THE RED FLAG REPORT · FREE CHECKLIST

17 Red Flags to Check Before You Buy a Small Business

Most of the risk in buying a small business is hidden in plain sight — in the listing, the information memorandum and the broker's pitch. Work through these 17 checks before you spend a dollar on formal due diligence.

1. **Add-backs that don't add up**
   Sellers "normalise" profit by adding expenses back — owner wages, vehicles, travel, "one-off" costs. Check every one: if a cost will still be there after you buy, it is not an add-back.

2. **The "runs under management" claim**
   Sellers love to say the business runs itself. Read what the owner actually does each day. If they quote the work, hold the customers and run the team, you are buying a job, not an asset.

3. **Owner dependency**
   Ask whether customers deal with the business or with the owner personally. If the relationships and know-how walk out the door at settlement, the goodwill you are paying for may not exist.

4. **No replacement-owner cost**
   The profit figure should include a realistic salary for someone hired to do the owner's job. If it does not, the earnings are overstated — often by six figures.

5. **Customer concentration**
   Find out what share of revenue comes from the largest one, five and ten customers. If a single client is 20%+ of the book, the business is far more fragile than the headline suggests.

6. **Flat revenue dressed up as growth**
   One strong year or cherry-picked figures can hide a business going sideways. Ask for five full years and look at the trend, not the highlight.

7. **One-off income in "maintainable" earnings**
   Asset sales, grants, insurance payouts or a single abnormal contract can flatter a year's profit. Strip anything that will not repeat before you value the business.

8. **Lumpy revenue sold as steady**
   Annual figures hide the swings. Look quarter by quarter — weather-, season- or project-driven income cannot be banked on like a steady run rate.

9. **No recurring revenue**
   If every dollar is ad-hoc work that must be won again next week, the business is only as strong as its next quote. Recurring contracts are worth far more than one-off jobs.

10. **Key-person staff risk**

    Beyond the owner, is there one manager, tradesperson or salesperson the business cannot run without? Check their tenure, their contract, and whether they will stay after the sale.

11. **Lease and rent traps**

    A short lease, a demolition clause, or a rent review about to reset to market can quietly wreck the economics. Read the lease before you read the financials.

12. **Tired plant and equipment**

    Ageing vehicles, machinery and tools mean a capital bill is coming. If it is not priced into the deal, you will pay for the business twice.

13. **A multiple that does not fit**

    A hands-on, owner-run business is not a passive investment and should not be priced like one. Make sure the asking multiple matches the risk and the work involved.

14. **Vague or stale financials**

    No recent signed tax returns, or accounts that do not reconcile to the BAS, are a warning in themselves. If you cannot verify a number, do not value the business on it.

15. **Undisclosed problems**

    Pending litigation, warranty claims, an ATO debt, WHS incidents or a poor insurance history rarely appear in the sales pitch. Ask for each of them directly, in writing.

16. **Supplier and supply risk**

    One key supplier, no written terms, or heavy exposure to a single input price can put the business at someone else's mercy. Know exactly who it depends on.

17. **A handover that is too short**

    "I'll stay two weeks" is not a transition. For an owner-dependent business, insist on a genuine handover, a consulting tail and a real non-compete — written into the contract.

Looking at a specific business?

A checklist tells you what to look for. The Red Flag Report does the looking — an operator-level review of the actual listing and information memorandum, every one of these flags checked against the real numbers, with a clear Red / Amber / Green verdict. See it at theredflagreport.com.au