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Thinking of Buying a Business? Need Financing for the Acquisition? Here Is What You Need to Know!

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I have prepared this article to assist people considering buying a business for the first time get a better understanding of what one needs to consider when looking for financing for their proposed transaction.

With respect to financing, banks have a strong appetite to finance acquisitions and typically provide term loans which can be repaid over 5 to 7 years, and sometimes longer. These loans are normally secured by assets of the business being acquired and almost always require personal guarantees and/or sometimes cross corporate guarantees, if available.

I think one of the bigger issues to consider when looking for financing to fund an acquisition is that one often needs to complete their due diligence (see notes below) in parallel to sourcing financing and that can be quite challenging.

With respect to financing, banks have a strong appetite to finance acquisitions and typically provide term loans which can be repaid over 5 to 7 years, and sometimes longer.

Here is a list of important items to consider:

- **Letter of Intent (LOI)** – banks typically want to see a signed LOI before they will invest a lot of time reviewing a bank loan application for acquisition financing. At a minimum, it should identify the purchase price, payment terms, whether it is an asset or share purchase and if there is any type of Vendor Take Back loan (or "VTB"). LOI's can be made conditional on financing and if done, be sure to provide enough time to get the financing put in place.

- **Business valuation** – depending on the size of the transactions, banks may want the buyer to obtain a formal business valuation (done by a Chartered Business Valuator or CBV) to support the purchase price of the business. Some banks may also want the valuator to prepare a Quality of Earnings report (QOE report) to give the bank some comfort around the reliability and predictability of the revenues. It is worth noting that this is different from a market value appraisal of the fixed assets, which may be required if it is a straight asset purchase.

- **Down payment/equity** – the percentage of down payment varies widely and is determined by factors such as industry, purchase price relative to valuation, financial position of the target company and management experience. I have seen ranges from 15% to 50%. Of note, banks consider a VTB as part of the down payment/equity consideration.

- **How much can I borrow?** – while it is very dependent on the facts, a good rule of thumb is banks will lend up to 75% of the Purchase Price. But as noted above, this could vary based on the facts at hand.

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- **How do I know if the business can make the payments?** – a general guide for this is to take the 75% financed amount and divide it over 5, 6 or 7 years to get the annual principal repayments. You can then compare this to the EBITDA (Earnings before Income Tax, Depreciation and Amortization) generated by the business. Banks run a calculation called the Debt Service Calculation (DSC) which models this out on a more granular level, but, in summary, they will require that for every $1 of loan repayment, the business should be generating $1.25 in earnings.

- **Financial model** – banks generally want to see a 12-month integrated financial model which at a minimum should include a Profit and Loss Statement, a Balance Sheet and Cash Flow Forecast.

- **Professional fee costs** – It is important to budget enough to cover these costs when considering an acquisition. There can be legal fees for both the Agreement of Purchase & Sale (APA) as well as to put the financing in place. Plus, consider costs for a business valuation or appraisal if needed and/or the advice of an accountant needed for planning purposes. There could also be costs associated with retaining an Advisor to source the financing and if you need to hire someone to assist with any due diligence.

- **Time -** getting financing for an M&A transaction can be quite time consuming. It normally takes 3 to 6 months to get all the paperwork in place, albeit shorter for less complicated businesses and ones that do not require a formal business valuation.

- **Due diligence** – it is important to consider if you are going to be doing this yourself or engaging an outside consultant to assist. I like to think of this as the same concept of buying a car and having a mechanic "kick the tires" to make sure it is in working order. You ideally need someone with a finance and/or accounting background to "look under the hood" of the business to ensure what you think you are buying is actually what you are buying!

As you can see, there are a lot of factors to consider when acquiring a business. And then having to still sort out the financing can add a whole level of additional work. That is why many business owners and/or CFO's engage Advisors to help them source their M&A financing needs. It enables them to focus their efforts on due diligence and other aspects while having the financing search being run parallel.

At Isaacs Advisory, we have extensive experience in advising, structuring, and sourcing a wide range of traditional and non-traditional financing solutions for small & medium sized businesses.

For more information on raising financing solutions for a start-up, early stage, growth, in-transition or business in distress, please contact Adrian Isaacs at (416) 835-4511 or aisaacs@isaacsadvisory.ca.