Most owners have two options and both of them are bad. The first is to spend three to five years making the business ready to sell, then long enough to prove the changes worked. The second is to go to market as they are, where it either does not sell or sells on terms they regret.

There is a third. Sell now, at a number agreed before anything starts, with no cleanup and no preparation, and take the payments over ten years instead of at closing. Below is the arithmetic, the present value, the comparison against doing nothing, and the cases where the answer is no. If it does not fit your client, this should make that conclusion faster to reach.

The Instrument

Price	Fixed at closing. Becomes the principal of a seller note.
Cash at closing	None.
Note rate	Fixed, not below the applicable federal rate for the month of sale.
Payment	Fifty percent of the business's free cash flow, uncapped on the upside.
Term	Ten years. Unpaid principal is due as a balloon at maturity.
Security	First-priority perfected lien on the operating company's assets. Your client is a senior secured creditor with foreclosure rights.
Operating control	The buyer takes full operational and financial control at closing and installs its own operator. Your client stops running the business on day one.
Fees	No broker or intermediary commission. Also none paid to you: see the last section.

How the Payment Is Computed

Free cash flow is EBITDA less capital expenditures, less the net change in working capital, less third-party debt service. It is computed before the seller note, so the payment is not defined in terms of itself.

The first twelve months run at a stated baseline payment, paid monthly. From month thirteen the payment resets quarterly on a trailing twelve months basis rather than on the quarter alone, which removes seasonality and spreads lumpy capital expenditure across four quarters. A downward adjustment carries thirty days written notice. Quarterly figures are management-prepared, so the annual reviewed statements govern by way of a true-up, and your client holds audit rights over the calculation.

THE ONE PROVISION WORTH READING TWICE

The payment is the greater of fifty percent of free cash flow or the interest accruing on the note, and never more than seventy-five percent of free cash flow.

Without the interest floor, a share-of-cash-flow payment can fall below accruing interest in a weak year. The note would then negatively amortize and the balloon at maturity would exceed the price paid. The floor prevents that. The seventy-five percent limit prevents the floor from taking so much of a struggling business's cash flow that the business itself is put at risk, which would be the worse outcome for a secured creditor. Below that limit interest capitalizes, and it is disclosed in writing at the time rather than discovered at maturity.

Worked Illustration

Price $8,000,000, note rate 5.0 percent, opening free cash flow $1,000,000 growing at five percent. Annualized for legibility; payments are monthly. The arithmetic scales linearly with principal.

The price here is a placeholder chosen for round arithmetic. It is not a valuation method, and no multiple of revenue, earnings, or cash flow is stated or implied anywhere in this document.

Yr	Free cash flow	Payment	Interest	Principal	Balance
1	$1,000,000	$500,000	$400,000	$100,000	$7,900,000
5	$1,215,506	$607,753	$370,440	$237,313	$7,171,487
7	$1,340,096	$670,048	$344,596	$325,452	$6,566,469

10	$1,551,328	$775,664	$288,104	$487,560	$5,274,516

Payments total $6,288,946 and the balloon is $5,274,516. If cash flow is flat instead, payments total $5,000,000 and the balloon rises to $6,742,211, since principal retires more slowly. The flat case therefore produces the larger nominal total, which is why nominal totals are a poor measure of what a seller receives and why we do not use them.

What It Is Worth

Discount rate	Present value	Reading
3 percent	$9,226,000	Above the price.
5 percent	$8,000,000	Equal to the price. True by construction, since the note carries five percent.
7 percent	$6,980,000	Roughly $1.0M below the price.
10 percent	$5,753,000	Roughly $2.3M below the price.

At your client's own cost of capital there is likely a gap, and we would rather put it in front of you than wait for you to find it. It is the price of not running the business for another decade and not having to find a buyer.

Compared To Doing Nothing

The comparison that decides these transactions is rarely against a cash offer. It is against option one above, or against keeping the business as it is.

Alternative	Cash over ten years	Business at year ten	Owner's role
Keep operating it	$12,577,893	Retained, grown	Full engagement, all risk
Keep it, hire a manager	Roughly $9.7M after management cost	Retained, grown	Hiring and supervising, still all risk
Annuity Sale	$8.0M present value at the note rate	Transferred	None
Keep it while disengaged	Roughly $8.0M on a five percent annual decline	Retained, worth materially less	Nominal, all risk

WHERE THIS STRUCTURE IS THE WRONG ANSWER

Against a healthy business whose owner still wants to run it, this structure loses on the arithmetic and there is nothing that rescues it. Your client keeps more cash and keeps the company. If that describes your client, stop here.

It also does not fit an owner who needs cash at closing, an owner with a live competitive process and real cash bids, or ownership spread across a group expecting conventional liquidity.

It fits the owner who has stopped driving the business, because the first row above quietly assumes performance continues while engagement stops. It fits the business that will not sell conventionally at a price the owner will accept.

Tax Treatment

Installment reporting under section 453 spreads gain across the years payments are received rather than recognizing it at closing. Each payment carries interest taxed as ordinary income and principal taxed at capital gain rates. Where stated consideration lacks adequate interest, sections 483 and 1274 impute it.

One point stated rather than glossed, because materials of this kind commonly get it wrong. An installment obligation is income in respect of a decedent under section 691(a)(4), and section 1014(c) denies it a basis step-up. Heirs do not take the remaining note free of the deferred gain; they keep reporting it as payments arrive. Section 691(c) gives them a deduction for the federal estate tax attributable to that income, which is a real benefit and a smaller one. State treatment varies. Nothing here is tax advice.

What We Do Not Do

We pay no transaction-based compensation for sourcing or introductions. That is a structural rule rather than a negotiating position, and we state it first rather than last. We do not act as an agent for either side, run a process, or ask an advisor to represent anyone. Nor do we ask you to introduce anyone on the strength of a document: if this looks plausible for someone in your book, the next step is a conversation in which you press on it directly.