

If you buy a company without understanding its numbers at a granular level, you are gambling, not investing. The seller’s narrative matters, but the scoreboard is in the KPIs. Sharp acquirers, whether first-time buyers or veterans, read those metrics like radiologists read scans. Patterns, anomalies, and context tell the story. A single ratio rarely kills a deal, yet a cluster of indicators, trending together, reveals the true pulse of the operation.

I have walked plants with spotless floors and strong top-line growth that hid disastrous cash cycles. I have also seen drab offices turn into cash fountains because a few misunderstood metrics had depressed the price. The difference lies in knowing which KPIs to pull, how to normalize them, and where the traps live. If you are Buying a Business or building your own Business Acquisition Training regimen, the following metrics form the core of a disciplined pre-acquisition assessment.

Revenue quality beats revenue size

Buyers often start with the top line, but the measure you want is revenue quality. Two businesses with the same sales can carry very different risk profiles depending on how those sales are earned.

Customer concentration is the first lens. If one client represents more than 20 to 30 percent of revenue, you are not buying a diversified income stream, you are buying a relationship. Relationships walk. Even when there are long-term agreements, assignment clauses and termination for convenience provisions can unwind your assumptions the day after closing. Ask for revenue by customer for at least three fiscal years. Track churn, expansion, and the stickiness of each cohort. A seller who resists this breakdown is waving a flag.

Contracted versus transactional revenue changes stability. Subscription or maintenance streams with auto-renewal and modest annual price escalators carry more value than project-based work. Look beyond the headline “recurring revenue” figure to the net retention rate. A business with 90 percent net retention and 10 percent price lift acts very differently from one with 95 percent gross retention but constant discounting to backfill churn. I like to see separate KPIs for gross retention, expansion, and downgrade rates because they explain pricing power.

Revenue recognition policies also distort quality. Construction and professional services often recognize revenue on a percentage-of-completion basis. If inputs or milestones are subjective, earnings can be pulled forward, inflating both revenue and margin in the short term. Tie revenue recognition to contract terms and delivered value, then compare recognized revenue to billings and cash collected. A swelling unbilled receivables balance often signals aggressive recognition.

Seasonality matters more than many admit. A retailer that makes its year in the fourth quarter can look fine on an annual P&L but can run dangerously tight cash in September. Pull monthly revenue for at least 24 months and calculate a simple seasonality index. Then test working capital against the trough months to understand the capital you will need to bridge.

Finally, investigate channel mix and discounting. Heavy reliance on a single marketplace or lead aggregator puts your fate in someone else’s algorithm. If discounting has crept up to maintain volume, the top line may be masking a margin bleed.

Gross margin tells you whether the engine is sound

Gross margin is where product-market fit shows up in dollars. High margins with low volatility suggest pricing power and operational discipline. Thin or volatile margins hint at supply chain fragility, cost inflation risk, or price pressure from smarter competitors.

Normalize for counting errors. Many small companies record freight-in, rebates, or installation labor below the line. Recast cost of goods sold to include all direct costs required to deliver the product or service. I have seen “marketing” lines quietly carrying sales engineer salaries that are, in reality, delivery costs. When you move these to COGS, the true gross margin appears, and the story can change overnight.

Vendor rebate programs and volume tiers can create step-function changes in cost that vanish when volume dips. Ask for purchase data by SKU and vendor, with rebate accruals and true-ups separated. If 3 percentage points of margin rely on end-of-year rebates, what happens in a down year?

For services firms, gross margin is mostly about utilization and effective hourly rate. Check billable hours per FTE, average bill rate, and write-offs. Compare scheduled utilization to actual realized utilization. A small change here, say from 70 to 75 percent, often drives more value than headline growth.

EBITDA is a starting point, not an answer

Adjusted EBITDA gets thrown around in every deal, then twisted beyond recognition. It is still useful if you keep discipline. Separate true add-backs from fantasy. One-time legal fees tied to a unique dispute? Fine. Owner’s Mercedes lease? Often defensible, provided the business will not carry it post-close. Chronic “one-time” marketing experiments every quarter for the past three years? That is not one-time, it is a way of doing business. Trend the adjustments over multiple years and compute EBITDA with and without them. If adjustments exceed 10 to 15 percent of EBITDA consistently, treat the quality of earnings as suspect and dig into why.

EBITDA margin trend matters as much as the level. Flat revenue with rising EBITDA could mean cost discipline, or it could mean deferred maintenance and [how to buy a business in the UK](#) underinvestment. Ask for maintenance capex history, key hire vacancies, and deferred software or equipment replacements. If opex compression is not supported by process improvements, you may inherit a coiled spring of expenses.

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Be mindful of the tax posture. S-corps and LLCs often engage in income minimization. That does not bother me, but it means you must separate tax strategy from operating reality. A proper quality of earnings report that ties bank statements to reported EBITDA will save you grief and, in many cases, negotiate your purchase price.

Cash conversion cycle exposes the heartbeat

Profit is a theory. Cash is oxygen. The cash conversion cycle, or CCC, adds discipline to your view of working capital. You measure, in days, how long a dollar is tied up from buying inputs to collecting cash from customers. Days Sales Outstanding shows your collection muscle. Map DSO by customer segment and payment terms. If credit memos and write-offs spike after quarter end, collections may be softer than advertised. Watch for extended terms used as a sales lever.

Sixty-day terms paired with early-pay discounts can be reasonable, but you need to see the uptake rate on those discounts.

Days Inventory Outstanding reveals demand forecasting and supply resilience. Compare DIO by SKU or product family. Averages hide rot. Slow-moving items often accumulate in the tail, destroying cash while everyone celebrates top sellers. Tie inventory accuracy to cycle counts and shrink results. In manufacturing, reconcile work-in-process balances to routing times and scrap rates. If you cannot tie what is on the floor to what is on the books, assume leakage.

Days Payable Outstanding illustrates supplier relationships and purchasing leverage. Stretching payables feels like free cash until it starts damaging supply assurance or forfeiting early-pay discounts that exceed your cost of capital. Check for rising supplier concentration, hidden factoring, and any “net 30” vendors who quietly operate at net 15 because the relationship is strained.

Trend CCC over 24 to 36 months. Combine it with seasonal patterns. A business with a 60-day CCC can still be safe if it grows predictably and has committed lines sized to the peak. Without that, growth can paradoxically starve cash.

Unit economics prevent scale from amplifying mistakes

Unit economics anchor decisions in the behavior of a single customer or transaction. If a unit is not profitable after fully loaded direct costs and a rational share of variable overhead, adding volume simply magnifies the problem.

Contribution margin per unit is the first gate. Include discounts, returns, and all direct variable costs. For recurring revenue models, calculate gross profit per customer by cohort. The truth hides in the cohorts, not the averages. If 2021 customers pay back in 4 months and 2023 customers need 10, your acquisition timing matters.

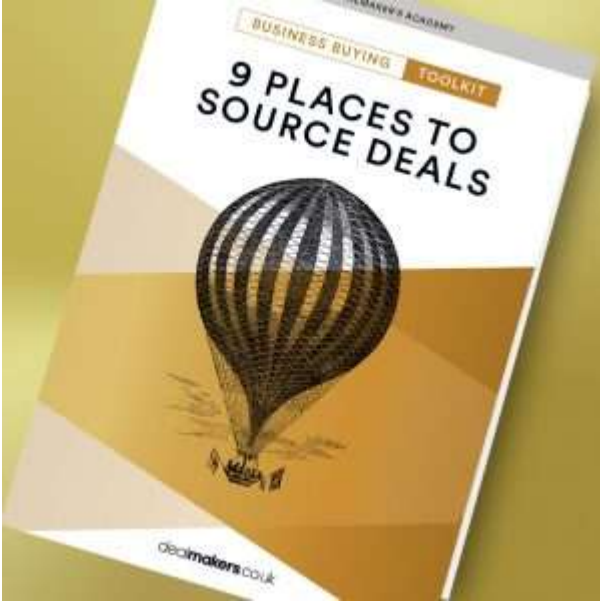
Customer acquisition cost should be grounded in attributable spend, not a blended marketing budget. Tie CAC to specific channels and campaigns, then reconcile with opportunity-to-close rates and sales cycle length. Beware the trap of sales teams that push leads across quarters to meet targets. If you see month-end or quarter-end spikes in “new customers,” expect some elasticity in how results are recorded.

Customer lifetime value is only credible if you base it on observed churn, gross margin, expansion rates, and a discount rate that reflects your actual cost of capital. When LTV to CAC falls below 3 to 1 in subscription businesses, I want to see a plan that improves onboarding, reduces churn drivers, or raises price. Sometimes the fix is as simple as building an onboarding playbook. Sometimes it requires reshaping the product, which is not a Day 1 lever for a new owner.

Cost structure and operating leverage determine resilience

When revenue dips 10 percent, does profit drop 10 percent or 40? The answer lies in fixed versus variable cost mix. Break down payroll into roles tied directly to output and roles that remain regardless of volume. In services, people are the product, yet many firms treat them as fixed. That overstates safety.

Map step-fixed costs. Rent, software licenses, and supervisor layers often jump at thresholds. A plant may be efficient up to 70 percent capacity, then need a second shift coordinator, extra maintenance coverage, and added QC. Those steps matter to your ramp plan and to your downside cases.



Scrutinize vendor contracts for escalators and minimums. A “great rate” on cloud services with a three-year minimum can turn into a weight if your strategy changes. Similarly, outsourced manufacturing often carries take-or-pay clauses. If volume falls, you still pay.

Check wage drift and benefits creep. In a tight labor market, comp can rise faster than revenue if pricing is not dynamic. Compare your price increase cadence to wage adjustments and benefits renewal cycles. If the seller has not increased prices in two years, you may have an immediate lever, but you also risk churn if service has slipped.

Pricing power is a strategic KPI hiding in plain sight

I have rarely seen a deal break because price was too high. More often, deals stall because the company lacks the courage or the process to charge for its value. The KPI is not just price level, it is price realization.

Measure discount incidence and depth by rep and by product. If your top sellers also give the deepest discounts, you have a training or incentive problem. Tie win rates to price bands to see your elasticity. Many teams assume a 5 percent price increase will tank close rates. Data often shows that an assertive, well-framed increase barely moves win probability, especially if your competitor pool has also taken increases.

Track price increase execution. Announced increases do not equal collected increases. Look for uplift by cohort after price change dates. In B2B, contract language matters. Do you have CPI-linked escalators or caps? Are there MFN clauses that force you to preserve low prices across clients? These details determine how fast you can align price to cost.

If you inherit a model where sales throws discounts to close deals late in the quarter, build controls. Specific approval thresholds, incentives that reward margin, and a review of payment terms will lift realization without changing the list price.

Retention and churn show whether customers vote with their wallets

Happy talk in diligence often leans on NPS or anecdotal praise. Good, but money is better. Measure retention with words that count: dollars and logos. Gross revenue retention tells you how much recurring revenue you keep before expansion. Net dollar retention tells you the combined effect of churn, downsell, and upsell.

Logo churn, especially for SMB-heavy bases, should be read alongside acquisition volume. If you add 30 percent more customers each year but shed 25 percent, your engine needs constant fuel to maintain stasis. That is fine if CAC payback is short and cash is abundant. It is dangerous if cash is tight, marketing channels are saturating, or payback has stretched.

Use cohorts to separate onboarding from long-term fit. If most churn happens in the first 60 days, your problem is positioning and onboarding. If churn hits at renewal, you likely have product gaps or value gaps. Many acquirers underestimate how much tribal knowledge in customer success keeps churn low. When that team leaves post-close, retention can wobble. Budget for knowledge transfer and shadowing in your integration plan.

Operational KPIs reveal execution risk

Every industry has a handful of operational KPIs that predict whether promises will be kept. In distribution, order fill rate and on-time shipment percentage drive customer satisfaction and pricing leverage. In manufacturing, overall equipment effectiveness and first pass yield determine gross margin more than any spreadsheet assumption. In software, deployment time and bug backlog correlate with churn far more than leadership admits.

Pick the two or three that truly govern value creation in the target's model. Then study their variability and their root causes. Do they swing with staffing, supplier performance, or demand spikes? If the business relies on a few key employees to keep those KPIs within bounds, your deal risk is higher than the P&L suggests. Build contingency plans and retention packages.

Debt service coverage and covenant headroom keep you out of trouble

Most deals carry leverage. Your lender will care less about your brilliant growth plan than about the company's ability to service debt through cycles. Two KPIs stabilize the conversation: debt service coverage ratio and fixed charge coverage ratio.

Model these ratios under base, optimistic, and downside cases with sensitivity to gross margin, DSO, and volume. Do not just test revenue shocks. Test a 2 to 3 point margin compression, 10 to 15 day worsening in DSO, and a 10 percent inventory overbuy. These are common and survivable if sized, deadly if ignored.

Covenant headroom matters as much as today's compliance. If you are buying a business that runs close to its leverage or interest coverage thresholds, one quarter's noise could force an amendment at the worst time. Price that risk, or restructure the debt to buy headroom.

Capital expenditure and maintenance intensity anchor free cash flow

Some businesses look wonderful on EBITDA, then quietly consume cash because the equipment base is old, the buildings leak, or the software stack is brittle. Separate growth capex from maintenance capex. The latter sustains current performance. Underfunding it is tempting for sellers. Your job is to reset it to reality.

Tour facilities with a skeptical eye. If you see Band-Aid fixes, spare parts on backorder, or key machines with persistent downtime, expect a catch-up spend. Ask for a three-year capex ledger, match it to depreciation schedules, and speak with the maintenance lead without management present. In digital businesses, apply the same rigor to the product roadmap and technical debt. If core components are near end of life, your "capex" will take the form of engineering sprints and vendor migrations.

People metrics decide whether the plan survives the handoff

KPIs around human capital rarely appear in teaser decks, yet they determine whether you can sustain performance post-close. Voluntary turnover, regrettable turnover, time to fill key roles, and span of control reveal stability.

Look at compensation bands versus market medians. If pay is below the 50th percentile in a hot market, retention risk is high, especially after an ownership change. Verify that sales compensation aligns with profitable growth, not just booked revenue. I have seen comp plans that reward bookings with no tie to margin or collections. That will wreck your CAC and your cash in a single quarter.

Cultural KPIs are softer but visible in small signs. Are performance reviews current? Does the safety record show trending improvement or plateau? Are training hours per FTE growing or shrinking? If the seller has run a tight, founder-centric shop, plan for managerial layering and process formalization. Budget time and money, not just good intentions.

Technology and data integrity are part of financial diligence

If the ERP, CRM, or billing system cannot produce clean, reconciled data, your KPI picture is foggy. Treat data integrity as its own KPI: percentage of orders with complete fields, variance between CRM pipeline and booked deals, reconciliation timeliness between subledgers and the general ledger.

Review system change logs and user permissions. If the controller and sales leader have admin rights everywhere, adjust your fraud risk lens. Request data exports early. If those take weeks or arrive with broken joins, expect a painful integration. Some buyers skip this because it feels technical. Then they discover after closing that simple reports are handmade each month in Excel. Your ability to run the business on time depends on fixing that.

Legal and compliance KPIs quietly swing valuation

Litigation reserves, OSHA incident rates, environmental compliance scores, and audit findings by severity level may sit outside the P&L, but they influence cash needs and deal structure. In healthcare, look at denial rates and days in accounts receivable by payer category. In government contracting, track backlog by contract type and protest frequency. If any single regulatory relationship accounts for a disproportionate share of approvals, you have a key-person risk that may require an earn-out or holdback.

What to normalize before you trust any KPI

Diligence data arrives messy. If you compare Year 1 and Year 2 without cleaning, you can draw the wrong conclusion with great confidence. Before you hang a decision on a metric, normalize for:

- Accounting policy changes, especially revenue recognition and capitalization decisions, that shift timing rather than economics.
- M&A events, such as tuck-ins or asset sales, that break comparability across periods.

Once you adjust for those, test for survivorship bias. If the seller has cut unprofitable SKUs or territories in the past year, recent KPIs may look better than the longer average. That is good if the cuts are durable, less good if the unprofitable volume has crept back through discounting or channel incentives.

This is also the stage to align definitions. I ask the team to write one-paragraph definitions for each key metric, including inclusions, exclusions, and data sources. It sounds bureaucratic but it prevents “apples to slightly different apples” debates in the eleventh hour.

Two small, high-leverage diagnostics

The thick binders matter, but I like two fast tests that expose reality.

First, tie the P&L to the bank. Pick three random months across two fiscal years. For each, reconcile cash collections and disbursements to revenue and expense recognition. You will not trace every line, but you will discover whether timing differences are routine or used to polish results.

Second, request the top ten lost deals from the past year with the full email correspondence or CRM notes. You will learn more about product gaps, pricing, and competitor tactics in those ten losses than you will from hours of sales narration. If the seller cannot produce credible loss data, expect a weak pipeline hygiene culture.

Building your own acquisition KPI muscle

Templates help, but judgment beats checklists. Business Acquisition Training programs worth their fees focus on pattern recognition. You read three years of monthly data, you tour the floor, you interview the ops lead, and your brain cross-links the story. That is how you see that rising gross margin plus longer DSO equals discounting at quarter end. Or that steady EBITDA with slumping maintenance capex equals a tired asset base waiting to break.

Practice by deconstructing public company 10-Ks in the same industry as your target, even if your target is private and smaller. Translate their segment KPIs down a size or two. Then layer in the human side, because numbers travel with people. A strong plant manager with pride in first pass yield can lift margin faster than a new pricing schedule. A brittle founder who hoards relationships can spook customers regardless of your LTV model.

When to walk, when to lean in

Every deal has hair. The question is whether the hair is groomable. If revenue quality is poor, cash conversion is worsening, unit economics do not pay back within a reasonable window, and the team is thin, you are not buying a fixer, you are buying a turnaround. That is a different price and a different plan.

If, however, you see a business with decent margins, fair retention, sloppy working capital, and timid pricing, lean in. Those are eminently fixable with process, training, and a few systems upgrades. I have watched deals like that return capital in under two years, not because the market was kind, but because the buyer respected the KPIs and pulled the obvious levers with discipline.

Buying a Business is not a lottery ticket. It is an exercise in measured risk, cash discipline, and operational empathy. The KPIs give you the map. The judgment to weigh them, normalize them, and turn them into a post-close plan is your craft. If you build that craft deliberately, the numbers stop being noise and start telling you exactly where value hides.