



Guidelines for Acquisition Financing

Eligibility and qualification for bank financing of a business acquisition is subject to the credit standards of your bank. It is always best to consult a lending professional on questions and further detail.

1. Loan Size

Typical borrower down payment is 20%; typical seller financing is 10% to 15%. Bank loan, then, is typically 65% to 70% of total costs (selling price, plus working capital, plus loan fees and costs). To achieve 65% financing with a \$2 million loan limit, selling price can't exceed \$3.0 million.

a. **Maximum Transaction Size:** Financing is rarely practical for transactions with a sale price exceeding \$6 million; most transactions are priced at \$4 million and below.

b. **Minimum Transaction Size:** No minimum loan size.

c. **Maximum and Minimum EBIDAT:** following the above, at typical multiples companies with EBIDAT under \$150K or over \$2 million are likely to be too small or too large respectively.

2. Trends in Gross Revenues and EBIDAT: downward trends in EBIDAT, continuing downward through the current year interim statements, are not acceptable for financing. This is true regardless of the absolute level of adjusted net earnings (SDE or EBIDAT), or the multiple of net earnings in relation to debt service: it is the trend which is disqualifying. Downward gross revenue trends are usually disqualifying, unless EBIDAT is stable or increasing at the same time (usually indicating shift to lower volume but higher-margin business).

A dip in gross or net revenues for a year or two can sometimes be tolerated when the trend has flattened or has been reversed for a full calendar or fiscal year (usually at least 9 months' flat or improving trend must be shown, and for such a partial-year recovery, approval will be contingent on reviewing yearend statements prior to closing). Banks typically underwrite on the basis of the calendar or fiscal year period for which tax returns are filed, not on the basis of 12-month trailing periods, or projections.

3. Change of Ownership Considerations:

a. Exiting owners must exit completely. A selling owner cannot retain any ownership after the transaction, and may not be an officer, director or consultant of the business for longer than 12 months after the sale.

b. **Will not finance a partial change of ownership.** If one or more partners are buying out another partner or partners, the transaction must result in 100% ownership by the purchasing owners. An existing owner cannot be financed to purchase the partial ownership interest of another partner (for example, with 3 partners, one partner may not buy out a single other partner.) An outside party (someone not currently an owner) cannot purchase anything less than 100% ownership (for example, if there are partners, must buy out all the partners).

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c. **Business real estate involved in a business purchase cannot be financed separately from the loan**, unless the lender is given a shared (pari passu) lien position with the real estate lender.

d. A **leasehold business**, as of closing date, must have a lease term plus extensions equal to the term of the loan (usually, 10 years)--or else be able to demonstrate that location is not a critical factor, and that equivalent space at equivalent rent is readily available in the local market.

e. **Landlords** must be willing to sign a “landlord’s consent,” allowing lender to enter the premises to seize collateral in event of a default.

5. Requirements for principals (20% or greater shareholders; officers, directors):

a. All principals must 100% personally guarantee the loan—no exceptions.

b. If the loan is not 100% secured by hard assets of the business (real estate and FFE only) at bank liquidation value of the assets, then principals may require a pledge of personal assets (typically real estate and significant financial assets), up to the point that the loan is 100% secured (This is ONLY for loans \$350,000 and above). If all available resources are pledged and loan is still not fully secured, collateral shortfall in itself is not a reason for decline.

c. Principals must be active owner-managers, not passive investors.

d. Principals must have significant, related-industry ownership/general management experience, with strong preference for same-industry experience in independent business (as opposed to nonrelated industry, or corporate middle management).

e. Principals must have good credit history (generally, at least a 650 FICO score) with no bankruptcies in last 7 years. Judgments, defaults, and frequent delinquencies may disqualify.

f. Principals must be of good character: all arrests for other than minor traffic violations must be disclosed; more than 3 misdemeanors or any felony may be disqualifying.

g. Principals (at minimum, those who will be active managers) must be US citizens or resident aliens with a green card.

6. Equity Injection (down payment).

a. **Buyer Equity** - Banks typically require at least 20% of total project costs to be injected by the borrower. (Total project costs = purchase price, plus loan fees, plus required working capital). Usually, up to half that requirement (10% of total costs) can come in the form of seller take-back financing that is on full standby, receiving no payments of principal or interest for the term of the note, or until that note is paid off.

b. **Seller Financing** - Banks will generally also require at least 10% of costs to be financed by the seller (including, not in addition to, any “standby note” such as the above.) Exception: when the borrower is a current key employee or manager of the business being acquired, seller financing may not be required.

c. **Intangibles**- If the purchase price of the business includes \$500,000 or more of intangibles (goodwill, patents, non-competes, trade name, customer list, etc) the bank may require that there must be combined buyer and seller equity equal to at least 25% of the purchase price. “Seller equity” is defined, for this purpose, as any seller take-back financing for which payments are deferred for at least 2 years. When real estate is transferred along with the business this 25% equity rule applies to the real estate also

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7. Ineligible Businesses

- a. Non-profit business (for profit subsidiaries are eligible)
- b. Businesses engaged in lending (banks, finance & investment companies, factors, others whose “stock in trade is money.”
Note: exceptions for certain kinds of companies, such as check cashing & pawn shops, when >50% of revenues are from services or activities other than finance.
- c. Life insurance companies.
- d. Businesses with >1/3 of revenues from SBA loan packaging.
- e. Borrower plus all affiliates exceeding size standard determinations (each must meet own standard; all total meet the group’s main industry standard)
- f. Businesses/Private Clubs that limit membership for reasons other than capacity
- g. Businesses located in a Foreign Country
- h. Businesses that derive >1/3 gross annual revenue from gambling, or whose main purpose is gambling (such as a casino) regardless of revenue proportions
- i. Businesses engaged in illegal activity
- j. Government-owned entities (except Tribally controlled)
- k. Landlords, businesses primarily engaged in renting space (“passive companies”).
- l. Businesses primarily engaged in promoting, instructing, indoctrinating religion.
- m. Businesses primarily engaged in political or lobbying activities
- n. Consumer and marketing cooperatives (producer cooperatives are eligible)
- o. Speculative businesses (traders speculating on gain in asset values—such as commodity or stock investors; inherently risky “speculative” businesses such as oil wildcatting, research and development; “spec home” construction).
- p. Businesses primarily sexual in nature
- q. Pyramid sales plans and multilevel marketing companies
- r. Business in which the Lender applying for guarantee, or any employee or associate of Lender, owns an equity interest.
- s. Business with Franchise/Licensee/Dealer/Jobber agreement that does not meet SBA standards (imposes “unacceptable control,” thereby renders the business effectively an affiliate or subsidiary of the franchisor or licensor).
- t. Franchise developers (master franchisees): considered passive & speculative

8. Ineligible Uses of Funds

- a. Payments, distributions or loans to principals:
- b. Business relocations that cause unemployment; financial hardship to leaseholder; or nullify labor agreement
- c. Investments in real or personal property acquired and primarily held for sale, lease or investment (including remodeling of rental space)
- d. Illegal Activities
- e. Refinancing debt owed to an SBIC
- f. Payment of delinquent payroll taxes (income taxes eligible, but a credit issue)
- g. Use of funds for refinancing is allowed, but subject to numerous restrictions— consult with a lending professional on any proposed refinance.

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9. Ineligible Personal Guarantors / Principals (20% or more owner/shareholder)

- a. Principal is on probation, parole or pending criminal charges, or has a legal history demonstrating poor character or “moral turpitude.”
- b. Principal has caused a prior loss to the government: -defaulted student loans -delinquency on trust fund taxes (Soc.Sec, Medicare, UI, Work Comp) -loss, whether through settlement or otherwise, to any federal agency
- c. Conflict of interest: principal is a high government or military official,

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