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Business Valuations, Mergers, Acquisitions, and Consulting
NEWSLETTER ARTICLE ARCHIVE

Accept Seller Financing With Eyes Wide Open

When a seller wishes to sell their business, they have different markets to which they can sell. Without getting too much into the weeds, let's just divide the market into two different halves. One half represents the "financial buyer". This buyer is typically new in the industry and will only be able to pull value from the business based on the seller's company profits. With many "Main Street" businesses, this is your typical buyer…the corporate refugee, the person who knows how to run a business but does not have specific industry knowledge or synergy. This buyer brings money to the table with a willingness to learn the industry. They are determined to make a better product or service based on their personal skill set.

Some sellers, however, have the ability to sell to a synergistic or investment buyer. These sellers can sell to a business partner, a family relative involved in the business; an industry buyer outside of the geographic market or even…yes…more than often…the dreaded COMPETITOR!

Sometimes, this investment buyer will put down the same amount of cash at closing as the financial buyer…or maybe a little more, but the balance will be seller financing in some form or another. Seller financing is a promissory note from the buyer to the seller for a set amount paid out typically monthly with terms that reflect an interest rate. Depending on the strength of the seller, this interest rate can be below market or above market standards. Another form of seller financing is the "earn-out". This level of seller financing is based upon the company, under the guidance of the new owner(s) hitting certain revenue or profit levels that the parties have agreed to up front. If the levels are hit, the seller is paid more on a monthly, quarterly, or annual basis. If the levels are not hit, the seller is paid nothing or little.

Definitions of the terminology in the contract are paramount! What is revenue, gross profit, net profit, seller's discretionary income? Make sure all parties clearly set the formula up front to avoid frustrations and lawsuits in the future.

As you can see in the chart on page 2 seller financing requirements dropped significantly year-over-year. Seller financing reached an all-time low of just 4% in the $5M-$50M sector, since the survey began in 2013.

I personally have sold businesses I have owned with some seller financing and all went well…because believe me…all was clearly defined and the seller and the buyer trusted each other. If you do not trust the other party….walk away or be satisfied with what you have been given up front…whether you are the seller or the buyer! At some point in the deal, you have to trust who you are dealing with. Again, when you do not trust the other party…walk away! Life is too short and profits in the short run will not cover you in the long walk of life!

	Q2 2019 Cash at Close	Seller Financing	Earn Out	Retained Equity	Q2 2018 Cash at Close	Seller Financing	Earn Out	Retained Equity
<$500K	87%	12%	1%		83%	12%	1%	
$500K-$1MM	84%	10%			81%	16%	3%	
$1MM-$2MM	85%	8%	3%	1%	80%	17%	7%	2%
$2MM-$5MM	83%	8%			82%	14%	6%	
$5MM-$50MM	94%	4%	1%		80%	15%	3%	15%

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