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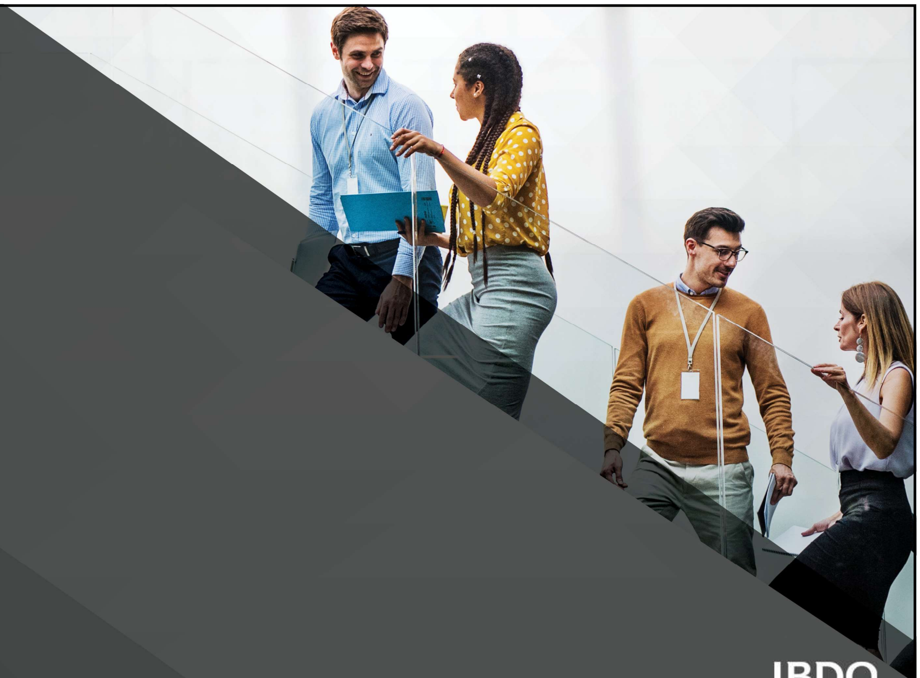

M&A UPDATE

January 9, 2023

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With You Today

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Agenda

State of M&A
Examine recent trends in deal activity and fundraising

Valuation Topics
Discuss recent trends in valuation considerations

Tax Topics
Discuss recent tax trends impacting M&A

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State of M&A

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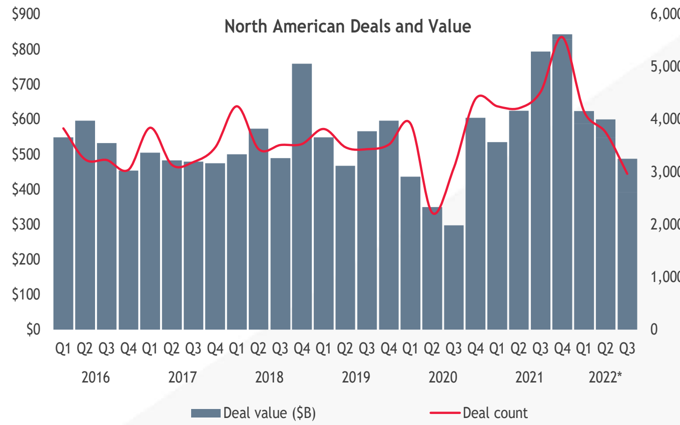
Current State of M&A

Deal volume and value has fallen for all M&A types

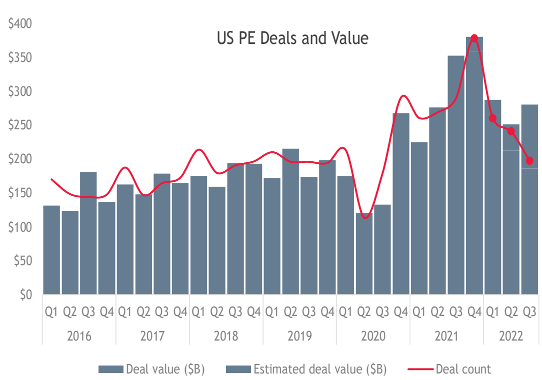
- The COVID-19 impact on M&A was short-lived
- COVID-19 signaled a shift in the political landscape, and potential cap gains tax hike influenced 2020 & 2021
- M&A volume is falling fast. Currently at pre-pandemic levels as the current environment is analyzed

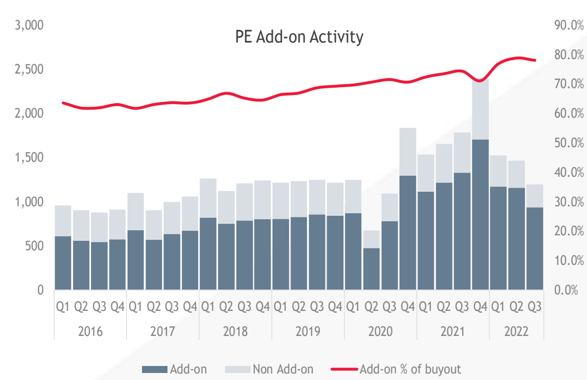


Source: Pitchbook Q3 2022 Global M&A Summary

Current State of M&A

US PE deal value and volumes continue above pre-pandemic levels

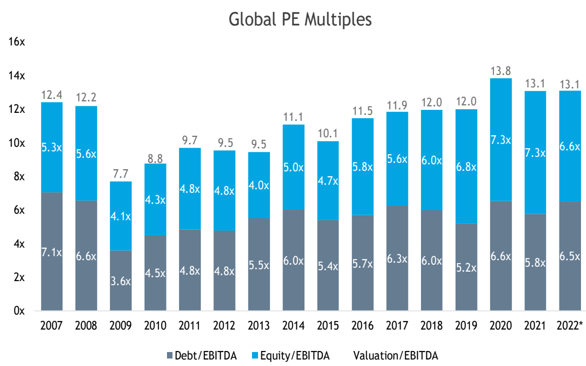


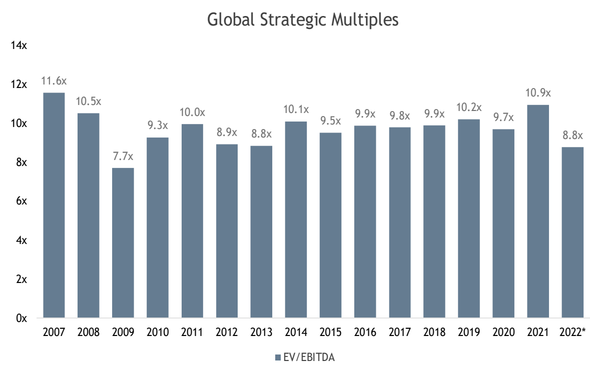


Source: Pitchbook Q3-2022 US PE Breakdown Summary

Current State of M&A

PE multiples remain elevated while strategic multiples drop

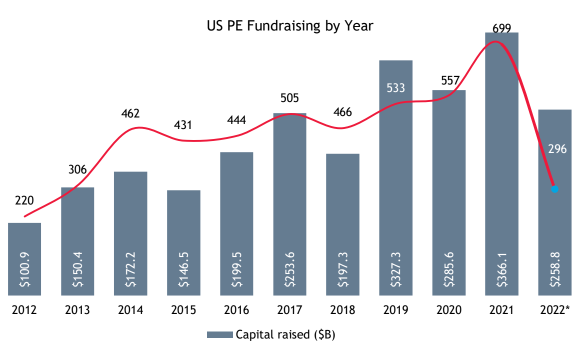


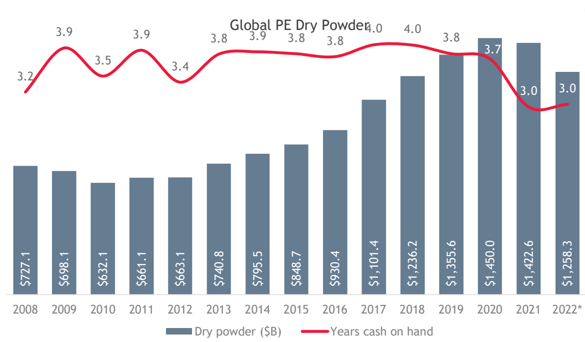


Source: Pitchbook Q3 2022 Global M&A Summary

Current State of M&A

US PE fundraising and dry powder remains strong and above pre-pandemic levels





Source: Pitchbook Q3-2022 Global Private Market Fundraising Report

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Valuation and Deal Structure

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Current Trends in Valuation and Purchase Consideration

- Valuation:
  - Valuation methodologies
  - COVID and Inflation's impact on valuation methods

- Purchase Consideration:
  - Increased reliance on rollover equity and earnouts to bridge value gap between buyers and sellers and to provide a form of seller financing
  - Decreased reliance on third-party debt financing due to:
    - Rising interest rates
    - Interest deductible limit change from effectively EBITDA to EBIT

      Especially challenging environment for capital intensive businesses that typically rely on greater debt financing and generally have greater depreciation

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Valuation Methods

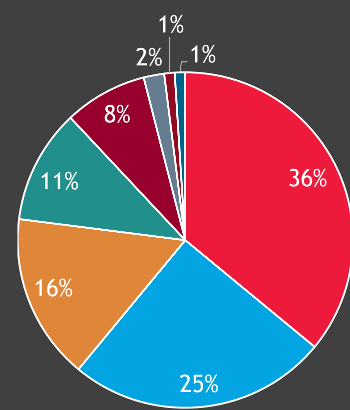
With percentage usage by Appraisers (2022)

Pepperdine private cost of capital survey

- Income Approach
  - Multi-year Discounted Cash Flow (DCF) Approach (36%)
  - Capitalization of Earnings Approach (25%)
- Market Approach
  - Guideline Public Company Method (16%)
  - Comparable Company Transactions Method (11%)
- Asset Approach – Adjusted Net Asset Method (8%)

* Recent Financing (2%) Gut feel (1%) and Other Approaches (1%) make up remainder

While PE generally applied valuation approaches inline with appraisers, investment bankers relied significantly more on comparable transactions; 31% of the time.



Source: Everett, Craig Phd; 2022 Private Capital Markets Report; Pepperdine Graziadio Business School

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COVID and Inflation's Impact on Valuation Methods

- Changes due to COVID (2020-2021)
  - Increased reliance on Income Approach as projections better reflect specific impact on subject company
  - Increased market volatility and uncertainty generally resulted in higher discount rates
  - Reduced reliance on comparable transaction approach, due primarily to lack of comparable transactions in the post-COVID market
- Changes due to Inflation (2022)
  - Renewed reliance on Guideline Public Company approach to capture market sentiment on inflation given challenges in accurately including inflation into long-term forecasts
  - While general market uncertainty has decreased since 2020, reducing discount rates, increased borrowing rates frequently offset that reduction

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Impact of Inflation on Value and Free Cash Flow

Revenue Growth	Operating Margin	Growth / Investment Efficiency
Companies with pricing power should be able to pass through inflation into their products or service prices, allowing revenues to grow with inflation	Companies with significant costs (low gross margins) and inputs that are most exposed to inflation (commodities) will see margins decrease, relative to other companies	Companies with longer term investments will invest less, as uncertainty about future inflation makes it more difficult to justify large upfront investments

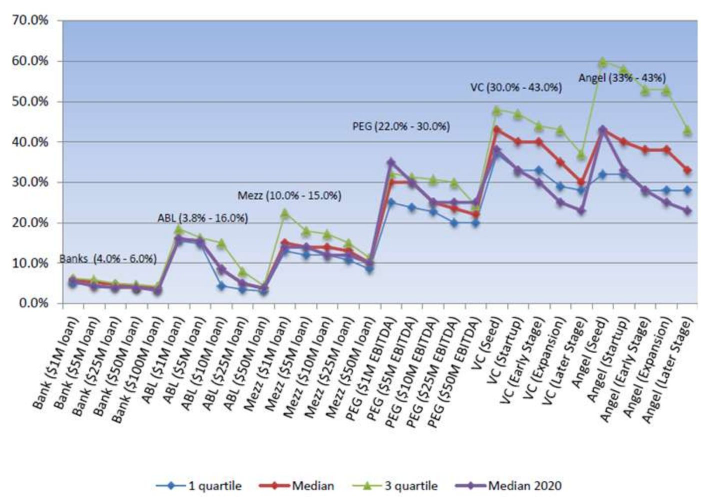
Who benefits…

Strongest brand, product differentiation, or greater scale	Services oriented companies with high gross margin	Greater ability to pass through costs and ST investments

Source: Damodaran, Aswath; In Search of a Steady State: Inflation, Interest Rates and Value; 2022.

Private Capital Market Required Rates of Return (2022)

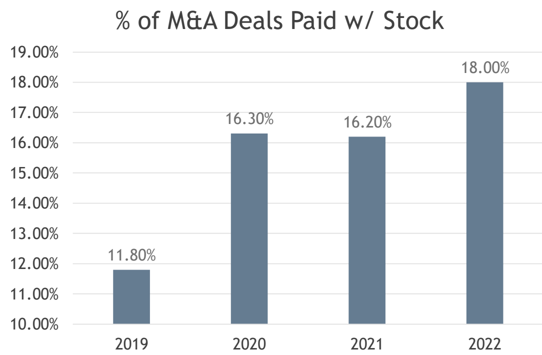
- Cost to borrow range (Banks and ABL) generally increased 100 bps to 200 bps as compared with 2021 survey results
- Mezzanine financing rates flat as compared with 2021
- Private Equity (PEG) rates were down (300 bps), which the author proposed may be due to increase competition among investment funds for deals
- The low end of the range for Venture Capital and Angel Investors was up 1,000 bps, while the high end of the ranges were relatively stable year-over-year

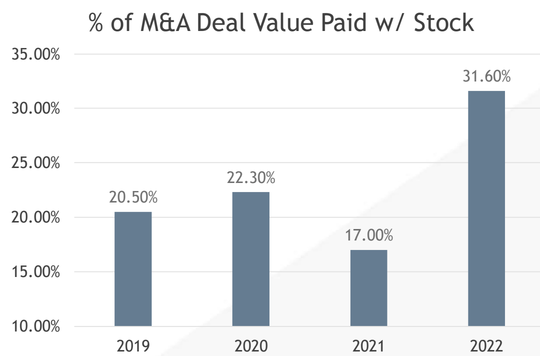


Source: Everett, Craig Phd; 2022 Private Capital Markets Report; Pepperdine Graziadio Business School

M&A Deal Value by Form of Payment

Uncertainty around COVID and inflation contributed to increased stock consideration in M&A deals





Source: Pitchbook Q3 2022 Global M&A Summary

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Tax Topics

Tax Trends Impacting Deals

- Seeing less tax-driven urgency in deals in 2022
- Phase-out of benefits under the Tax Cuts and Jobs Act of 2017 (unless Congress extends)
  - Bonus Depreciation on certain depreciable property ("Qualified Property") placed in service:

September 28, 2017 to 2022	100%
2023	80%
2024	60%
2025	40%
2026	20%
2027 and thereafter	0%

Implications

- Reduced tax savings on acquisitions of qualified property in deals should be considered
- Consider cost segregation studies
- Small businesses can consider use of Section 179 expensing, which is subject to stricter limitations

Tax Trends Impacting Deals

- Phase-out of benefits under the Tax Cuts and Jobs Act of 2017 (continued)
  - Section 163(j) Interest Limitations
  - Generally limits interest deductions to sum of:
    1. Business interest income,
    2. 30%* of "adjusted taxable income", and
    3. Floor plan financing interest
- Beginning in 2022, depreciation and amortization is no longer added back to "adjusted taxable income"
  - Similar to going from EBITDA to EBIT
- Reduces ability to deduct interest

* Was 50% for 2019 and 2020

Implications

- May reduce benefit of tax step-up in assets for debt financed acquisitions
- Take into account potential impact of Section 163(j) Interest Limitations when valuing the benefit of the tax step-up
- Consider structuring alternatives that may reduce the impact of depreciation and amortization on interest limitations

Tax Diligence Trends

- Post-Wayfair Sales Tax Issues
  - Continuing to see significant sales tax issues on tax diligence post-Wayfair
  - Consider obtaining or updating your sales tax nexus analysis
  - Make sure you have a robust process for obtaining and reviewing exemption certificates

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Tax Structuring Trends

- Gross-Up Payments
  - On acquisitions of S Corporations, a buyer is often able to obtain a tax step up with a Section 338(h)(10) election or similar transaction that results in a taxable asset acquisition
    - Seller generally incurs additional tax on such deals because of:
      - Differences in ordinary income rates and capital gains rates, or
      - Differences in the state taxation of an asset deal vs. a stock deal
  - Seller may ask for a "gross-up" payment for the additional tax
      - Disputes may arise between buyers and sellers' post-transaction on amount of "gross up"
  - Consider agreeing to a fixed payment amount from the buyer determined before closing, instead of a post-closing calculation

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Things to Consider if M&A Slows Down

- Assess the tax efficiency of your current structure:
  - Administrative costs may be reduced through a legal entity rationalization
  - The effective tax rate of your structure may be improved through an internal reorganization

- Look for tax benefits within your structure:
  - Ordinary bad debt deductions may be available if a debt has become wholly or partially worthless during the year
  - Ordinary worthless stock deductions may be available for stock in affiliated corporations that have become worthless during the year

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Thank you

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