



Succession Planning Sell-side M&A Best Practices

April 26, 2024

What a law firm *should* be.

POLSINELLI

Meet the Speaker

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Phil is a deal lawyer. Whether it is a business sale or purchase transaction with a short timeline or a must close financing, he brings practical solutions and creative thinking to get to closing. As a Certified Public Accountant (AZ) and Chartered Financial Analyst (CFA®), Phil takes a multidisciplinary approach to serving his clients. He is a trusted adviser who strives to help his clients minimize taxes, maximize their business enterprise value and keep the larger picture in focus

Polsinelli STRENGTHS

Firm History

50+ years partnering with clients in more than 170 service & industries

Practice Strengths

Core practices bolstered by supporting legal services

Geography

22 offices across U.S. located in major financial centers serving domestic & international clients

Rates

Highly competitive hourly rates, facilitating full spectrum of legal work

Pricing Strategies

Flexible and thoughtful pricing strategies and models to support your needs

Practice Management

Practices managed as businesses and supported through admin staff and structured processes

Technology

Utilize leading industry software, internal developers and innovation teams to better serve you

Operations and Client Benefits

Project and process governance for legal and admin operations geared toward improving client experiences

POLSINELLI

BY THE NUMBERS

1,000
attorneys nationwide

50
years of client service

170+
services/industries

7
core practice areas

Nationally recognized
for Real Estate, Mid-Market Transactions, Disputes Financial Services, IP and Health Care

BEST LAW FIRMS RANKED BY Best Lawyers UNITED STATES 2024

15 national Tier One rankings

84 regional Tier One rankings

2024 Edition of Best Law Firms®

63rd in Am Law's annual firm rankings.

Am Law 100 Firm
The American Lawyer

Recognized
for **strongest client relationships** overall
BTI's Industry Power Rankings

Excellence
in client service
BTI's Client Service A-Team Report

Recognized by legal research firm BTI Consulting as one of the top firms for excellent client service and client relationships, the firm's attorneys provide value through practical legal counsel infused with business insight.

PRACTICE STRENGTHS TO ALIGN TO YOUR NEEDS

- Health Care
- Financial Services
- Real Estate
- Intellectual Property
- Middle-Market Corporate
- Labor and Employment
- Business Litigation

GEOGRAPHIC FOOTPRINT SUPPORTS PRACTICE STRENGTHS

Strategically located in major financial centers

Located in gateway cities, as well as offices with close proximity to critical transportation and logistical hubs

22
offices with full service capabilities

2022 M&A DEAL VOLUME

333
M&A Deals Closed

$17B
Total M&A Deal Value

Nationally Recognized

BEST LAW FIRMS RANKED BY Best Lawyers UNITED STATES 2024

2023 BTI CLIENT SERVICE 100

PitchBook

The LEGAL 500

Chambers TOP RANKED USA 2023

Sell-Side Mergers and Acquisitions

Recently ranked by Pitchbook as one of the most active law firms for representing companies nationally & globally (#13, #21) and most active in US (overall, #15), Polsinelli is reliable for closing deals. Providing comprehensive and practical business advice on transactions, our sell-side M&A team partners with clients across various industries to navigate the process of selling their equity securities or assets.

Our sell-side M&A service includes:

Collaborating with our sell-side clients in all phases of the sales process

- Identify the most tax-efficient deal structure
- Identify barriers to deal execution
- Negotiate key pre-Sales documents, such as investment banker engagement letter, NDA and LOI

Identifying key diligence workstreams to anticipate and mitigate issues

- Audited or reviewed financials
- Sell-side quality of earnings
- Ownership/cap table
- Sales and use tax
- Employee classification
- IP ownership
- Pending litigation
- Regulatory

Providing a fully-integrated, collaborative deal team

- Tax
- Finance
- Labor and employment
- Employee benefits

...and experienced working with outside parties, including:

- Tax advisors
- Accountants
- Investment bankers
- Wealth managers
- Estate planners
- Other advisors

Bringing in specialized tools to execute the transaction

- Negotiating key economic points, such as risk allocation and deal
- proceeds protection
- Current M&A deal points
- Utilization of R&W Insurance
- Technology-enabled due diligence

The CTA

The Corporate Transparency Act is in Effect – *Don't Ignore It*

See https://www.fincen.gov/boi

FinCEN


An official website of the United States Government
FINANCIAL CRIMES
ENFORCEMENT NETWORK
U.S. TREASURY
FINANCIAL CRIMES ENFORCEMENT NETWORK
HOME
ABOUT
RESOURCES
NEWSROOM
CAREERS
ADVISORIES
GLOSSARY
Search
Small Business Resources
Reference Materials
BOI Newsroom
Get FinCEN News Updates
Stay Informed with FinCEN Updates
Subscribe
BOI
BENEFICIAL OWNERSHIP INFORMATION
Many companies are required to report information to FinCEN about the individuals who ultimately own or control them. FinCEN began accepting reports on January 1, 2024. Learn more about reporting deadlines.
Prepare
How do I file?
Do I qualify for an exemption?
How do I get a FinCEN ID?
File
File a report using the BOI E-Filing System
Create a FinCEN ID (optional)
FAQ
Need More Information? View our FAQ page.
Need More Information? Chat With Us Here.
Stay Informed. Subscribe to FinCEN Updates.
Alert: FinCEN has been notified of recent fraudulent attempts to solicit information from individuals

About the Corporate Transparency Act (CTA)

The CTA is intended to combat the use of "shell" companies in the commission of Illicit activity and corrupt practices, as well as protect national security.

MONEY LAUNDERING

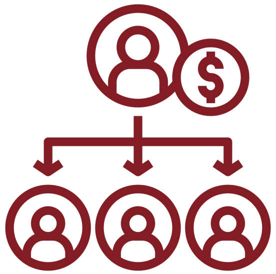
FINANCIAL AND TAX FRAUD

TERRORIST FINANCING

The CTA was enacted by Congress on January 1, 2021

About the CTA Requirement

The CTA requires certain businesses (including privately held and non-profit entities) to ***report direct and indirect, human, beneficial ownership, control and service provider information*** *to the Financial Crimes Enforcement Network of the US Department of Treasury (i.e., FinCEN).*

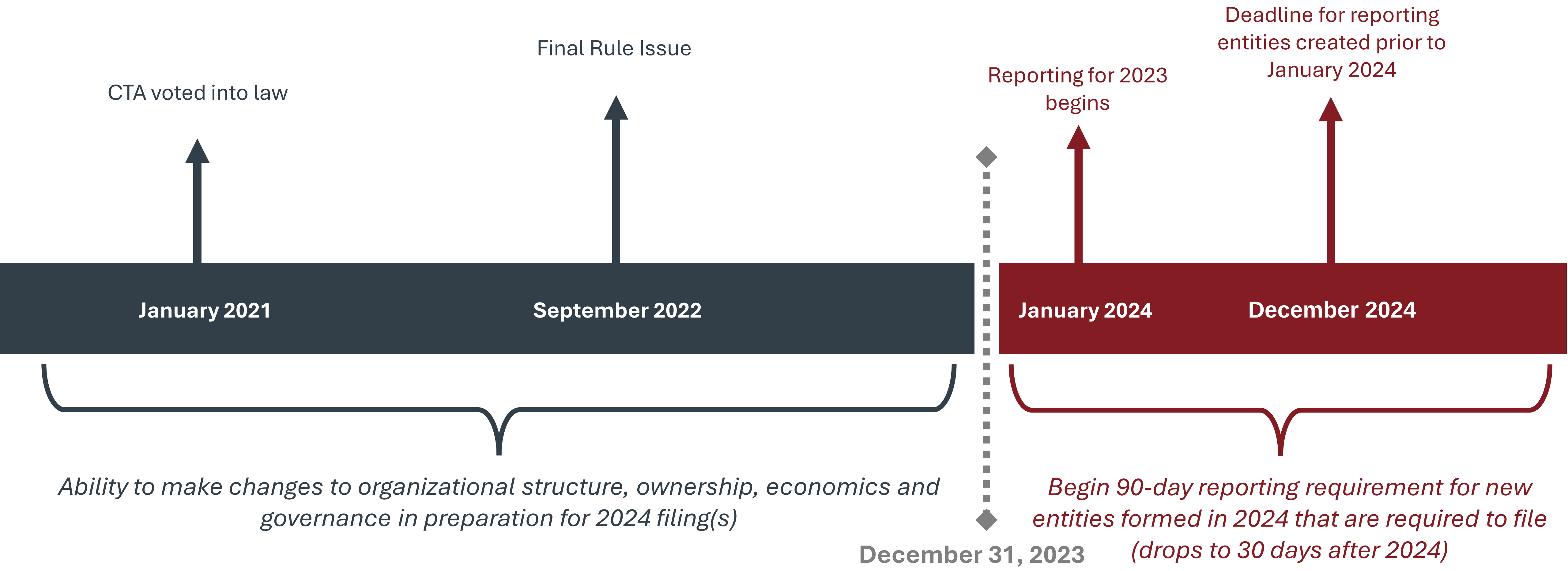


Beneficial Owners

"Beneficial Owner," with respect to a reporting company, refers to:

An individual, who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise exercises **substantial control** over the reporting company; or owns or controls not less than 25 percent of the **ownership interests** of the entity.

Timing


CTA voted into law
Final Rule Issue
Reporting for 2023 begins
Deadline for reporting entities created prior to January 2024
January 2021
September 2022
January 2024
December 2024
Ability to make changes to organizational structure, ownership, economics and governance in preparation for 2024 filing(s)
December 31, 2023
Begin 90-day reporting requirement for new entities formed in 2024 that are required to file (drops to 30 days after 2024)

Private Party Penalties

The CTA makes it unlawful for any person to willfully provide, or attempt to provide, false or fraudulent BOI, including a false or fraudulent identifying photograph or document, or to willfully fail to report complete or updated BOI to FinCEN in complying with the CTA (i.e., “reporting violations”).

Any person committing a reporting violation is liable to the United States for a civil penalty of not more than **$500 for each day** that the violation continues (**not to exceed $10,000**), and/or imprisonment (**up to 2 years**).

CTA Reporting Exemptions

Are you one of the following?

• Sole Proprietorship	• Estate Plan Trust	• General Partnership* **Not to be confused with a limited partnership or the general partner of a limited partnership.*

No

Is your business one of these entity types?

• Corporation • Business Trust • Cooperative Association *Or a similar entity that is (i) created by the filing of a document with a secretary of state's office, or (ii) a non-US entity registered to do business in the United States by a filing with a secretary of state's office.*	• Limited liability company • Series of a series LLC • Decentralized autonomous organization (DAO)	• Limited partnership • Limited liability partnership • Limited liability limited partnership

Yes

Are you in a highly regulated industry or sector?

• SEC Registered Parties • Utilities • Financial Institutions • Insurance Providers • Commodity	• CPA firms registered under Sarbanes-Oxley Act • Pooled Investment Vehicles • IRC § 501(c) registered non-profit entities • Wholly owned subsidiary of an exempt company	• Governmental or quasi-governmental entities • Un-capitalized entities without activity or foreign owners

No

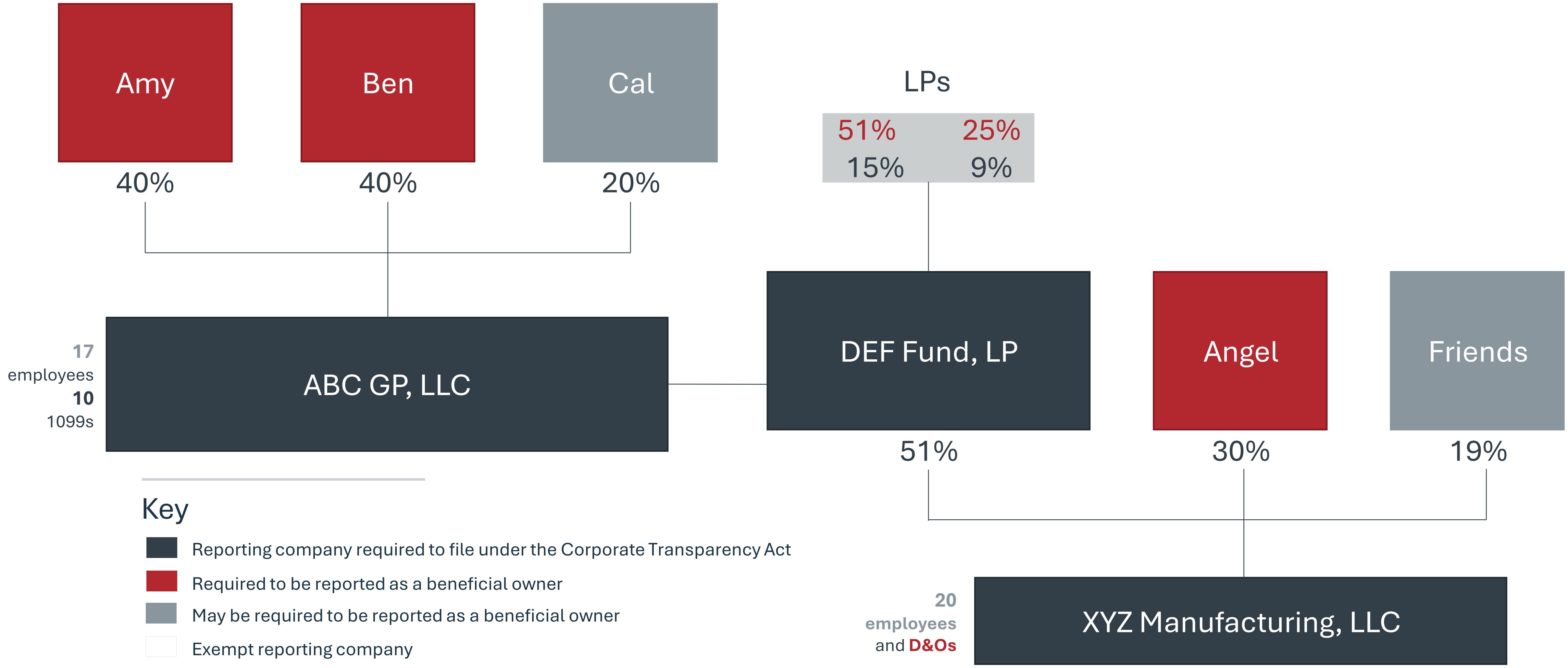
Do you meet all three criteria?

• Physical U.D. address *Lease or deed*	• Over $5 Million reported gross receipts or sales on most recent tax filing	• Over 20 Full Time Employees Not 1099 or Full time equivalent

No

You are a "reporting company" under the CTA and need to discuss reporting requirements.

Hypothetical: Who Needs to Report and What Needs to be Reported?



Key

- Reporting company required to file under the Corporate Transparency Act
- Required to be reported as a beneficial owner
- May be required to be reported as a beneficial owner
- Exempt reporting company

Preparing for Filing

- Determine if your existing business entities are reporting companies
- Determine who is in your control group for each entity
- Identify and notify your beneficial owners (direct and indirect) in each entity and gather BOI
- Establish policies, procedures and protocols, and responsible parties, to ensure timely compliance (including for corrections and changes)
- Develop system for tracking and retaining reported information
- Determine when to file in 2024 for pre-2024 entities
- Establish protocol and deadlines for new entities formations steps
- Keep apprised of new CTA developments

Succession Planning

Overview

- Pre-Sale Planning and Preparation
- Valuation – How much can I get?
- Exit Options – Sale Process Overview – Type of Deals
- Other Considerations

"Begin With the End in Mind®"

-Stephen Covey, 7 Habits of Highly Effective People; Habit 2

POLSINELLI® What a law firm *should* be.™

Typical Business Owner

THE "END" TO KEEP IN MIND?

- Liquidity
- Assets Protected
- Minimal Taxes

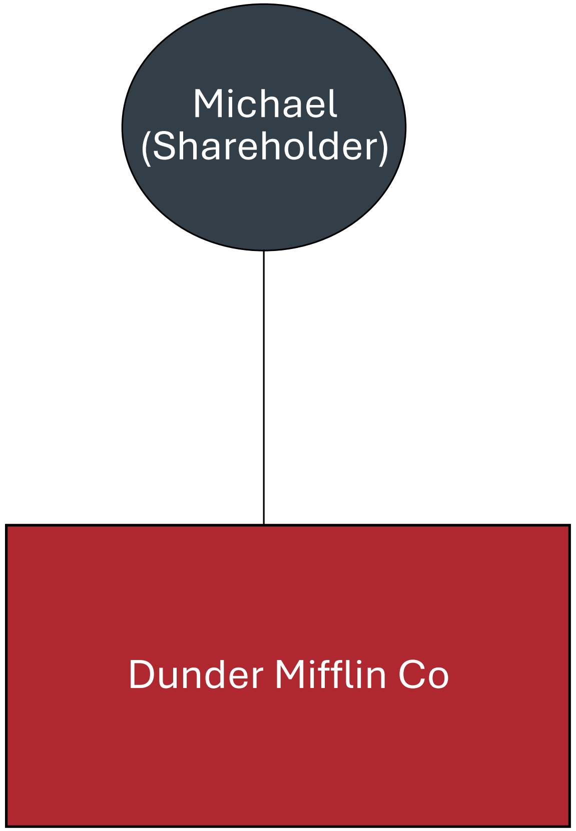
Pre-Sale Planning and Preparation

- Ownership & Estate Planning
- Do you have a sellable company?
- Pre Sale Diligence

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

Typical Ownership Structure



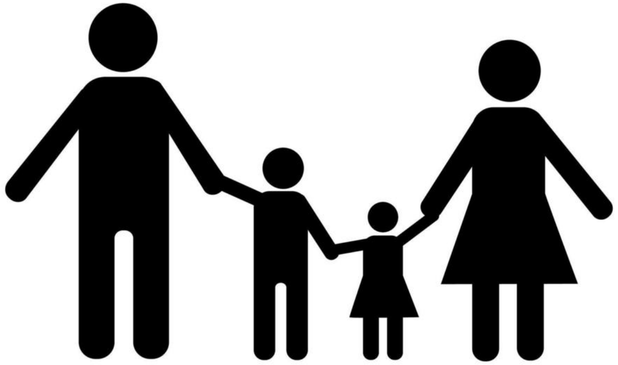
Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

Pre-Sale Planning and Preparation

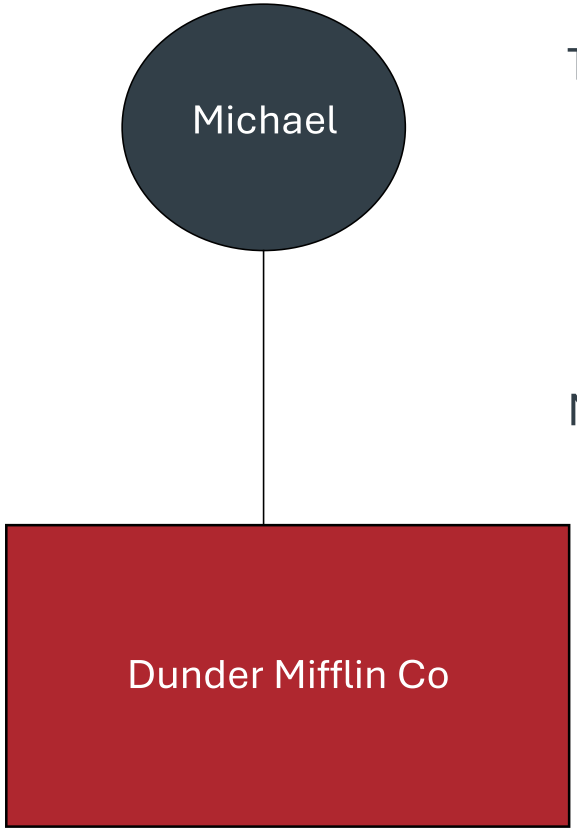
OWNERSHIP & ESTATE PLANNING

Most important things?



Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING



The Problem –

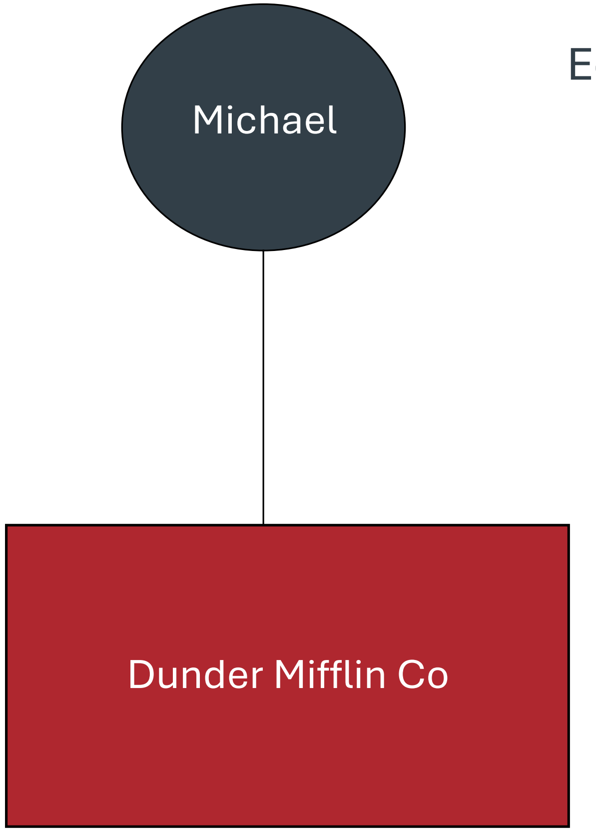
Taxable Estate

> Federal tax applies in excess of $13.61M, but drops to around $6.8M in 2026

No Asset Protection

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

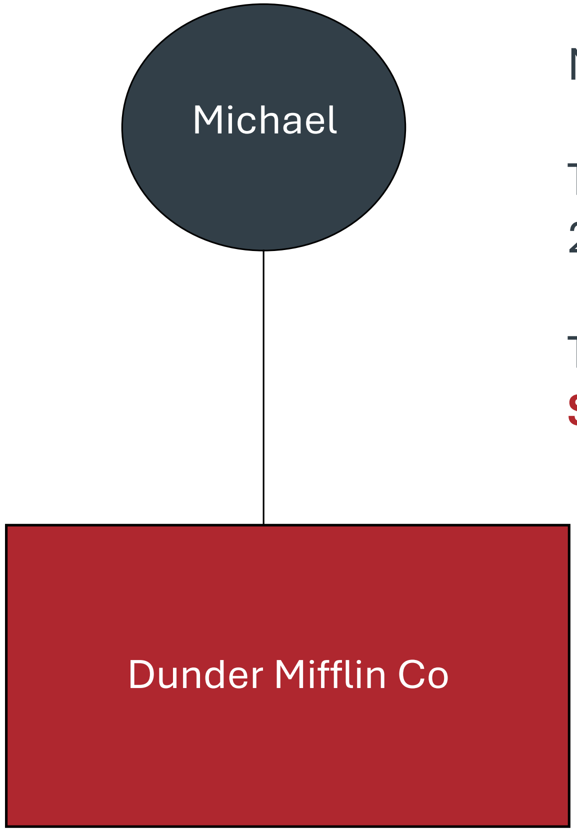


Assumption:

Equity Value of $32M

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING



Tax at death:

Net taxable estate is **$32,000,000**

The federal estate tax is **$7,356,000** in 2024

The tax will increase to around **$10,000,000** in 2026

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

SOLUTION:

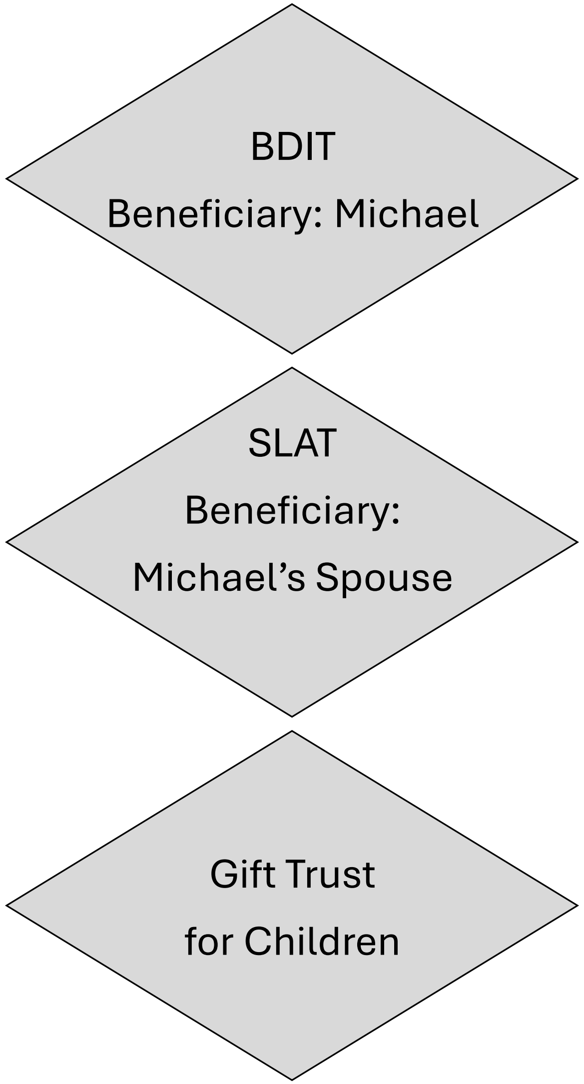
Advanced Estate Planning

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

Step 1 –

Set up Estate Tax Protected Trusts



Each Trust is a "Grantor" Trust

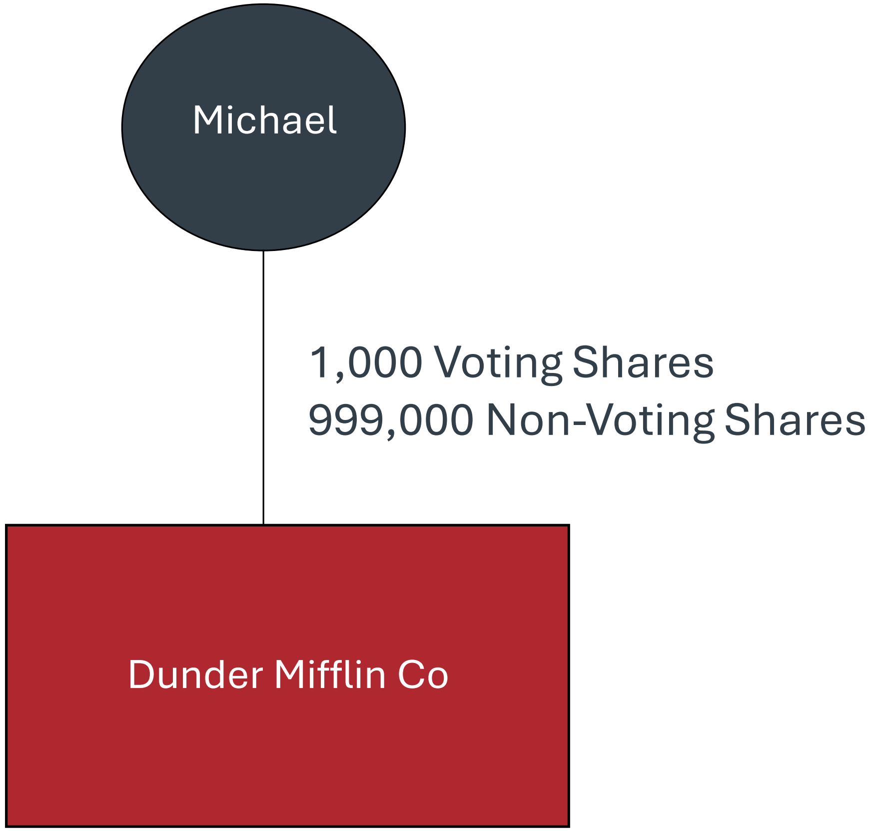
Michael pays the income and capital gains taxes on income of each trust

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

Step 2 –

Voting – Non-Voting Recapitalization



Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

Step 3 – Valuation

Obtain a gift tax valuation of the Dunder Mifflin Co's equity

- Discount Study
  - Lack of Control 20%
  - Lack of Marketability 15%
  - Non-voting 5%

100% Equity Value, on a controlling interest basis	$32,000,000
Less: 20.0% Valuation Discount for Lack of Control	(6,400,000)
100% Equity Value, on a noncontrolling interest basis	$25,600,000
Less: 15% Valuation Discount for Lack of Marketability	(3,840,000)
100% Equity Value, on a noncontrolling, nonmarketable interest basis	$21,760,000

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

Step 2 – Valuation

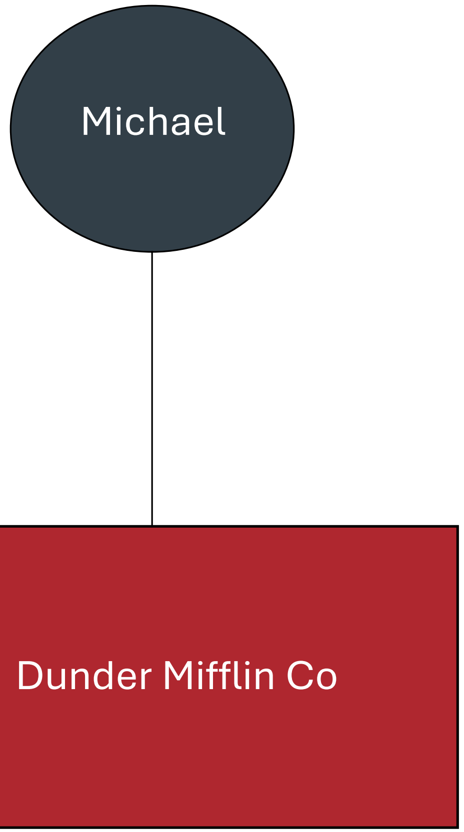
Obtain a gift tax valuation of the Dunder Mifflin Co's equity

- 100% Equity Value, on a noncontrolling, nonmarketable interest basis $21,760,000

- Less: 5% Valuation Discount for Lack of Voting Rights ($1,088,000)
- Value for Gift Tax purposes: $20,672,000
- The combined discount equals 35.4%

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

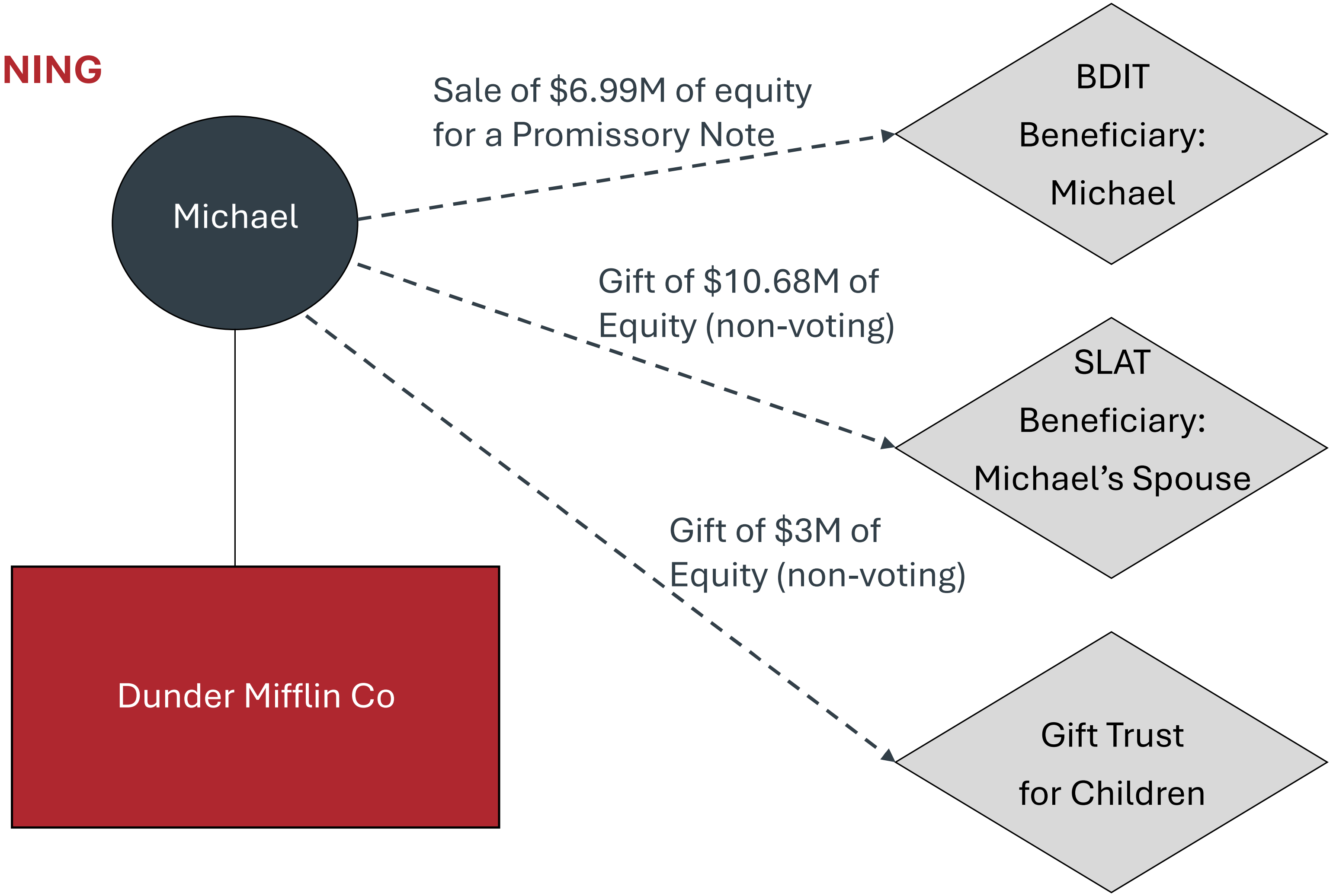


$32M Fair Value

$20.67M Value for Gifting

Pre-Sale Planning and Preparation

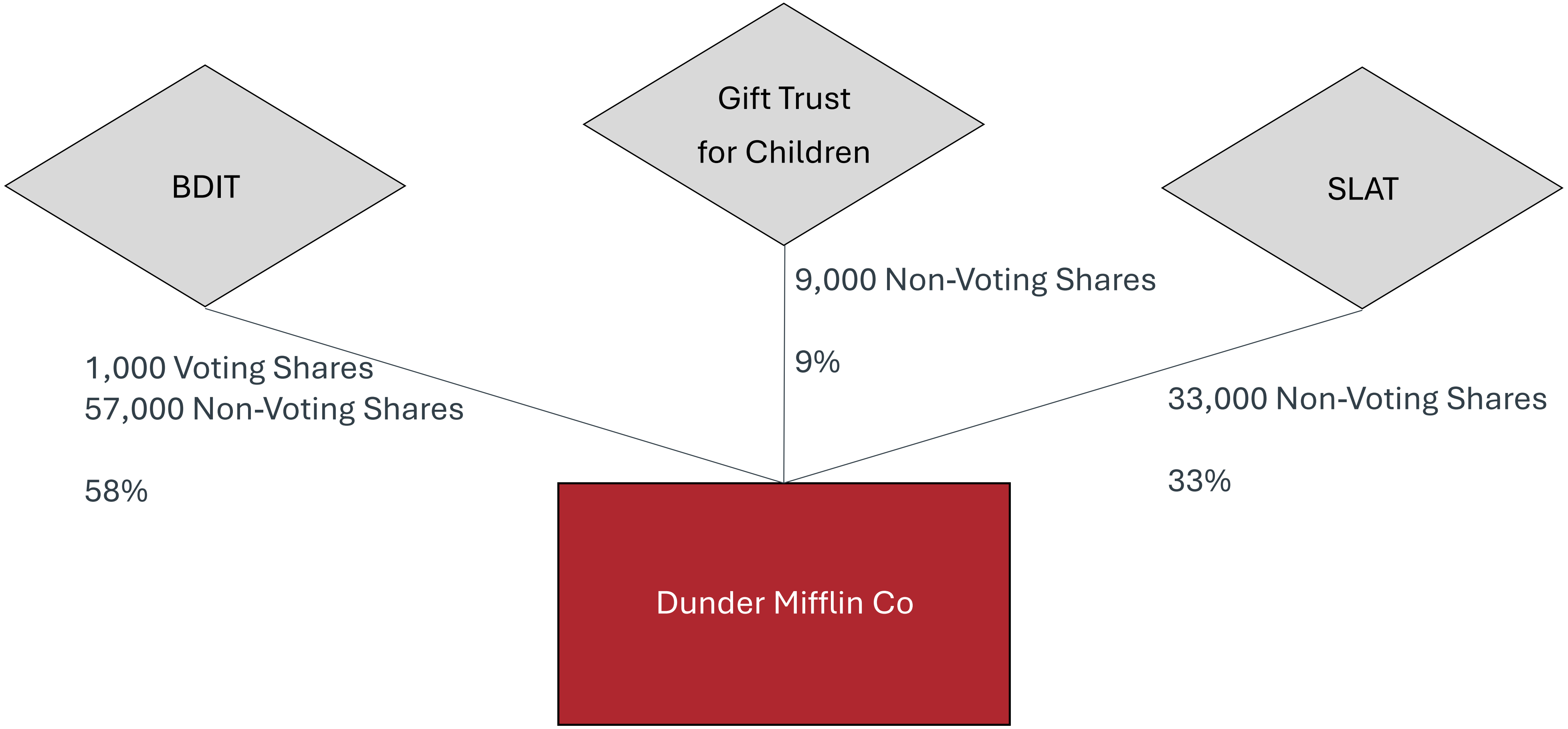
OWNERSHIP & ESTATE PLANNING



Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

End Result



Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

Success - Dunder Mifflin is sold for $50M

Each Trust receives cash of:

BDIT

$18,560,000

Gift Trust for Children

$2,880,000

SLAT

$10,560,000

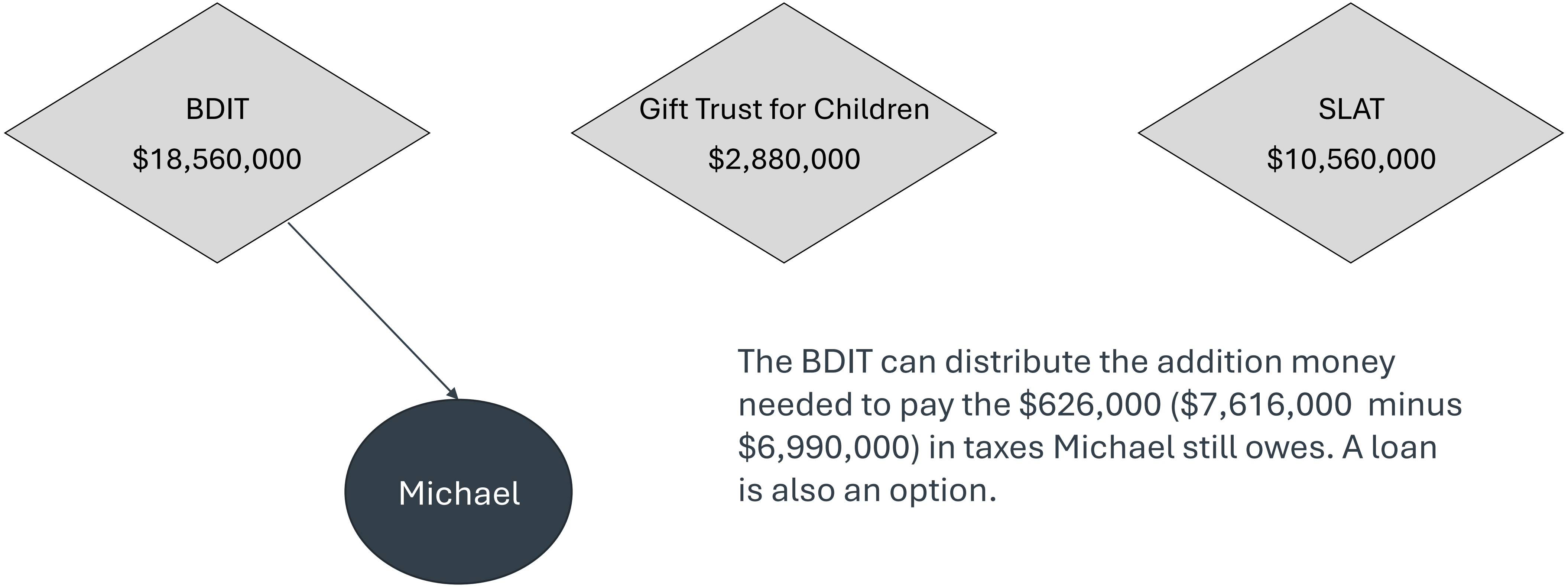
But Income taxes are due.

Michael – not the trusts – owes $7,616,000 in capital gains taxes (23.8% x $32M)
The BDIT owes Michael $6,990,000 for the stock the trust purchased.
The BDIT pays of $6,990,000 of the Note and Michael pays the IRS.

Pre-Sale Planning and Preparation

OWNERSHIP & ESTATE PLANNING

After Tax Cash in each Trust would be:



The BDIT can distribute the addition money needed to pay the $626,000 ($7,616,000 minus $6,990,000) in taxes Michael still owes. A loan is also an option.

Preparing Your Company for Sale

Why Prepare?
Time Kills Deals

Why is Time the Enemy?

- Economic Changes
- Pandemic
- Acts of War
- Regulation
- Change of Heart

Best Practices

PRE-DILIGENCE YOUR OWN COMPANY

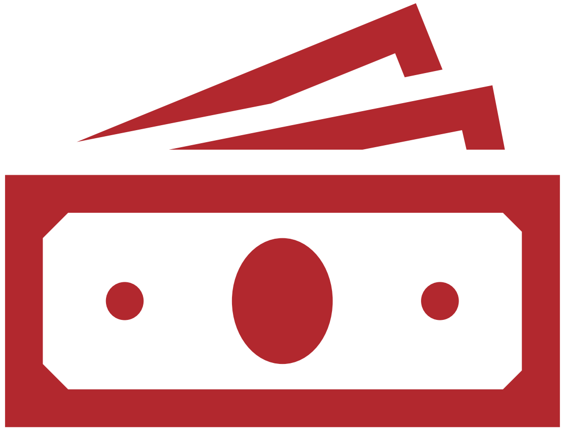
- Virtual Data Room
- Respond to a Due Diligence Request List (DDRL)
- Use a Project Management Process

Best Practices

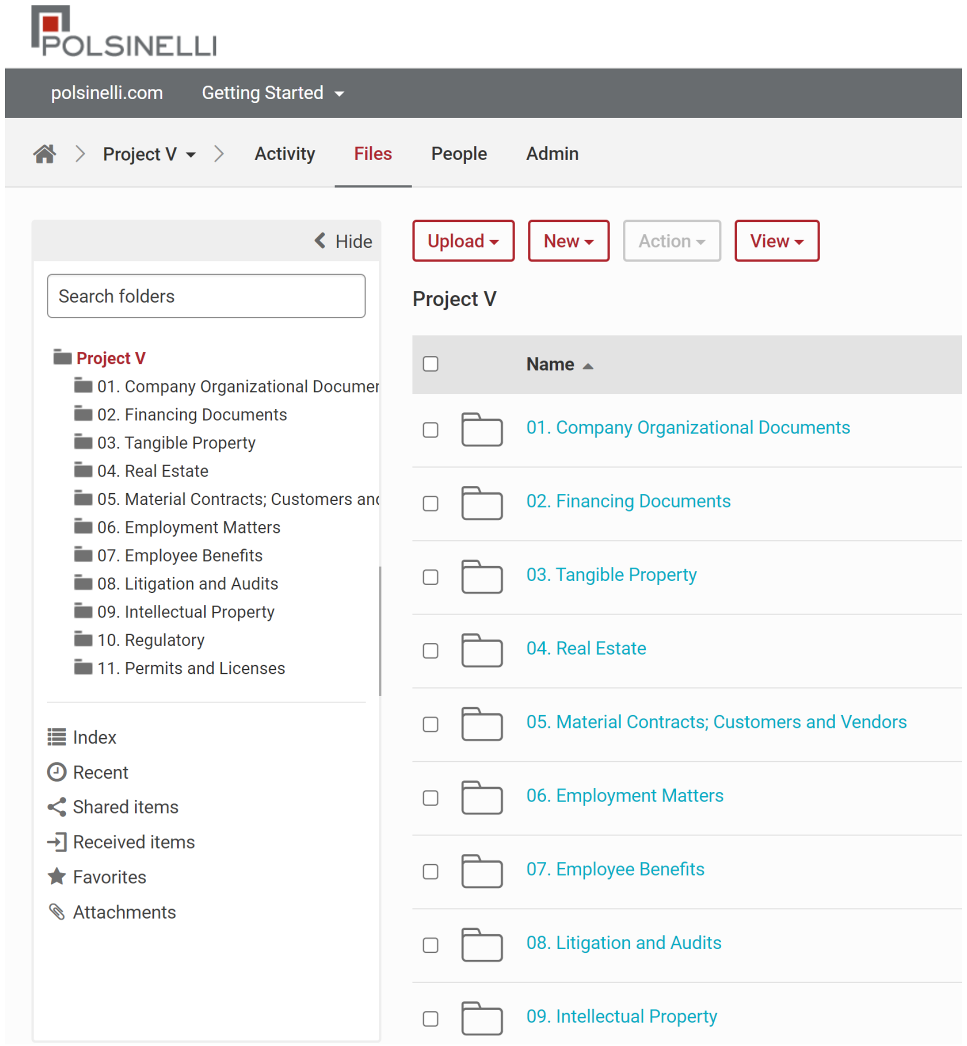
Getting your legal and financial house in order

=

a shorter time to closing and higher value



Virtual Data Room



Due Diligence

Due Diligence Request List

- General Corporate Information and Organizational Records
- Subsidiaries
- Governmental Filings, Compliance and Licenses
- Financing Documents
- Financial Statements; Accounting Matters; Tax Matters
- Officers and Managers/Directors; Employees; Related Agreements
- Labor Matters
- Employee Benefit Plans
- Contracts and Arrangements

Due Diligence Request List

- Assets
- Marketing and Operations
- Intellectual Property
- Real Property
- Environmental and Related Matters
- Consents
- Insurance
- Litigation and Other Legal Matters
- Miscellaneous

Main Benefit –
Identify Gaps and Address them Early

Brokers and Investment Bankers

Role of a Broker/Investment Banker

- Finding buyers, create competitive process
- Drafts a teaser and a CIM (Confidential Information Memorandum)
- Markets the company
- IOI, final and best offer -> LOI

Hiring a Broker/Investment Banker

Broker Engagements

- Fee Structure Generally.
- Success Fee.
- Transaction Value.
- Expenses.
- Tail Transactions.
- Assigned Bankers.
- Anti-Trust
- Non-Disclosure Agreements

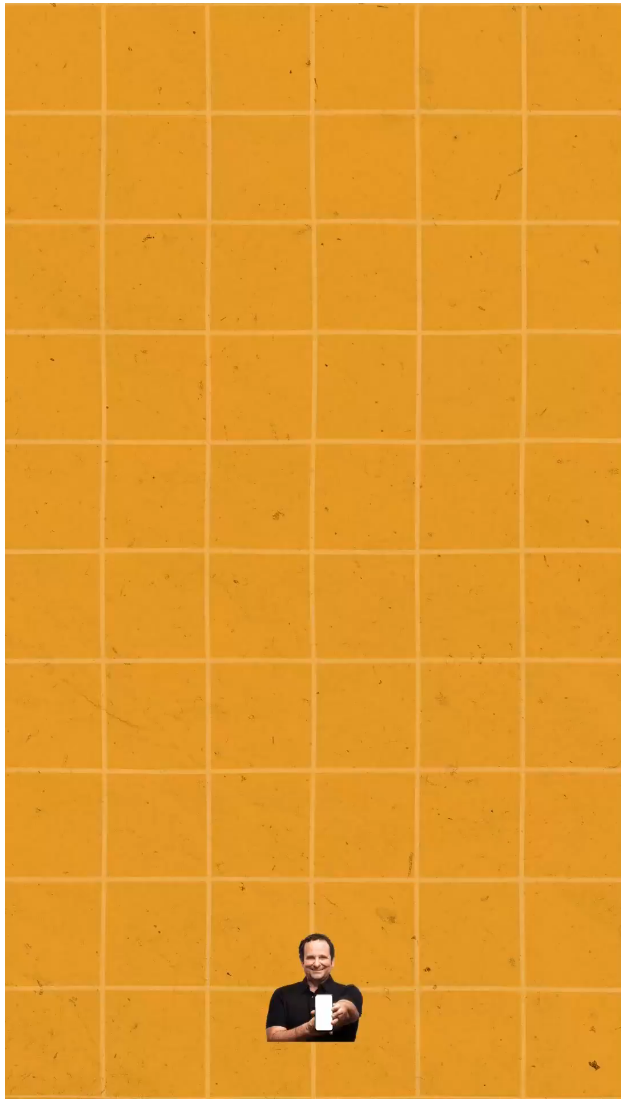
Non-Disclosure Agreements

NDAs

BEFORE SHARING CONFIDENTIAL INFORMATION, YOU NEED A STRONG NDA

- Key protection for sellers (including a partial sale / sale of a division) is to include non-solicitation of employees and restrict contact beyond a finite management group.
- Include language limiting a buyer's treatment or use of information to, among other reasons, avoid situations like this:
  - *We shall not use the Internet, including, without limitation, social networking sites, in connection with diligence or otherwise, to ascertain information about the Company or its employees, if such use could inform or alert any employee or consultant of the Company that we and the Company are engaged in discussions or negotiations regarding a Potential Transaction.*
  - *We will not expose any Confidential Information to any Generative AI Tool (defined below) without the express written permission of Company or Polsinelli. "**Generative AI Tool**" means any algorithm or machine learning tool or software capable of producing various types of content, including text, images, media, code, simulations, video, audio, and synthetic data based on the data it was trained on and often in response to prompts.*

NDAs



Valuation

Starts with the LOI

- Purchase Price of $32M = Enterprise Value
  - based on a multiple of 8 times the company’s EBITDA of $4M
- “cash and debt free”
- Normal level of net working capital

Importance of Cash Flow

Enterprise Value

=

multiple of EBITDA

What is Enterprise Value?

Dunder Mifflin Co's

Balance Sheet (as of 4/30/2024)

Assets		Liabilities and Shareholders' Equity	
Current Assets:		**Current Liabilities:**	
Cash and Cash Equivalents	$500,000	Accounts Payable	$800,000
Accounts Receivable	$1,000,000	Short-term Debt	$500,000
Inventory	$2,000,000	Accrued Expenses	$300,000
Total Current Assets	$3,500,000	**Total Current Liabilities**	$1,600,000
Property, Plant, and Equipment:			
Machinery and Equipment	$5,000,000	**Long-term Debt**	$2,000,000
Less: Accumulated Depreciation	($2,000,000)		
Net Property, Plant, and Equipment	$3,000,000	**Shareholders' Equity:**	
		Common Stock	$1,000,000
Intangible Assets:		Retained Earnings	$2,900,000
Patents and Trademarks	$1,500,000	**Total Equity**	$3,900,000
Less: Accumulated Amortization	($500,000)		
Net Intangible Assets	$1,000,000		
Total Assets	$7,500,000	**Total Liabilities and Equity**	$7,500,000

Enterprise Value Defined:

The total value of a Company’s assets as a going concern

Enterprise Value

Dunder Mifflin Co's

Balance Sheet (as of 4/30/2024)

Assets			Liabilities and Shareholders' Equity		
Current Assets:			**Current Liabilities:**		
Cash and Cash Equivalents	$500,000		Accounts Payable	$800,000	
Accounts Receivable	$1,000,000		Short-term Debt	$500,000	
Inventory	$2,000,000		Accrued Expenses	$300,000	
Total Current Assets		$3,500,000	**Total Current Liabilities**		$1,600,000
Property, Plant, and Equipment:					
Machinery and Equipment	$5,000,000		**Long-term Debt**		
Less: Accumulated Depreciation	($2,000,000)				
Net Property, Plant, and Equipment		$3,000,000	**Shareholders' Equity:**		
			Common Stock		
Intangible Assets:			Retained Earnings		
Patents and Trademarks	$1,500,000		**Total Equity**		
Less: Accumulated Amortization	($500,000)				
Net Intangible Assets		$1,000,000			
Total Assets		$7,500,000	**Total Liabilities and Equity**		

Why EBITDA?

Warren Buffett once said, “it all relates to cash flows. The only reason for putting cash into any kind of an investment now is because you expect to take cash out.”

EBITDA is a proxy for cash flow

EBITDA

Earnings [Net Income] Before Interest, Taxes, Depreciation, and Amortization

Earnings [Net Income]

+ interest

+ taxes

+ depreciation

+ amortization

= EBITDA

Dunder Mifflin Co's Income Statement TTM

For the Twelve Months Ending 4/30/2024

Revenue:	$10,000,000
Cost of Goods Sold (COGS):	$4,000,000
Operating Expenses:	$2,000,000
Depreciation Expense:	$500,000
Interest Expense:	$200,000
Taxes:	$300,000
Net Income:	$3,000,000

Next Step Calculate EBITDA

Earnings [Net Income]	$3,000,000
+ interest	$ 200,000
+ taxes	$ 300,000
+ depreciation	$ 500,000
+ amortization	-
= EBITDA of	$4,000,000

EBITDA Multiples

EBITDA Multiples can be translated into discount rates assuming no growth

- An EBITDA multiple of 5 corresponds discount rate of 20%.
- An EBITDA multiple of 10 corresponds to a discount rate of 10%
- An EBITDA multiple of 8 corresponds discount rate of 12.5%.

EBITDA Multiples

EBITDA of $4,000,000

Multiple of 8 [based on industry averages]

Enterprise Value: EBITDA x EBITDA Multiple

Enterprise Value: $4,000,000 x 8

Enterprise Value = $32,000,000

Business Value | Enterprise Value =

the present value of its expected future cash flows.

Importance of Normalizing Earnings

There is a magnified impact of every dollar added back to earnings.

What is Normalizing Earnings?

- Identify Non-Recurring Items
- Identify Excess Expenses
  - Family members on payroll
  - Vanity purchases
  - Vehicles
  - Aircraft
  - Excess T&E

- Add back the above back to earnings

Example

Dunder Mifflin Co’s

Operating Expenses:	$2,000,000
Extra Payroll and “Toys”	($1,000,000)
Normalized Operating Expenses:	$1,000,000

Next Step – Calculate EBITDA

Earnings [Net Income]	~~$3,000,000~~ $4,000,000
+ interest	$ 200,000
+ taxes	$ 300,000
+ depreciation	$ 500,000
+ amortization	-
= EBITDA of	~~$4,000,000~~ $5,000,000

Enterprise Value = Multiple x EBITDA

Enterprise Value = 8 x $5M = $40M (an increase of $8M)

Debt

Company's debt get paid out of the sale proceeds

Be careful.

Debt

"***Indebtedness***" with respect to any Person as of a specific date, means an amount equal to the sum, without duplication in Net Working Capital or otherwise, of the following: (i) all Liabilities for borrowed money, whether current or funded, secured or unsecured, all obligations evidenced by bonds, debentures, notes or similar instruments, and all Liabilities in respect of mandatorily redeemable or purchasable capital equity or securities convertible into capital equity (including any accrued and unpaid interest, any accumulated and unpaid dividends in respect of any of the foregoing and any prepayment penalties, fees, premiums, make-whole amounts and similar Liabilities arising from or relating to early retirement or redemption of any of the foregoing, including those required as a result of the change of control of the Person, or the refinancing of such Person's Indebtedness in connection with the Closing); (ii) any net debt, Liabilities or obligations under any derivative financial instruments and any debt, Liabilities or obligations in connection with terminating such financial instruments; (iii) **all Liabilities in respect of any lease of (or other arrangement conveying the right to use) real or personal property, or a combination thereof, which Liabilities are accounted for by such Person as capital leases or are required to be classified and accounted for under GAAP as capital leases**; (iv) all Liabilities for the reimbursement of any obligor on **any letter of credit**, banker's acceptance or similar credit transaction securing obligations of a type described in clauses (i), (ii), or (iii) above to the extent of the obligation secured; (v) obligations secured by any Lien on any property or assets of the Company; (vi) obligations for the deferred purchase price for purchases of property that are not evidenced by accounts payable which are current liabilities; (vii) any accrued and/or unpaid fees, interest, dividends, premiums, breakage costs, penalties or similar monetary obligations with respect to any of the foregoing; (viii) all Liabilities for any underfunded Employee Plan; (ix) all Liabilities of the Company in respect of due, but unpaid payroll, any bonuses, commissions, or other discretionary payments, including any *pro rata* amounts earned, accrued or unpaid for the current fiscal year, and any Taxes payable in connection therewith (including the employer portion of any payroll, social security, unemployment or similar Tax imposed on such amounts); (x) all Liabilities of the Company in respect of any severance rights, deferred compensation payments, withdrawal Liabilities under multiemployer plans, and similar Liabilities triggered by the transactions contemplated by this Agreement and any Taxes payable in connection therewith (including the employer portion of any payroll, social security, unemployment, or similar Tax imposed on such amounts); (xi) all Liabilities with respect to Accrued PTO; or (xi) any direct or indirect guaranty of any of the foregoing.

Debt

Example see the FT Story "The inequity method of accounting"

Kingswood Capital is clawing back $109M from the family that sold Save Mart (a California grocery chain)

https://www.ft.com/content/7ef1559a-0b7c-48cd-80dc-084081bea8ad

Debt

Project Sierra - The Save Mart Companies Funds Flow - Sources & Uses and Backup	Amount
Determination of Estimated Purchase Price	
(a) Base Value	245,000,000.00
Plus: (b) Estimated Closing Working Capital Surplus	0.00
Less: (c) Estimated Closing Working Capital Shortfall	(73,800,782.81)
Plus: (d) Estimated Closing Cash ***(Net of Register Cash)***	41,483,772.87
Less: (e) Estimated Closing Date Indebtedness	(104,401,542.59)
Less: (f) Estimated Seller's Transaction Expenses	(53,038,416.18)
Less: (g) Deemed Accrual Amount	(15,645,000.00)
Determination of Estimated Purchase Price	**39,598,031.29**
Less: Escrow Amount	(7,007,300.00)
Closing Payment to Seller	**32,590,731.29**

Debt

Save Mart's stake in SSI was listed as a single line on its balance sheet — worth $22.5mn — as seen below. (Sometimes the equity method is referred to as a "one-line consolidation").

Save Mart Supermarkets and Subsidiaries
(dba The Save Mart Companies)
Consolidated Balance Sheets
Years Ended December 27, 2020 and December 29, 2019
(dollars in thousands)

	2020	2019
Assets		
Current assets		
Cash and cash equivalents	$ 569,931	$ 89,195
Marketable securities	252,475	-
Accounts receivable, net	55,650	49,569
Current portion of notes receivable	4,945	6,453
Inventories, net	167,562	202,006
Assets held for sale	5,200	7,691
Prepaid expenses and other current assets	10,250	9,050
Total current assets	1,066,013	363,964
Property, plant, and equipment, net	701,117	508,733
Investment in joint venture	22,451	20,110
Goodwill	83,524	83,524
Other intangible assets, net	51,416	53,160
Deferred tax asset, net	7,256	1,566
Notes receivable, net of current portion	10,858	16,222
Other assets	6,500	6,031
Total assets	$ 1,949,135	$ 1,053,310

Debt

	2020	2019
Financial position		
Current assets	$ 197,570	$ 174,671
Long-term assets	24,118	26,821
Property, plant, and equipment, net	48,677	44,776
Total assets	$ 270,365	$ 246,268
Current liabilities	$ 129,949	$ 99,202
Long-term debt	93,820	104,772
Other long-term liabilities	3,837	2,979
Total liabilities	$ 227,606	$ 206,953
Save Mart Supermarkets' equity	$ 22,453	$ 20,166
Remaining partners' equity	20,306	19,149
Total partnership equity	$ 42,759	$ 39,315

Debt

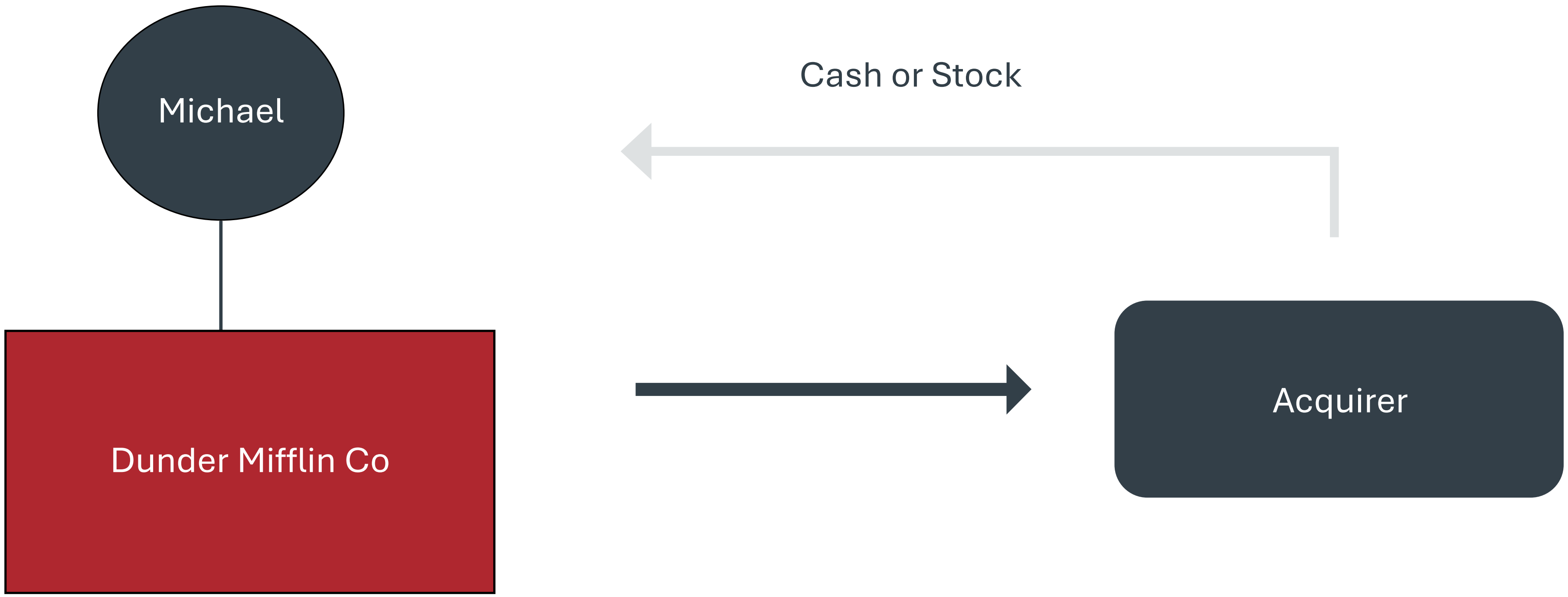
Kingswood added back $109mn of SSI debt, and claimed it was “Indebtedness”.

Deal Structures

Common Deal Structures

ALTERNATIVES	TAX
Sale of Stock	20% (Federal)
Sale of Assets	Can be 23.8% - 40% or more
Tax-Free Exchange or Merger	-0-
302 Redemption	Varies
Qualifying Sale to ESOP	-0-

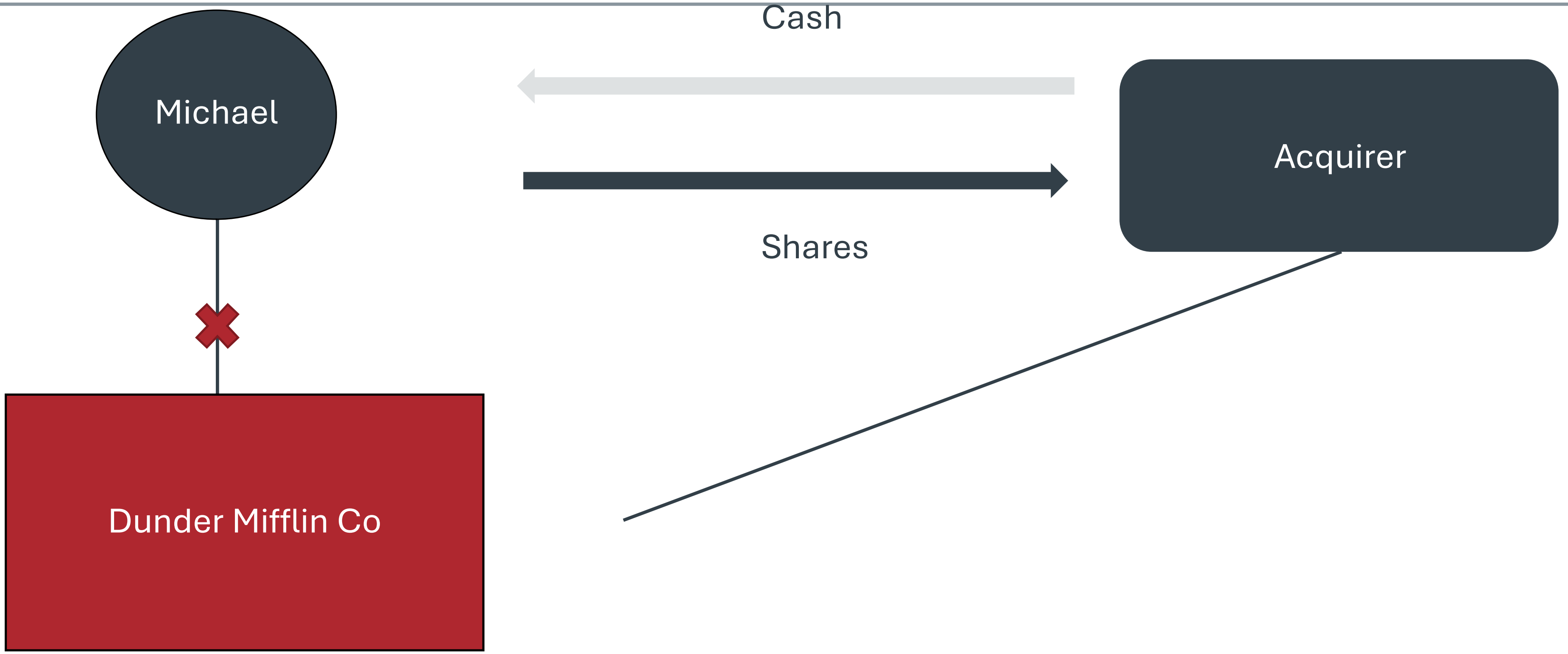
Merger



STRUCTURE PROS

- Tax benefits (no tax on the stock received if done right)
- Efficient logistics (few third party consents, etc)

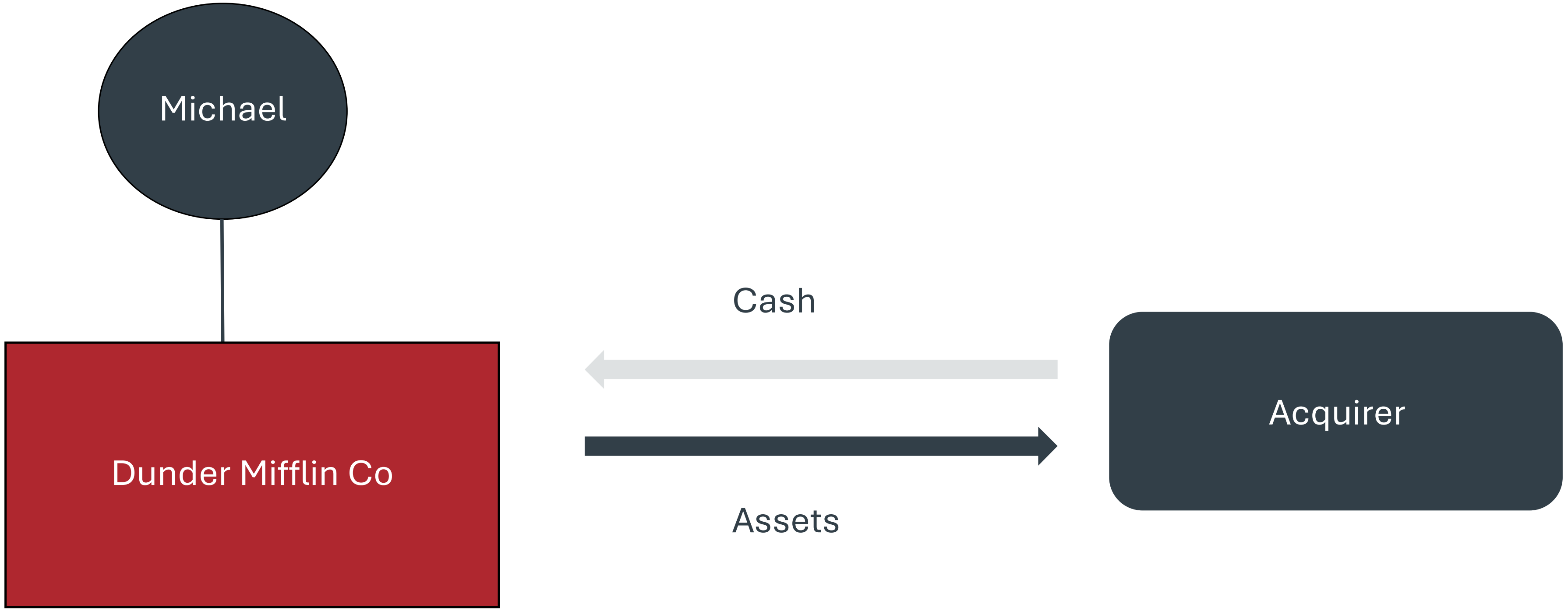
Stock Deal



STRUCTURE PROS

- Tax benefits to the seller (capital gains)
- Efficient logistics (only difference is change in control above the target)

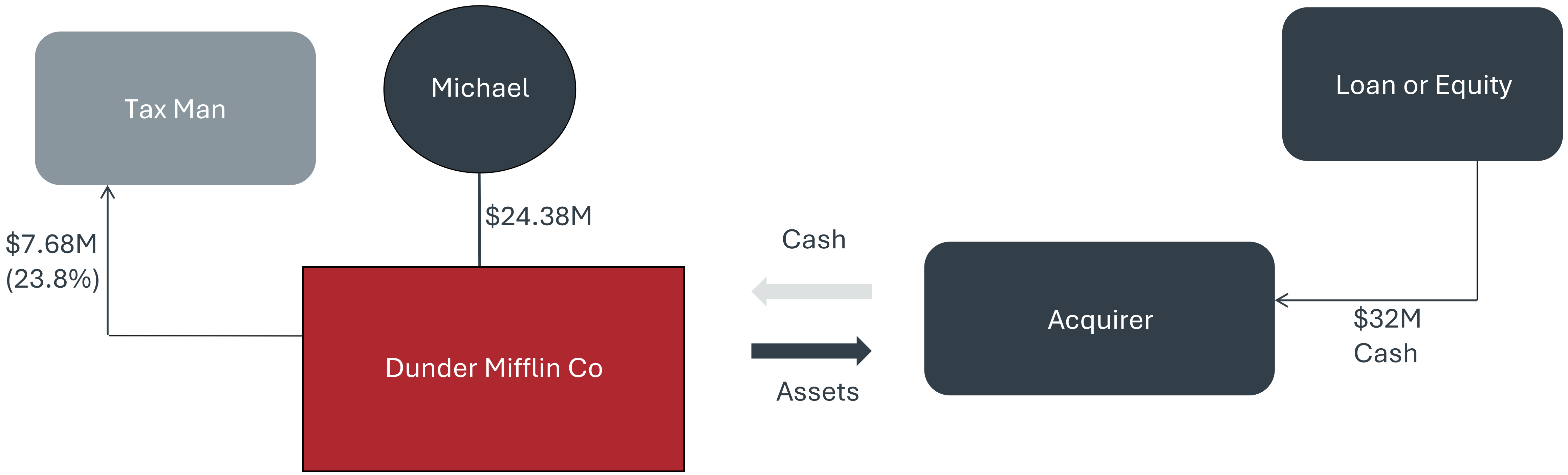
Asset Deal



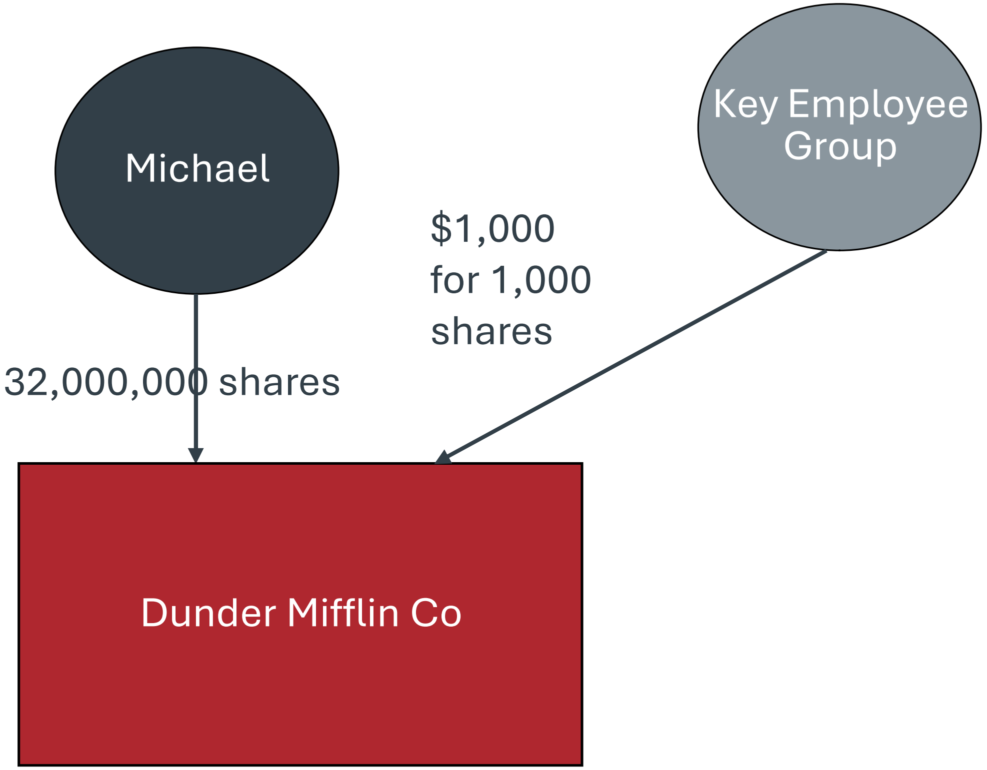
STRUCTURE PROS

- Tax benefits for Buyer
- Buyer protected from liabilities

Asset Deal – Taxes and Net Proceeds



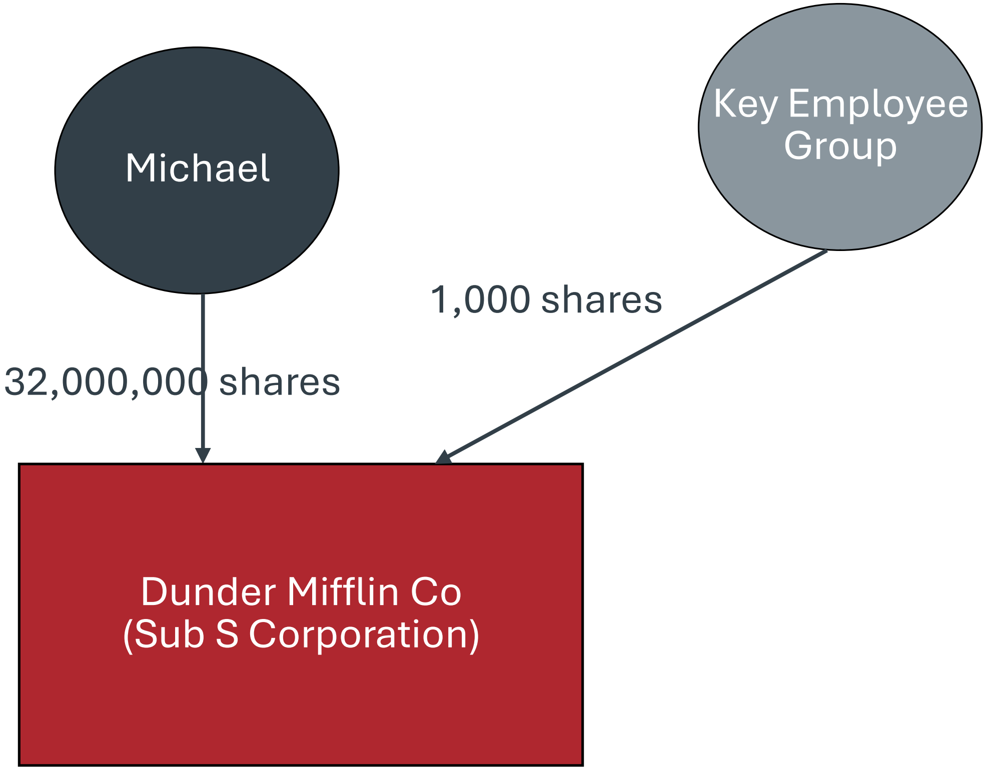
302 Redemption



302 Redemption

The Key Employees

302 Redemption



Dunder Mifflin Co Earns $3M per year, assuming it grows 10% per year

Y1: Tax distribution 40% x $3M = 1.2M
  Redeems 1.8M shares at $1 per share

…

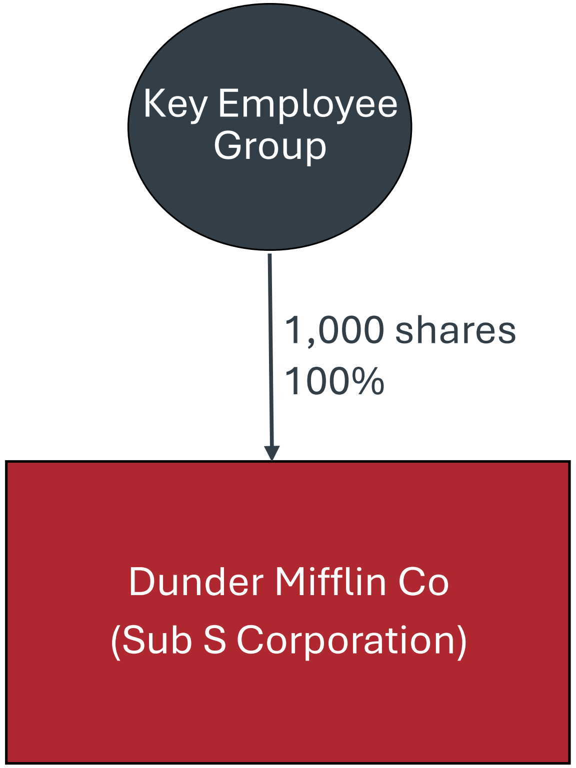
Y5: Tax distribution 40% x $4.4M = 1.76M
  Redeems 2.64 shares at $1 per share

…

Y11: A total of $32M has been paid to Michael to redeem his stock.

The purchases can be tax free if spread out over enough time

302 Redemption – Final Result



At Year 11 Dunder Mifflin Co is 100% owned by the Key Employees

Each dollar of earnings is taxed only once.

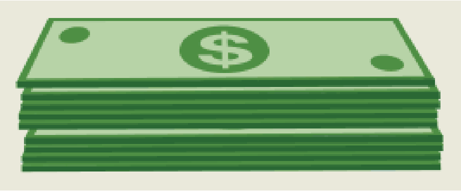
The company cash flow is used to buy out the founder/owner

Selling to an ESOP

- "ESOP" stands for employee stock ownership plan
- An ESOP is an ERISA qualified retirement plan that is tax-exempt and used to provide a retirement benefit to employees of the company/plan sponsor

ESOP Advantages

- A way to sell a business that benefits the company, the employees, and the selling business owners
- Business owners sell some or all of their shares to an ESOP trust, which owns those shares on behalf of employees



- ✓ Sellers can defer taxation
- ✓ Tax benefits for the business
- ✓ Sell the business at once or gradually in installments
- ✓ Sellers can define their role in the company moving forward

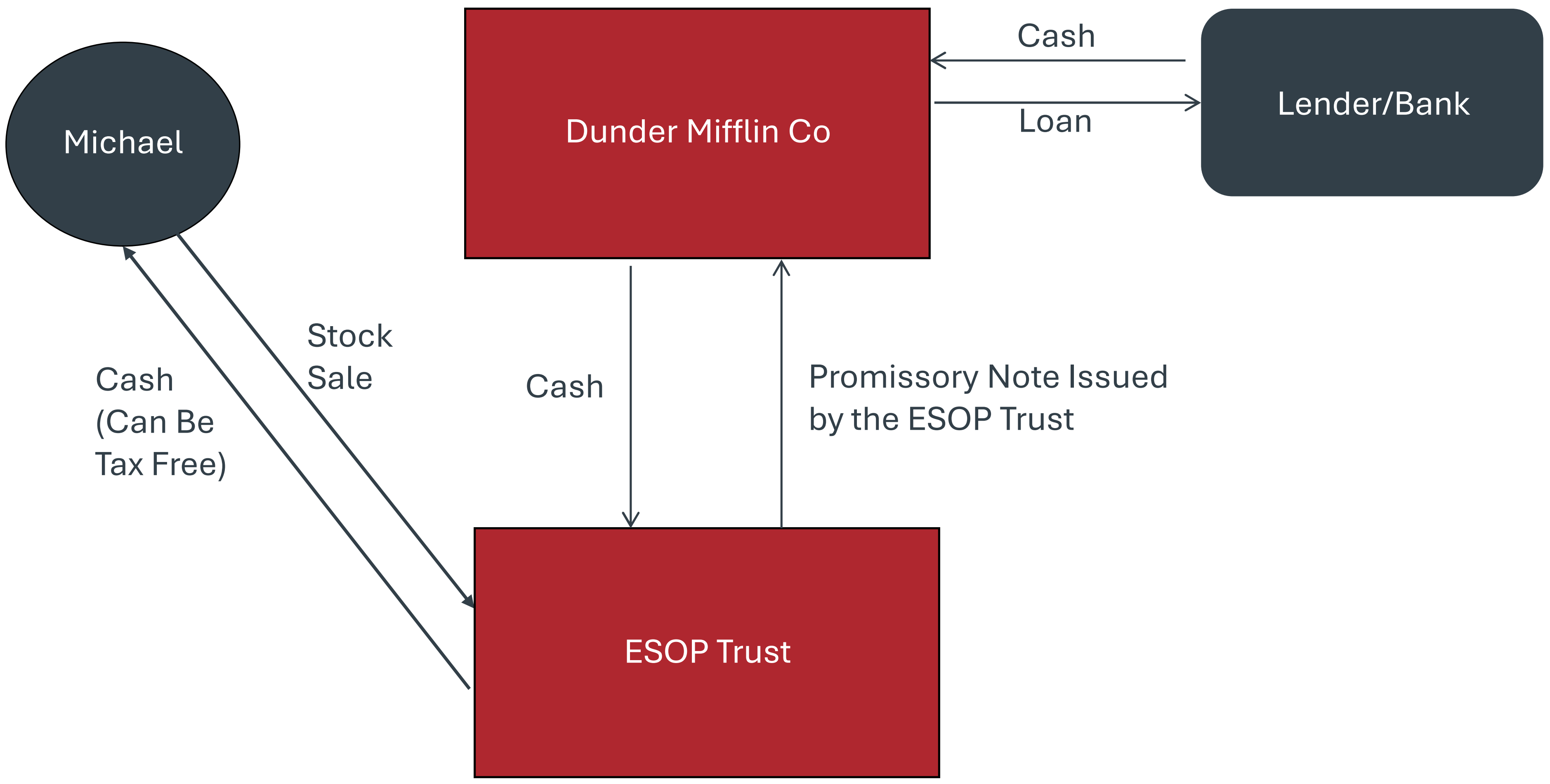
ESOP Structure

- Company establishes ESOP
- Company obtains financing and/or uses existing cash
- Company loans proceeds to ESOP to enable ESOP to purchase company stock
- Shares purchased by ESOP
  - Purchase may be direct from the existing shareholders (structure typically used when C corporation and 1042 elected)
  - Shares may be redeemed for cash or notes and then re-sold by Company to ESOP (structure typically used with seller financing)

ESOP Structure

- Company makes tax-deductible contributions to ESOP to allow ESOP to repay loan to Company
  - Company stock in ESOP is allocated to ESOP participants over time as “inside” loan is repaid
- Company repays lender
- ESOP participants “vest” in the stock in their accounts over time
- ESOP participants receive distribution generally at termination of employment
- 100% ESOP owned S corporations pay no federal income tax

Sale to an ESOP



How is the ESOP Loan Repaid?

- Every year, the company makes a tax-deductible contribution to the ESOP (can be like a profit sharing contribution/can also include a 401(k) match)
- The ESOP uses the contribution to repay the loan to the company
  - Dividends may also be used to repay the loan.
- With each ESOP loan payment, a pro rata portion of the shares are allocated to participant accounts, “earning” the benefit

<u>As a result</u>

- Tax deduction equal to the principal and interest on the loan
- Shares allocated to participant accounts.

Principal payments are tax deductible

When Might an ESOP be Appropriate?

- An aging shareholder wants to diversify
- Desire to sell on a tax-deferred, tax-free or tax-advantaged basis
- Strong successor management team in place
- Ability to finance transaction
- Appropriate ratio of payroll base to debt
- Ability to manage repurchase obligation
- Possible S corporation tax savings
- Belief in and commitment to concept of employee ownership

Overview of Sell-Side M&A Transaction

Buyer Types

STRATEGIC BUYERS:

- Competitors
- Buy with cash, possibly earnout
- Generally no equity rollover

FINANCIAL BUYERS:

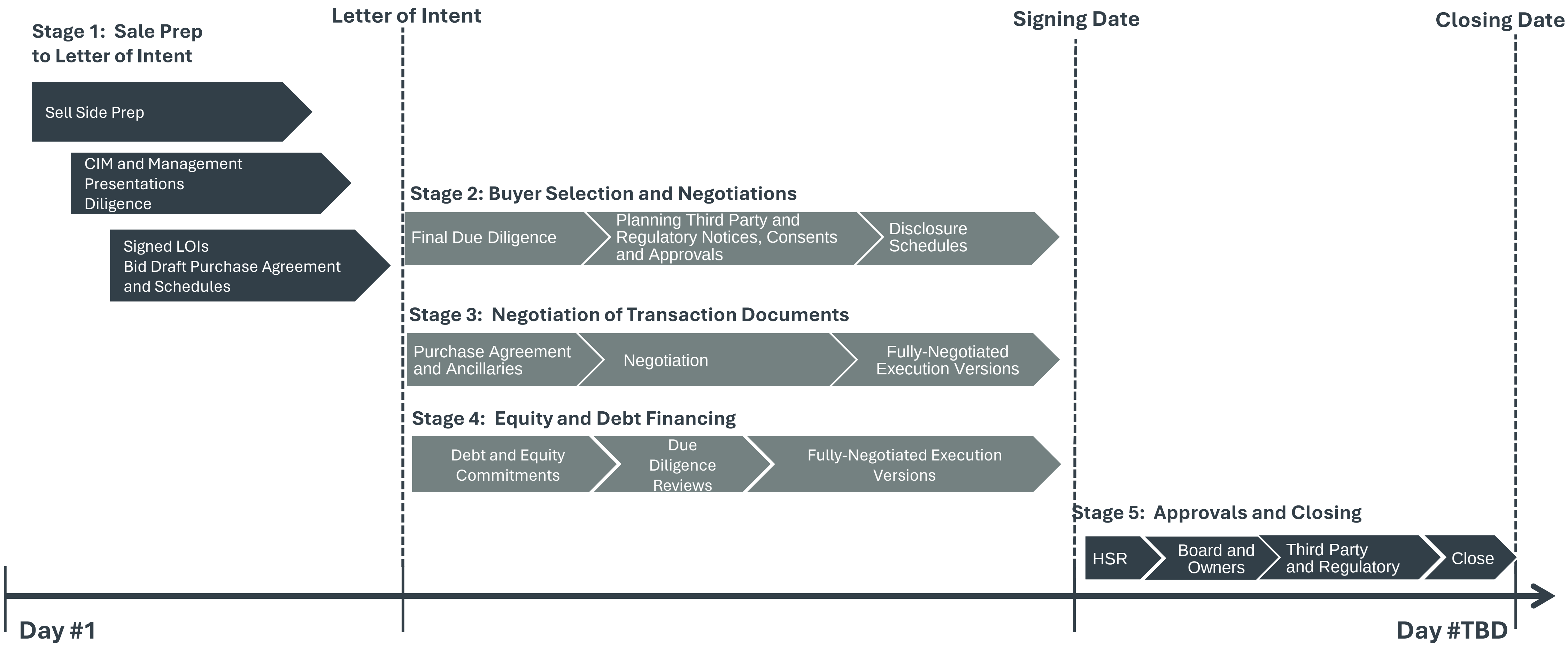
- Private equity, family office, etc.
- Buy with cash, equity rollover, earnout
- Utilize debt

Buyers, Generally

MOTIVATED TO GROW THROUGH ACQUISITIONS:

- Strategic – accretive growth, complementary product line, etc.
- Financial – returns for investors

Illustrative Transaction Process Timeline



Letter of Intent

- **Non-Binding Provisions**
  - Key purchase agreement terms (indemnity, purchase price, etc.)
  - Key deal terms and deliverables (employment agreements, etc.)
- **Binding Provisions**
  - Exclusivity
  - Non-solicitation
  - Legal boilerplate

Legal Due Diligence

Key areas:

REGULATORY

LABOR & EMPLOYMENT

BENEFITS

CONTRACTS

LEGAL PROCEEDINGS AND COMPLIANCE WITH LAW

INTELLECTUAL PROPERTY, AND OTHER INDUSTRY-SPECIFIC DILIGENCE AS NEEDED

Key Transaction Documents

- Purchase Agreement
- Disclosure Schedules
- Other:
  - Leases
  - Employment Agreements

Key Purchase Agreement Terms

- Indemnification / Representations and Warranty Insurance
- Termination Provisions (ex: Elon Musk Twitter deal)
- Regulatory
  - Licenses
  - HSR
- Consideration Provisions
  - Working Capital
  - Earnouts

Indemnification

Traditional Seller Exposure (without Representation and Warranty Insurance)

TYPICAL LIABILITY CAPS OF 10% OF DEAL VALUE (NON-FUNDAMENTAL REPRESENTATIONS) AND 100% OF DEAL VALUE (FUNDAMENTAL REPRESENTATIONS)

DEDUCTIBLE OF 1% OF DEAL VALUE (FOR NON-FUNDAMENTAL REPRESENTATIONS)

ESCROW ~10% OF DEAL VALUE FOR 12-24 MONTHS

Representation and Warranty Insurance

Seller exposure / indemnification structure with Representation and Warranty Insurance:

PREMIUM OF 2-4% OF DESIRED LIMIT

RETENTION (DEDUCTIBLE) OF 0.5%-1.0% OF DEAL VALUE

ESCROW 0%-100% OF RETENTION (DEDUCTIBLE)

Representation and Warranty Insurance

- More cash at closing for Seller
- More risk protection for Buyer
- Example: $100mm transaction with a desired $20mm limit, $800k premium (4% of limit), and $1mm deductible (1% of transaction value)

	Escrowed Amount	Buyer Risk Coverage	Seller Closing Cash Reduction
RWI	$500,000* (0.5%)	$20mm Limit (20%)	($500,000)
No RWI	$10mm (10%)	$10mm Escrow (10%)	($10mm)

*Parties may agree that buyer will pay all of the retention, eliminating the need for an escrow.

Additionally, parties may agree that seller pay for some portion of the $800k premium.

Representation and Warranty Insurance

- Can only insure for unknown risks – drives heightened diligence
  - Diligence risks = policy exclusions
  - Market exclusions:
    - Transfer pricing
    - Underfunded benefits plans
    - COVID issues
    - Availability of NOLs or other tax attributes
    - Asbestos or polychlorinated biphenyls

Representation and Warranty Insurance

- Approximately 55% of deals use RWI*
- 97% of policies acquired by buyer*
- 51% of the time, buyer pays; 36% of the time, cost is split*
- Minimizes negotiation of indemnity
- Strategic buyers tend to be late adopters of RWI – good way to differentiate bids

***ABA 2023 Private Target Mergers & Acquisitions Deal Point Study**

Trend of "Walk Away" Structure

A number of deals in the middle market trend toward a "walk away" RWI structure:*

	2018-2019	2020-2021	2022-2023
RWI sole remedy for all representations	14%	38%	49%
RWI sole remedy for non-fundamentals only	23%	25%	22%

**ABA 2023 Private Target Mergers & Acquisitions Deal Point Study*

Thank you

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