Structuring Larger Goodwill Transactions

There are More Options then you Might Think

By Steve Mariani

You've just advised your seller to accept the presented LOI and now need a lender to agree to finance this transaction. The only concern is the 3.4-Million-dollar goodwill piece included in the 4.0-million-dollar purchase price. The lender you typically use for most transactions seems to be hesitating a bit on the lack of collateral included in the transaction and after reviewing the financials of the buyer realizes, there's not much else to place a lien on. Today we'll talk about the many options that can be used to combat this concern and get your deal closed.

The first thing to determine is the TPC or Total Project Cost? To understand the project cost we must dig deeper into the actual needs of the operation. TPC will be including all the items that will need to be considered by a buyer before, during and after the closing to ensure the business continues to operate as presented. These items begin with operating or working capital as most people know it best. That said, did you know there are really 2 kinds of operating capital in our financing world? Most people don't and we'll explain the differences here. There is "permanent" working capital and "revolving" lines of credit and each is utilized for different purposes.

The "permanent" working capital is the money required to operate the business on a daily or monthly basis. We calculate permanent working capital to be the monies required to support the ongoing expenses needed to run the operation including rents, salaries and general operating overhead.

Once we understand the needs of the operation from an overhead cost perspective, we then need to understand the collection process and what amount might be required to support the account receivables, if any. Calculating this amount is sometimes more or less important depending upon the business's customer base. If the business sells to other business customers and is mostly B to B then I would expect to see some amount of A/R's on the balance sheet that we'll have to account for in some fashion.

Depending upon the amount shown on the A/R aging and considering the profit margins, we can determine the correct amount of capital required to support this portion of the operation. Many times, on these larger transactions, a great amount of operating capital can be required. As an example, using an average A/R amount of 1MM per month for an acquisition and knowing their collection policy allows 30 days for payment, this would equate to an operating line requirement of approximately 1.5MM just for the financing of the receivables. The three options for this additional funding can be seller notes, additional buyer injection or lender provided financing.

Many times, we would recommend that each party share in this amount to ensure the buyers success. What I mean by this is that maybe the seller will allow the payment of a certain amount of his receivables to be paid off over time as opposed to being paid to the them within a few days of collection, as most purchase agreements state. Other avenues might be the buyer increases his or her injection a bit and the lender then can also include an operating line of credit. Typically, between these three methods, we can find a solution to this larger A/R concern and move this deal forward and an SBA express line of credit might be the answer.

SBA Express line now have a much longer interest only period and worth mentioning here. Prior to 2018, all SBA express lines had a mandatory term out after the initial interest only period of 2 years. Since then the rules have changed and now allow a lender to allow interest only payments for up to 5 full years and then it terms out for an additional 5 years, a much better option for the above type scenarios.

Other structuring considerations on these size transactions might include a seller consulting agreement. The SBA allows the buyer to hire the seller as a consultant for a period not to exceed 1 year. If your buyer is truly in need of seller support post-closing, this could be a valuable option. Reducing the selling price and offering a consultant agreement could be another great option.

One more option, that I hesitate to bring to any brokers attention, is seller financing. Our firm advises against it for many reasons, but we do consider these at specific times and for specific reasons. To bridge a gap between our maximum loan amount of 5MM and the purchase price or maybe to combat a customer concentration concern, as an example, might be times we suggest seller financing.

The bottom line in all larger, goodwill transactions, is the wiliness of all parties to make the deal happen. Once we understand the motivation of each side, we can then best strike a solution that satisfies each party. Today we describe just a few of the options available for the structuring of larger loans but you should know, these are just a few examples and there are many more. This is where there is no substitution for experience and lender criteria knowledge along with SBA rule understanding.

Creative structuring is only achieved through experienced, knowledgeable SBA professionals.

When you really explore seller notes as a financing option, it is not typically beneficial to the transaction and if it can be avoided, is usually in the buyer's best interest to do so. Don't let conservative SBA lenders convince you otherwise.

We hope this newsletter helps you close more transactions.

AskDiamond@easysba.com is always available for specific questions regarding this or other SBA rules.