MidCap Advisors

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Bittiger Elias & Triolo P.C.
ATTORNEYS AT LAW

THE IMPACT OF COVID-19 ON EXIT PLANNING

November 11, 2020

Today’s Agenda

- Exit Planning Fundamentals
- Proactive Financial and Tax Planning
- Selling to an Insider vs. Outsider
- Preparing the Company for Sale
- Post-sale Considerations, and What Life Looks Like After a Sale

Meet Our Presenters

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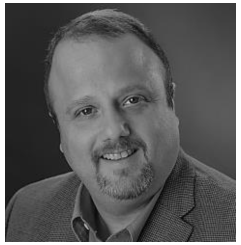

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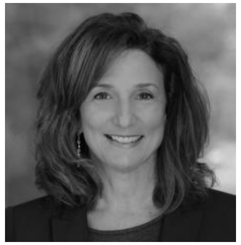

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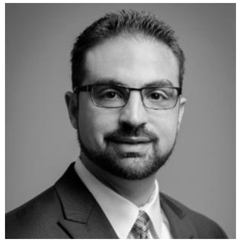

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EXIT PLANNING FUNDAMENTALS

EXIT PLANNING FRAMEWORK

Personal

– Who do you want to exit to?

– What do you want to accomplish as part of your eventual exit?

– When do you want to exit?

– How do you want to exit – over time or in one event?

– How much money do you need from the sale of company to meet your personal financial needs?

– What does life post-exit look like?

Business

– Maximize the value of my business

Taxes

– Eliminate, minimize, or defer taxes

FINANCIAL PLANNING

Lifestyle: Need to have some idea of what comes next

- If you are not running your business, how will you spend your time
- Will you still spend time in the business
- Do you have hobbies, like to travel, spend time with family
- Are you prepared if your health is not good

Cashflow: Will you have enough?

Understand what your expenses will be in retirement

Are there expensive insurance policies you may not need anymore?

Are there additional things you will be paying for now that you have free time?

What bills will you have to pay for that the business previously did?

Legacy: Planning your estate

- Charitable giving
- Gifting to family
- Estate tax considerations
- Family vacation home
- Organize and simplify finances

TAX PLANNING & DEAL STRUCTURE

Tax Aspects of Sale – Sellers Financial Considerations

Focus on maximum after-tax results, not just the sales price

- Taxable income and gain on a transaction
- Use of proceeds to satisfy obligation that remain with the seller
- Tax Liability
- Net proceeds to seller

Sale Structures – Asset Sale and Equity Sale

Two General Sale Structures

- **Asset Sale**
  - Sale of substantially all of the assets of the Company to a buying entity
  - Nearly all assets transferred; only specified liabilities assumed
- **Equity Sale**
  - Sale of ownership interest of company (stock or membership interest) to buyer
  - All assets and liabilities transferred/assumed

Asset Sale vs. Equity Sale

- **Asset Sale Advantages/Disadvantages**
  - Advantages – simpler contractual process; less in depth and less complex due diligence
  - Disadvantages – greater tax impact to seller; unassumed contracts remain with seller; customer contracts harder to transfer
- **Equity Sale Advantages/Disadvantages**
  - Advantages – tax favorable for seller; assets and liabilities transfer easier
  - Disadvantages – more complex/difficult contract and due diligence process; buyers often reluctant due to liability assumption

Sellers Financial Considerations:
Taxable Income and Gain on a Transaction

- **Taxable income and gain on a transaction**
  - Asset sale vs. stock sale
- **Asset Sale**
  - Capital gain and/or OI (recapture, 1250 gain, etc.)
  - Cash basis: (OI on sale of AR, WIP)
  - Gain on sale flows through schedule K-1 (1120s & 1065)
  - S/H has gain/loss on subsequent liquidation of corporation; timing of liquidation is very important
- **Stock / Equity Sale**
  - Generally capital gain
  - Gain reported on S/H tax return
  - Corporation continues after sale

Sellers Financial Considerations (cont'd)

Taxable Income and Gain on a Transaction

- **338(h)(10) Election Treatment – gross up for tax impact**
- **Tax Treatment of a Merger Transaction**
- **State Considerations – taxability by non-resident states**
- **C-Corp – Consider making S-Election now prior to any deal. Built-in gains 5-year window.**

Factors Impacting Net Proceeds and Taxes

- **Earn out provisions and Installment sales**
  - Basis allocation
- **How much working capital needs to be left in company when sold**
- **Balance sheet adjustments determined during due diligence**
- **Payouts to key employees**
- **How much debt needs to be repaid upon sale**

SELLING TO AN INSIDER VS. OUTSIDER

Selling to Insiders

- **Key Employees/Management**
  - Common place for an owner to explore to determine potential suitor for company purchase
  - Typically successful if there is an obvious heir apparent
  - Advantages – can avoid the need for outside brokerage; can be an easier negotiation process; often not as much transition assistance needed
  - Disadvantages – can often involve a form of seller financing

Selling to Outsiders

- **Financial Buyer (Private Equity)**
  - Private equity buyers often the suitor for larger companies
  - Advantages – better valuations; experienced and professional acquisition team; self-financed
  - Disadvantages – often involve post-Closing employment of owner for a significant period of time (note – this may not be a disadvantage for all sellers)

Selling to Strategic/Competitor Buyer

- **A common way of finding a buyer for a business without marketing for sale**
- **This can be a direct competitor, upstream industry participant (e.g. supplier), or downstream industry participant (e.g. customer)**
- **Advantages – can result in a premium valuation as the company can have enhanced value to this type of buyer**
- **Disadvantages – confidentiality issues if the deal is not completed**

New Entrants to Industry or Ownership

- **These are sales in which individuals or small groups of individuals are entering an industry for the first time, or work in the industry and are looking to move to ownership for the first time**
- **These transactions often involve smaller companies**
- **Advantages – bank financing often available**

PREPARING THE COMPANY FOR SALE

Preparing Key Employees/Management

- **Employment Agreements**
  - Beneficial for key employees/management to be under employment agreements
  - Provides assurances to a buyer that management team will remain in place after the Closing
- **Restrictive Covenants**
  - Non-compete, non-solicitation, confidential information covenants
  - Typically included in employment agreements or can be a stand-alone agreement
  - Ensures buyers that key persons will not impair the goodwill after the Closing

Legal Issues & Compliance

- **Buyers often do extensive due diligence and require broad range of representation and warranties**
- **If a company has legal compliance issues, or has threatened or pending disputes, it will come out in the contractual process**
- **Important to address these issues in advance as buyers may make a bigger deal out of them than is warranted**

PPP Loan – What Happens

- **Oct 2, 2020 SBA released guidance for PPP borrowers considering change in control**
  - 20% or more equity change; or 50% or more of FMV of assets; or merger
- **Specific procedures for lenders if there is a transaction**
  - PPP loan paid off or forgiven before transaction, no restrictions
  - May be approved by lender if:
    - Sale or other transfer equity less than 50%
    - Sale greater than 50% of equity or greater than 50% of assets and together with forgiveness application package (full package with required substantiation documents), borrower funds escrow account with lender equal to the PPP loan.
- **If above criteria not met, transaction will require SBA approval and could take up to 60 days once request is made by lender.**

PPP Loan – What Happens (cont'd)

- **If there is a greater than 50% of assets sold, and buyer is assuming PPP obligations and no escrow, Agreement must include appropriate language and borrower may submit a separate agreement to the SBA reflecting said language**

- **All stock transaction / other mergers**
  - PPP borrower remains subject to all obligations under PPP loan.
  - SBA will have recourse against former owners where new owners use PPP funds for unauthorized purposes
  - Lender must notify SBA

POST-SALE CONSIDERATIONS, AND WHAT LIFE LOOKS LIKE AFTER A SALE

Post-Sale Restrictive Covenants

- **Non-Compete – prohibition against working in the industry in a certain geographic area**
  - Restricted area will be based upon the area in which the business serves its customers
- **Non-Solicitation – prohibition against soliciting customers, employees, referral sources**
- **Confidential Information – prohibition against using any confidential or proprietary information of the company after the Closing**
- **Typical duration of covenants – 3 to 5 years but indefinite on Confidential Information**

Post-Sale Transition

- **Sellers will often provide transition assistance after a sale**
- **Can be achieved by way of a “transition agreement”**
  - Range from as short as 15-30 days to as long as 6 months
- **Or by way of post-closing employment**
  - Range from as short as 6 months to as long as 5 years

Questions & Answers

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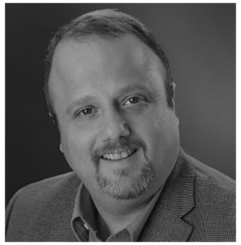

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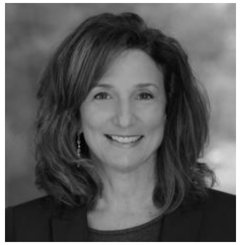

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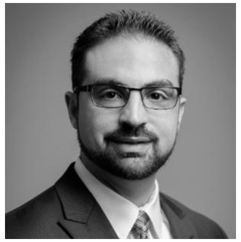

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