce a new company policy and direct the money that is normally spent on corporate Christmas gifts into programs that help change the world. By selecting a project or initiative to fund that is meaningful to your customer, you can do some good on their behalf. Here are just a few ways charitable organisations can help you make an impact:

Tear's arguably the world's most useful gift catalogue

www.usefulgifts.org - Buy a goat (\$50) or even a heifer (\$300) for a needy family in a third world nation affected by war or disaster and gives them a new start. Promote sustainability with a small business loan (\$120), or fight disease and buy a well for a village to supply fresh water (\$1,200).

The Royal Institute for the Deaf & Blind

www.ridbc.org.au - The 2007 Executive Diary (\$30) would make a great Christmas gift.

Starlight Foundation

www.starlight.org.au - Make a seriously ill child's wish come true this Christmas (\$5,000).

Oxfam unwrapped www.oxfamunwrapped.com.au - Buy food for a child (\$60), fishing nets (\$30), or sponsor an aid worker (\$1,000).

UNICEF

www.unicef.org.au - Give 80 children temporary schooling during an emergency (\$280), or purchase 20 woven cotton blankets to keep new born babies warm (\$120).

World Vision

www.worldvision.com.au - Sponsor a child, buy a lamb for a needy family (\$47), or immunise children and pregnant women from the spread of disease in Zambia and the Sudan (\$24).

Anglicare *The gift that gives*

www.anglicare.org.au - \$25 will give a toy to a child who would otherwise go without.

With many of these organisations, your donation is tax deductible (in the name of the contributing organisation or individual) and you receive a gift card describing what the donation will achieve.

A Taxing Christmas

On the twelfth day of Christmas my employer gave to me...

If you're planning your Christmas celebration, be wary of the tax implications as not all celebrations are equal. Here's how to avoid adding a gift for the Tax Commissioner to your Christmas list:

A Christmas party is only exempt from Fringe Benefits Tax if it is considered to be a 'minor benefit'. To be a minor benefit, the benefit (say, a staff Christmas party and hamper) must be provided infrequently and cost less than a total of \$100 per employee. If the partners of your employees also attend the party, then the cost must be less than \$100 for both the employee and their partner to be exempt. So, if the cost of the food, entertainment, drinks and hamper for an employee and their partner is less than \$100, then it is exempt from FBT.

Alternatively, you could give your staff their hampers on a different day and avoid the total employee benefit being aggregated to keep it under \$100.

If the total employee benefit is over \$100, fringe benefits tax will apply. However, if you do have to pay FBT, your business can claim GST input tax credits on the celebration costs. Employee entertainment is not deductible as a business expense unless it is subject to FBT.

If you do not pay FBT, you cannot claim the GST input tax credits or a deduction.

The minor benefit exemption limit is being increased to \$300 from 1 April 2007. It should be easier to avoid FBT at next year's party.

The material and contents provided in this publication are informative in nature only. It is not intended to be advice and you should not act specifically on the basis of this information alone. If expert assistance is required, professional advice should be obtained.