FEINTERNATIONAL

GUIDE TO BUYING AN ONLINE BUSINESS

A definitive guide to the successful purchase of an internet business

IBBA INTERNATIONAL BUSINESS BROKERS ASSOCIATION, INC.® · MEMBER IN GOOD STANDING ·

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Foreword

Thank you for downloading this 'Guide to Buying an Online Business'.

This book has been put together to help inform, educate and advise individuals interested in potentially acquiring an online business.

Over the following pages we take an in-depth look at the reasons to invest in an e-business, what investment options are available and what buyers should look for in any acquisition. The book then shifts focus to the practical aspects of executing a business purchase, giving best practice advice on business search, structuring an offer, conducting due diligence and closing the deal safely and successfully.

We hope you enjoy reading it and find the information found within these pages useful for your business dealings in future. If you have any questions, comments or feedback please don't hesitate to get in touch.

The Brokerage Team

FE International

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Chapter 1

Why Buy An Online Business?

‘For business, our internet love affair was a gift from the gods.’

- Gary Vaynerchuk

Why Buy An Online Business Versus Offline?

Investors looking to acquire a business typically start the process contemplating what business model is right them, which sector(s) they want to invest in and what they want to get out of the experience personally and financially.

Every buyer is different but there are some common investment objectives across the market such as strong profitability, good growth potential and operational flexibility. Though there are many options in the traditional offline business-for-sale market, an increasing number of investors are starting to realise that benefits offered by online businesses could actually be superior on all fronts.

This section explores the rapid growth of the internet and the rise of the online business. It explores some of the operational and financial advantages of e-business models and how investors can reap significant benefits through investing online.

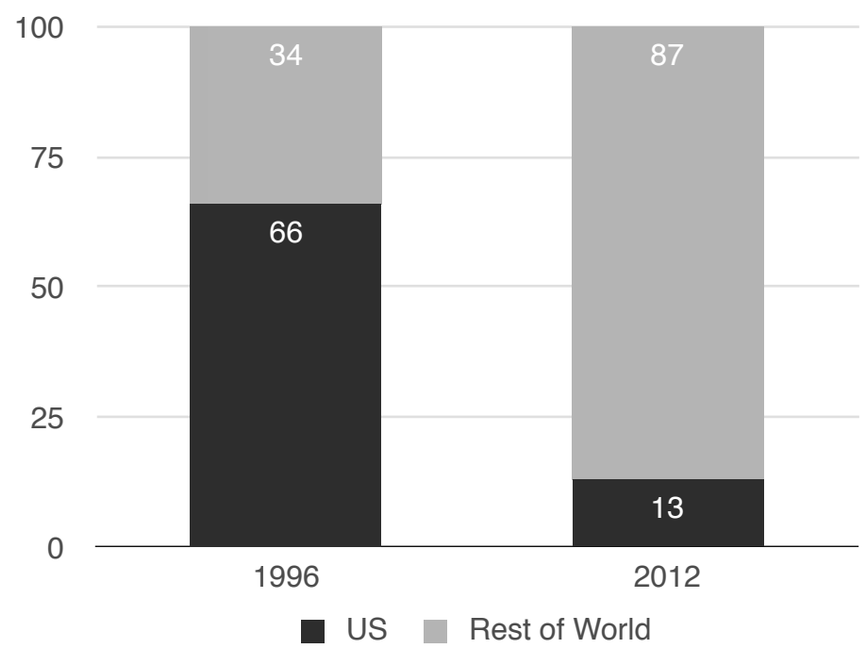
SIX REASONS TO BUY AN ONLINE BUSINESS

- *Tap into the explosive growth of the internet, across mobile and desktop*
- *Leverage remote working to realize significant operational cost savings*
- *Make instant changes in marketing strategy and track customers real time with unrivaled granularity*
- *Generate a passive income stream and create the freedom to pursue other things*
- *Relative ease of scalability*
- *Own a high return asset with liquidity*

Internet Facts

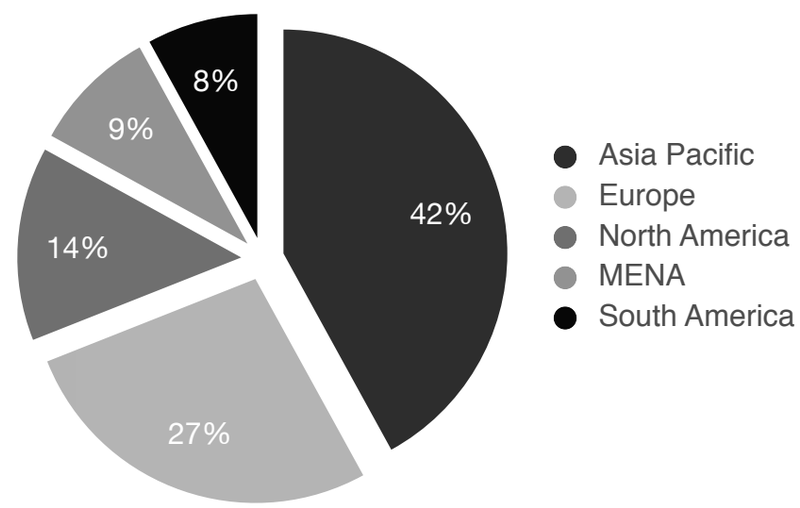
- The number of internet users globally has increased six-fold in the last 10 years
- The proliferation of smartphones and tablets has served to double overall usage
- Global eCommerce is forecast to grow from $1.5 trillion to $2.4 trillion in 2017
- Digital advertising revenue is now worth $37bn in the US alone, rising 5x faster than any other medium
- $7.7bn was spent on banner advertisements alone in the US in 2012

The explosion in growth of internet users and usage in the last decade is remarkable. It was estimated there were 2.7bn internet users globally in 2013 (39% of global population), up more than 6 times on 10 years ago. The demographic has switched significantly too, in 1996, 66% of internet users were from the US and now that figure is just 13%, with Asia and Europe accounting for nearly 70% of all internet users.

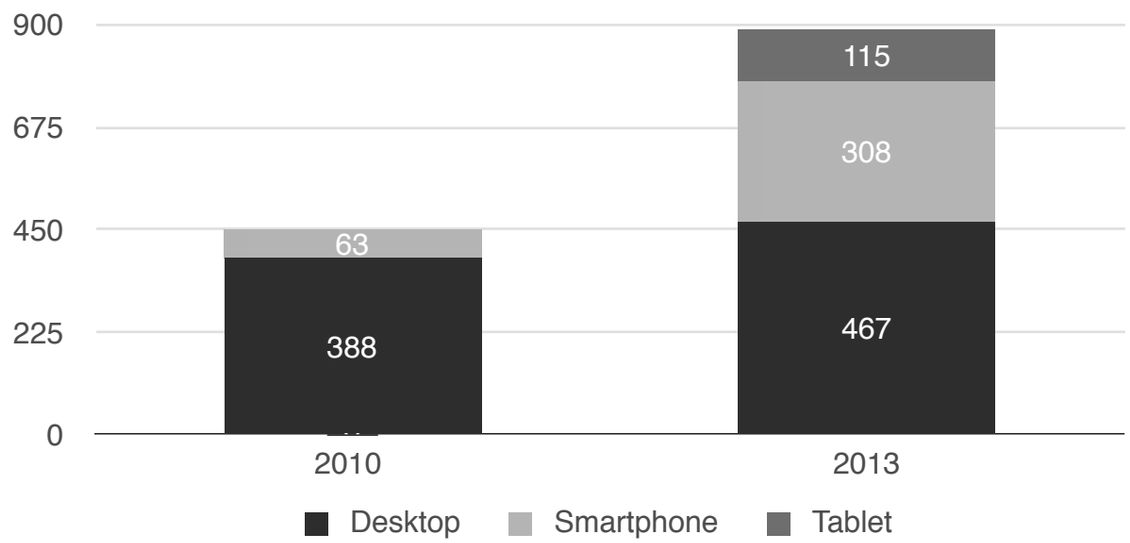


Percentage of internet users located in US vs. RoW (1996, 2012). Source: ComScore (2012).

Increased penetration of smartphones and tablets has been a major driver of both internet adoption and average usage time. Multi-device ownership is increasingly becoming commonplace in developed markets with 1 in 4 smartphone owners in the US and Western Europe also owning a tablet. Early signs from these markets indicate that multi-device has not served to cannibalise desktop browsing but instead complement it with overall usage time rising.



Percentage of global internet users by region (2013). Source: ComScore (2013).

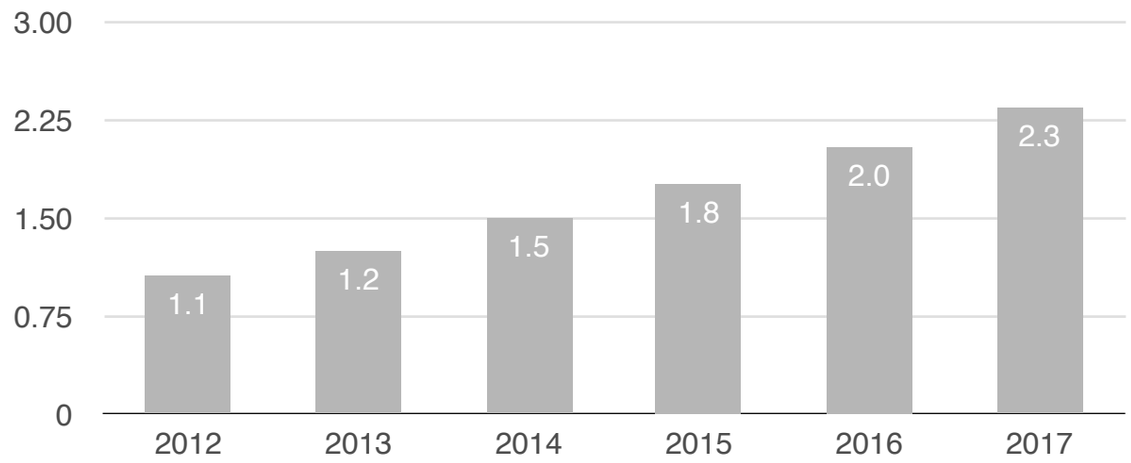


US total internet time spent (billions of minutes).
Source: ComScore.

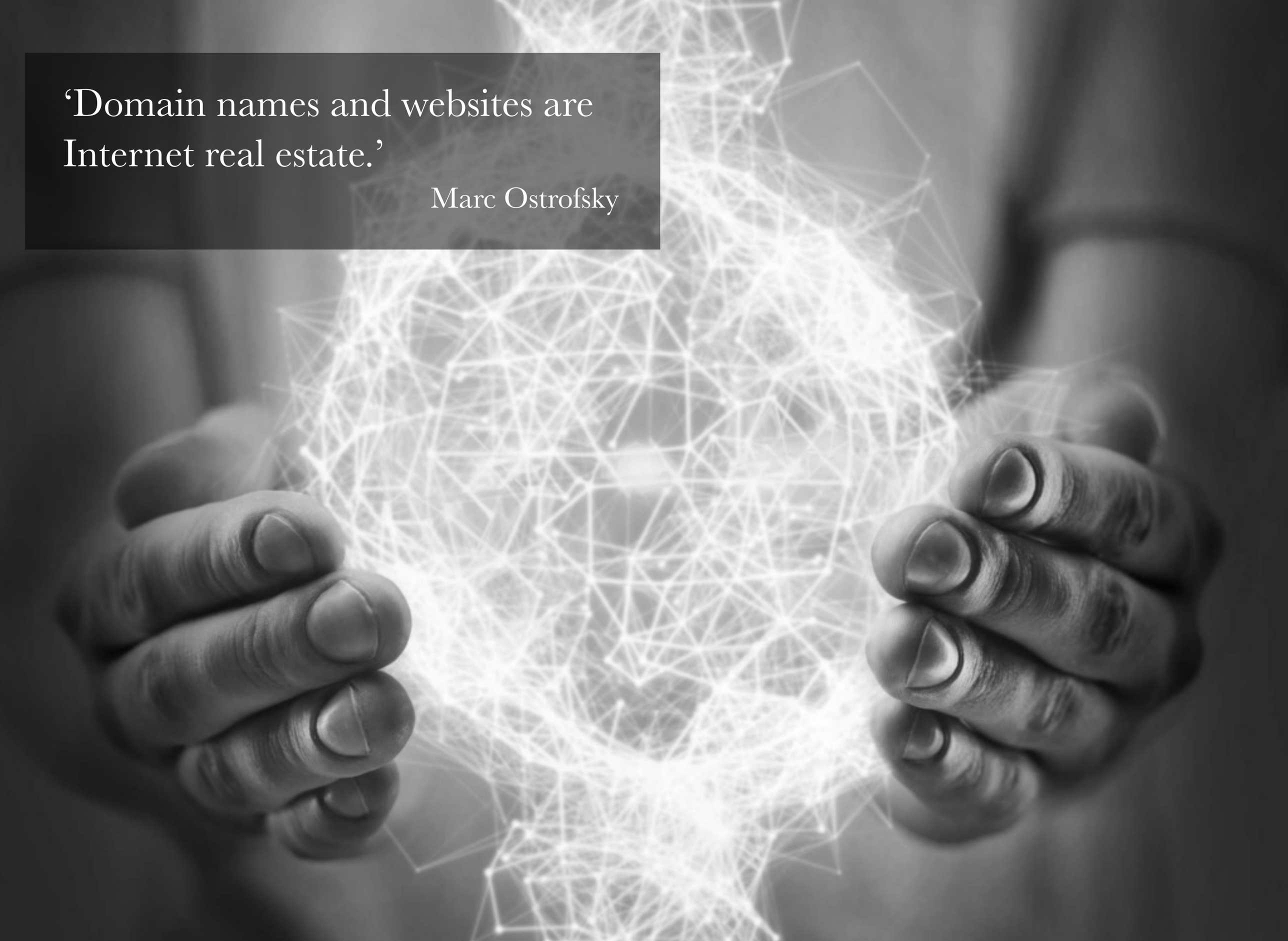
But what does all of this mean for online businesses and for a buyer looking to acquire one? Firstly, the number of consumers online is growing significantly each year and as the internet becomes an increasingly popular purchasing channel, eCommerce businesses will continue to experience explosive growth.

According to eMarketer's latest forecasts, worldwide business-to-consumer eCommerce sales will increase by 20.1% this year to reach $1.5 trillion, up a staggering $400bn from 2012. That growth is coming primarily from the rapidly expanding online and mobile user bases in emerging markets, increases in mobile commerce as well as improved shipping and payment options for customers. Interestingly, the latest research indicates online consumers are more valuable than offline ones. In a recent comprehensive study of European consumers, the consultancy firm McKinsey found that 38% of online buyers had household income of >€40,000 versus just 25% for offline channel buyers.

Secondly, the attractiveness of the internet as an advertising medium for major brands continues to rise with the growth in internet adoption and value of the eCommerce market. Digital advertising revenue is now worth $37bn in the US alone, second only to TV, and rising at 15% per annum (5x faster than any other medium). Don't think that it is just search engines benefiting from increases in advertising spend, though, $7.7bn was spent on banner advertisements alone in the US in 2012 . Website owners with authoritative content in the right niches and of course the right traffic can command a good price for onscreen real estate.



B2C eCommerce sales worldwide, 2012 - 2017, trillions.
Source: eMarketer (2014).



‘Domain names and websites are Internet real estate.’

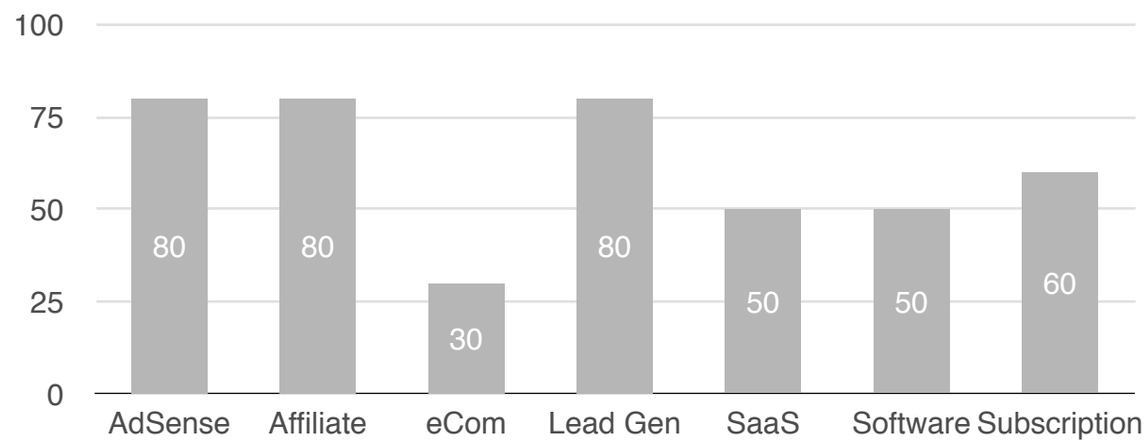
Marc Ostrofsky

Superior Operating Margins?

An often cited benefit of the online business model are the potential cost savings. There are typically much lower start-up costs when creating and running a website. Without physical assets there is no large capital outlay and instead the focus for many online businesses is on creating relevant content and outreach (not always the case with SaaS or Software etc).

With so many e-business models and unique monetisation methods, accurate studies on the differences in cost structures between on and offline businesses are somewhat sparse. One good comparison is an analysis of profit margins between retailers, e-tailers (click-and-brick operations) and pure eCommerce stores. Matt Carroll at FailHarder has written extensively on the economics of each. His analysis of the average profit margin achieved in the apparel niche (he models the sale of shoes) shows retailers on average achieve 51% gross margins whilst eCommerce achieve 65% through charging for shipping. Note, gross margin doesn't then take into account the savings in operating expenditure for the online model (rent, utilities, employees) which can take the typical net margins of eCommerce stores to ~30% versus ~10% for offline equivalents.

Asides from eCommerce, there are a number of e-business models that offer very attractive profit margins to business owners. Using data from the sale of over 150 online businesses over the last four years at FEI, we have compiled the net margin comparison table below for the most common business models:



EBITDA margin percentage comparison for the most common online business models.
Note: owner's salary excluded.
Source: FEI (2014).

Online Provides More Marketing Insights

Great marketing is at the heart of many successful businesses and the online space is no different. What is interesting about internet marketing is that whilst it requires a slightly different skill set to traditional businesses it offers a number of major benefits versus marketing in the offline world.

The tools and strategies for marketing to consumers online provide much more data to the marketer in terms of customer engagement, relationship building and fine tuning of the conversion funnel.

> "The aim of marketing is to know and understand the customer so well the product or service fits him and sells itself."
>
> — Peter Drucker

Make changes on the fly

Marketing online allows business owners to instantly split test new landing pages, site layouts, order forms, email sequences, newsletters, all within the click of a button.

Track real-time results

With internet traffic, webmasters often have enough of a customer sample to observe the impacts of changes in just a few days or a week allowing analysis and decision-making in a comparatively short time period and with low operational impact on the business.

Target specific demographics for marketing

The rise in social media as a platform for marketing has enabled internet business owners to target specific demographics and customer profiles (e.g. age, gender, ethnicity and location). Paid-traffic campaigns can be run on specific locations to expand awareness in particular areas (local and national) as well as driving the right traffic to the business.

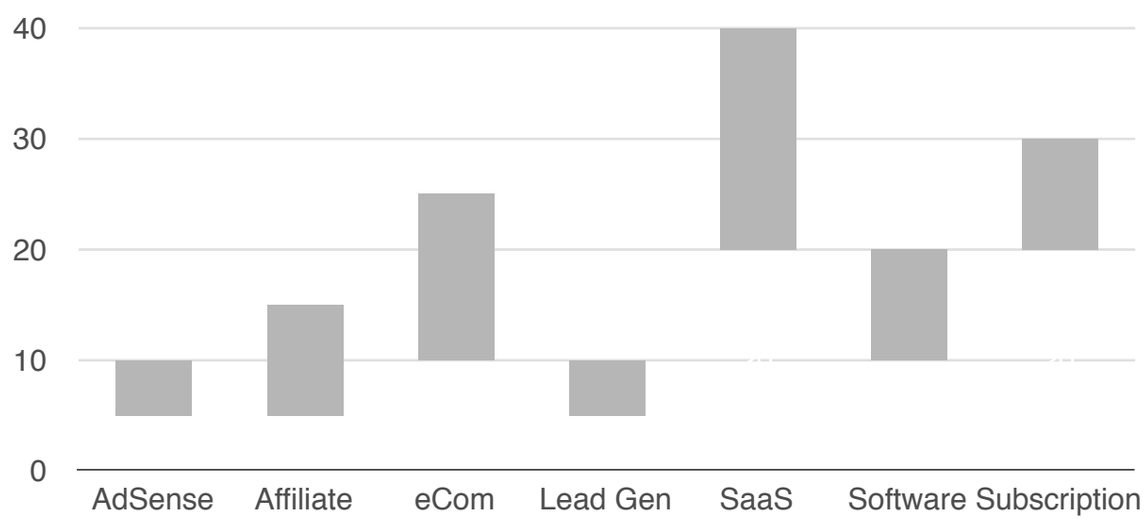
Variety of methods in marketing online

Online marketing strategies are increasingly adopting a multimedia approach to create and develop relationships with consumers, embracing content across email, audio, video, blog, social media and newsletters. E-mail marketing has been shown to be a powerful tool to help raise brand awareness, build relationships and generate revenue.

Online Provides More Freedom

One of the major draws of the online business model is the ability to operate from home and in fact anywhere in the world. With more people looking to supplement income from their main jobs, the attraction of an online business as a means of passive income is on the rise. Latest figures show 1 in 6 people in the UK alone (8m people) are operating an online business from home as a way to do this.

Without employees and infrastructure to manage, the owner time commitment on a well-established online business can be very low. Using the same transaction data, we have compiled an estimate of the average owner time commitments for the most common online business models:



Average hours per week spent by owners on the business.
Source: FEI (2014).

Ease Of Scalability

Operating an online business can require little in the way of ongoing costs and a generally lower time requirement can often mean it is easy to own and run several e-businesses simultaneously. Comparatively speaking, with an eCommerce business versus a traditional offline retail business, it would be significantly more onerous to acquire or open another physical store. It may take years to raise the funds and find the right location with enough footfall and a lengthy lease could be required to secure the premises.

Operating online is somewhat simpler in this respect; owners can take a model in one niche and apply it to another with relative ease if they have the relevant experience and knowledge. There is little or no physical presence required and there is often opportunity to synergise staffing. Buyers can use their skills and resources across their entire portfolio, significantly increasing their ROI and financial independence.

Greater Liquidity Than Offline

Any prudent investor should be mindful about the liquidity profile of their investments and buying an online business is no exception. The good news is that a website is typically a much more liquid asset than an offline business. Given most online businesses are geography-independent and quite often simpler from an operational standpoint, there is a lot of investor demand and shorter due diligence periods during sale.

At FEI, depending on the size and complexity of the asset, we typically see websites sell within 24 hours of listing to 3 months with the average being somewhere in the middle. Many offline businesses can take 6 or more months to sell with 3 of those in due diligence alone.

Businesses That Help The Environment

Whilst probably not a deciding factor in a decision to make an online vs offline business acquisition, being environmentally conscious is becoming increasingly important in this day and age. An online business offers significant carbon footprint savings with fewer employees, remote working (thereby no transportation costs) and no requirement for utilities like water and heating. Information is processed electronically and stored online too which helps to save paper. Research shows that approximately 65% of total emissions generated by the traditional retail model stemmed from customer transport. Accordingly, online retailers use 30% less energy than traditional retail operations. Clearly though the internet does present more demand for power consumption but research conducted by the ACI found that eCommerce will still achieve a net reduction of 1 billion tons of greenhouse gas emissions per annum, constituting 11% of US annual oil imports.

Online Versus Offline: The Key Is Getting The Right Fit

Operating in a high growth environment with superior margins and often a reduced time commitment, an online venture should be an attractive alternative to a traditional offline business. That is not to say there aren't other considerations though. Some businesses will require more work than others and that may be of a technical or bespoke nature. It's important as a buyer to approach any business acquisition taking due consideration of background, skill set and acquisition goals.

‘Fools build houses, and wise men buy them.’

Proverb

Build Or Buy A Business?

The decision to build a business or buy an existing one is an important one investors should take from the outset. Three important considerations for the decision are time available, funds for investment and resources accessible to the buyer.

This section explores some of the benefits and drawbacks of buying an online business versus building one from scratch and looks at how investors can make a quick decision based on their personal situation and business objectives.

FOUR REASONS TO BUY AN EXISTING BUSINESS

- *The business model has already proven itself, a buyer can enjoy positive cash flow right away*
- *Gain existing assets, years of customer data, supplier relationships, intellectual property, that can be leveraged for growth*
- *Improve the business from a fresh perspective and with different knowledge, contacts and resources*
- *Leverage the existing knowledge of seller*

Advantages Of Acquiring An Existing Online Business

There are a number of advantages to acquiring a business versus building one from scratch.

- *The business model has already proven itself, a buyer can enjoy positive cash flow from day 1*

Being able to hit the ground running is one of the most attractive things about buying an established business. From day one, the business will be making a new owner positive cash flow and has a proven business offering.

- *Gain existing assets, years of customer data, supplier relationships, intellectual property, that can be leveraged for growth*

Particularly where the business has a long history, the tangible and intangible assets associated with the business are very rich. For example, the intellectual property attached to a software business that has been developed and successfully monetised for five years is very high.

- *Improve the business from a fresh perspective and with different knowledge, contacts and resources*

Often business owners are looking to sell because they have run out of inspiration or energy to continue to grow their venture. It is quite common for buyers with a different skill set and resource base to come in and add significant value right away. In the online space, this is most often seen with buyers who bring fresh sector or internet marketing experience that hasn't yet been employed in the business. The rate of the subsequent uplift in value can be startling.

- *Increase an existing market position*

If the buyer already operates in the niche and is looking to expand the business' activities either directly or with a complementary offering, then strategic acquisition may make a

lot of commercial sense.

★ *Leverage the existing knowledge of seller*

Having access to the seller's contacts and experience is invaluable, especially if the buyer is acquiring a business with a long history. Sellers usually commit to a minimum period of transition assistance post-sale (see section "Transferring the Business" in Chapter 4) which is a valuable for buyers to master the operations of the business as well as learn some unique and beneficial market information.

Disadvantages Of Acquiring An Existing Online Business

There are also a few potential drawbacks to acquiring a business.

★ *Takes a significant amount of upfront capital*

Typically businesses sale for a multiple of their annual earnings (see more on this in the section 'How to Value on An Online Business') which for can be a significant capital outlay. Whilst this can be partially mitigated with creative financing there is an initial hurdle of upfront consideration that an investor should be willing to sacrifice for inheriting the assets and associated goodwill.

★ *Inherit the previous owner's issues*

Not always obvious is the potential to inherit the previous owners operational problems when taking over the business. This could be for example poor quality content and backlinks, lack of customer service, soured relationships with suppliers or haphazard internal processes. It is always highly recommended to conduct proper due diligence to avoid purchasing something with insurmountable faults.

★ *Risk of loss*

As with many investments, there is potentially a risk of losing some or all of the initial consideration when purchasing an existing business. Many times a loss comes from a lack of work by the buyer so its important to correctly assess the time and skills required to run the business being acquired.

Buyers should look to actively manage this through exercising cautious business judgement from the outset, conducting extensive due diligence during the acquisition process and employing a financing structure that matches their risk/return profile.

Advantages Of Building A New Online Business

It is worth taking a similar approach to analysing the merits and drawbacks if building a business from scratch.

★ *May cost less in the long run*

Typically online businesses have low startup costs and it is possible to create a new website with professional design, outsourced content and basic SEO for relatively cheap. In the initial stages then a build approach can be comparatively much less expensive. Naturally though, building a compelling value proposition and marketing it to customers can take substantially more time and money.

Buyers should always aim to compare the cost of building vs. buying on any new acquisition opportunity.

★ *Gain first-hand knowledge and experience*

Either through success of failure, entrepreneurs will always know more at the end than the start.

★ *Full control over the quality*

Starting an online business from scratch means that important things such as SEO, monetization strategy and testing, products and services, customer service, direction to take the business, etc. can be under control from the outset.

Disadvantages Of Building A New Online Business

★ *Takes a significant amount of time and resources*

There are no guarantees of success in business and this especially stands true with starting a business from scratch. Just as in the offline world, a high percentage of online businesses struggle to take off, remain consistently profitable or worth the owner's effort. An established business can help solve these issues from the outset.

Final Thoughts

Clearly there are a wealth of advantages and disadvantages to both building and buying with only a handful of these considered in these pages amongst the array of other factors that are personal to each particular buyer.

For most investors it seems in principle to be a trade off between time, inclination and knowledge. As a buyer you should carefully consider these in your decision and see how buying versus building may be a better fit. If you remain interested, Chapter 2 overleaf goes in-depth on what potential options are available.

Chapter 2

Investment Options

‘Know what you own, and know why you own it.’

Peter Lynch

Choosing The Right Business Model

The internet has become a breeding ground for imaginative ways of making money, from software services delivered through the cloud to products sold through eCommerce websites to channeling customers onwards to affiliate networks.

There are a wealth of e-business models to invest in and many online ventures are an amalgamation of two or more monetisation styles. As an investor, it pays to have a good understanding of each model, its strengths and weaknesses and suitability for the buyer's own background, time requirements and risk appetite.

This section explores a range of popular e-business models, discusses their strengths and weaknesses and classifies them into seven common categories.

'Opportunities multiply as they are seized.'

– Sun Tzu

Interesting Marketing Facts

- Email opens on smartphones and tablets have increased 80% over the last six months (Litmus)
- By 2016, more than half of the dollars spent in US retail will be influenced by the web (Forrester)
- The average yield for email marketing is $44.25 for every dollar spent (OptiMind)
- Consumers who receive e- mail marketing order 28% more often than others (OM)
- Blogs are 63% more likely to influence purchasing decisions than newspapers (OM)

1. Advertising

The web advertising model is one the simplest and most popular e-businesses. It is the internet's digital extension of the traditional media broadcast model. Effectively a website provides content, usually for free, interspersed with advertising messages in the form of banner ads or other ad placements.

Naturally the value of this type of business is in the volume of traffic that the site has, the demographic of visitors and usually the niche it is in. Content sites come in many forms including blogs, forums, news and informational sites etc. Webmasters of these sites have a range of advertising payout models to adopt (see box overleaf).

Advertising Monetisation

- **Pay-Per-Click**: advertising revenue is generated by users clicking on the web advertisement.
- **Pay-Per-Lead**: advertising revenue is generated when users click and sign up through a web advertisement.
- **Pay-Per-Action**: advertising revenue is generated when users click and purchase something through a web advertisement (the site owner receives an agreed % commission of the sale value).
- **Pay-Per-Impression**: advertising revenue is generated by users viewing the web advertisement. This is usually paid per thousand impressions (CPM).

There are two common avenues for monetising content via online advertising: 1) through an automated advert delivery platform and 2) via direct adverts. Google AdSense is by far the most common ad-delivery network and generally speaking is one of the best paying for the average webmaster. Second tier alternatives include Media.net, Chitika and Matomy. The other option is to organise advertising relationships directly with relevant product/service sellers. This more hands-on approach requires some time investment from the site owner but often translates into improved advertising terms.

High quality content sites with a strong traffic profile are typically very attractive to buyers as they offer relatively secure income with low maintenance requirements.

2. Affiliate

An affiliate business model is one where the business exclusively sells other suppliers' products and services in exchange for a commission payment that is an agreed percentage of each sale. Affiliate marketers are effectively independent sales entities that are paid on a performance basis (i.e. when an actual sale is made). Websites use tracking codes which identify who referred the sale to them.

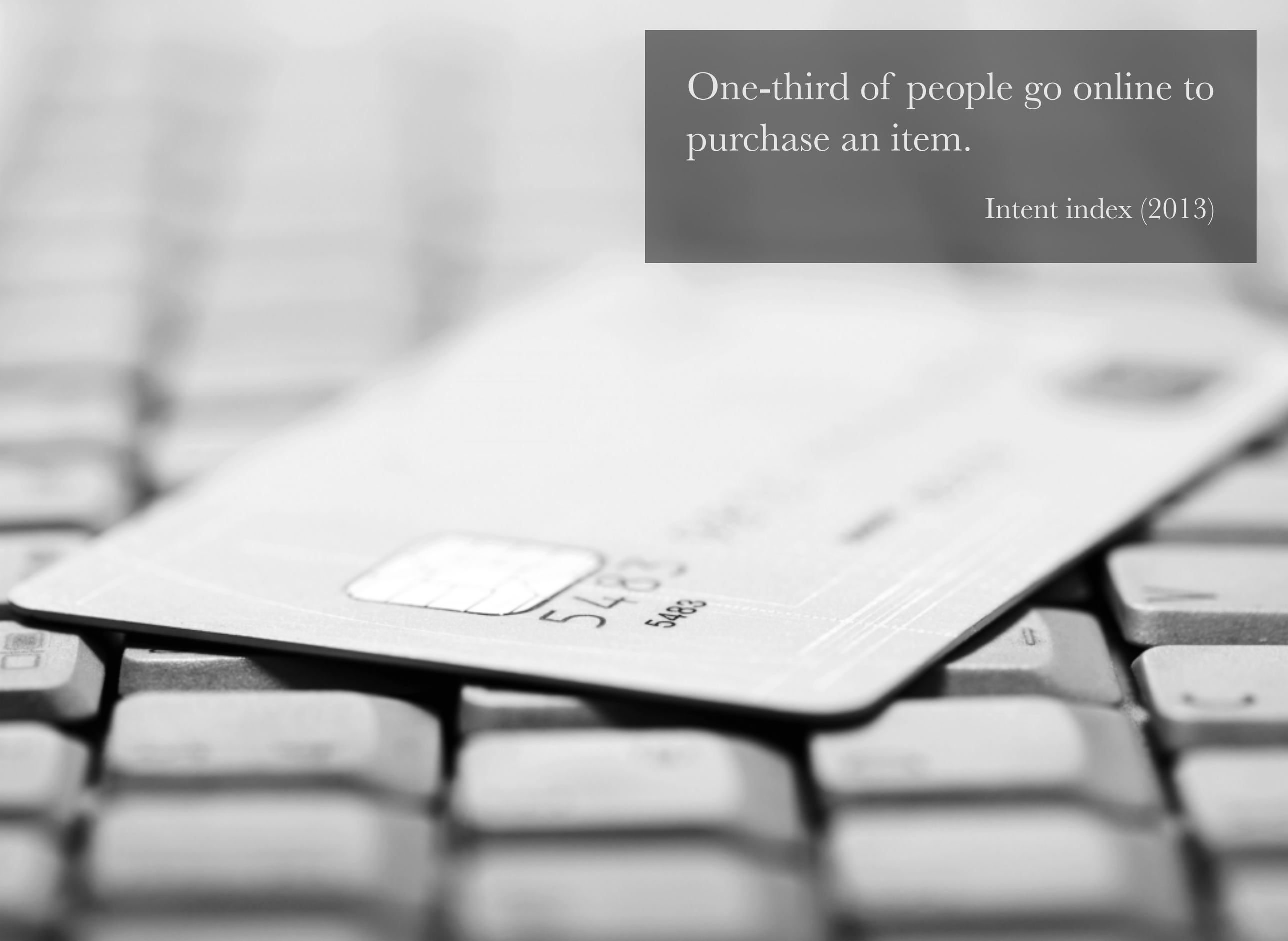
Some of the major affiliate programs include ClickBank, Amazon and Commission Junction. In some cases affiliate marketers can receive c.50% of a sale (especially with digital products) but this usually ranges from anywhere between 5% to 75% depending on the product and the niche. Typically physical products are at the lower end of the spectrum and digital at the higher end of the payout range. Usually, there are higher tier payouts for those who send a high volume of sales.

Successful affiliate marketing sites are ones that have become an authority product referrer, usually through building high quality content around the product or service being sold.

3. eCommerce

eCommerce has been a dominant theme of the internet for the last decade and is one of, if not the most common e-business model. By definition, eCommerce is buying and selling of products and services over the internet. There are different types of eCommerce sites depending on the approach to inventory and

eCommerce sites tend to be attractive to both online and offline investors as retail experience can often translate well into this model. The market is very large and growing with global eCommerce forecast to grow from $1.5 trillion to $2.4 trillion in 2017, mainly driven by mobile.



One-third of people go online to purchase an item.

Intent index (2013)

distribution taken.

Store - A store approach requires the site owner to hold inventory, ship the product and effectively take control of the entire supply chain.

Dropship - Becoming more common is the dropship model where the eCommerce store acts as an online platform for selling goods but outsources the storage and shipping of the products to the original supplier. Naturally there is some margin reduction in a dropship model but it also cuts out the logistical burden of running a retail store and allows the owner to focus on internet marketing which is typically their core competence.

Brokerage - Somewhere in between store and dropship is the brokerage model which brings buyers and sellers together, facilitating but not actively participating in the transaction. Marketplaces like eBay and Fiverr are good examples of this.

eCommerce sites tend to be attractive to both online and offline investors as retail experience can often translate well into this model. The dropship approach is generally favoured as physical warehousing and responsibilities for logistics can for many outweigh the natural benefits of owning an online business. Buyers reviewing eCommerce businesses should focus on product margins, owner time involvement as well as traffic sources, trends and sustainability.

4. Lead Generation

Lead Generation business models are those where a website is used to attract traffic and convert users into leads for a sellable service (e.g. car insurance). Typically the site owner creates a website of relevant content for the lead-type and then employs an internet marketing strategy to attract traffic to the site. User information is collected (usually through a customer form) and then the lead data is sold to companies interested in marketing to or selling to those collected leads. The quality of the lead (contact information, conversion rate) will correlate heavily with the price paid.

An example of a lead generation business is LendingTree.com, where they use radio advertisements, Google Adwords, SEO, etc. to drive leads to the site and then sell these to banks and mortgage companies. Another good example is QuinStreet. QuinStreet works in a series of verticals to develop proprietary content sites, publisher partnerships, ad placements, email campaigns, etc. to develop a lead flow, and then sells that on to buyers at a higher price per lead than they are paying overall to acquire the leads.

The main focus with a lead generation business is establishing a higher revenue-per-lead (RPL) than the total cost-per-lead. Owners of lead generation businesses can arbitrage paid traffic well if their conversion rate and RPL is higher than the CPC of

Software and Software-as-a-Service (SaaS) businesses are popular with investors, particularly those that operate a recurring revenue model.

running AdWords (or equivalent). Lead generation businesses can be very high margin (80%+ net margins) and relatively hands-off once established. Buyers reviewing lead generation businesses for potential acquisition should focus on traffic sources and sustainability, owner time involvement and of course conversion rates for both leads and sales.

5. Software

Software businesses often spring up from hobbyists looking to create a relevant product within their niche. Usually the developer has created a niche software product and either opted to sell through word of mouth and referrals or to employ affiliates to sell it via an established partner network such as ClickBank. Software businesses can be set up with either one-time or subscription-payment types depending on the nature of the product and the customer base.

Buyers looking at software businesses should focus on the marketing strategy, traffic sources, quality and integrity of the software's source code as well as technical requirements for future upgrades.

6. Software-as-a-Service ('SaaS')

Software as a Service or 'SaaS' is a business model where users pay a subscription to rent software hosted online instead of purchasing it outright and installing it locally on their computers. SaaS is at the core of centralised or cloud computing with the aim being that users can run their computer tools as online rented products. All of the processing work and file saving is conducted on the internet with users accessing their tools and files using a web browser.

Users benefit from reduced upfront cost of ownership, quick and easy access with immediate upgrades, no need for additional hardware and often much better technical support as well as customer care.

SaaS businesses are becoming increasingly popular for online acquisition as, like subscription businesses, they typically employ a monthly or quarterly billing model and enjoy a strong amount of recurring income. Again, acquirers should be focussed on the strength of the base, churn, monthly-recurring-revenue (MRR) and customer lifetime value (CLV). Often SaaS businesses are backed with a high amount of content marketing to get users into the conversion funnel and onto a subscription. They also require a strong technical support system in place for good customer care.

7. Subscription

The Subscription business model is where users are charged a periodic – daily, monthly or annual – fee to subscribe to a service, commonly a content offering (e.g. Netflix, Listen.com). A number of these businesses combine free content with premium (i.e. member-only) content (referred to as a "freemium" model. Often converting customers into long-term billing relationships requires time and effective marketing so many successful subscription models have a well-refined internet marketing strategy and conversion funnel in place.

Subscription businesses are attractive for online acquisitions as they typically employ a monthly or quarterly billing model and therefore enjoy a significant amount of recurring (vs. 'one-off') income which is held in high(er) regard. Acquirers should be focussed on the strength of the customer base, churn rate, customer lifetime value ('CLV') and the associated customer acquisition costs.

Choosing The Right Business Model

The internet has helped create a number of e-business models and investment opportunities for buyers. We have outlined seven of the main models we see, but many can fall into more than one

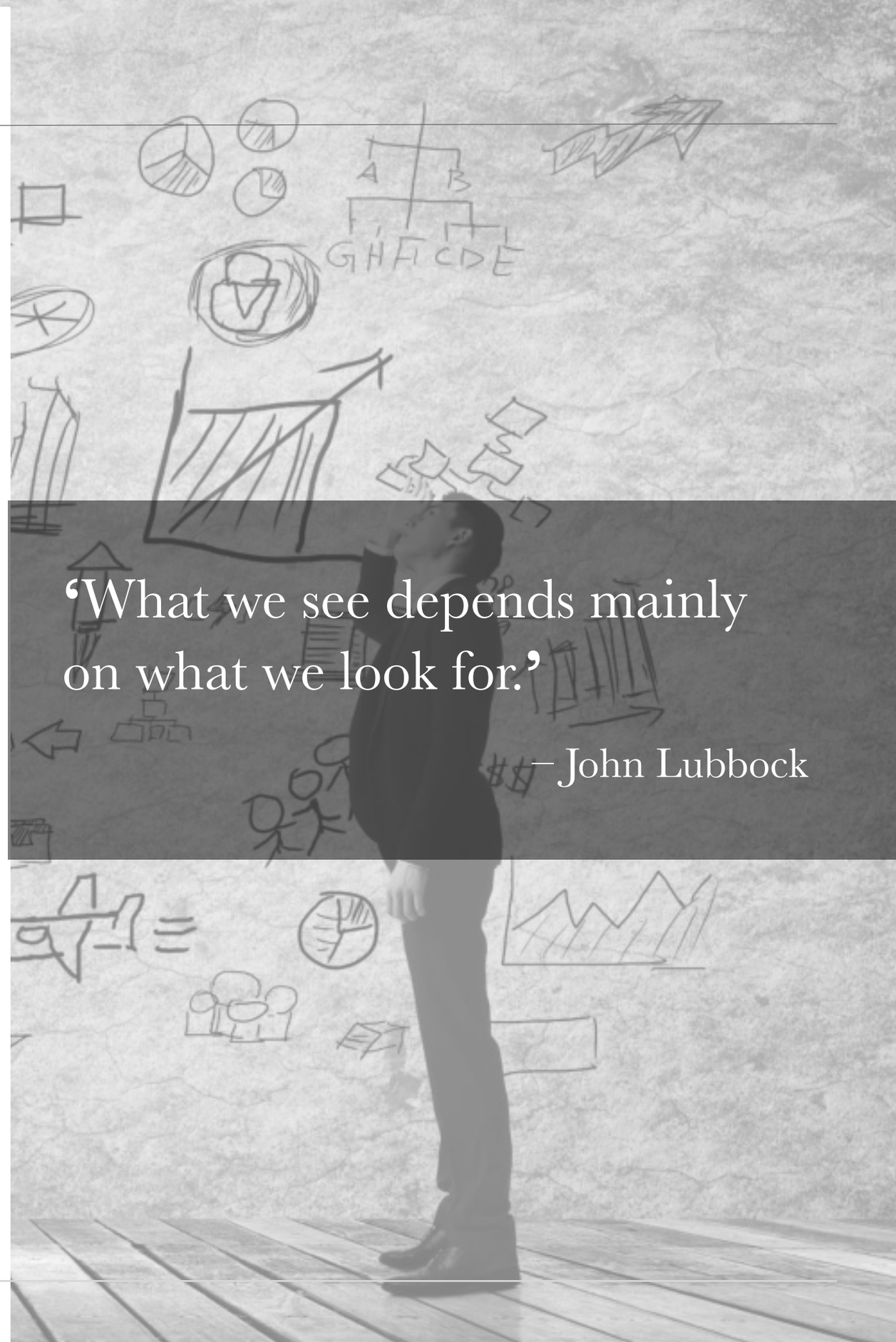
category or be rotated for fuller effect. Ultimately, the key to acquiring the right business (both on and offline) is for buyers to know their strengths and limitations, leveraging their experience and put these together into a growth plan for the business.

Whichever business model(s) an investor takes a preference for, there are a few golden rules when it comes to reviewing a business for potential acquisition. The next section goes into detail on precisely this.

What To Look For In An Online Business

Purchasing an online business, particularly for the first time, can be a nervous experience for many buyers. With an online business, most of the assets are intangible and it can be hard to connect with the value of the purchase. It is therefore important as a buyer to understand what makes an online business valuable and viable for long-term growth to provide the comfort needed to conclude a business purchase.

This section explores three of the most important aspects for buyers to look at when buying an online business. Understanding these will help save time and energy during the search process and help maximize return on investment, by starting with a strong foundation from the outset.



Tips For Traffic Verification

- Diversity - ensure the business has a mix of traffic from the main sources: search, paid, referral, social and direct
- Backlinks - conduct a thorough audit of the backlinks for the site, especially if it relies heavily on search traffic
- Historic performance - analyse each traffic source historically and in detail. Take care to notice any spikes and overlay this with changes in search engine algorithms or other events

Traffic is the life blood of most online businesses and buyers should be careful to audit it's sources and trends.

Traffic

Thousands of people may walk past a storefront, a few hundred may come in and browse, and some will purchase an item. Traffic that reaches a website is the equivalent of customers walking through the door, that's why it is the most critical component of a healthy online business. When looking at the traffic of a potential online business to purchase, buyers should pay attention to the following:

Diversity

Typically the most robust online businesses will have a mix of online traffic from the main sources: search, paid, referral, social and direct. Relying too heavily on one source of traffic is risky, particularly search where sites leave themselves at risk of algorithm changes by Google. Make sure if the site has a high percentage of search traffic that the site is compliant with Google best practices and be sure to audit the history against previous

Google updates.

Backlinks

Google and other search engines place high value on the quality and quantity of natural backlinks to a website. Buyers should take a careful audit of the backlink profile of an online business, monitoring for any anomalies in links and link-building strategies. See the section 'Due Diligence' in Chapter 4 for more on this.

Historical Performance

Buyers should take heed to closely examine every source of traffic and look for trends as well as unexplained spikes. Was the site affected by a Google update, if so, why? Has referral traffic been on a decline as of late? Are there traffic sources that the current owner has yet to pursue? There are a number of useful sense checking metrics including time on site, pages viewed, which will help give a sense of the quality of traffic. See the section 'Due Diligence' in Chapter 4 for more on this.

Financials & Growth

Just like any business acquisition, buyers should take care to review the financials of the business in depth. For online specifically, investors should look for the following:

Trends

Check for trends in the revenue over the lifetime of the business. Did it peak after its first year and has been trailing off over the last 6 months? Is it a seasonal business that sees higher revenue during the holidays and slower elsewhere? Always ask to see financial data in monthly increments to clearly see the direction the business is heading. If it's moving downward, fully understand what would be required to revive it.

Expenses

Every online business has expenses such as hosting, domain renewals, web content, and marketing, but not every online business owner spends intelligently. Look for overspend in stated expenses that could by cut or reallocated right away to increase profit. The biggest culprits are usually hosting and marketing. It's also important to look for expenses that seem unreasonably low or the owner failed to mention for the business model, such as payment processor fees, refunds for software products or on-going writing requirements for content sites.

Growth Potential

It should be a priority for buyers to develop a strong growth strategy for the business they are acquiring unless it is a purposely passive investment. There are numerous ways to increase revenue from existing traffic as well as build new traffic channels. Examples include hiring a Conversion Rate Optimization (CRO) service to audit the site for improvements in the conversion process, starting or increasing expenditure on paid traffic or starting a social media marketing campaign.

Personal Fit

Its very important for buyers of all backgrounds to be sure about taking a business on that they have the time to properly manage and the confidence or experience to take it to the next level. Even if making an acquisition of a passive investment, it should still ideally align with a buyer's personal strengths, interests and investment strategy.

A useful exercise to run through is to envision working on the site – considering the skills and experience required for the business model and the niche. Consider the after sale training and support and whether this as well as any third parties can fill in the gaps. Most importantly, does the business generate excitement and interest.

Time

No matter how passive an online business is, there is still some level of planning involved to maintain stability or growth in the dynamic online environment. Buyers should determine a realistic amount of time they are willing to spend per week running a business and allow for additional time in the weeks following an acquisition to embrace the inevitable learning curve.

Budget

As with any other investment, it is always good advice for buyers to only invest an amount which they are comfortable with. Investing too much from the outset can cloud a buyer's judgement post-sale and also potentially leave to little working capital if required to grow the business.

Conclusion

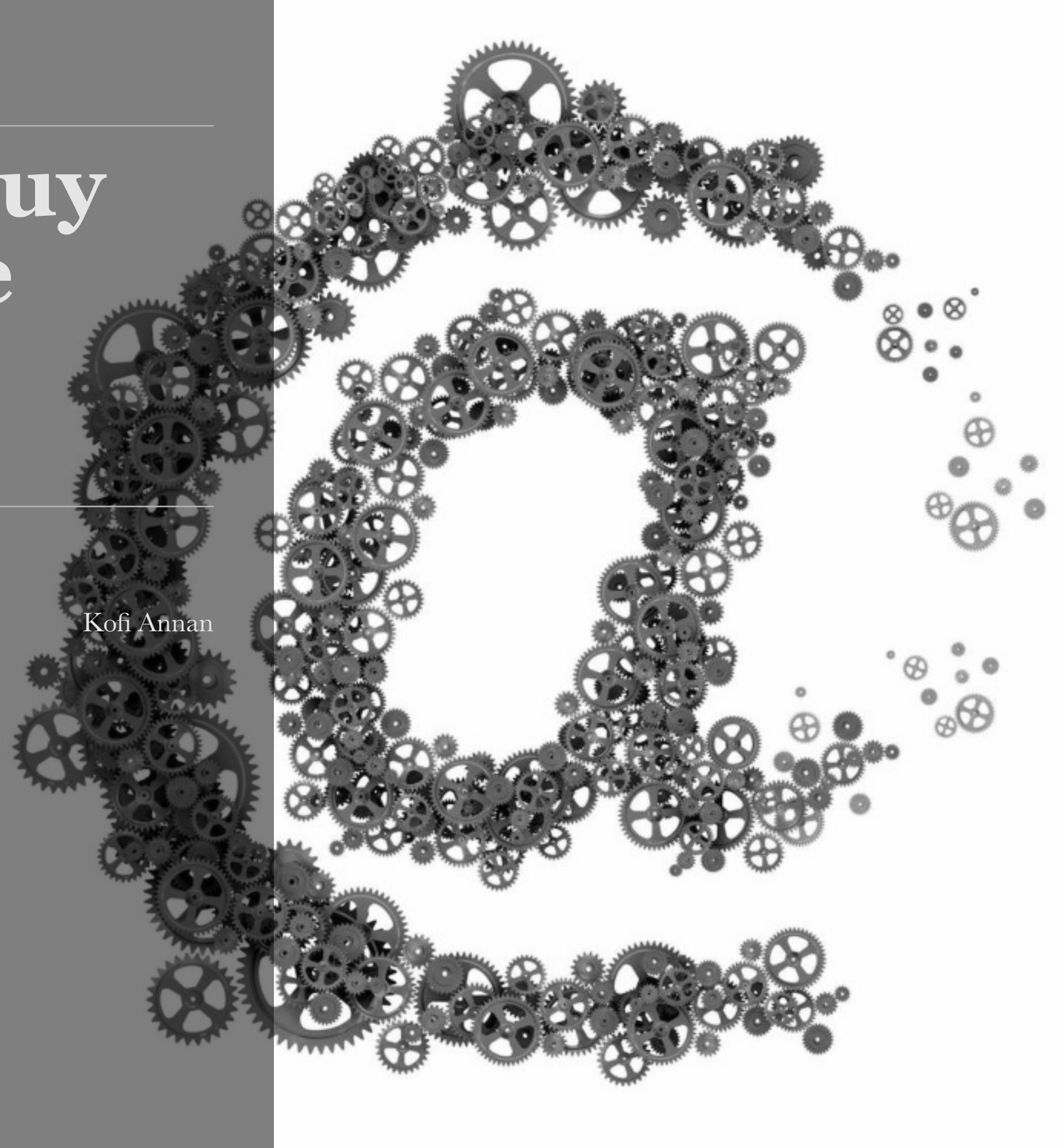
With strong conviction on the traffic, financial and personal perspectives of a business opportunity, it is time to turn attention to the process of actually buying an online business.

Chapter 3

How To Buy An Online Business

‘Knowledge is power.’

Kofi Annan



The Buying Process

The process of acquiring an online business is similar to a traditional offline M&A process. A potential business buyer should be sure to follow the steps closely to ensure success at each stage. It also pays to understand some of the subtle differences to procedure that accompany an online business purchase.

As a general rule, it is advisable to work with a well-established online business broker when making a business purchase. A quality broker will help guide buyers through the process and invariably represents the best quality businesses in the marketplace.

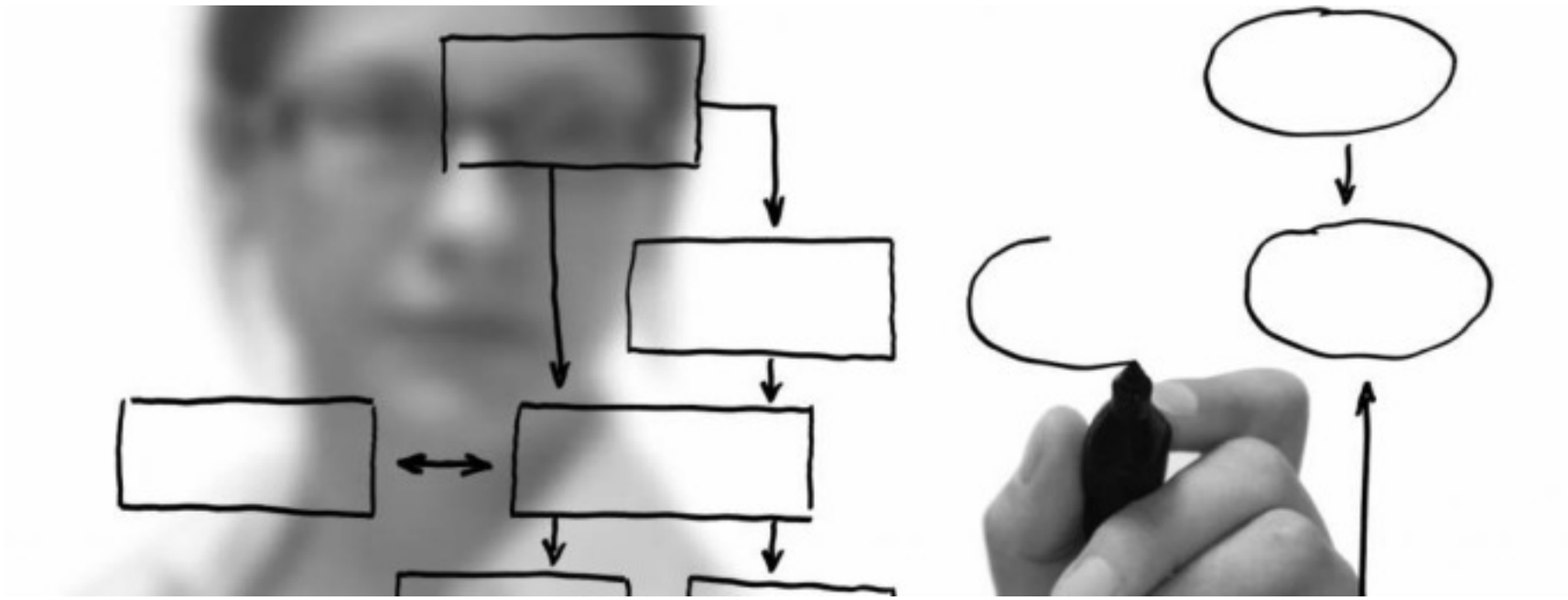
This section outlines the process of working with a broker through the acquisition process, discussing the steps from business identification through to making an offer, conducting due diligence and closing the sale.

‘Perfection has to do with the end product, but excellence has to do with the process.’

– Jerry Moran

Buying Process

1. Identify acquisitions opportunities through a variety of qualified channels
2. Review each opportunity methodically against specific criteria
3. Learn more about the business and formulate an offer
4. Conduct extensive due diligence on all aspects of the business
5. Seek professional counsel for drafting and reviewing the contract
6. Use a secure payment service for the transfer
7. Arrange for training and post sale support



The business acquisition process should follow a set of discrete steps that help buyers methodically identify, evaluate, value, due diligence and ultimately purchase a business successfully.

Identifying the Opportunity

It is important to only use high quality channels for sourcing acquisition opportunities. Buyers should spend time researching brokers that have a multi-year track record and a good reputation online. Once established, review the broker's business listings and contact them directly to discuss criteria and interests.

If it is first time enquiry, most of the time a buyer will be asked to complete a non-disclosure agreement (NDA). This protects the seller's information and allows a broker to share information on all future listings. In some cases, buyers may be asked to further qualify eligibility for information, including documented proof of funds or experience acquiring businesses.

Reviewing the Business

A professional broker will prepare a very detailed prospectus for buyers to examine the business. Transparency is very important so if the prospectus is light in detail or confusing, be sure to investigate further. The document typically includes information on business operations, growth opportunities, market trends, traffic, financial performance and continuing obligations.

The prospectus also usually includes a detailed seller questionnaire covering a number of topics including day-to-day operations, sale rationale, customer base, products/services and marketing etc.

Having reviewed the marketing materials it is wise to ask questions of the broker and arrange a call to discuss the business with the seller before proceeding forward with offer discussions.

A professional broker will prepare a very detailed prospectus for buyers to examine the business. The document typically includes information on business operations, growth opportunities, market trends, traffic, financial performance and continuing obligations.

Making an Offer

Once satisfied with their research into the business, the buyer should be ready to make an offer. Investors formalise this with a letter of interest (LOI), which is a standard-form non-binding agreement between buyer and seller to proceed forward with certain offer terms on a good-faith basis. Note, it is not legally binding but changes to its terms later in the process without reason or mutual agreement is heavily frowned upon. There are a number of things to think about when writing an LOI (see right).

Due Diligence

If the offer is accepted, the transaction proceeds into due diligence (DD). Due diligence of an online business is slightly different from a brick-and-mortar company. Naturally, the principle of fact-checking is still the same but without significant tangible assets and a very different customer acquisition process, due diligence is usually focused on 3 main areas:

Traffic

Buyers should focus on checking the traffic sources, the backlink profile and metrics for visits to make sure everything looks appropriate (see more 'Due Diligence' section in Chapter 4). Most established brokers will provide access to Google Analytics (or another service) to enable the buyer to carry this out.

Creating An Offer

1. **Consideration** – Describe explicitly what the offer structure is. What is the split between upfront consideration vs. holdback and/or seller financing? What are the conditions attached?
2. **Owner financing** – Does a portion of consideration need to be financed by the seller? On what terms?
3. **Non-compete** – Make sure to ask for a market standard non-compete agreement of 1-3 years.
4. **Exclusivity** – A period of no marketing may be agreed to by the seller if the terms of the offer are very competitive, the business is very complex or the seller has a high level of confidence in the buyer's ability to execute.
5. **Timetable** – Buyers that can proceed through due diligence into closing in a timely manner will be more likely to have their offer accepted from the outset.

Financials

Traditional investors often expect to see audited books or tax returns for the business during the sale process. In reality, the majority of online businesses are owner-managed and having audited statements is quite rare. A good broker will perform extensive pre-listing due diligence on the financials and then provide all the supporting documentation (merchant statements, invoices, credit card statements etc.) to the buyer during due diligence. As a second step of verification, buyers should arrange for a live screen-share with the seller to walk through the back-end of the website and associated payment platform(s). This will authenticate ownership and verify the financials further.

Maintenance

Many online businesses (even relatively large ones) have grown out from hobby websites or family businesses, and as such are very often owner-run. As such it's important for investors to analyse the business owner's daily, weekly, and monthly tasks to be able to properly account with the cost and effort of outsourcing or taking on those work streams. It's particularly important to evaluate and understand the difficulty of the tasks that the current owner is performing if they are going to be kept in house.

With comparatively few physical assets to examine or a large amount of audited statements to review, due diligence for online businesses usually takes 1-2 weeks depending on the size and complexity of the business.

Legals

In tandem with the due diligence process, the broker will usually prepare the Asset Purchase Agreement (APA) for the transaction. This typically works from a standard-form template and is then tailored to suit the specifics of each transaction. Within the contract, buyer and seller formalise amongst other things: the consideration terms, the assets to be transferred, the breadth of the non-compete and the training and support for the buyer post-sale.

Both buyer and seller should always have their legal counsel independently review the contract before signing.

Transfer & Escrow

Most well established brokers will use Escrow to facilitate the funding of the transaction and transfer of assets. Buyers should be extremely cautious about transferring funds outside of an Escrow service. Reputable brokers will be officially partnered with an independent Escrow service.

The Escrow process typically moves in the steps described in the box overleaf.

Escrow: Step-by-Step

1. Escrow transaction terms agreed by Buyer and Seller
2. Buyer transfers funds securely into Escrow, funds are secured but not released
3. Seller transfers the assets to Buyer
4. Buyer acknowledges receipt of assets and initiates Inspection Period
5. Inspection Period used to confirm correct representation of the assets
6. Buyer confirms satisfaction and releases funds to Seller

Many first-time buyers often ask what protection is afforded to them during this process. Its important to point out that at **no point** are buyer funds released to the seller without the buyer's consent. In the very rare case that assets have been misrepresented or not transferred in entirety, the buyer can notify Escrow during the inspection period. Generally speaking though, disputes pertaining to misrepresentation are rare. In the 160+ transactions completed by FEI since 2010, only one has been disputed.

Using a dedicated Escrow service gives buyer and seller a formal process for mediation and remedies. Escrow.com will conduct their owner internal domain checks before funds are released and in the case of a disagreement, will seek remediation through the America Arbitration Association which is a relatively quick and cost effective dispute resolution service.

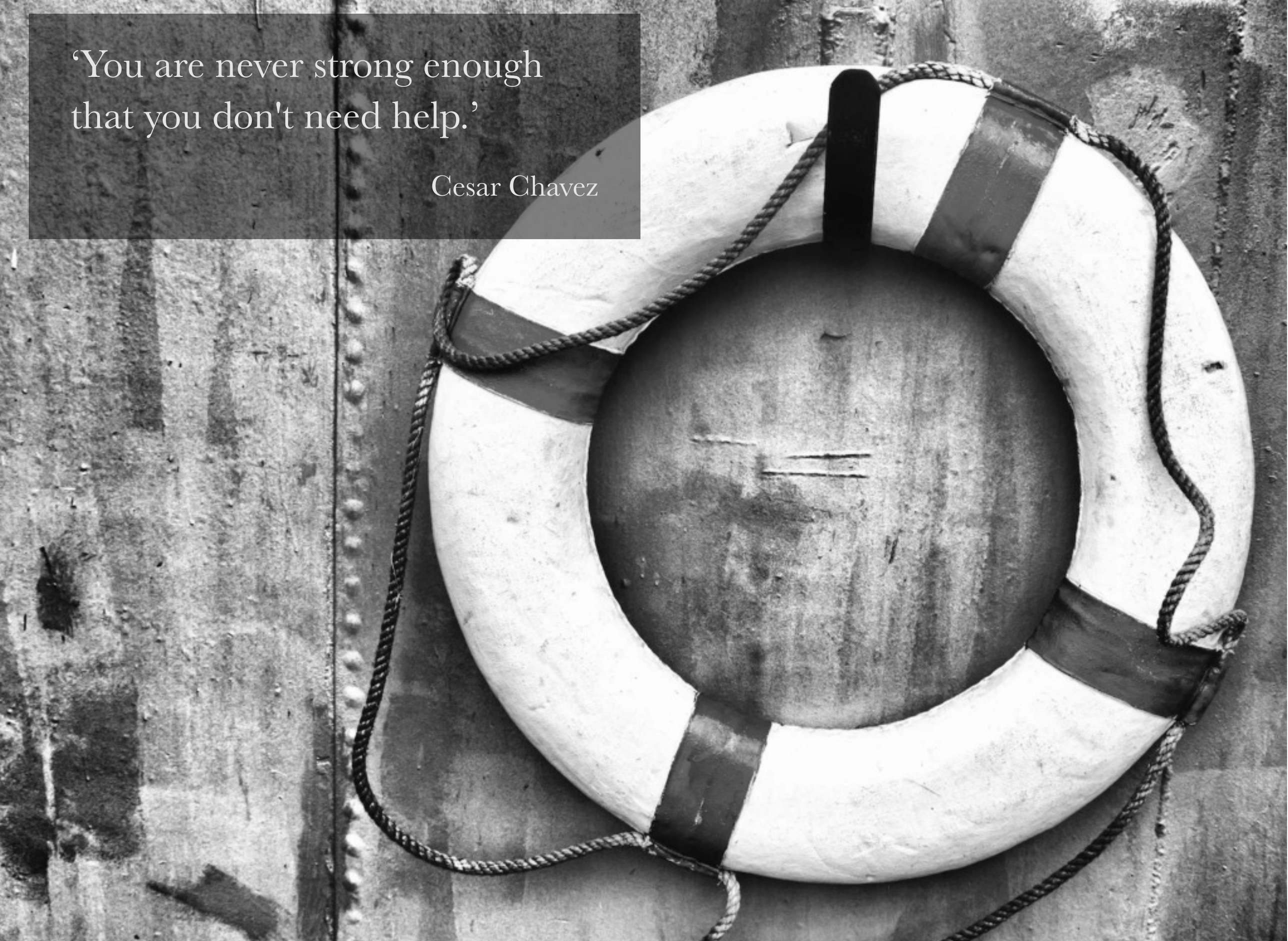
Training & Support

After the transaction has closed, there is typically a four-week period of training and support where the seller helps the buyer learn the day-to-day operations of the business. Occasionally, in the case of transactions with contingent consideration or seller financing, the seller will maintain a high level of involvement in order to meet mutually-agreed performance or training goals.

Buyers should make sure that the level of post-sale support is agreed beforehand and included in the signed APA.

Summary

The process can be a lot to take in the first time but a good broker will guide a buyer through each stage and explain what needs to happen. It is often a good idea to seek counsel from previous business acquirers to benefit from their experience in the same process.


‘You are never strong enough
that you don't need help.’
Cesar Chavez

Working With A Broker

Business brokers almost always represent the seller or the deal in a transactional role. The seller pays their commission and even if they are assisting the buyer in the process, they have a fiduciary duty to the seller. This is not to say that they won't provide a buyer with helpful advice. Why then, should a buyer use a broker?

This section discusses the role of the business broker and highlights some of the key advantages to the buyer of working with one in the process of purchasing an online business.

FOUR REASONS TO WORK WITH AN ONLINE BROKER

- *Brokers typically have the largest supply of pre-vetted businesses for sale*
- *They can be a useful and expert source of information, advice and support*
- *Oftentimes a much needed conduit between buyer and seller, particularly during delicate negotiations.*
- *There is a significant paper trail attached to a business purchase which the broker will help support*

Most business brokers work on behalf of the seller but nonetheless can be a valuable source of information and guidance to buyers.

Finding the best business

Compared to the offline world, the industry of buying and selling online businesses is still in its relative infancy which presents buyers with opportunities as well as some challenges. One in particular is the quality and quantity of businesses available for purchase.

Regulatory oversight of the industry is still some way off and as a unfortunate consequence, fraudulent sales activity is high. Unregulated marketplaces and some internet forums are common candidates for the sale of misrepresented or fraudulent web businesses and so buyers should be cautious about making purchases through these channels. Likewise, brokerage firms with little or no track record can in some cases list businesses of dubious quality either through inexperience or to build profile.

Working with an established online business broker will ensure that the listings being reviewed are of good quality. Most brokers operate on a success-fee only so are incentivised to ensure the listings they take on will pass through due diligence and close successfully. Serious brokers will vet the businesses before

agreeing to take them on and also independently verify the business' financial and operational performance before listing.

Education and advice

Whilst they are vested in the sale of the site, a good broker should be able to provide valuable advice to the buyer throughout the transaction process. A serious brokerage will be on hand to educate and support the buyer through the process, highlight due diligence areas of interest, provide relevant business referrals and nurture a good relationship with the seller. In other words, a good broker will make the business purchase process a smooth, secure and enjoyable experience for any buyer.

Buffer between buyer and seller

Brokers can be a useful conduit between buyer and seller, particularly during delicate negotiations. There may be instances where a buyer has to retract or modify an offer and times where an aggressive negotiating position is needed. It's important to maintain a good relationship with the seller, not just to secure the sale but for ongoing training and support post-closing, and so an intermediary can be beneficial to harbouring good relations through this tricky stage.

Paperwork? Most brokers will take care of collecting the due diligence materials, drafting the contract and co-ordinating communication

Paperwork and process

A business purchase, no matter how small, requires a significant amount of coordination and document chasing. The data needed from a seller to evaluate a business, the documentation required to close a deal and the overall chasing that must be done between buyer/seller and their professional advisors, can be overwhelming. A good broker will be a huge help putting all of it together.

Picking the right online business broker

Finding and working with the right broker is an important step for a business purchase. Buyers should do some research before working with any firm. Below are some of the questions to ask of a professional brokerage:

- How experienced are they?
- How many transactions have they been involved with?
- Have they ever owned their own business?
- Do they specialize in a particular business type?
- How many clients are they working with presently?
- How many agents work in their office?

Building a good broker relationship

After establishing reputation, a buyer should look to foster a strong working relationship with the broker. Reaching out with information on investment criteria and budget is a good start. It's also important to demonstrate serious intention and ability to move quickly if the right opportunity comes along. Investors should try to maintain regular contact with their broker and keep them apprised of their investment situation.

How Do You Value An Online Business?

Accurately valuing a business for sale can often be the most challenging part of the business purchase process. In the case of online businesses, the relative infancy of cash flows and small or absent physical asset base can complicate the task further.

Buyers can navigate these obstacles with a clear understanding of the uses and limitations of the methods available. Gathering the right information on the most important valuation drivers and applying this correctly will lead to a sound investment decision.

This section discusses some common approaches to valuing online businesses, identifies the most widely adopted methodology and offers some practical guidance on how to apply it using empirical evidence for support.

> ‘Price is what you pay.
> Value is what you get.’
>
> – Warren Buffet

Spotlight On Valuation

- The earnings-multiple valuation approach is the most widely adopted across the market
- Automated valuation tools generally undervalue online businesses
- There are a number of adjustments or 'add backs' to calculate seller discretionary cash flow
- Businesses with a recurring revenue model tend to sell at a premium multiple to one-time sales
- Third party research suggests multiples of online businesses have increased 30% since 2010

There is a wide variety of approaches to valuing online business with the earnings multiple methodology being the most prevalent in the marketplace.

Approaches To Valuation

As with offline businesses there are a number of ways to value an online business. Exploring each of these in detail, buyers should take note that a flexible and pragmatic approach is usually required, taking account of the data available and the profile of the business being valued.

Discounted Cashflow Analysis

One of the most detailed ways to value a business is through a discounted cashflow analysis (DCF) which involves forecasting the free cash flows of the acquisition target and discounting them with a predetermined discount rate, usually the weighted average cost of capital (WACC) for the business in question. The model's theoretical underpinning is based on the time value of money, which stipulates that a dollar today is worth more than a dollar

than a dollar tomorrow.

A DCF should be a serious consideration for investors appraising mature, stable businesses with predictable cashflows. Unfortunately, those prerequisites are not often satisfied, even with the most established and consistent online businesses. The variance in monthly cashflow, immaturity of business model and quality of financial data available typically make a DCF at best a useful data point for comparison and at worst, redundant. As such it's something of a 'nice-to-have' in the online business environment.

Precedent Transactions

Looking for precedent acquisitions of similar companies is another traditional approach to benchmarking the valuation for a business. It is typically used as a frame of reference or sanity check against a DCF (or other method) rather than being the foundation of a valuation. With the comparable transactions method, investors must look for comparable metrics, usually multiples of earnings or revenue. It is important to identify the key valuation parameter for each deal. That is, were the companies in those transactions valued as a multiple of EBIT, EBITDA, revenue, or some other parameter? Once the key valuation parameter is defined, the buyer can examine at what multiples of those parameters the comparable companies were valued and apply the average of these to value the company being considered.

The main prerequisite for a useful and accurate precedent transactions analysis is access to transaction data. In a public company situation this type of information is abundant but in the world of private M&A and specifically, the nascent area of online business M&A, transaction data is mostly privately kept.

There have been a few examples of analysis from Centurica and Sitepoint, which can provide a helpful starting point for new investors. For the most part though, precedents analysis is a tricky technique to work with unless the buyer knows the parties involved in previous deals. There is scope to analyse deals on marketplaces but these are often misrepresented or low quality versus brokered deals.

Earnings-Multiple

The third major valuation method is the use of earnings multiples. In a public company setting this tends to manifest as P/E multiples as well as EV/EBITDA and EV/Sales or other iterations of these core metrics. In the online business world, investors have increasingly gravitated around the multiple-based methodology because of its simplicity and robustness in the face of scant financial or comparable data.

The multiple-led method stipulates the buyer should arrive at a

by a multiple that is appropriate for the business. Naturally the 'appropriate' multiple is where all parties seek to formulate their own opinion and arrive at a consensus before consummating the deal. Identifying the factors that affect a business multiple is the key part of the business valuation process. We shall explore these in detail after considering some other methods.

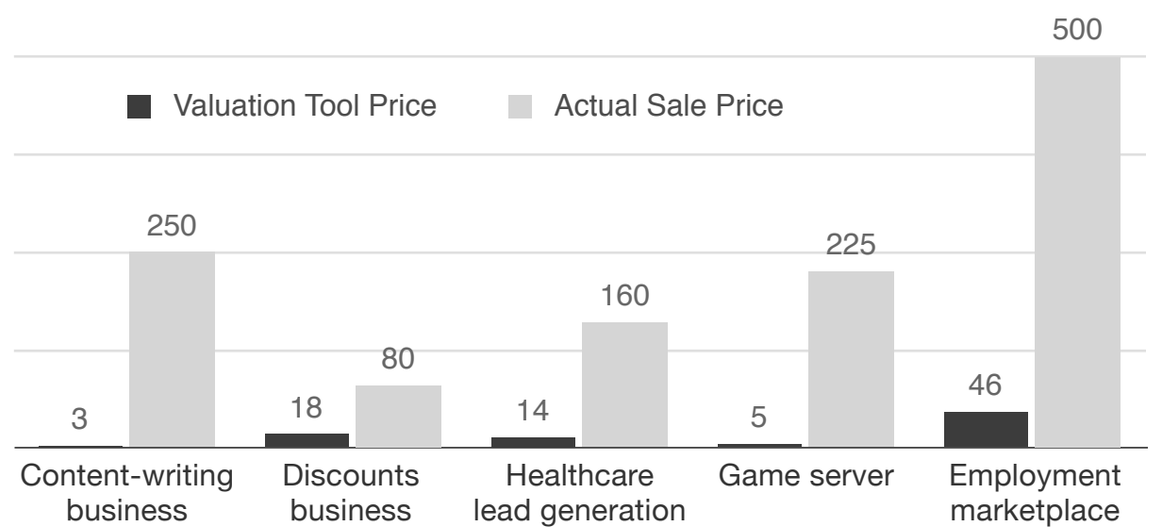
Traffic Valuation

Another approach to determining the value of a site, specifically sites that have yet to be monetized but have traffic, is the Traffic Value Valuation Method. To do this the buyer must research the top key phrases that drive the majority of search traffic to the site. Then identify the Cost-Per-Click value of the keywords. For example, if a site has three key phrases driving over 90% of its traffic, find the CPC in Google Adwords and multiply that for each phrase by the number of visitors being driven to the site by that search term. This will give some sense on the value of the traffic for the site.

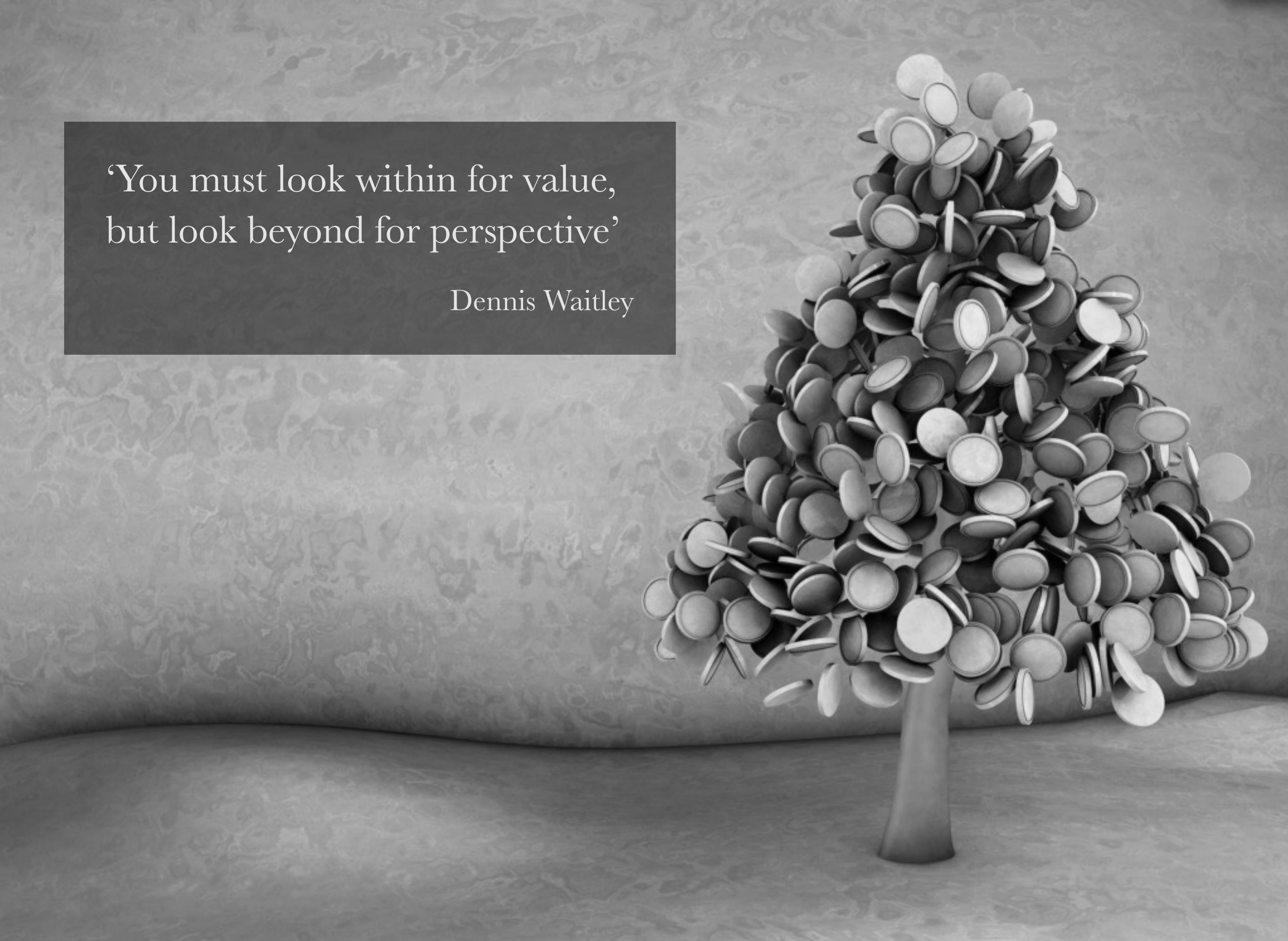
The traffic valuation method can be useful for devising a value for a non-monetised site (e.g. sites primed for AdSense) but falls down against other methodologies with its prescriptive approach to traffic-only evaluation. Online businesses that don't rely on significant traffic (e.g. software or SaaS businesses) to drive revenue, will be valued significantly below fair market price using the traffic valuation method. As such, it should be employed carefully and only in certain situations.

A Word On Automated Tools

There are a host of automated tools online that aim to simplify the valuation process. These valuation tools instead usually work off publicly available traffic statistics (typically Alexa rank) and apply an estimated CPM to guess advertising revenue. Some arbitrary discount rates are then applied based on domain age, number of backlinks and other metrics. Naturally there are some limitations with to this, for example no accounting for financial performance and no accounting for different types of monetisation. Inputting a handful of five recent transactions completed by FEI into SitePrice's tool shows the valuation deltas an investor should expect (errors in the magnitude of 5x to 90x the actual sale price.)



A comparison of valuations offered by automated tools online vs. actual sale prices ($'000s). Source: FEI (2014).



‘You must look within for value, but look beyond for perspective’

Dennis Waitley

Adopting The Multiple Framework

Earnings multiples are by and large the consensual valuation approach in small online business M&A. There are two elements to the method that buyers should become expert in, defining profitability and identifying the factors that should influence the multiple.

Defining Profitability

The profit number that is of use in a multiple based valuation for an owner-operator managed business is the "seller discretionary cash flow" or SDC. SDC is the earnings left once all costs of goods sold and critical, non-discretionary operating expenses have been deducted from gross income.

SDC is subjective in nature and can vary based on each investor's own interpretation of what is discretionary operating expenditure (e.g. "we should include/exclude [x]"). Fortunately, online businesses on the whole enjoy simpler cost structures so there is less margin for deviation in SDC estimates.

When evaluating the financial statements of an online business, buyers should sense check the SDC calculation of the broker and ensure it features only the right add backs such as:

- Owner compensation
- Depreciation (uncommon but a legitimate add back)
- Travel expenses (if unrelated to the business)
- Office rent (if the business can be run from home)

Defining Profitability

"The pre-tax earnings of the business before non-cash expenses, one owner's compensation, interest expense or income, as well as one-time and non-business related income and expense items. If there are additional owners working in the business, their compensation needs to be adjusted to market rates"

There are a number of other valid add backs so it is important to analyse the financial statements in depth and focus a lot of questions on the cost structure in particular. This will ensure the profit number is the cleanest one for multiplication.

Another important point is to ensure the profit figure includes the personal, buyer-specific costs of replicating the current business. i.e. any incremental operating expenditure a buyer will incur taking ownership of the business.

With the SDC clearly defined and calculated, the next step is to devise a suitable multiple.

Factors That Influence The Multiple

Evaluating a business' strength and competitive position is a complex task and as such there are many factors that influence the multiple of a business. Whilst there is no definitive list of variables there are certainly three key focus areas which are the **transferability**, **sustainability** and **scalability** of revenue. Any operational or market factor that directly or indirectly impacts these core drivers will influence the multiple to attach to the business.

In the boxes below are some of the most common valuation drivers to think about when appraising online businesses for acquisition.

Operations

- How much of the owner's time is required to run the business?
- What are the owner's responsibilities? Are there high technical requirements?
- What technical knowledge is required to run or manage the business?
- Are their employees/contractors in the business and how are they managed?

Financials

- How old is the business?
- How has gross and net income been trending for the last 1-3 years? The last few months?
- Can a new owner replicate the cost structure? Can they make any savings?
- Are there any anomalies in the financial history of the business? If so, are they explained?
- Can all of the revenue streams be transferred to a new owner?
- How stable is the earning power e.g. are CPMs in this niche on the decline/hard to replace?
- Is the owner an influence on the earnings power (i.e. owner-specific earning relationships)?

Traffic

- What percentage of traffic comes from search? (i.e. what percentage is potentially at risk from search engine algorithm changes)
- How secure are the search rankings? What is the mix of short and long tail?

Traffic (cont'd)

- How has traffic between trending for the last year? The last few months?
- Has the site been affected by any Google algorithm changes or manual penalties?
- What is the industry trend (see Google Trends)?
- Where does the referral traffic come from? Is it sustainable?

Niche

- How competitive is the niche?
- What are the barriers to entry?
- Is the niche growing?
- What are the recent trends and developments in the niche?
- What expansion options are available?

Customer base

- Where does the business get customers from?
- How much do customers cost to acquire?
- If subscription, what is the customer lifetime value and churn rate?
- If one-time, how active is the customer base? Are they re-ordering?
- Is it possible to remarket to the existing customers? Is there a mailing list

Other

- Are there physical assets or specific locational responsibilities with the business?
- Are there any licensing requirements in order to run the business?
- Does it infringe in any trademarks?

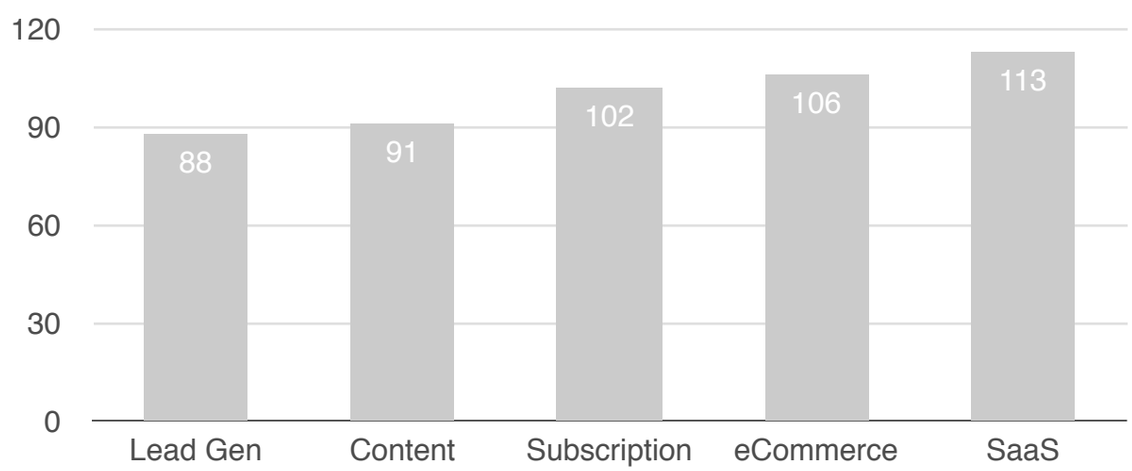
With a sense of the relevant valuation drivers, an investor can be much clearer about what to look for when appraising a business and what to seek information on from the seller. A good broker will ask the right questions of the seller and weed out companies before they even come to market.

With answers to the right questions, one can begin to devise a multiple for the business.

Naturally some frame of reference is needed to arrive at a number within a market-accepted range. Typically online business valuations range from 1x to 5x annual net income with the vast majority of transactions occurring between **2x to 4x**.

To guide further, there have a been a handful of empirical studies conducted by various industry commentators including **Centurica** and **SitePoint** which detail precedent transaction data. Both studies are somewhat susceptible to the limitations of publicly available data but are a useful starting point.

Data from a sample of 60 transactions completed by FEI in recent years serves to highlight the valuation differential between different business models. Establishing a mean sale price multiple across the group as a base (set to 100) and calculating each business model's variance from the mean highlights some interesting differences.

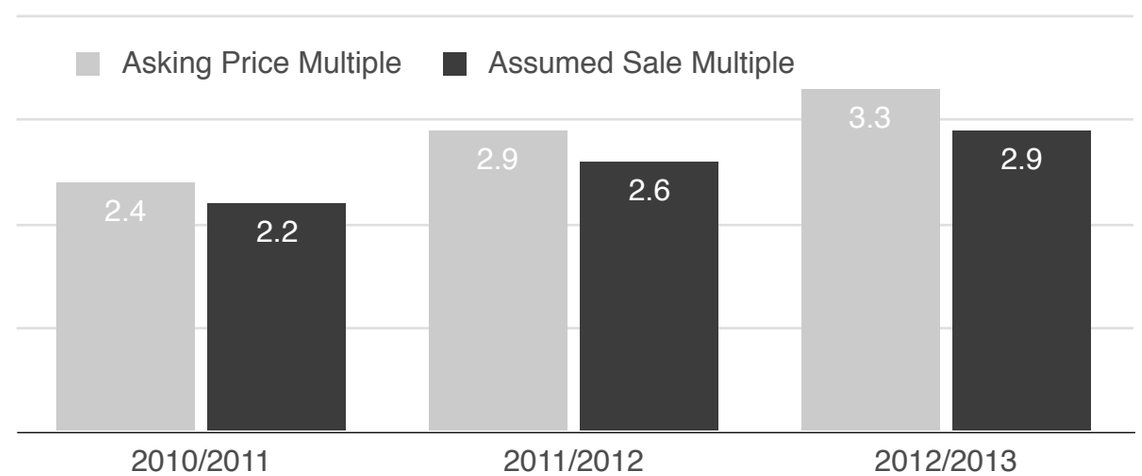


Index of mean sale price multiples for 60 transactions completed by FEI from 2012 - 2014. Average for group = 100.
Source: FEI.

Intuitively it makes sense that SaaS and Subscription businesses are valued at a premium to the average as buyers' pay for the certainty of recurring income. eCommerce businesses generally attract wide interest (including the offline community) which creates a halo of demand around them. Content and Lead Generation sites can often be high workload and search-dependent (respectively) so tend to be discounted.

The Market Effect

Whilst a rational investor shouldn't be overly influenced by the market prices for assets, it pays to keep abreast of changing trends in online business M&A. Some interesting research by **Centurica** suggests that industry-wide, asking price multiples have increased from an average of 2.4x in 2010 to 3.3x in 2013. Be mindful that the sale price multiple can vary considerably though.



Average asking price vs. assumed sale price multiples for online businesses, 2010 - 2013.
Source: Centurica, BizBuySell.

As the industry continues to develop, formalise and mature over coming years, it is likely that more buyers will be attracted to the space and consequently demand for online businesses will rise. Supply of high quality online businesses, particularly in the sub $1m range, is relatively low and as a result there will likely be increased competition for listings for the foreseeable future.

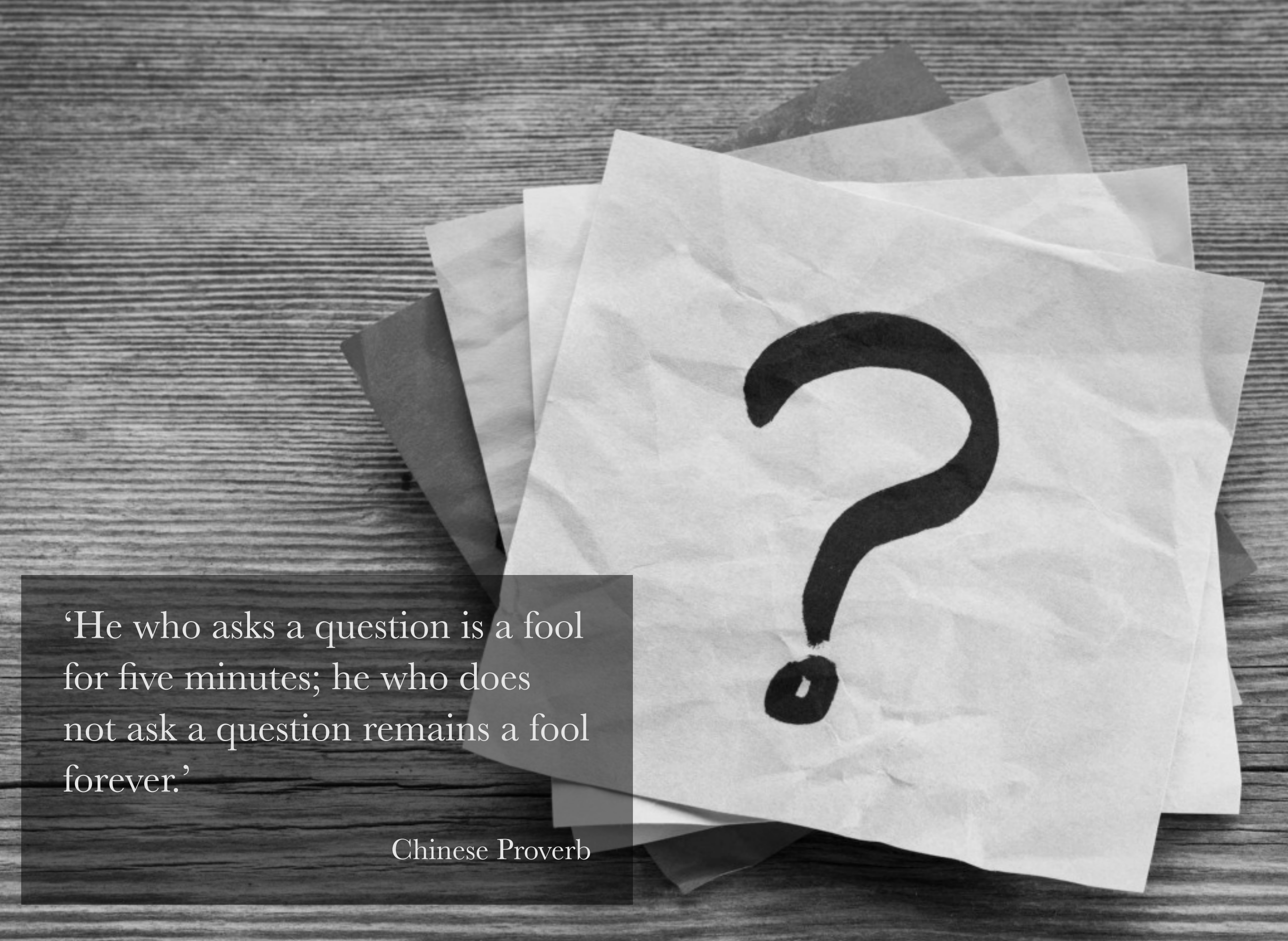
It's important though as an investor to stick to an objective, rational, deductive valuation process and try not to get caught in market dynamics, instead just be aware of where there may be high levels of competition for some listings.

'Great riches come from heaven; small riches come from diligence.'

– Anon

The Last Word – Due Diligence

A theme that should be implicit in all discussions on business valuation is the need to be robust, methodical and most importantly detailed in approach. The real underpinning to a successful business valuation and indeed online acquisition, is due diligence. It's vital to gather the right information for the valuation and verify it thoroughly during due diligence. The key areas to focus due diligence on are financials, traffic and operations (see more in the 'Due Diligence' section in Chapter 4).



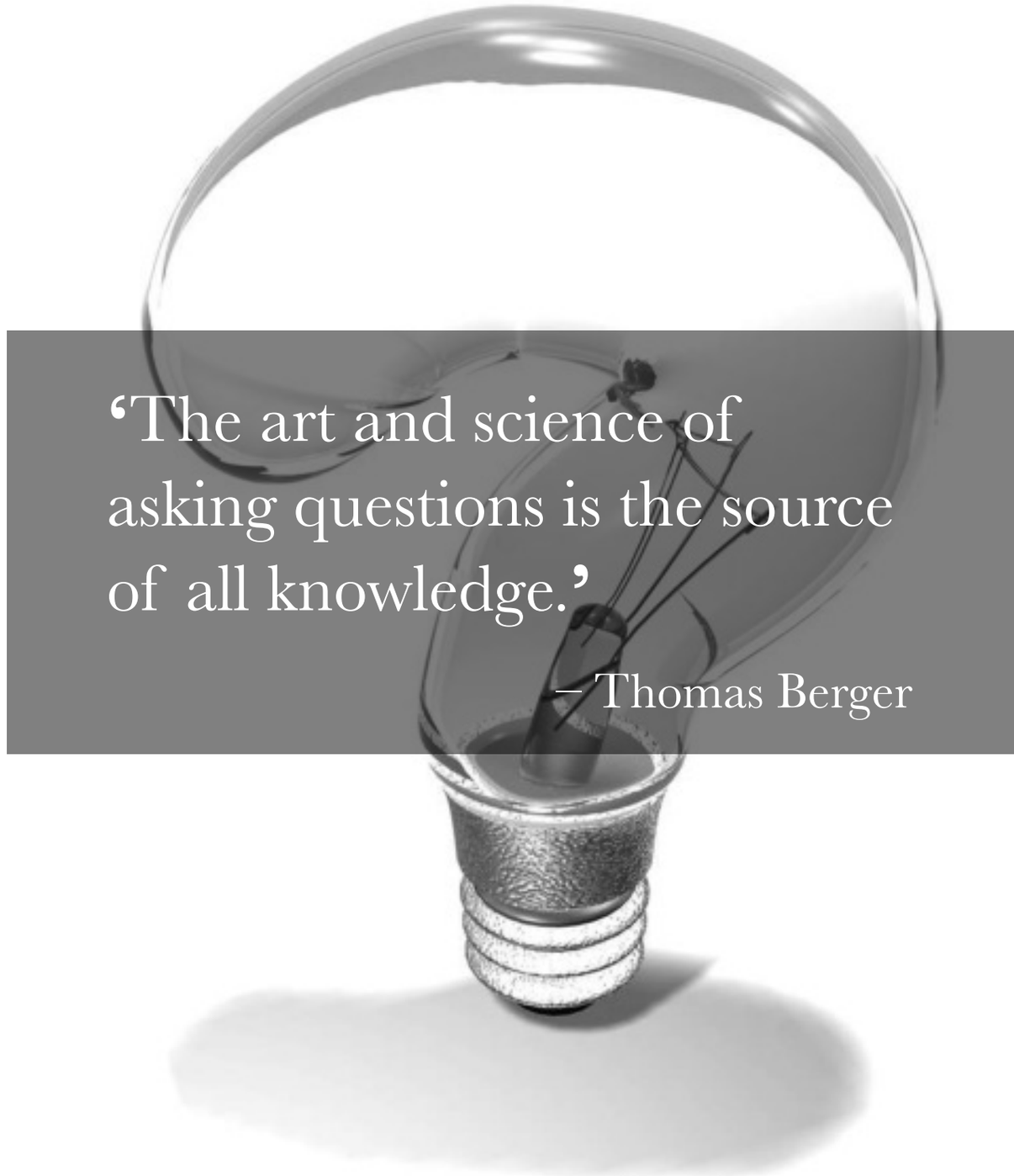
‘He who asks a question is a fool for five minutes; he who does not ask a question remains a fool forever.’

Chinese Proverb

What To Ask Before Making An Offer

Business buyers often go into the acquisition process with an arsenal of questions for the seller but the questions that really need answering are the ones they usually don't think to ask.

This short section covers five of the most important questions to seek answers to before submitting a formal offer for a business. They cover the seller's intentions, sale rationale, operating requirements, growth options and post-sale arrangements.



What are the most important questions to ask before making an offer?

1. Why and when is the owner selling the business?

Knowing the seller's rationale for a business sale is vital. Buyers should look for natural reasons and explore them in depth. If the seller is moving to another business venture ask in detail about what the venture is, why they are moving on and what they intend to use to capital for. An investor should keenly examine the seller's motivations and look for any evidence in the information provided that conflicts or confirms the story.

Just as important but asked a lot less often is the 'when' instead of the 'why'. If the seller's answer to why seems unconvincing then it is worth analysing the timing of the decision. Are they selling after a recent growth spurt? What has contributed to this and will it last? Is the opposite true and sales are sliding? Has the seller run out of ideas to grow the business?

A buyer should look for a cohesive sale rationale that provides an honest message, backed up by the information provided

during due diligence. E.g. “I’ve managed this business for many years now and am moving on to fund a new venture in another niche.” If the business has financial statements for several years, performance has been solid and the seller has provided information on the new business plans elsewhere then it makes sense to proceed.

2. How much time is involved and what is required to run the business?

Online businesses can vary substantially in the amount and nature of work associated with them (as discussed in the chapter ‘Investment Options’). During the business sale process the seller will typically declare how much time they spend on the business and what they do in the day-to-day operations. It’s unlikely there will be any formal record of this as most online businesses are owner-managed so the buyer is somewhat reliant on the seller’s honesty. It’s very important though, especially if a buyer only has a limited amount of time or specific technical/ management skills, that these claims are confirmed before making an offer for the business.

The best way to do this is to build a strong understanding of the workings of the business through the prospectus and Q&A with the seller. Ask questions like:

- How much content is written and uploaded per week?
- Who is posting to social media and how often?
- How many support requests are there per week?
- How much SEO / link-building is being done?

Once a list of work tasks has been established, a buyer should estimate the time required to carry each one out, then arrange a call with the seller to go through their version of operations and see how the two compare. Make sure to be clear on the technical requirements for each task, which will help clarify whether to insource or outsource and at what potential cost. This exercise will give comfort on whether the business can be run the sale and also more information to factor into the offer for the business.

3. What would the seller do to grow the business?

Naturally, a common aim for buyers is to grow the business beyond its current profitability. Unless the buyer has significant experience in the space, the person who is most qualified to offer a perspective about the business and its future growth prospects is usually the current owner. Buyers should carefully probe the seller’s thoughts on potential growth strategies and get some ideas on how best to execute these.

4. Will the seller agree to a non-compete?

An established business, brand and customer base is a major reason for buying an existing business versus starting one from

scratch. That fails to be the case though if the owner plans to sell the business and compete with the funds raised. Buyers should be sure to have the seller commit to a non-compete and ensure this is contractually agreed in the Asset Purchase Agreement. As always, the devil is in the detail and investors should pay close attention to the wording of the 'restricted business' as well as the duration of the agreement. Typically, a three year non-compete is standard.

5. What does the seller care about?

Before making an offer for the business, buyers should carefully think about what the owner wants to get from the sale. Although it's unlikely that the seller will disclose their bottom line before the negotiation process has started, it's important for the buyer to make an effort to discover what matters to the seller.

Knowing whether the seller is open to financing or contingency-based consideration for example is very important and will allow the buyer to structure a deal that is fairer for both parties from risk and value perspectives. Equally, non-cash motivations can be useful to know and potentially a powerful negotiation tool for buyers. If the seller is entertaining multiple offers for example and one is differentiated by offering strategic support for a new business venture, this could be a deciding factor for the deal.

Making an offer with the intention to close

Overall it's important that buyers do a lot of work upfront and gather enough information to get comfortable before you make an offer. Pulling out of a deal during due diligence because of a simple oversight will damage a buyer's reputation with both the seller and the broker. Asking the right questions early on will help identify the best opportunities quickly and potentially help get ahead of the competition in the process to acquire the business.

Chapter 4

Completing The Deal

‘The distance between who you are and who you might be is closing.’

Jan Chipchase

Financing An Acquisition

Naturally one of the primary objectives for buyers when pursuing the acquisition of an online business is to secure the best possible terms in respect of their funds available and risk appetite. It is quite common in larger acquisitions to take a creative approach to financing to manage risk and align both parties' interests. As such, it is important for investors to have a good understanding of the funding options for buying an online business.

This section explores some of the financing methods available, describes the many sources investors can use for cash and outlines the way in which creative financing solutions can strengthen a buyer's position, mitigate risk and move up the purchasing scale.

'It's all about the money.'

– Joseph Jackson

Funding Options For Buying An Online Business

For most sellers, an all cash offer is the most preferred, risk free option, but there are many situations where making an all cash offer is not the most sensible way for a buyer to proceed. Often, where the business for sale is based in a foreign jurisdiction, has complex operations, is relatively new or is very large, creative financing solutions are required to satisfy the needs of both parties.

Every buyer is in a unique financial situation and as such, will benefit by understanding the options available to them.

Cash

Cash forms the primary (and usually largest) tranche of the total consideration in most business acquisitions. Buyers tend to look to their liquid assets to meet the cash requirements and many limit their search to their bank accounts, which can reduce the ability to make offers on a business. Numerous buyers have seen success in more unconventional methods of cash raising, including (but not limited to):

Sources of Cash

- Retirement funds: cashing out a portion or all of retirement accounts (401k, IRA, etc.);
- Borrowing: Borrow from a 401k account (up to $50,000 is allowed in the US); taking regular IRA pay-outs (must do so for the next 5 years);
- Securities: taking a loan against securities/equities;
- Roth Contributions: Taking back a Roth Contribution can be an option for buyers over the age of 59 ½ in the US;
- Small Business Administration (SBA) loans;
- Asset based lending / Collateral based lending;
- Business partnerships/JVs: Finding someone with cash and/or experience to partner with; and
- Peer-to-peer lending: prosper.com, lendingtree.com, etc.

Seller Financing

Seller or owner financing is where the seller allows for a proportion of the total consideration to be paid off post-sale in loan installments. For example, in a deal valued at $100,000, the buyer could agree to pay $80,000 at closing and a further $20,000 to the seller over a set period of months at an agreed interest rate. The table overleaf shows an example based over 12 months at an interest rate of 5%.

Period	Beginning Balance	Payment	Principal	Interest	Cum. Principal	Cum. Interest	Ending Balance
1	$20,000	$1,712	$1,629	$83	$0	$0	$18,371
2	$18,371	$1,712	$1,636	$77	$1,636	$77	$16,736
3	$16,736	$1,712	$1,642	$70	$3,278	$146	$15,093
4	$15,093	$1,712	$1,649	$63	$4,927	$209	$13,444
5	$13,444	$1,712	$1,656	$56	$6,583	$265	$11,788
6	$11,788	$1,712	$1,663	$49	$8,246	$314	$10,125
7	$10,125	$1,712	$1,670	$42	$9,916	$356	$8,455
8	$8,455	$1,712	$1,677	$35	$11,583	$392	$6,778
9	$6,778	$1,712	$1,684	$28	$13,277	$420	$5,094
10	$5,094	$1,712	$1,691	$21	$14,928	$441	$3,403
11	$3,403	$1,712	$1,698	$14	$16,666	$455	$1,705
12	$1,705	$1,712	$1,705	$7	$18,371	$462	$0
Total	**-**	**$20,546**	**$20,000**	**$546**	**-**	**-**	**$0**

In this case, the buyer would pay the seller the full $20,000 over 12 months, plus $546 in interest. The total consideration of the acquisition is the sale price of $100,000 plus the $546 in interest (Total: $100,546).

Owner financing is a popular option as it removes the red tape and often slow pace of dealing with a bank or other financial institution, however, a buyer needs to be careful when signing agreements without proper consideration of future cash flows – a default on a scheduled payment may prove costly and in some cases can result in the seller taking back possession of the assets without surrendering any consideration paid up until that point from the buyer.

Earn-out

An earn-out is where the buyer agrees to pay the seller a percentage of either the revenue or the profit of the business for a set period of time. This is used in situations where the business may be young, have erratic cash flows or an uncertain future, so the buyer wants to leverage the seller's knowledge and resources in an attempt to run/grow the business in the period immediately post-sale.

In this case, the buyer will need to project the future cash flow of the business based off historic figures, as well as micro and macro industry data. Most earn-out calculations will be far cruder than a full detailed valuation analysis (i.e. a Discounted Cash Flow model) but the buyer and seller must ensure they agree on what the site is expected to earn over the earn-out period (all things being equal), to avoid disputes at a later stage.

In an earn-out, the seller is taking some risk that the buyer will not default on payments or weaken the business. In exchange a seller may ask for a higher total consideration (say $110,000). This would usually be achieved by extending the earn-out period beyond the 12 month period rather than increasing the profit split, to achieve a total implied price they are happy with.

In an earn-out, a buyer should be mindful that the performance of the business can go down as well as up, even with the help of the seller. If the revenues go down over time, the buyer must ensure they are able to cover any external obligations.

Nearly 30% of online business acquisitions involve creative financing.

FE International (2014)

Holdback

A holdback agreement is sometimes used in larger deals where a business may be reliant on certain arrangements staying in place, such as long-term service agreements or employees of the business continuing to work for the firm. Even though online businesses are often simpler to run than offline businesses, there can still be many moving parts. A buyer should be aware of the variable elements and protect against a material change in any of them in the near future. A holdback might also be used to verify certain revenues or costs, that cannot be fully explored pre-sale (i.e. chargebacks, refund rates, etc.)

Although it would not usually be applicable on a $100,000 transaction, in this case the buyer would offer $80,000 in cash and $20,000 to be paid at the end of a chosen date, held against milestones such as (but not limited to):

- Post sale obligations by the seller being met such as training a newly hired contractor or help setting up a paid advertisement campaign
- Contractual agreements in place at the time of sale being fulfilled such as getting a merchant account approved and setup or verifying income from advertising networks that pay every 30 days
- The business hitting certain targets, i.e. maintaining the LTM gross revenue averages

A seller may underestimate/understate the value of contractual or other arrangements and post-sale obligations, so a buyer should look at case studies of other similar businesses to ascertain what may and may not affect the future performance of the business. A full due diligence report on such activities may highlight some areas of concern in relation to this and areas which are difficult to verify before the assets swap hands.

Equity

Equity is an uncommon option as most sellers wish to move on to something else post sale and equity is often offered in exchange for services (similar to a Service Agreement, but with a profit share based on equity ownership). In this case the buyer could offer $80,000 plus 20-30% equity in the business to the seller. It would be an on-going partnership, with both parties sharing in the long term success of the business.

This would require additional legal drafting, not only with the Asset Purchase Agreement, but with a Partnership Agreement and other legal documents. There is usually a need to come to a legal arrangement with regard to the entity, whereby both the buyer and the seller are shareholders in the parent firm.

Service Agreement

In some cases, such as with online businesses that require regular content updates or product launches, the buyer may offer the seller a service agreement as part of the total consideration. This is typically offered by sellers if the buyer is concerned about the skills and expertise required to run the business, and is not considered a form of financing.

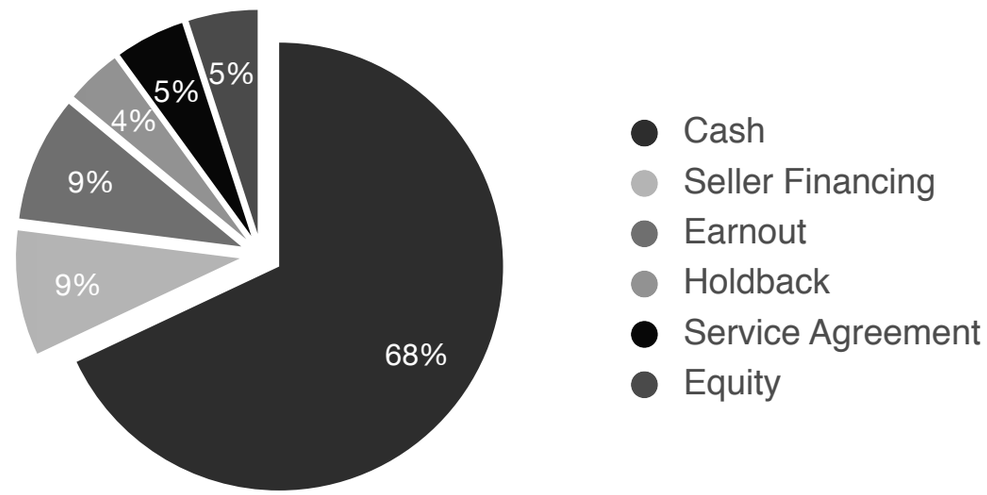
A buyer would offer the seller a fixed monthly fee in exchange for a pre-agreed set of defined tasks. The total consideration of the business would remain the same, but the total value of the service agreement would be held by the buyer and released periodically (usually each month) on completion of said tasks.

Using the example, the buyer would pay the seller the cash consideration of $80,000 and pay the remaining $20,000 on an equal monthly basis as part of a service agreement. This may be supplemented by revenue sharing incentives or other bonuses based on the performance of the business. This differs from Seller Financing by the fact that the agreement is contingent on a series of tasks being completed in order to receive payment, whereas Seller Financing does not require the seller to meet any requirements.

A buyer should also keep in mind that this agreement may fall outside of a typical Asset Purchase Agreement, so there could be increased legal drafting costs incurred.

Financing in Context

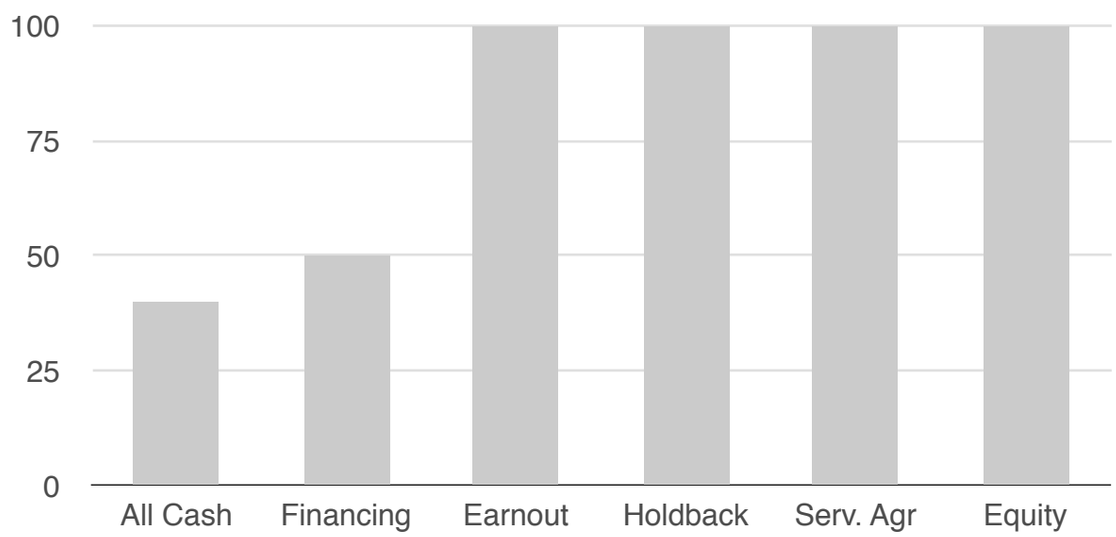
Out of the transactions completed by FEI so far in 2014 to date, we have seen nearly 30% of deals including some element of creative financing. The distribution is relatively consistent for acquisitions in the sub-$1m range. Beyond this valuation range, the balance tends to start to shift depending on the total business size and its model.



Percentage of transactions including some element of creative financing.
Sample of 30 transactions completed by FEI in 2014.
Source: FEI (2014).

The All Cash Deal

Out of the same set of transactions completed by FEI in 2014 so far, only all cash and seller financed deals saw a discount to the asking price. Many of the other deals completed under the other various structures saw the buyer paying above the market price in exchange for the additional flexibility offered by these arrangements. This shows the power of an all cash deal.



Percentage of FEI transactions in H1 2014 reaching asking price or higher.
Sample of 30 transactions completed by FEI in 2014.
Source: FEI (2014).

The numbers above make for a compelling case in favour of all cash and seller financed deals, but a buyer needs to assess the situation on an acquisition-by-acquisition basis. There will be many factors that play a role in the offer structure and there is no blanket solution that a buyer should apply to all deals.

Summary

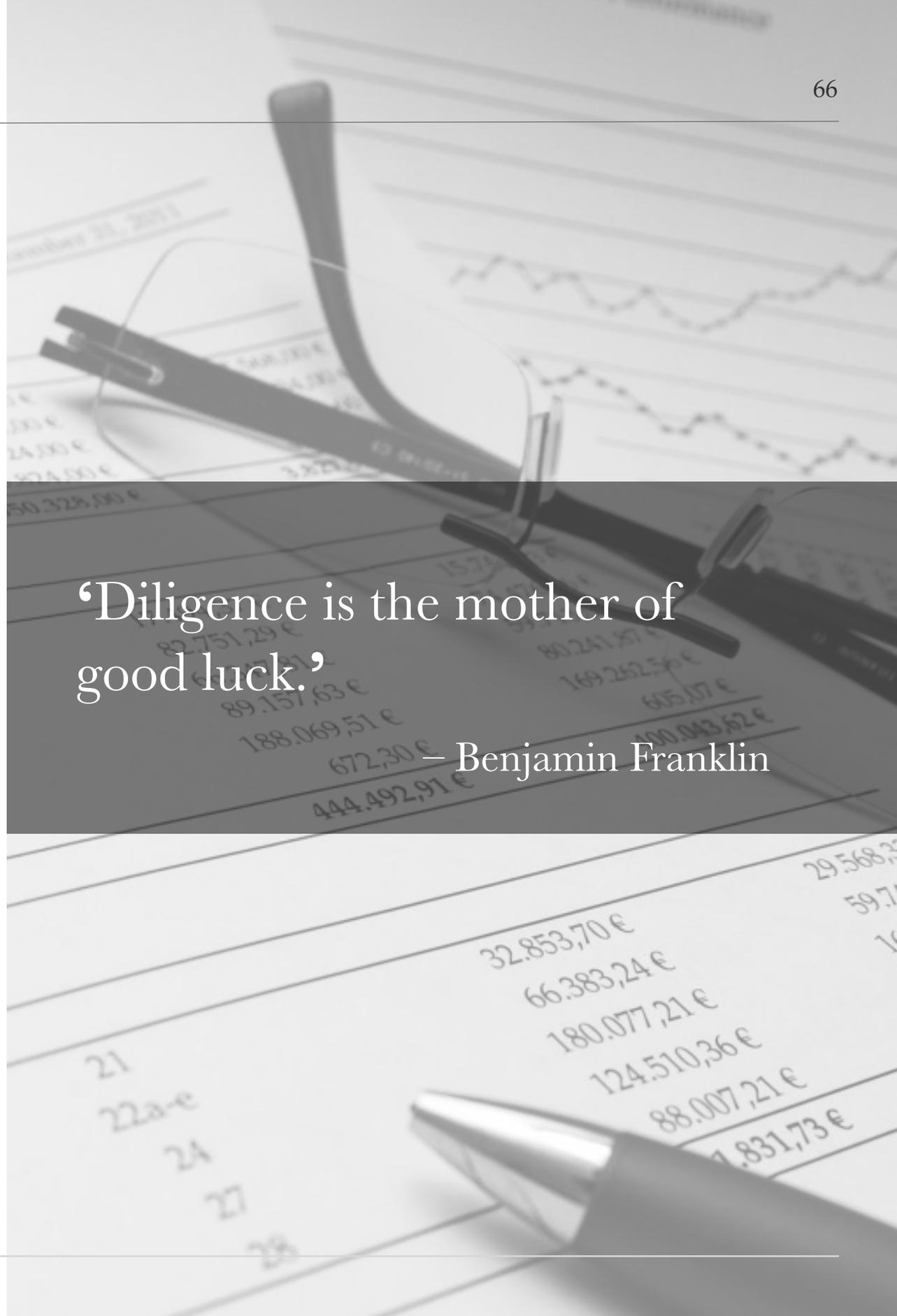
There are numerous ways to supplement the cash tranche a buyer is willing to use or has readily available to purchase an online business. A buyer can strengthen their position, mitigate risk and move up the purchasing scale by using a variety of options outlined in this section.

Investors should be mindful that competition exists and in order to secure the right acquisition at the right price, the offer that prevails is often the one that meets the needs of both the buyer and seller. It is good practice for buyers to ascertain the objectives of the seller early on to find a structure that is fair for all parties and mitigates as much risk as possible, on both sides.

Due Diligence

Having made an offer on the business, signed a letter of interest (LOI) and assuming the offer is accepted by the seller, a transaction will proceed to due diligence. For larger acquisitions, depending on relative size and complexity, due diligence is likely to be the most lengthy aspect of the end-to-end sales process.

This section explores in detail six key components for successfully conducting due diligence on an online business and gives buyers some practical advice on how to conduct a robust and thorough investigation for their own business



‘Diligence is the mother of good luck.’

– Benjamin Franklin

Due Diligence

1. **Traffic** - check the traffic to the website, observe any anomalies and ensure the link profile looks natural
2. **Financial** - verify the P&L against documented evidence
3. **Owner** - conduct a background check on the trustworthiness of the business owner
4. **Technical** - look at the technology platform underlying the business' operations
5. **Operational** - verify the time commitment and tasks required to run the business
6. **Legal** - seek independent legal advice on the legality of the business' operations

Due diligence is a critical step to be taken by any business or individual prior to making the commitment to any legally binding contract.

Why Conduct Due Diligence?

In effect, due diligence in both an offline and online sense is based on the premise that any major investment should be examined from a number of different lenses to unearth any underlying risks that may not have been duly duly considered. Due diligence is a critical step to be taken by any business or individual prior to making the commitment to a legally binding contract. Conducted well and with an appropriate standard of care, due diligence should bring peace of mind to both buyers and sellers alike.

Art or Science?

Due diligence should be thought of as an objective fact-finding exercise (science) used to inform subjective decision-making (art). There is no right or wrong way to do it and one

person's perspective or interpretation of the information put forward may differ substantially from another's. Sharp investors will be thorough when conducting due diligence and will approach the task with inquisitiveness, using the breadth of collected data to inform their final go/no go decision. At the end of the day, if something goes wrong during the course of due diligence, at least it was picked up before signing.

Due diligence can be conducted in a host of different ways, the level of detail may depend on the size of investment and associated risk as well as the nature of the online business. To conduct a thorough due diligence exercise in the context of online, there are six key areas to verify for a robust process:

- Traffic
- Financial
- Owner
- Operational
- Technical
- Legal

It is worth mentioning that some parts of the process may be considered more important by some investors compared to other. Regardless of this, all aspects should at least be probed to some extent.

Traffic – Assess the Traffic Before Crossing

Traffic verification is a case of analysing the traffic reported to be coming into the website, checking for anomalies and ensuring the link profile looks natural.

When assessing traffic (using Google Analytics, for example), buyers should ensure that any bought traffic appears on the income statement and reconciles in terms of money spent and traffic generated. As always, transparency with the seller is key, if the seller is buying traffic without fully disclosing, there could be a material misrepresentation.

Even if traffic volumes look legitimate, the traffic sources may still require validation. It is important for buyers to look for any signs of paid or sponsored links that may not have necessarily been declared. For example, a well ranked website that has a number of links may seem good on paper, but in reality the seller may be paying (and not disclosing) thousands of dollars a year in sponsorship for the privilege. It is a good idea to evaluate the link profile in general (tools for this are outlined on the following page) and examine how many back links have been added in the last six to twelve months and what the nature of these additions are.

Other things look for include:

- Average time on site – how long (on average) does each visitor spend on the site? If this figure is low (<30 seconds), then website links may be of poor quality or the UX/content is of poor quality depending on the nature of the website content of course.
- Number of pages visited – how many webpages is the visitor viewing? If high, then the content across these pages is likely to be appealing and the audience is captivated.
- Traffic numbers vs. financials – how much is each unique visitor generating in terms of revenue figures, if they don't correlate, it is likely that there are alternative sources of traffic (e.g. inorganic).
- Traffic sources – where is the traffic coming from? Traffic sources include search, social media and referral. Is the website over reliant on one specific traffic source that could be considered unstable? How have these sources evolved over time and are their explanations for the changes?

It is best practice for the seller to allow the buyer access to Google Analytics or whichever 3rd party traffic analytics platform they use in order to facilitate analysis of the traffic during due diligence.

Useful Tools:

- Google Analytics
- SEM Rush
- Ahrefs

Financial – Assess the Financial Situation

Financial verification is a key stage in both the due diligence and overall buying process. When acquiring a business, it is critical that buyers are fully aware of the current and historical financial status of the venture. In order to do so, buyers should check that the business has maintained an accurate and detailed financial record since its inception.

> 'Diligence is a priceless treasure; prudence a protective charm.'
>
> – Proverb

Buyers should start the audit trail by checking monthly affiliate statements and/or merchant processor statements against the bank statements provided by the seller. Tax returns are often requested but less often useful. Most online businesses are

owner managed and usually part of a larger LLC, so reviewing the tax returns shows a muddled picture. A combination of merchant/affiliate statements and bank records is typically enough to allay any concerns on the financial audit trail.

A document check is the first round of verification, buyers should also always request a live screen share with the seller to go through the back end of the website, any affiliate partners and possibly online banking portals in order to conduct a 2nd stage of verification of the financials as well as authentication of ownership.

It is also worth buyers tracing any historic, current or likely future debts or liabilities associated with the business (credit rating checks are a good place to start). Doing so, will put the investor in good stead for assessing whether the business is, from a financial perspective, in a healthy or unhealthy state.

Useful Tools:

- Team Viewer
- Google Analytics

Owner – Know Who You Are Dealing With

It may seem obvious to some but owner verification is important. That is, ensuring that the owner is who he or she says they are. Unlike in the offline world, it is uncommon that buyers will meet the sellers during the sale process. Ensuring that the seller has a company, history, a decent reputation and a legitimate audit trail should be a key step in your verification exercise.

The growth of social media has made this easier, albeit still relatively subjective. You could try looking the seller up on LinkedIn, Facebook or Twitter. If they don't exist, there may be a plausible reason why, either way it is worth exploring. Websites like Scam are useful ways to quickly check the trustworthiness of the seller.

Useful Tools:

- Facebook
- Twitter
- LinkedIn
- Scam

‘Everything yields to diligence.’

Antiphanes

Technical – Avoid Investing in a Burning Platform

Depending on the business and underpinning technology, it is important that the buyer is comfortable with the level of technical risk attached. Investors need to avoid a situation where a future technical issue does not permanently jeopardise the continuity of business operations. For example, if a buyer is looking to acquire an eCommerce business that sits on the Magento platform they should consider whether custom plug-ins or extensions been used. If they have, will they have access to clean code that can be modified quickly and cheaply, if required? If no, can they be put in touch with in-house programmers if technical issues arise?

For content sites operated on WordPress, buyers should conduct an audit of the plugins used and ensure they have been paid and licensed for by the seller. For SaaS and software business, investors should ensure they are given a sample of the source code for auditing to ensure authenticity as well as gaining comfort with the quality and annotation of the code for any future amendments.

Useful Tools:

- Built With

Operational – Understanding the Task Ahead

Before making a formal offer, buyers should verify the time commitment required to successfully run the business. Whilst it is difficult to know the precise time/effort, the seller should be able to break down the tasks, responsibilities and an estimation of the number of hours required to run the business. By analysing this information, a buyer should be able to gain a good understanding of the size of the task ahead.

Legal – Stick Within the Law

Is the business illegal? It may be legal in a specific country of origin, but it may be illegal in another. Therefore, opportunities for growth could be constrained, thus limiting the value placed on the business. As the deal size increases, the more legal due diligence will be required. Common litigious issues include trademark infringement and image licensing, for example.

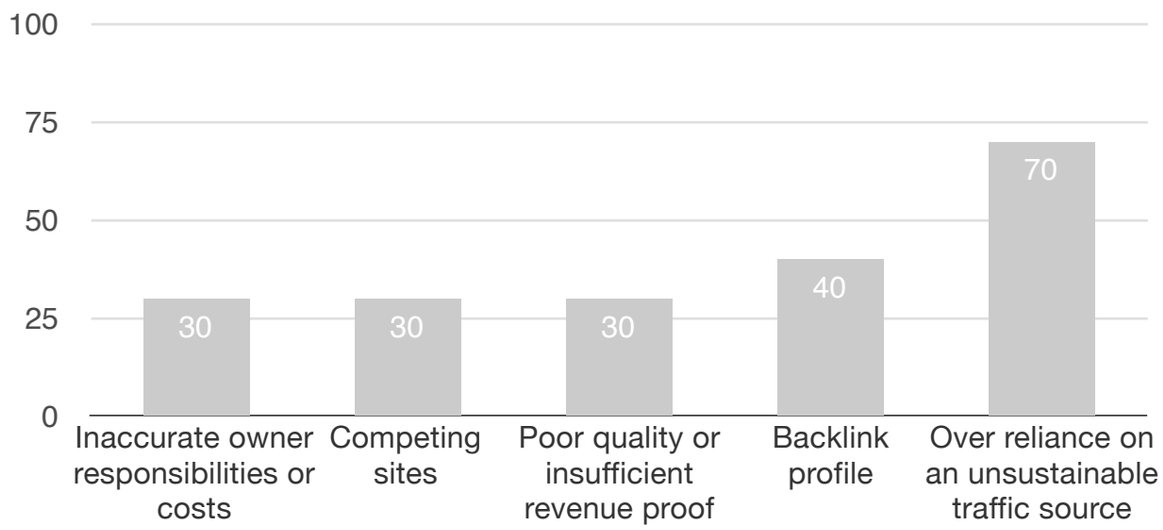
Useful Tools:

- Trademark Search
- Content Check
- Image Source Accreditation

Final Thoughts

In summary, conducting due diligence is critical to any major business transaction; it is the time to pinpoint and discuss any underlying risks that may influence the purchase decision. Done correctly it helps to put both buyer and seller at ease.

It can be useful for buyers to seek counsel from other investors that have bought historically to get a sense of issues that may have arisen. A recent survey of common issues that arise in the due diligence of online businesses highlighted that traffic verification can often be a sticking point for buyers.



Survey percentages highlighting most common due diligence issues with online businesses. Source: Centurica (2013).

Following the six-step process outlined above is a good basis for commencing online business due diligence, but its important for buyers to be flexible and not afraid of approaching it in a different way based on the specifics of a particular transaction.

Legals and Escrow

Once an offer for a business has been accepted and proceeded through due diligence successfully then the final stages of the transaction process are on the horizon. At this point, finalising the transaction is a matter of review and signing the contract and then arranging Escrow for the transfer of ownership.

This short section covers the process of drafting the contract for sale, commonly known as the Asset Purchase Agreement (APA), and arranging the Escrow transaction.

‘Thoroughly read all your contracts. I really mean thoroughly.’

– Bret Michaels

Typically after due diligence has completed, the broker representing the transaction will prepare an Asset Purchase Agreement (APA) for the deal. This is the legal document underpinning the transaction and the contractual agreement between buyer and seller. For the most part, APAs are quite standard in form but they contain a number of clauses that vary with each deal and that both parties should pay close attention the drafting of.

Consideration

The size, structure, timing and form of the consideration for the assets is clearly of high import when drafting the APA. If there is a seller financing or an earn-out the terms and timing of each payment should be made explicit in this section. Likewise, holdback consideration should have very clear conditions attached to it that are objective and verifiable in the case of dispute.

Non-Compete

Most online business sales involve a non-compete agreement between the buyer and seller providing the size of the asset and its business activities merit it. Both parties should pay close attention to the exact wording of the “Restricted Business” definition which encapsulates what the seller is prohibited from doing post-sale. A good broker will strike a middle ground between protecting the buyer from competition and the seller from being able to pursue other non-competing business in the future.

Assets For Transfer

Both the buyer and seller should be very clear upfront on the assets for transfer. With larger website sales there can be a significant amount of content and additional assets to transfer so it pays to be thorough with the documentation of these in the APA. Normally a website transfer will include (but by no means be limited to):

- Domain(s)
- Website source code, content and related files
- Graphics, images, logos etc
- Social media accounts; and
- Client database (email lists)

Transition Assistance

Agreeing the level of post-sale support given by the seller is something that should be done upfront and made explicit within the contract. The number of hours per week/month, response time and nature of communication should all be recorded. It is also wise to build in an agreement to make all relevant introductions to partners of the business.

Naturally both buyer and seller should be comfortable with what

is finally drafted for the purposes of the transaction. It is very important though to seek professional legal counsel before putting pen to paper.

Escrow and Transfer

With the APA signed it is time to transfer the funds and assets for the transaction. A reputable broker will typically direct the buyer and seller to a third party service such as Escrow.com to protect both parties through the transfer. Escrow is effectively an independent service that collects, holds and releases funds online, according to the transaction terms agreed upon by the buyer and seller. The process typically moves in the steps outlined to the right.

The Escrow service provides strong protection for the buyer by allowing inspection of the assets for a pre-agreed period (the Inspection Period) before releasing the funds. In the unlikely event there has been misrepresentation, the buyer's funds are protected and the assets can be returned to the seller. Either party can seek remediation for a grievance through Escrow's arbitration service.

Escrow is an invaluable service for the smooth transition of funds and assets. The service usually charges a fee of c.1% of transaction value on deals over $25,000. Buyers can calculate exactly how much it will be using Escrow's fee calculator. The fee is typically split between buyer and seller.

Escrow Transfer Process

1. Escrow transaction terms agreed by Buyer and Seller
2. Buyer transfers funds securely into Escrow (funds are secured but not released)
3. Seller transfers assets to Buyer
4. Buyer acknowledges receipt of assets and initiates the inspection period
5. Inspection period of 1-3 days used to confirm correct representation of assets
6. Buyer confirms satisfaction with assets and releases funds to Seller

For transactions including some form of owner or contingency based financing, it is often best practice to place the domain in the ownership of an independent third party. This protects both buyer and seller and ensures each side adheres to the financing terms agreed in the APA. Escrow offers a domain holding service for this particular situation and is recommended by most brokers.

Transferring The Business

Once advanced along the business acquisition process to the point of contract signing and funding Escrow, then a buyer's attention will start to focus on the practical challenges of transferring the business' ownership and operations.

There are many components to an online business and buyers can often be caught off guard by the logistics when the process begins. As with many things in business, preparation is key.

This section summarises the key components of an online business and provides best practice guidance on how to smoothly transfer each one.

TIPS FOR A SUCCESSFUL TRANSFER OF OWNERSHIP

- *Set up an account with the same registrar as the seller to expedite the transfer of domains*
- *Consider inheriting the existing hosting environment instead of transferring to a new setup*
- *Take an audit of all accounts associated with the business and pre-apply for accounts as needed*
- *Contact all partners of the business within 48 hours of taking ownership*
- *Identify critical tasks for the first 72 hours before taking over*

Domains & Hosting

Domain(s)

If the domain is being transferred directly, a buyer should be sure to set up an account with the same registrar that the seller is currently registered with. This will significantly expedite the domain transfer (from days to minutes). If the buyer has a preferred registrar they can always transfer the domain later. It is important to ensure the seller chooses the option to 'keep nameservers the same' to avoid a nameserver reset and downtime on the website(s) during transfer.

Hosting

All buyers have their own preferences when it comes to hosting arrangements, the key is to ensure that the planned new hosting environment has the same or more power than the current setup. Often it can be easiest to open an account at the same hosting provider as the seller (to facilitate an intra-host transfer) or take direct control of the seller's account if they agree to it. If the seller is facilitating the transfer, make sure they know what the new hosting arrangements are. In a heavy hosted environment (e.g. SaaS businesses) it is usually advised that the buyer inherits the existing infrastructure rather than attempt a migration of hundreds (or thousands) of users.

Email Lists

Most major email management tools (e.g. Aweber, MailChimp) are very flexible with transferal of email lists so be sure to create an account with the same provider and get the seller to push the list(s) over.

Accounts

This is where some buyers fall down in their preparation. In general it is good practice for the buyer to take an 'account audit' with the seller before starting the transfer to ascertain all accounts that the business currently uses. This may include:

- Affiliate (e.g. Amazon, Commission Junction)
- Lead generation (e.g. QuinStreet, CMN)
- Merchant processor (e.g. PayPal, Stripe, BrainTree, 2Checkout)
- Advertising (e.g. AdSense, Say Media)
- Email (e.g. MailChimp, Aweber)
- Social media (e.g. Facebook, Twitter, LinkedIn)

Once a complete audit is made, the buyer should ask the seller which accounts they can take full control of (i.e. inherit) and which they need to make copies of and have the existing data transferred over. Buyers should start making preparations to open accounts as soon as funds are in Escrow.

Note: On subscription-based businesses with recurring billing the transfer process can be more involved and will involve the buyer providing proof of business ownership, photo identification and proof of address.

Contact Information

Buyers should make sure to get contact information for anyone associated with the business and its day-to-day operations. It's a good idea to have the seller make personal introductions within 48 hours of the transfer. Business contacts may include:

- Employees / VAs
- Advertising and/or affiliate account managers
- Third party developers
- Fulfillment center and drop shipping partners

Other Items

Often there are some miscellaneous bits and pieces that can be forgotten in the transfer. Below are a few that have cropped up in transactions with FEI that are worth thinking about if relevant:

- Toll-free telephone number(s)
- Contact information for old business partners
- Unreleased products or services (included in the sale)
- Details of growth plans (if mentioned)

On eCommerce businesses it is often the case that the buyer will be inheriting inventory so buyers should take care with details of storage etc.

Final Thoughts

When taking over an online business of five, six or seven figure scale then it's very likely there will be tasks to take care of from day one of ownership. Buyers should make sure they understand from the seller exactly what tasks are required for the first 72 hours of ownership, how they are done and who has responsibility for them. This will ensure business continuity during the transfer process and minimise any disruption to the business' operations.

Chapter 5

About Us

'A leader is one who knows the way, goes the way, and shows the way.'

John C. Maxwell

About FEI

Highlights

- We have the largest team dedicated to brokering online businesses
- We have a 93% sale success rate and sell most businesses in less than 3 months
- We have clients spanning 100+ countries
- On average we send over 100,000 deal-related emails per year
- We sell more online businesses per year (<$5m) than any other dedicated online broker
- Find out more at: www.feinternational.com

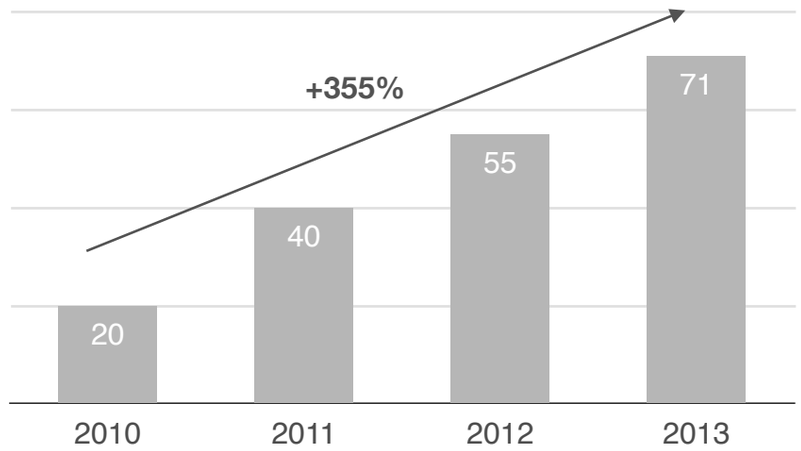
Overview

FE International (formerly Flipping Enterprises) was founded in 2010 to provide brokerage services for mid-market online businesses. The company has become the **pre-eminent advisor** within the industry and enjoys a well-earned reputation for integrity, creativity and delivering results. In 2013 alone, the firm successfully executed an industry-leading 71 transactions.

The team is comprised of professionals from investment banking, strategy consulting as well as online entrepreneurs, all of which have extensive transaction execution expertise.

Originally established in London, the company expanded internationally to San Diego in mid-2013 to bring its dedicated brokers closer to the US client base. An expansion to the East Coast is planned in early 2015 to broaden coverage in North America.

Transaction History



FEI completed transactions.
Source: FEI (2014).

Locations

Management

Thomas Smale

Co-Owner

Thomas originally co-founded FE International in 2010 (previously Flipping Enterprises) after graduating the University of Bath with a degree in Business.

Having owned and run several successful websites in a variety of niches, Thomas is passionate about entrepreneurship and online business. He is a respected expert in the industry with particular experience in due diligence, online business valuation and strategic exit planning.

Ismael Wrixen

Co-Owner

Ismael is co-owner of FE International. With a background in M&A investment banking, Ismael has executed high profile deals across several sectors, namely Technology.

Ismael is fluent in several languages and graduated from the University of Bath with 1st Class Bsc (Hons) in Business, gaining the Accenture prize for excellence in the process.

David Newell

Senior Broker

David joined FE International as a Senior Broker in October 2013. Prior to this, he worked for three years in Investment Banking for Citigroup.

David graduated at the top of his class from the University of Bath with a 1st Class in Business, gaining the Accenture prize for excellence in the process.

Thank You For Reading

For more information visit:

www.feinternational.com