Case Study:
Buy-side hidden risks

Lack of reporting and controls

Overview

A $ 5MM twenty-five-year-old business services company was for sale. As the industry leader, the company's methodologies had become the industry standard. The company enjoyed an excellent reputation in the market along with a strong customer base.   During the economic downturn, the company continued to have steady growth and profitability.

The company experienced strong growth during a downturned economy.

With a new, experienced management team to take the company forward, the founders would be staying on. Market conditions, as well as the company's services and reputation, presented excellent opportunity for expansion.

Challenge

As a life-style company, the two founders would take all cash out of the company each year. As a result, they felt no need to have an accounting or project management system in place.

The lack of financial reporting and controls added to the difficulty in analyzing the company and understanding where potential trouble spots may exist.

Normal buy side financial analysis did not identify hidden risks.

Benchmark Findings

We benchmarked the company against 167 same size competitors in its industry. While the company's sales where growing at 10% its COGS was growing at 20% while for the same period the industry sales were flat and COGS was declining.

Overall the company's financial scorecard was rated in the bottom 10% of the industry. Some key financial ratios were:

- Current and quick ratio – **ranked in the industry bottom 6% and 9%.**
- COGS - **75.3% higher than the industry.**
- Gross profit margins – **ranked in the industry bottom 10%.**
- EBITDA – **ranked in the industry bottom 10%.**
- Collection period – **ranked in the industry bottom 10%.**

Conclusion

Analyzing a privately held company for an acquisition can be challenging since many of these companies are run on a life-style basis and accounting practices are aimed at reducing the tax burden.

The lack of financial reporting and controls added to the difficulty in analyzing this privately held company for sale. Financial benchmarking ranked the financial health of the company in the bottom 10% of the industry. Several critical hidden financial risks and performance gaps were identified, making the acquisition even more challenging moving forward.