Crimson Cardinal
Healthcare Intermediary

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3 Must Haves For Buyers

This article examines the three conditions a deal must have before a buyer says "yes" AND closes the transaction.

Picture this. You worked with your business intermediary and got a reasonable price range to sell your operations. You attracted a qualified buyer. There is a great fit between the business operations and the buyer's skillset. Now what? How do you structure the deal so you get your price and the buyer gets what she needs?

There are three conditions the deal must meet in order for the buyer to say "yes" and close the transaction. First, the business must generate enough seller discretionary earnings (SDE) to pay the buyer a reasonable salary with benefits. Second, the business must generate sufficient cash flow to service any business debt the buyer incurs to acquire the business. Finally, the business must generate sufficient cash flow to give the buyer a reasonable return on her invested capital.

Reasonable Salary and Benefits

A buyer is, in effect, buying a job. She must make a reasonable wage for the services she provides. Since she is the new boss, the new buyer will also want the similar perks that the prior owner enjoyed (e.g., travel and entertainment allowance, health and life insurance, car allowance). These benefits should be comparable to what she would have gotten if she accepted a senior leadership role from an employer.

Debt Service Coverage

The operation must generate sufficient cash flow to service any business acquisition debt incurred by the new owner. These debts may include the seller's promissory note and any bank notes. The new buyer has no other sources to pay the business debt than what gets generated from the operation. Typical bank underwriting standards require a debt service coverage ratio (DSCR) of 1.25 or more. This means the bank will require that the cash generated to service all business debt must be at least 25% more than the minimum amount to service the debt. Below this 25% means the business may struggle to meet its debt service obligations. *See* our article on financial terms that discuss DSCR.

Return on Invested Capital

Finally, the new owner wants to get a good return on the money she invested into the business. She probably made a substantial down payment toward the purchase price. The new owner expects a reasonable return on that money.

These three conditions are essential to getting a transaction closed. Even if the agreed-to selling price is "in the market," the SDE must support the buyer's needs and the deal must be correctly structured to allow the new owner to be successful.