

GROWING, SELLING & RISK

Buying a Business: The Financial Checks

What to examine before you buy a business, how to read the numbers behind the headline profit, and how the deal structure changes your risk.

FOR: OWNERS BUYING A BUSINESS OR A COMPETITOR · SOME TO EXPERIENCED

Why the checks matter

Buying a business is one of the biggest financial decisions an owner makes, and it is also one of the easiest places to lose money. The seller knows far more than you, and what you see in the accounts is a summary. The financial due diligence, as the checks are called, is how you find out what you are really buying before you are committed. It is not a formality. It is the point at which you can walk away, or change the price or the terms.

Start with why

Be clear about what you are buying and why: customers, people, premises, technology, a market position, or simply profit. The reason shapes the checks, and the price you are willing to pay. A business bought for its customers should be tested on the customers, not just on the profit.

The main questions

- **What is the real profit?** Reported profit often includes unusual items: owner's pay that is above or below a fair rate, personal costs paid by the business, one-off gains or costs, and related-party deals at non-market prices. Adjusting for them gives a clearer picture of what the business earns.
- **Is it sustainable?** Look at several years of figures, and at trends in sales, margins and costs. Be wary of a sudden improvement just before sale.
- **How good is the cash?** Compare profit to cash flow. A business that is profitable on paper but consumes cash is a worry.
- **What is the working capital?** The normal level of stock, debtors and creditors that the business needs. A price is often set on the basis of delivering a normal level, with adjustments.
- **What debt and commitments come with it?** Loans, leases, deferred payments, guarantees, pensions, and contracts with long-term obligations.
- **What are the tax risks?** Past tax compliance, open enquiries, VAT and payroll treatment, and the position on research and other claims.

Who this is for

- Owners considering an acquisition
- Directors buying out a partner
- Investors looking at a family firm

Key points

- Buy the future earnings, not the past profit.
- Adjust the profit for one-off and personal items.
- Compare profit with cash.
- Test the customers, staff and contracts.
- The structure of the deal allocates the risk.

Beyond the accounts

- **Customers.** Do a few customers account for most sales? Will they stay after a sale? Are the contracts transferable?
- **People.** Which key staff matter, and will they stay? What are their contracts and pensions?
- **Suppliers and contracts.** Are there change-of-control clauses, exclusive arrangements or unusual terms?
- **Assets.** Do they exist, are they owned, and are they in good condition?
- **Records and systems.** How reliable is the bookkeeping? Poor records usually mean poor control.
- **Legal and regulatory.** Licences, disputes, intellectual property and compliance, with a solicitor's help.

Before you make an offer

- Why do I want it?
- What is the adjusted profit?
- How is cash and working capital?
- Which customers and staff matter?
- Share or asset deal?
- How will it be funded?
- Who is on my team?

Share purchase or asset purchase

- **Buying shares** in the company means buying everything, including past liabilities, known and unknown, so more protection is needed through the contract.
- **Buying assets and trade** lets you choose what you take and what you leave, but contracts, permits and staff may need to be transferred, and the tax and stamp duty differ.

The choice affects tax for both sides, risk, and the process, so take advice early.

Protecting yourself in the deal

- **Price adjustments**, for working capital and debt at completion.
- **Deferred or earn-out payments**, which tie part of the price to future performance and keep the seller involved.
- **Warranties and indemnities** from the seller, drawn up by a solicitor, to cover problems that emerge later.
- **Retention or escrow**, holding back part of the price.
- **Insurance**, in some cases, for warranty claims.

Pay for the right advice

A good team includes a solicitor, an accountant, and sometimes a corporate finance adviser. The cost is small compared with the price, and a bad deal costs far more.

Related guides

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- [Raising finance](#)
- [Group structures](#)

How King Street can help

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We carry out financial due diligence for buyers, adjust the profit to its real level, test cash and working capital, review the tax position, and advise on the structure and the price. We work with your solicitor on the legal documents.

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