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August 2020 - In This Issue:

AUGUST 2020 THINGS...

By John Zoellner, BCA, MCMEA And Morgan Vaive

If Labor Day is the (unofficial) end of summer, I suppose that means that summer is coming to an end.

Some schools have started while others soon will. In person and virtual classes will each have their challenges for both students and parents alike. Our work environments for many of us have changed while working from our home offices, social distancing, masks, fewer in-person meetings amongst others is our new normal.

Adapting to required changes in most aspects of our lives both personally and professionally will continue and for the most part we accept these changes and carry on with our day-to-day activities. Hopefully, we will be able to improve the things we can, and deal with the things we cannot. As for managing our businesses, now more than ever we should be questioning where we are and where we are

BUSINESS ACQUISITIONS THAT CANNOT BE FINANCED

Some prospective sellers think a prospective buyer is just going to write them a check for the full price of the business. That is the rare exception indeed!

Almost all prospective buyers will pursue financing for their business acquisition. But there are pitfalls that prevent financing and they tend to parallel the potential obstacles to a sale.

Pitfalls to lender-financed acquisitions

Prior to September of 2008, business acquisition financing was much more readily available than it is today. Before the credit crunch in the fall of 2008, qualified buyers could obtain a Small Business Administration (SBA) loan for the purchase of a business that was reasonably priced in relation to its Sellers Discretionary Earnings (SDE) with a 15% to 20% down payment. The most common pitfalls at that time were:

1) Inadequate SDE
2) Business not priced right in relation to its SDE
3) Buyer with insufficient cash for the down payment and working capital needs of the business
4) Buyer with inadequate experience in the industry
5) Business with too high of a customer concentration
6) Current year's interim financial statements indicate decreasing operating results versus historical financial statements
7) Buyer unable to secure a lease term to match the loan term

Prior to the credit crisis in September 2008, it was usually possible for prospective buyers to obtain SBA loans without the seller participating in the financing of an acquisition. After that crisis, the SBA underwriting criteria is now much more restrictive. In addition, the SBA is currently requiring a prospective going. If things are good, ask why and focus on how to continue. If we are struggling, ask why, analyze, and look at alternatives.

One thing I do know is that businesses are selling. How do I know? Because I do Business and Machinery & Equipment Appraisals, and most are for banks that are financing acquisitions. The contrary is that a few M&E Appraisals is to determine collateral value for lenders with borrowers that are struggling.

If you would like to discuss the value of a Business for whatever reason, or if you would be willing to discuss the *POSSIBLE* sale of your business, please contact us. There is no obligation, just an opportunity. We look forward to hearing from you.

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NEXT ISSUE

Business Acquisitions That Cannot Be Financed

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buyer to have a higher level of direct industry experience, down payment requirements have increased and it's more difficult to finance the goodwill portion (business enterprise value in excess of hard asset value) of a business acquisition. In addition the debt service coverage ratios have increased. (Debt service coverage is the excess of SDE less the new owner's salary, less the annual loan payment on the acquisition loan.)

Most lenders prefer transactions larger than $250,000

Historically, it's been difficult to obtain financing for business acquisitions under about $125,000 for two reasons: (1) SDE is insufficient to enable a prospective buyer to pay himself enough to meet his other financial obligations. As a result, there's not enough left over for debt service coverage. (2) Lenders prefer larger deals to smaller deals.

In today's lending environment, most SBA lenders are unwilling to consider transactions less than about $250,000 (which requires about $100,000 of SDE). Again, there are two reasons: (1) with ever-increasing requirements, it is difficult to achieve adequate debt service coverage ratios at SDE less than $100,000. (2) With tightening credit standards, lenders are being much more selective of transactions they will consider, with minimums often set at $250,000 for business acquisition financing.

Financing pitfalls tend to parallel obstacles to the sale of a business

With a better understanding of lenders' requirements, you can see why Inadequate Seller's Discretionary Earnings (SDE) is one of the primary obstacles to a sale. Of the seven financing pitfalls listed above, all but number 4 are also obstacles to a successful sale of a business.

Seller financing can be minimized

To put it simply, prior to September of 2008 an owner could sell his business without having to "carry any paper." In the new economic environment, owners are much more likely to be asked to provide some seller financing. That's the bad news. The good news: in many instances, seller "carry back" can be limited to about 10% of the purchase price.

However, if other financing pitfalls/business sale obstacles are encountered, the percentage of seller financing required to complete a transaction will increase. That's why it is so important to identify obstacles to a successful business sale. Once identified, you can address the issues and likely reduce the amount of seller financing that will be required when it's time to sell your business.

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