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Funds for acquisition financing are finding their way back into the marketplace

October 18, 2011 - Connecticut

The market for business sales has been depressed since the onset of the financial crisis in 2008, but there are signs that this is changing. One of the reasons is funds for acquisition financing are finding their way back into the marketplace mainly through the SBA loan guarantee program. The other reason is that sellers are becoming more receptive to taking back paper as a part of a transaction. If you're a buyer then accessing either type of credit should be on your radar and if you're a seller whose business will require debt financing then you should begin to consider what the requirements are for an SBA loan and what the ramifications are of taking back paper.

The U.S. government offers loan guarantees to banks to loan money to acquire businesses, initiate partner buyouts and/or provide commercial re-financing through the SBA 7a guaranteed loan program. The SBA guarantees 80% of a loan that a participating bank makes to the buyer. Loan amounts vary by bank, but lending starts as low as $200,000 and tops out at $2,500,000. They have a 10-year term with an interest rate of prime plus 2.75%. The program has different down payment requirements depending on the level of good will acquired in the transaction. For business with less than $500,000 in good will, the SBA requires 15% down. For businesses with more than $500,000 of goodwill, 25% down is required, but in these cases the down payment can come as a combination of buyer funds and a seller's note that totals 25% of the sale price. The caveat for the seller is that this note is subordinated to the bank loan and has a two year standby before payments begin in the third year. Payments are then amortized over years three through ten.

Loans will be approved by the banks primarily on the cash flow of the business, the industry it is in and the strength of the buyer. In general, their underwriters will examine the tax returns of the business to determine if it has a debt service capacity of 1.25 times to 1.4 times the cash flow of the business net of the buyers anticipated salary (For acquisitions that are less than 50% collateralized, the bank will look to impose the higher multiple). Obviously, it's to the advantage of the seller to show as high a net income on the tax return as possible. This will make the deal more financeable and therefore more valuable. While the banks allow for certain "add backs" to the net income such as depreciation, interest and amortization expenses, and certain non-recurring expenses, if you're burying many personal expenses in the returns, you may wish to begin to limit the practice in advance of the sale.

For the buyer, banks will want to review your resume, and personal financial statement. The buyer's background is probably more important than their net worth. If you have experience in the industry, then they will look on this highly favorably.

In lieu of an SBA loan, a seller may wish to consider offering a "Seller's Note" to a buyer. While this is the least palatable option to many, it is also what is being done in today's market. Of the 28 businesses we've sold in the last two years, two thirds of them have involved seller financing. In the end, if you offer 25 to 50% of the purchase price in the form of a note with anywhere from a 3 to 7 year term, you'll have a greater likelihood of selling the business and doing so at a higher price. Most sellers craft a security notes on the assets of the business and personal assets of the buyer to protect their interests. Additionally, there is a market for seller's notes if the seller wishes to convert it to cash. Buyers of these notes generally will do so after the notes have had the chance to "season" which means the buyer has demonstrated a capacity to pay. In today's market, sellers need to consider this form of financing.

Until the economy fully improves, all parties to a transaction are going to have to remain creative in the terms of a sale. This is nothing new, but ever important in today's marketplace.

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