Businesses Looking to Cash Out Sometimes Need to Step in With a Loan as Credit Crunch Continues to Stymie Deals

By ARDEN DALE and SIMONA COVEL Wall Street Journal November 13, 2008

For small companies looking to cash out, this may be an ideal time -- if they are willing to give sellers a financial hand.

The reason is that fewer businesses are on the block these days as owners fret over the ability to live off their proceeds during the economic and market downturn. A smaller supply of sellers means those companies that show stability, profits and steady cash flow can command a premium price.

But there's a catch: Buyers are generally finding greater difficulty getting commercial loans from banks. Loans backed by the Small Business Administration have dropped off precipitously in recent months. Even private equity firms -- long known for taking a chance on scrappy young companies with high growth potential -- are acting more conservative.

Christina and David Sloan, former co-owners of Li'l Guy Foods, at the company's production facility

The upshot is that some businesses are finding they also need to provide some of the financing themselves in order to get a deal done.

Seller financing "is almost a mandatory piece of the deal," says Domenic Rinaldi, owner and managing partner of Chicagoland Sunbelt, a Chicago-based broker that helps people buy and sell businesses. "When we bring deals to the banks, they want to know that the seller will be in for some portion."

Michael Handelsman, general manager at BizBuySell.com, an online marketplace that lists companies for sale, says manufacturing businesses, hotel/motels, supermarkets and gas stations had the highest median sale prices in the third quarter.

After multiple conversations with investment bankers over the past year, 37-year-old David Sloan, co-owner of Li'l Guy Foods, a family-owned Mexican-food manufacturing business in Kansas City, Mo., realized "there weren't a whole lot of people wanting to jump into this industry."

Mr. Sloan was looking to sell because the 35-employee company was facing huge financial pressure from the rising costs of commodities like corn and other ingredients, as well as plastic packaging. "We were under an assault on margins," he says -- something that made outside investors nervous. Still, the business enjoyed a strong base of small-restaurant customers that paid a premium for its products.

That was enough to attract the attention of one of Li'l Guy Foods" competitors, Tortilla King Inc.

of Moundridge, Kan. The larger, more sophisticated company had hedging policies in place that allowed them to lock in prices, guarding against commodity-price increases. And since it was already familiar with the industry and the company's customer base in the region, it was willing to take risks that an outside investor might not.

With costs high and consumer spending on the wane, Tortilla King President Juan Guardiola saw the acquisition of Li'l Guy Foods as a way to reduce competition and increase market share. "We were fighting in the market, cutting each other's margins," he says. "So it made a lot of sense to merge."

The two companies hammered out a deal and a bank agreed to provide financing. But two months ago, as the deal was about to close, the bank backed out -- part of the broad pullback in business lending.

So, Mr. Sloan's company agreed to finance the purchase, whose price the two companies decline to disclose. Tortilla King has a five-year repayment term with a rate of around 8%, Mr. Sloan says.

Mr. Sloan says he would have preferred to walk away without being so invested in the combined company's future. But he felt it would be too difficult to continue running the small business, so he went along with the new terms. "It wasn't the most ideal transaction for us," he says. "I would have rather had it a lot cleaner."

Mr. Guardiola says he was surprised when the company's longtime bank declined to finance the deal, though he understands that banks are extra vigilant these days about debt. With commodity prices "like a train out of control," he says, the bank was concerned. But Mr. Guardiola is convinced the combined company will earn greater clout together than they did separately.

Alex Shlepakov of Elk Grove Village, Ill., had been thinking of selling his company for a while and decided to take advantage of the business's strength.

"I decided that while my numbers were strong, it would be a good time to get out," says Mr. Shlepakov, founder of Network One, a company that provides network support for small businesses. "I feel like I was selling at the top, because there's a lot of talk about a possible four- or five-year slowdown."

To facilitate the deal, Mr. Shlepakov offered to finance part of the purchase price. He received a large down payment from the buyers, two businessmen, and provided them with a 2 1/2-year loan for the balance. He says the buyers are paying off the loan in monthly installments, but declines to give further details.

Mr. Shlepakov says at first he was nervous about providing financing, but that his attorneys put together a "very tight finance contract." He adds that providing a loan demonstrates that he's confident in the business he's selling.