

How to Buy a Digital Business:

A Comprehensive Guide

by Hatchit – The Global Deal Directory
www.hatchit.us





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Overview

The purpose of this guide is to serve as a helpful resource in purchasing a business. While many of the tips apply to all small businesses, we have called out items that have particular relevance to web-based businesses. Our recommendations are not to be construed as advice, but rather as a framework for initiating discussions with sellers and conducting your own due diligence. Above all, we aim to sharpen your instruments of knowledge so that you can consummate the best deal possible with a promising seller. If you are seeking advice, we suggest you speak with a buyer's agent, CPA, or attorney.

Cheat Sheet Summary

- Define your criteria and research the market.
- Treat your search to buy a business like a job search.
- Keep a two-way conversation between you and a seller.
- Choose the right valuation method.
- Build trust and rapport through discussions.
- Convey an offer on a one-page term sheet.
- Gain a clear understanding of the business' assets.
- Understand the underlying market, not just the category.
- Keep enough cash on hand to run your business.
- Consider financing as a way to increase your ROI.
- Confirm assets that are part of the sale.
- Retain some leverage with the seller post-transaction.

1. Find a Business

The first step in finding the right online business acquisition opportunity is to gain a clear understanding of your target. Specific search criteria will not only make it easier for other people to help, but will also provide a framework for your decision-making through the process. When developing your parameters, think about your work experience and the skills that you bring to the table. What can be leveraged as the owner of an online business? Your criteria might look something like this:

- e-commerce apparel, personal care, home products
- Modest software technical skills
- 1-2 person team
- Dropship fulfillment for customers
- Strong social media presence
- Up to 15 hours/week to run
- \$250k budget

TIP: Treat your search to buy an online business like a job search.

Once you define what you're seeking, there are a number of channels you can pursue as part of a comprehensive search, including (1) business brokers and online marketplaces (2) networking (3) direct-to-business-owner inquiries, and (4) buy-side brokers.

Business Brokers and Online Marketplaces:

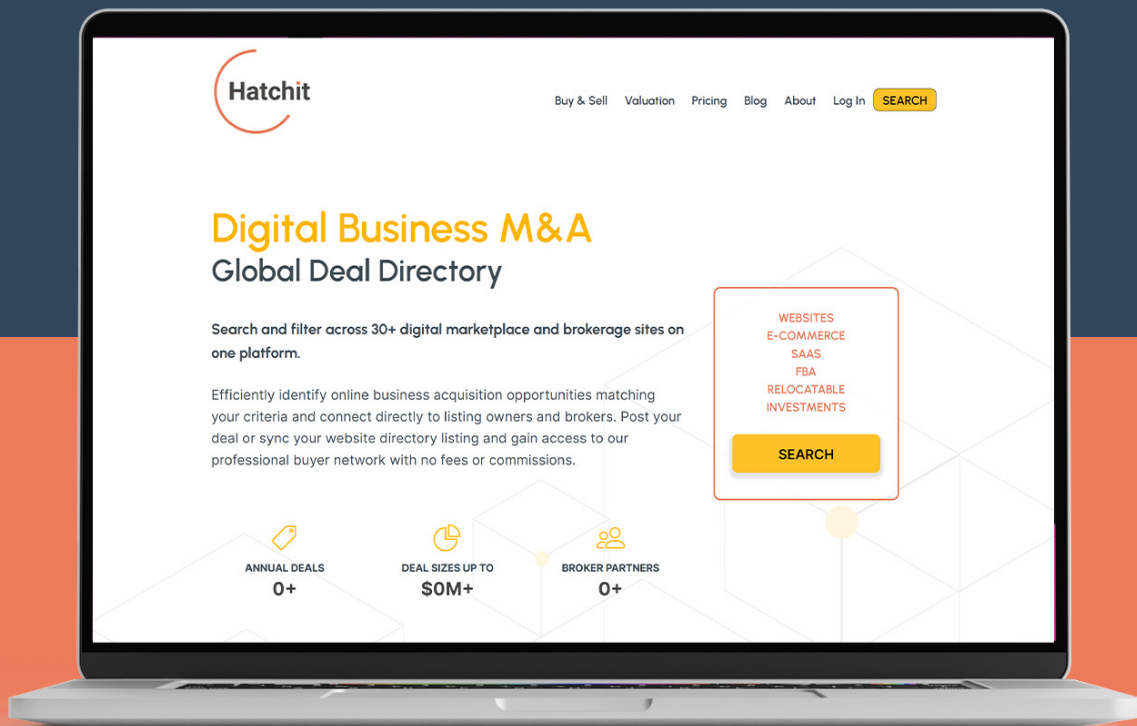
Business brokers and online marketplaces are a great place to start. Opportunities sourced from these channels are generally easiest to assess since the internet businesses have been vetted, the owners have demonstrated motivation to sell, and due diligence materials have been prepared in advance. It's also easier to browse businesses for sale when they are available as online listings. There is of course more buyer competition for "listed" businesses vs. those you source on your own. So, a comprehensive search should include tactics to identify both brokered and non-brokered opportunities. Putting in the leg work to identify non-brokered opportunities can allow buyers to develop a rapport with owners and to minimize buyer competition.

Business brokers serve an important role in identifying sellers, valuing and packaging their businesses for sale, and managing both the parties through a transaction.

There are a number of business brokers that focus on technology and e-commerce business opportunities, including:

- [Empire Flippers](#)
- Website Properties
- [Latona's Brokerage](#)
- Quiet Light Brokerage
- App Business Brokers
- SellerForce
- Investors Club
- Acquisitions Direct
- Foundy
- The Host Broker

[The Hatchit Marketplace](#) showcases current listings from these brokers and others, and buyers can reach out to brokers or sellers directly through the site.



You will also want to keep an eye on main street business brokerages as well, as they occasionally list online businesses for sale. Sign up for listing updates on brokerage and marketplace sites and work to develop relationships with brokers so your search is top of mind.



Networking: As part of your search, you will want to expand your network to include other individuals involved with mergers and acquisitions and entrepreneurship as well as professionals that work with online businesses. Angel Groups, Venture Capital firms, Family Offices, Search Funds, incubators and educational programs all hear about deal flow – if a deal does not fit their criteria, it might fit yours. Similarly, M&A attorneys, CPAs, lenders, and other “deal professionals” often learn first about companies considering a sale. They can be good sources of referral.

Lastly, service providers that work with online businesses, whether digital marketing, SEO, PR, social media, website hosting or otherwise, might learn of opportunities among their client base. These individuals can be good additions to your network. LinkedIn and other social media platforms are a great path to efficiently building your network.

Consider developing an informational website that includes your criteria, bio and other pertinent information for sellers, brokers and sources of referral. Further, develop an email list of your network contacts and provide periodic updates to keep your search top of mind.

Direct-to-Business-Owner Inquiries:

One often overlooked path to identifying acquisition opportunities is to proactively approach online businesses that are not for sale. It is estimated that upwards of 10% of businesses will consider a sale if approached professionally by a solid buyer candidate. Why not purchase a list of companies that match your criteria, contacting the owners about your interest in their businesses?



There are a number of list vendors that can help, including [D&B Hoovers](#) and [Data Axle](#) as examples. Develop your target list by identifying the appropriate business types, refining it with company revenue and other criteria. When you have a list, take the time to click through websites to ensure the companies could in fact be a fit with your criteria.

Keep in mind this approach is a “numbers game” – you may need to email a list of 500-1k candidates or more to find the right business at the right price.

Direct-to-Business Owner Metrics



It also takes some work. Ideally you will want emails to be personalized (either manually or through email software), and you'll need to follow up with responders to learn more about the business and assess motivation. However, there are benefits to this approach in that you will be working directly with sellers, presumably without other buyers in the mix.

Buy-side Brokers: While the vast majority of business brokers for smaller businesses are on the sell-side, it is also possible to hire a buy-side broker to help you identify target companies and take you through the process. In addition to already having a robust network of brokers and sources of referral, a good buy-side broker will have an established process to identify “proprietary” deals by marketing their buyer clients directly to business owners.

Additionally, experience with valuation, negotiation, financing, due diligence and the other elements of a transaction can be valuable services even for experienced buyers. Most buy-side brokers charge a retainer plus a back-end success fee (% of the transaction value).

Retainers can range from a few hundred dollars a month to thousands, while success fees can range from a flat 5-15% for small deals to a “Lehman Formula” or similar stair stepped fee for larger deals (the basic formula is 5% of the 1st million, plus 4% of the 2nd million, plus 3% of the 3rd million, plus 2% of the 4th million, plus 1% of the 5th million in transaction value). If you choose to go this route, be sure to do your due diligence on the broker you are considering to ensure they have solid experience and can be trusted.



Quick Answer Takeaways:

- Define your search criteria.
- Sign up for listing updates.
- Look at brokered and non-brokered opportunities.
- Develop a network of “deal professionals”.
- Consider reaching out to business owners directly.

2. Pre-Offer Analysis and Valuation

Before sharing details on a business, most brokers and sellers will ask that you sign a non-disclosure agreement ([NDA](#)). You should not need to put money in escrow in order to get basic information on the business. As part of your pre-offer analysis, some initial high-level topics to explore with the seller or broker include the following:

- A general overview including the business' products or services, competition, industry, and the state of the business.
- The underlying technology, traffic, and platform.
- Revenue, profitability, and employee count.
- Any concentration risk with customers or suppliers.
- Specifics on ownership, motivation to sell, and the goals of a sale.
- Thoughts on valuation and deal structure.

Remember, when you are talking with sellers and brokers, it should be a two-way conversation. While you're assessing the business, the owner or broker is likely assessing your ability to buy and run it. Come prepared to answer questions about your background, goals and sources of financing. Once you have gained a high-level understanding of the opportunity, it is reasonable to request some basic financial information and detail on the assets that will transfer with the sale.

Business Financials: An initial information request usually includes 3 to 5 years of financial statements. Take the time to develop a spreadsheet that lays out income statements, balance sheets, and cash flow figures so that they can be compared across the years provided. How have the sources of revenue changed from year to year? Are the expense categories consistent over time or do they change? Are there noteworthy balance sheet items? Use your analysis to develop a set of questions for the seller's team that can help provide you with a more accurate picture of the business's history and any challenges that might lie ahead.



Business Assets: Gain a clear understanding of the physical assets and intellectual property that will be included as part of the sale. Also, understand the assets that are not part of the sale. If there are items contributing to business operations that will not transfer with a sale, your valuation should take this into account. Similarly, items above and beyond what is needed to run the business, such as excess inventory, will also have an impact on valuation. The next step after your pre-offer analysis work is complete is to place a valuation on the business. There are many different ways to value a business, from asset-based and market-based approaches, to an assessment of historic and future earnings. Different approaches are favored based on the size of the organization, its growth trajectory, the profile of the buyer, and the state of the business. For buyers of smaller, closely-held businesses, a few useful methods are:

- (1) the multiple of earnings method,
- (2) and the market value method.

Multiple of Earnings Method: For an owner-operated, web-based business, the metric often used as the number being multiplied is “Seller’s Discretionary Earnings” (SDE). [SDE](#) is typically calculated by subtracting the cost of goods

sold and operating expenses from annual gross income, and adding back non-recurring, non-cash and discretionary expenses. Operating expenses are the necessary costs to running the business and are non-discretionary. Examples of expenses that are often added back to the businesses’ earnings include owner’s compensation, depreciation, charitable contributions and personal vehicle expenses. For larger companies where the value is less tied to owner benefits, the metric often used as the number being multiplied is “Earnings Before Interest, Taxes, Depreciation, and Amortization” ([EBITDA](#)). For businesses that are rapidly growing, have recurring revenue models or have high value to the buyer, “Revenue” is often used as the number multiplied. Since our focus is owner-operated, online businesses, we will use SDE as our example metric, however many of the same principles apply for other metrics. Multiples for smaller website, and similar businesses usually range from 1.5x to 4.5x SDE. Determining where a business falls within the range is tied to the predictability of future earnings and the effort required to maintain and increase them. Greater predictability and less effort lowers risk and improves the multiple.

TIP: Keep enough cash on hand to run your business.



How Much Should a Buyer Pay

- Owner-operated web-based businesses often sell for 1.5x to 4.5x Seller's Discretionary Expenses (SDE)
- Value is linked to predictability of earnings and the effort required to maintain/increase them

Questions to consider:

- What is the business category (e.g. lead generation, content, membership/subscription, e-commerce, or software/SaaS)?
- Where does the business' traffic come from? Organic vs. Paid?
- What is the customer retention rate?
- How stable are the earnings?
- How vulnerable is the company to new entrants in the field? Is the business easy to replicate?
- How quickly is the business growing?
- How easily can the assets be transferred to a new owner?

Market Value Method: Reviewing “comps” can be a great way to check whether your valuation assessment is on target. Comps can be obtained through brokerages and marketplaces online. The Hatchit Marketplace [comp tool](#) is good place to start. As a first step, conduct a thorough search for business listings similar to that which you’re assessing. Next, narrow down the group, identifying the 5-10 businesses closest in type and size to yours. Add these businesses to a spreadsheet, calculating a multiple of SDE or Net Profit for each (be careful to ensure that the figures being multiplied are “apples to apples”). You may want to include notes for each on your spreadsheet, as their unique attributes may help to further refine your range (e.g. “does not include inventory valued at \$10k”, or “includes 5 patents”). Lastly, remember, the purchase prices you source online are “asking” vs. “selling” prices – you may need to take this into account when negotiating with a seller.

Business Description	Sales	SDE	Asking Price	SDE Mult.	Sales Mult.	Notes
eCommerce Small Pet Supply Business	\$ 718,287	\$ 108,136	\$ 375,000	3.47	0.52	Does not include \$10k inv.
Shopify Site in the Pet Care Niche	\$ 735,792	\$ 500,461	\$ 540,378	1.08	0.73	
Pet Products Brand eCommerce Business	\$ 3,462,961	\$ 687,779	\$ 2,650,000	3.85	0.77	2 sites
Animal Shelter Products eCommerce Sites	\$ 2,652,876	\$ 588,576	\$ 1,961,932	3.33	0.74	
Amazon FBM Site in the Pet Category	\$ 4,914,168	\$ 1,021,440	\$ 3,660,173	3.58	0.74	
	\$ 1,248,408	\$ 290,639	\$ 918,748	3.06	0.70	
Target Company	\$ 2,512,232	\$ 355,900	\$ 1,500,000	4.21	0.60	

Consider hiring a professional for an opinion of value

- CPA with valuation experience
- Business appraiser (ABV, CVA)
- Web business broker



Choose Someone to Value the Business: To further support your offer, you might consider engaging a professional for a third-party opinion on the value of the business. CPAs, appraisers, and business brokers are all good candidates to help with a valuation.

Other approaches beyond the Multiple of Earnings and Market Value methods include assessments based on assets, discounted cash flow, and capitalization of earnings. Make sure you understand the assumptions behind each approach before presenting the result to the seller.

Quick Answer Takeaways:

- Working with a seller is a two-way conversation.
- Gain a clear understanding of the assets for sale.
- Review comps as part of the business valuation process.
- Understand the valuation method used by a professional.

3. Deal Structure and Offer

The next step in the process is to make an offer on the business. Remember, your goal as a buyer is not to convince the seller of your viewpoint, but to identify a proposal that works for both parties. As such, there are a number of considerations beyond your analysis and value assessment to consider. Moreover, relationship building and trust through your discussions are critical components. A few things to consider:

Manage the Seller's Expectations: As you build rapport with a seller, it's common to want to avoid discussion of what you think the company is worth. This can lead to a lot of wasted time. It's best to manage the seller's expectations right from the start, particularly if there is a significant discrepancy between an asking price and what you are willing to pay. Be upfront with how you plan to finance the deal, especially if you expect the seller to finance a portion. As the deal progresses, make sure to specifically address anything "new" or misaligned with prior discussions, even if it's something that seems trivial.

It's easy to lose trust or create animosity when there are surprises, so work to proactively head them off. In-person meetings or video conferences are generally better alternatives to phone, text, or email when addressing sensitive topics, and it's often better to work through issues directly with the seller rather than through a team member.

Listen and Understand the Seller's Point of View: There are often personal factors influencing a business owner's decision to sell, and specific deal points that are important to them. You will have a better chance of reaching an agreement if you understand the owner's drivers and then tailor your offer and structure to address them. Some sellers, for example, hope the sale of their business will allow them to retire. How much cash will they need to receive after taxes from a sale to make this possible? Can you structure your offer to help get them there? Or maybe the seller has a family member involved with the business whose livelihood will be impacted with a sale. Is there a way you can keep this person involved post transaction?

Allow a Third Party to Wear the "Black Hat": Whether a CPA, an appraiser, a buy-side advisor, or other knowledgeable professional, it can be helpful to involve a third party

help you to maintain a strong, cordial relationship with the seller while at the same time making a case for a more favorable deal. Presentation of your position is key. Any written assessment of the business or its value should be clear, concise and easily understandable to the owner. The individual you work with should have a relevant background, present themselves professionally, and be able to articulate your position in a respectful way.

TIP: Listen to the seller and identify a proposal that works for both of you.

Start with a Simple, One-Page Term Sheet: When conveying your offer, it is advisable to initially do so in the simplest way possible. Distill your offer to its key points and place them in bulleted format on a one-page term sheet. Points conveyed should include the purchase price, payment terms, any personal guarantees, specifics on the assets or stock being purchased (and not being purchased), handling of accounts receivable, accounts payable and inventory at close, specifics on any non-compete or consulting arrangements, specifics on any property or other leases (or purchases), and any conditions to the offer.

Once accepted, you can develop a more formal Letter of Intent ([LOI](#)) to be reviewed by an attorney and signed by both parties. Beginning with a term sheet ensures the more formal, legal language of an LOI does not impede the seller's understanding of your offer, and helps to minimize attorney involvement.



**E-commerce Company
Non-binding Term Sheet
September 30, 2022**

- * Purchase price of \$1,600,000; closing on or before December 31, 2022
 - \$1,000,000 cash at closing (combination buyer equity and bank financing)
 - \$600,000 financed by Seller at 6% over 7 years
- * Purchase of business assets:
 - Includes
 - All tangible and intangible properties required to operate the business, including the website, all inventory, accounts receivable, furniture fixtures & equipment, customer lists and contracts
 - Excludes
 - Cash or cash equivalents, prepaid refunds or deferred tax benefits, personal vehicle
 - All other liabilities except as stipulated; debts of seller will be satisfied prior to closing
 - Assumes accounts receivable, accounts payable and wholesale inventory values of \$91,286, \$55,246 and \$227,011 respectively, as per June 30, 2022 internal financials. Purchase price will be adjusted up or down at closing to reflect change in value of these accounts.
- * Seller agrees to 5 year non-compete
- * Buyer may offer employment to any employee. Controller to remain with company in current capacity during transition
- * Buyer to negotiate a lease term with options to extend not less than 7 years, with option to purchase building
- * Conditions
 - Drafting and execution of an Asset Purchase Agreement
 - Completion of satisfactory due diligence
 - Formal approval of bank financing
 - Full time training and transition for one year; on call as required during year two
 - Other customary closing conditions
- * Response requested by October 14th, 2022

Quick Answer Takeaways:

- Make an offer that works for both you and the seller.
- Build rapport through your discussions.
- Be upfront about how you plan to finance the deal.
- Distill your offer to a one-page Term Sheet with key points.



4. Due Diligence & Pro-forma Financials

Once a letter of intent or similar document has been signed, the next steps are for the buyer to conduct a more formal due diligence and to develop [pro forma financials](#). The main goals of due diligence are to confirm that the business is in fact as presented, and to gain a clear understanding of the risks and opportunities associated with the business. The high-level areas of focus for due diligence are legal, financial, business operations and market. Gaining a clear understanding of these items will allow you to develop a thoughtful set of pro-forma (forward-looking) financials, so you can get a read on how the business' performance might look post-transaction.

Your Team: Depending on the size of the business and the skill sets you have personally, it may be advisable to hire others to help with due diligence. For larger business acquisitions, an attorney will typically drive legal

due diligence and a CPA will drive financial due diligence. You might also consider engaging a broker, buy side advisor, financial advisor, or industry consultant to help you assess business operations and build knowledge of the industry. When choosing team members, look for individuals with mergers and acquisitions experience and with as much specific knowledge of the space as possible. In addition to becoming knowledgeable about the business operations and industry, you will be the project manager through due diligence. Create a master list of all items you wish to address through due diligence, assigning them to team members and checking them off as they are accomplished. Professional assistance is expensive, so use your team members judiciously to get the information you need.

Legal: The purpose of legal due diligence is to assess whether the company you are acquiring is in [good legal standing](#) and whether there are items that could present future risk to you as the new owner.

The key areas to address include:

- *Corporate Structure* – review the corporate structure, capitalization, organizational documents and general corporate records of the company in order to ensure that everything is in order.
- *Taxes* – review historical income tax liabilities and assess any tax carryforwards and their potential benefits.
- *Intellectual Property* – understand the company's technology and intellectual property, as well as its protection.
- *Assets & Liabilities* – scrutinize the value of the assets that will be transferred with the sale, whether tangible or intangible, as well as all debts and liabilities against them. Your attorney can help with a lien search.
- *Contracts* – review all contracts and commitments of the company. Remember, if you are purchasing the company's assets (vs. its stock) you may need to update the contracts to reflect your new corporate entity as the signatory.
- *Compliance & Litigation* – probe any pending, threatened, or settled litigation, arbitration, or regulatory proceedings involving the company and whether the company has faced any regulatory or compliance issues.



Financial: Similar to an audit, the purpose of financial due diligence is to verify that financial statements presented are accurate, and to gain a clear understanding of items that could impact the future financial performance of the company. For larger acquisitions, a CPA or other third party can prepare a Quality of Earnings ([QoE](#)) report to detail the components of the company's revenue and expenses. The extent of financial diligence performed, and the quality of information available will vary considerably with the size of the company being acquired.

Some exercises that can help gain clarity on the business and its financials:

- Review 12 months of monthly and 3-5 years of annual profit & loss, balance sheet, and cash flow statements.
- Examine 3-5 years of tax returns.
- Trace bank statements to bank reconciliation, and reconciled statements to tax returns / general ledger; if possible, trace affiliate statements and/or merchant processor statements to bank statements.
- Review past Accounts Receivable and Accounts Payable balances against subsequent deposits and payments.
- Study customer and supplier concentration risk by reviewing sales and profit by customer and supplier.
- Perform a trend analysis of sales, COGS and expenses by category and year over year to understand trends and fluctuations.
- Confirm tax and payroll filings are current.
- Assess sales and use tax requirements and confirm compliance.



A photograph showing a business meeting. Two people are seated at a table, looking at a laptop. One person's hands are clasped over the laptop, while the other is holding a pen over a document. A glass of water is visible on the left. The background is slightly blurred, showing an office environment.

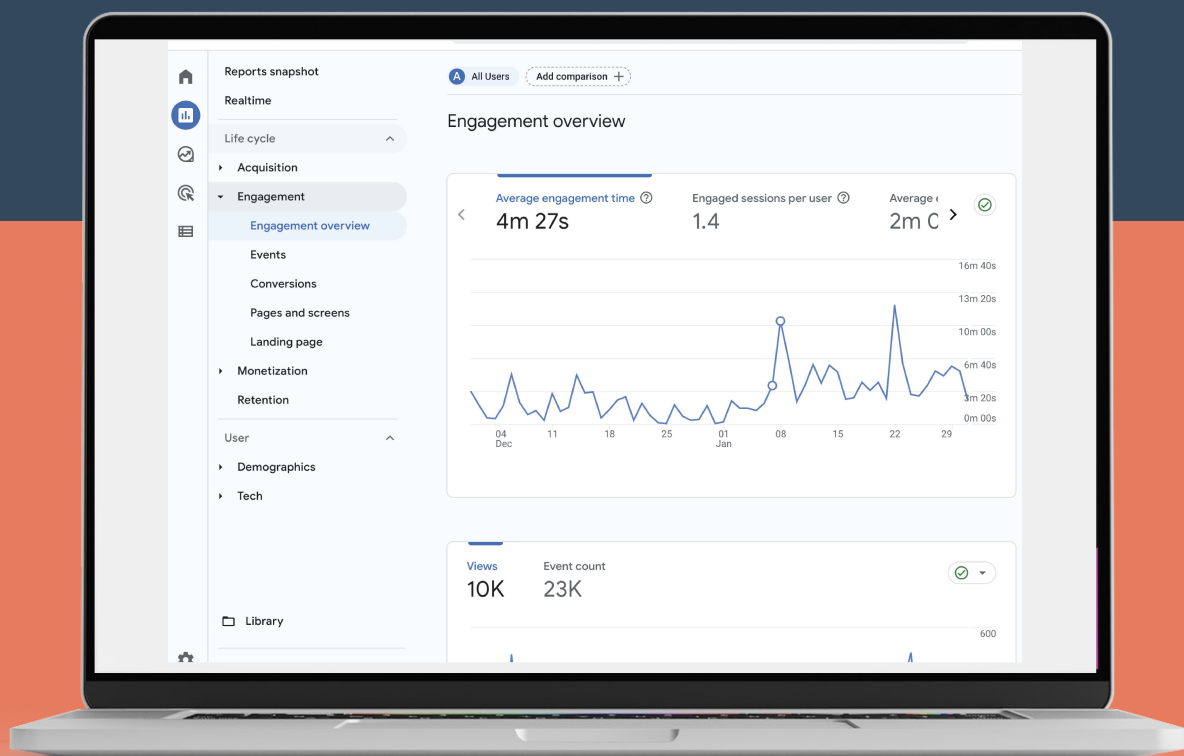
TIP: Verify what has been presented and potential risks to the business.

Business Operations: The purpose of business operations due diligence is to gain an understanding of the business' people, assets, technology, and processes. For online businesses, some of the most important assets are often the business' sources of traffic, its platform, and its reputation.

- *People* – Most importantly, can the seller of the business be trusted? You might consider a background check to determine if there is a criminal record and to confirm the validity of education, employment history and other activities from the owner's past. Determine what duties the seller performs at the business and whether you or your staff will be able to assume these. If the size of the business warrants it, create an org chart for the company with a short bio for each employee. Are there areas where experience is thin, potentially requiring future investment in training or additional staff? Are there areas of overlap with your skills? What changes do you envision over the next 5 years and how might that impact the financials? For larger businesses, you will want to review policies and procedures, assess employee benefits, plans, compensation and bonuses, and make sure the business is in compliance with all HR related requirements. You might want an HR expert to help with this effort. Finally, work with the seller to understand all contractor relationships and make sure you have their contact information. Remember, if you create a new corporate entity, you may need to put new employee and contractor agreements in place for your new corporation.

- *Digital Assets –*

Traffic – A key component of due diligence for an online business is understanding the nature of its traffic. Start with [Google Analytics](#) (GA4), [Ubersuggest](#), or other similar tools to analyze the traffic coming to the site. [Google Search Engine Console](#) is a good way for webmasters to check the indexing status of the site and its visibility. How many users does the site have per day, month, year? What is the engagement rate (ideally >50%), user behavior, site return rate, and how have these numbers changed over time? Where is traffic coming from and are the sources paid or unpaid (e.g. direct search, paid search, social media, referral, organic)? A website audit report will help you identify areas of strength and weakness. Make sure you understand the backlink profile, the specific sources of referral traffic, whether the sources are paid or unpaid and whether paid traffic is appearing on the company's financial statements. An untrustworthy seller could take advantage of a buyer by paying for, and not accounting for or disclosing, traffic and backlinks, artificially improving the site's search engine ranking.





Platform – It is important to gain an understanding of the platform upon which the business is built to ascertain whether it is a viable solution for the business as it grows. This requires an assessment of the platform itself as well as the plugins and extensions used. Is the technology likely to be viable and supported over the long term? Will the current set up allow for growth? Similarly for software and SaaS businesses, you should have the code reviewed to ensure that it is proprietary and of high quality.

Reputation – Understanding a business' reputation, both online and offline, is a critical component of due diligence. Check out reviews, message boards and other online venues to see what customers are saying about the business and its products/services. Sometimes owners will allow a buyer to conduct a customer survey, perhaps posing as a marketing consultant. The seller may be persuaded to allow this if you agree to provide a written report of the results and remind the seller that the information will be useful to the business whether or not the transaction consummates. Similarly, are there posts from current or future employees about working at the company? This can be valuable information. As a final step prior to closing, the seller may allow you to meet with the employees. If you receive this permission, you can inform them about the sale and confirm that they plan to continue with the business post-transaction.

Other Assets – While we have emphasized traffic, platform and reputation given our online focus, there are of course a wide variety of assets that can be conveyed as part of a business acquisition – tangible and intangible. Whether inventory, equipment, real estate, patents, domains, or insurance policies, you should have a clear understanding of the items included in the sale, their value, and confirmation that the seller is the owner of the items. For larger businesses with inventory, it is common for a third party to conduct an inventory assessment to assess its quality and whether its value has been captured accurately in the financial statements.

- *Technology* – In addition to the business' platform, you will want to understand the broader technology infrastructure, and the level of IT investment that will be required to maintain and grow the company. This means an assessment of the company's network, software, databases, computers, mobile devices, outsourced relationships, subscriptions and other IT-related items. With larger businesses, a third party assessment can be helpful. With smaller businesses, it is important to understand the seller's role in maintaining the IT infrastructure. If you are stepping into the seller's shoes, is this a role you are comfortable handling?



- *Processes* – Lastly, you will want to ensure you have an understanding of the business' internal processes, both to assess whether they present any risks to you as the new owner, but also to equip you with the knowledge you will need to run the business. Questions will vary widely depending on the type of business you are acquiring, but examples of questions include: How does the company acquire customers? How are products sourced? How do customer orders flow through the company's systems? How are orders ultimately fulfilled and recorded? What is the flow of customer communication? How is financial record-keeping handled? How are employees' schedules managed? How are personnel issues addressed? Consider gaining an understanding of company procedures by interacting with the company as a customer – order a product, send an email to customer service, or subscribe to the newsletter.

Market: Market due diligence is unlike other aspects of due diligence in that information is gathered from outside of the company rather than from within, with the purpose of understanding industry trends, the competitive landscape, and the buyers and vendors in the market. When buying an online business, it is important to investigate the underlying market, not just its category. For example, if you are conducting due diligence on an e-commerce business that resells fridge and HVAC filters, your due diligence should include learning about the market for fridge and HVAC filters. What opportunities or risks might be on the horizon? How, for example, will “smart” refrigerators and IoT connected HVAC systems impact the market? In addition to conducting secondary market research from written reports and materials and on the web, you will benefit greatly by conducting primary market research – talking with individuals who are intimately involved in the market and can answer your questions. For example, you might reach out to staff members with an industry association, individuals who work with similar (non-competitive) companies, consultants in the space, or visit a trade show to meet industry participants. What changes are happening in the market? Are there competitors that could pose a threat? What opportunities might not be obvious?

Similarly, you can learn a lot about the competitive landscape in a market by understanding the customer’s perspective. Try ordering a fridge or HVAC filter from Amazon and Lowe’s and compare the experience with that of ordering from the company you are evaluating. What are the positives and negatives of each experience? Lastly, research the company’s suppliers. Are they large, reliable vendors, or is there product availability risk? Are there substitute suppliers, or do they hold power over their customers?



Pro-forma Financials: An important exercise for any buyer, regardless of the size of the business being acquired in an M&A deal, is to develop a set of [pro-forma](#) (forward looking) financials. The goal of pro-forma financials is to assess your income, cash flow and balance sheet after the transaction, taking into account the new expenses you will have as a buyer, and removing expenses that are no longer relevant after the sale. Your pro-forma financials will ideally include monthly figures for the first year, and annual figures for 2-4 years following. It is important to include monthly figures for the first year, as that is when the business is at its most vulnerable from a cash flow perspective. While you are learning to operate the business, you may also be paying off debt, making investments, and perhaps paying the seller under a consulting agreement. Your pro-forma financials will help you assess the amount of debt you can afford to take on with the purchase, understand the amount of working capital you will need, and gauge your return on investment under different assumptions. You might consider working with your CPA on pro-forma financials as part of your financial due diligence.

A few items to think about when developing the document:

- Start with the company's historic financials – add back expenses no longer pertinent (e.g. the former owner's salary) and include new expenses (e.g. your salary).
- Include *your* debt service – interest payments should be included as a pre-tax expense while principal payments are an after-tax expense.
- Take into account the timing of cash flows, particularly for the first year – when will you *actually* get paid and when will *payments actually be made*?
- Include your expected capital expenditures.
- Make sure fixed and variable expenses are properly categorized.
- Develop conservative, moderate, and aggressive forecasts.
- Include a row on the spreadsheet that tracks your cumulative cash to assess the months and years in which the company is at its most vulnerable – ensure you have sufficient working capital (money) to cover these stretches of time.

Quick Answer Takeaways:

- Gain a clear understanding of the risks and opportunities in the business.
- Develop your own set of pro-forma financials.
- Create a master list of items to be assigned for due diligence.
- Know the competitive market as well as the customer experience.

5. Acquisition Financing

How you choose to fund your business acquisition could set you up for success or be a drag on your bottom line. While nearly half of business purchases are made in cash, looking to leverage your purchase with another funding source or two might give you a better return on your investment.

A few questions to keep in mind when reviewing your options:

- How much cash do I have available for a business purchase?
- How much debt am I comfortable taking on?
- How much free cash flow do I need the business to generate to cover my loan payments?
- Might the seller consider a seller note?
- Am I comfortable leveraging my home or retirement savings?
- Am I comfortable with an equity investor?

Depending on how you answer the questions above, some of the following options will appeal more to you than others.

Seller Financing: Sometimes sellers will agree to underwrite a portion of the buyer's debt as part of a purchase. This can help close a deal more quickly, especially if you are not a good candidate for a traditional loan. The amount a seller will allow you to finance is usually not more than 60% of the purchase price. The length of the contract is often 5-7 years and can feature a balloon payment at the end. Of course, if other buyers are offering all cash, you will likely be at a disadvantage.



Home Equity Loan: If you have more than 20% equity in your primary residence, a Home Equity Installment Loan (HEIL), aka “second mortgage,” or a Home Equity Line of Credit (HELOC), could be good options to consider. You will want to allow a cushion in case your home’s value declines, but generally your interest rate will be competitive, if not better, than other financing alternatives. Lenders will look at the equity in your home, your credit score, and your debt-to-income ratio as part of a decision.

Traditional Bank Loan: Getting financing for an existing business is often easier than for a startup, but it can still be challenging. An existing business will need a good track record of strong cash flows and assets. You’ll also need a very good personal credit score and may need to put down up to 30% of the purchase price in cash. A line of credit for your business is also a possibility, if you don’t need to finance the whole purchase and just need help managing cash flow. For example, you may be asked for a business valuation, a record of your business experience, and a business plan.

Lenders will likely want to see the following:

Personal Finances:

- Personal credit score
- Business credit score (if you already own a business)
- Tax returns
- Cash flow statement
- Outstanding debts

Finances of Acquired Business:

- Balance sheet
- Business tax returns
- Profit margin

TIP: An SBA backed loan makes a bank more likely to lend.





SBA Loan: Some business sellers will advertise that their business is eligible for a Small Business Association (SBA) [loan](#), meaning that the seller has pre-qualified the business for an SBA-based acquisition loan. An SBA guarantee can help get banks comfortable with a loan because the government agency is shouldering some of the risk. If a business is not advertised as SBA qualified, you can still apply for one through an eligible lender. The SBA has high standards for qualifying a business and a purchaser, so while desirable, it is not easily obtained. Here is a summary of the main loan types (subject to change):

- Standard 7(a): Up to \$5 million, 5-10 business day turnaround, 75% guarantee for loans over \$150,000, 85% guarantee under \$150,000, up to 10-year line of revolving credit.
- Small Loan 7(a): Up to \$350,000, 5-10 business day turnaround, 75% guarantee for loans over \$150,000, 85% guarantee under \$150,000.
- SBA Express: Up to \$350,000, 36-hour turnaround, up to 50% guarantee, up to 7-year line of revolving credit.

401k Business Financing: This type of financing is known as ROBS, Rollover for Business Startups. Offered by [Guidant Financial](#) and others, it allows you to use your IRA or 401k assets to invest in a new business. Essentially, the retirement fund becomes an investor by buying stock in a newly formed C Corp. You can then use that cash to help buy the business or manage your cash flow like a line of credit. You will need at least \$50,000 in your retirement account to qualify. This type of financing is often used as a second or third tier when needed. The downside is that if your business fails, your retirement savings will be jeopardized.

Investor Funding: To avoid the burden of debt and share the risk of an acquisition, some buyers will look to take on investment partners. An investment partner could be a family member or friend that wants to help you get into business, or it could be an angel, institutional investor or crowdfunding partner seeking a return or fee related to their investment. Partners may want equity in the business, a share in the profits, or a simple monthly loan payment. Most small business investors opt for a debt payment, because there is less risk involved. If you have a fast-growing e-commerce business, then an investor may opt for an equity investment or convertible note that could convert to equity in lieu of repayment. This allows the investor to get an interest payment at a fixed rate for an established period, and also enjoy the benefit of upside if the business does well. The Small Business Investment Companies [SBIC](#) has a venture capital program consisting of equity and debt that includes SBA dollars along with private funds. The basics are:

- Debt: \$250,000 to \$10 million loans; 9% to 16% interest
- Equity: \$100,000 to \$5 million investments
- Debt with equity: \$250,000 to \$10 million; 10% to 14% interest

Whichever path you choose, make sure you have a written agreement and that you are comfortable with the terms. Having an attorney review the document is always advisable. Also, depending on the situation, you may be required to get an [exemption](#) under federal and state securities laws (e.g. Reg D) or register as a private offering with the SEC.

Lastly, you will need some cash on hand to run the business and to ensure that any loan payments are manageable. Weighing the pros and cons of each option before moving forward on an acquisition will put you in a stronger position for the future. Owning a business can provide a nice income and lifestyle, but you have the best chance of success when you secure the right funding mix for your deal.

Quick Answer Takeaways:

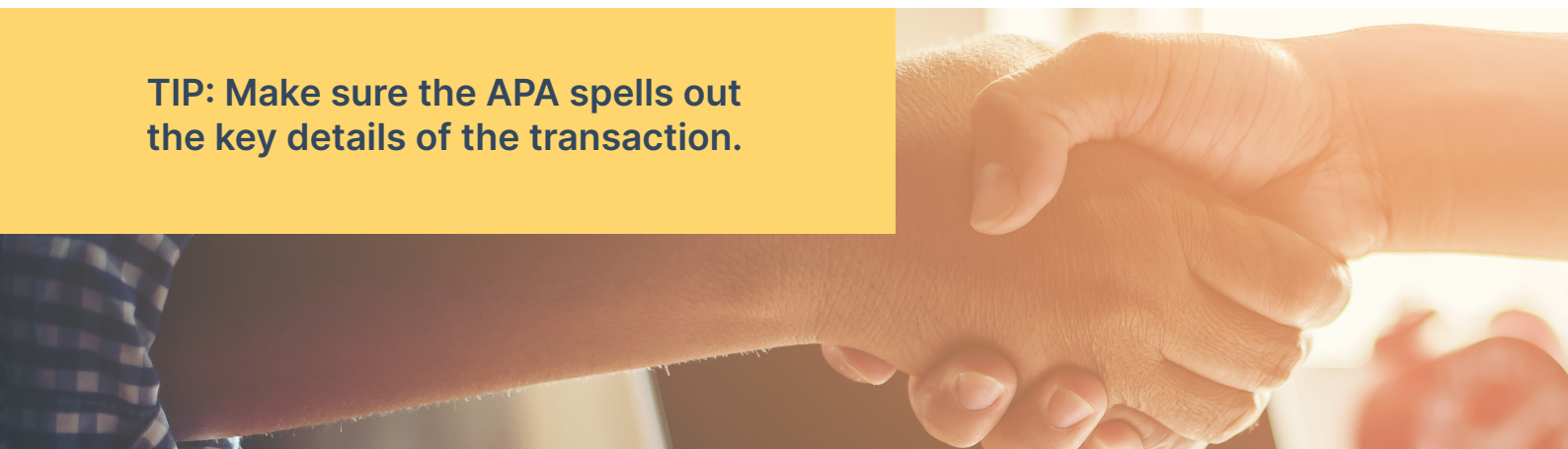
- Consider a mix of different funding sources.
- Make sure the cash flows of the business will meet any debt obligations.
- Keep enough cash (working capital) on hand to run the business.

6. Purchase Agreement & Closing

Depending on the complexity and size of the transaction, a [purchase agreement](#) can be very simple or very complex. While a simple transfer of a digital asset may only require a bill of sale, the acquisition of an income-producing business is typically accompanied by an Asset Purchase Agreement (APA) or Stock Purchase Agreement (SPA). Most acquisitions are asset purchases, meaning that the buyer transfers the tangible and intangible items owned by the company from the seller's corporate entity into a different corporate entity owned by the buyer. These items generally include everything from the website, customers, and inventory to trademarks, patents, and goodwill. By contrast, in a stock purchase, the buyer acquires the seller's business entity itself, which includes all of the assets and liabilities contained within. In either case, you will want to work with an M&A attorney and CPA to help you decide which route is best for your situation based on the legal, financial, and tax implications of your purchase. Since most owner-operated, web-based business transactions are asset purchases, we will focus on things to consider when drafting your APA.

Asset Purchase Agreement (APA): The APA is generally a far more robust document than a [Letter of Intent](#), often 20-40 pages, addressing many of the same items as the LOI but in greater detail. The key elements of an [APA](#) include a complete list of the assets being purchased (and not being purchased), liabilities assumed, the purchase price and how it will be paid and allocated for tax purposes, details on the closing and post-closing adjustments, seller and buyer representations and warranties, and the handling of disagreements post-transaction. There are typically schedules attached to the APA, including financials, organizational documents, contracts, permits and other key items upon which the purchase decision was based. Lastly, there are often separate agreements simultaneously signed at closing that handle elements of the transaction that fall outside of the APA, such as non-compete or consulting agreements.

TIP: Make sure the APA spells out the key details of the transaction.



A few things to consider when working with your attorney to draft an APA:

- Be specific when identifying included assets – detail domains, content, subscriptions, plugins, contracts, inventory and all other components of the business.
- Confirm that the seller owns the assets you are buying and that they are transferable to the new corporate entity.
- Think through how you can retain some leverage with the seller post-transaction. A seller note or escrowed funds will leave you in a stronger position if, for example, the seller does not deliver on training or other promises.
- Consider language where you have recourse if the seller does not deliver on promises (e.g. the seller note is reduced accordingly).
- Optimize the asset allocation and explore creative ways to minimize taxes on the deal – with different depreciation schedules, some asset categories are more tax friendly for the buyer than others (e.g. “Personal Goodwill”)
- Small deals do not need big contracts – speak up if you feel the template your attorney is working from is overkill.

Quick Answer Takeaways:

- An APA is the most common agreement used for a digital business purchase.
- Confirm the assets you are buying and that they are transferable.
- Try and maintain some leverage over the seller post-transaction.

We hope you took away a few insights that will help you successfully complete a business transaction. Feel free to [browse](#) businesses for sale in our deal directory. [Email](#) us with any comments, suggestions, or insights of your own.



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