

LSL



64%

76%

Webinar

**Year-End M & A Outlook
and Activity for 2023**

**TUE, DEC 6
10:00AM PST**

Disclaimer

Lance, Soll and Lunghard, LLP is providing this material for information purposes only. The content within the presentation was developed based on information available as of December 6, 2022. The material provided is general and is not intended to be complete tax or business advice. Nothing herein should be relied upon or used without consulting a tax or business advisor to consider your specific circumstances, possible changes to applicable laws, rules and regulations, and other tax or operational issues. Receipt of this material does not establish a client relationship.

Copyright 2022 Lance, Soll and Lunghard, LLP

Your Presenters



Pam Bustos, CPA
Partner
LSL



Robert Fahrenhorst
Managing Director
Plethora Businesses

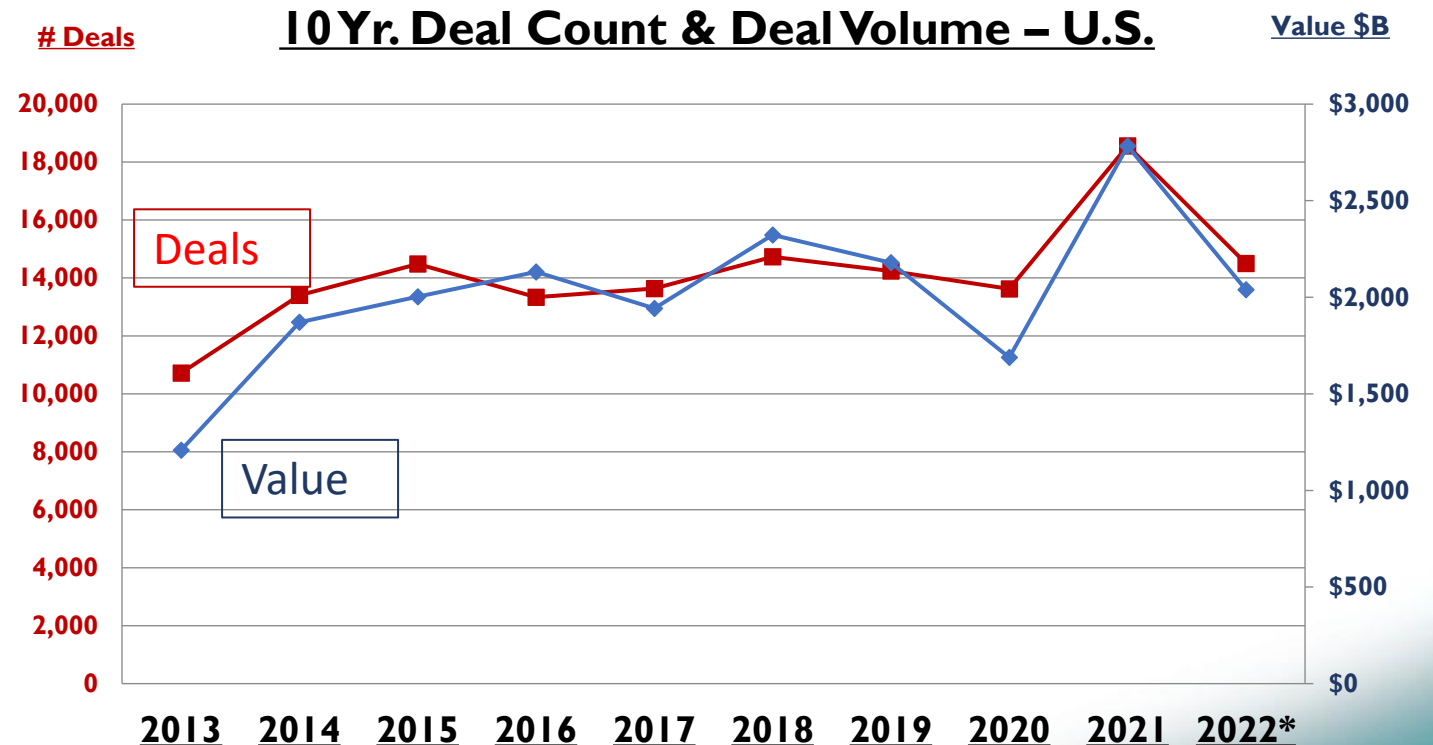


Brandon Lanza
Financial Analyst
Plethora Businesses



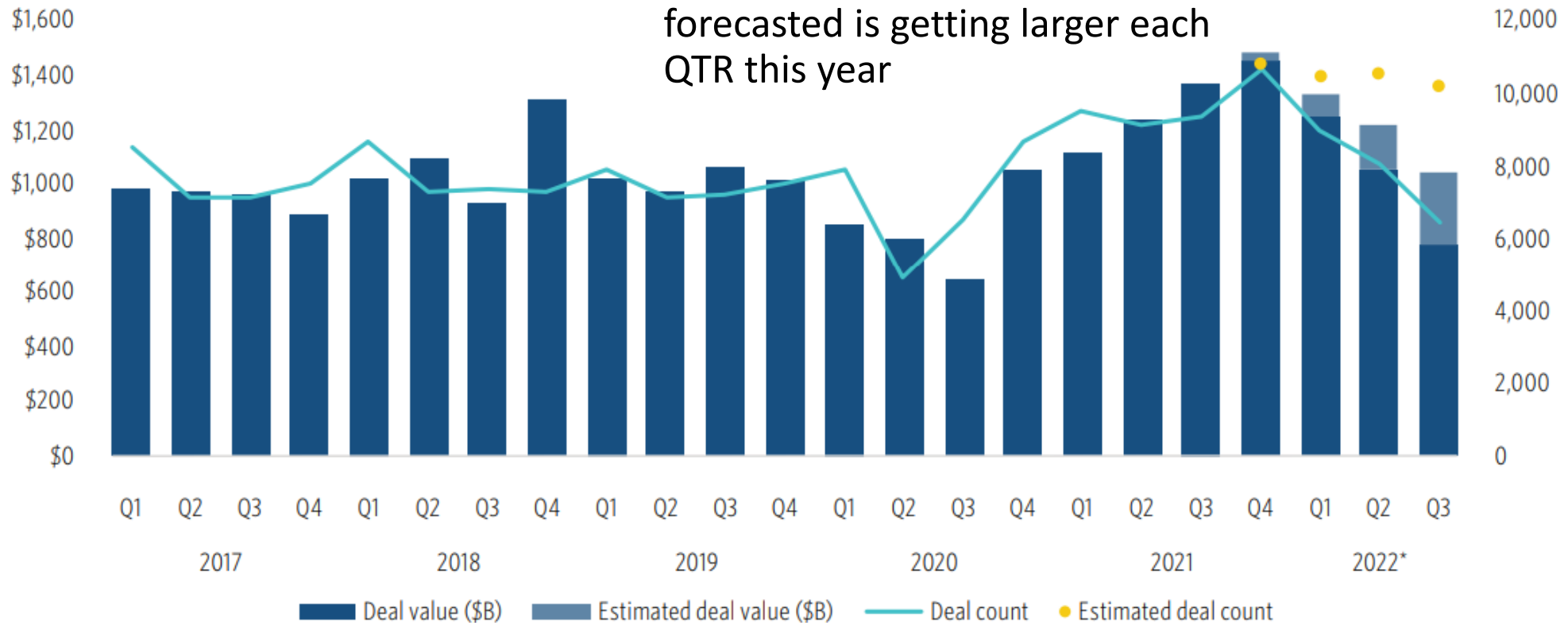
M&A Activity: 2022 Review

- Closing out a mixed year
 - 2022 M&A activity reverts to historical averages
 - HEADWINDS:
 - Inflation (40 yr high)
 - Increased inflation dampening M&A activity but not crushing it
 - US: Fed Reserve (6 rate hikes so far in 2022)
 - Anticipation of a looming/extended recession



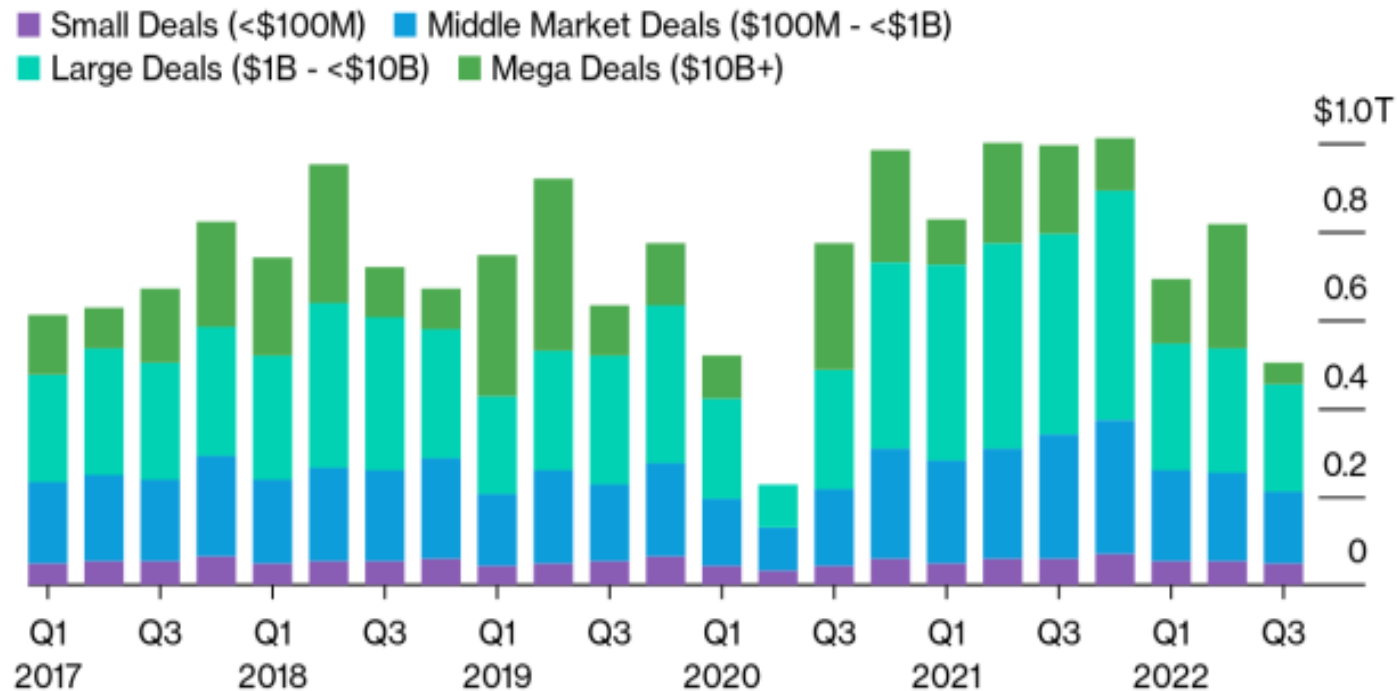
M&A Activity: Deal Review – Quarterly Basis

Global M&A activity by quarter



Source: PitchBook | Geography: Global
*As of September 30, 2022

All Market Segments Saw Drop in Global M&A Volume in Q3



- Small, Medium, & Large deals all down YOY
- SPACs partial reason for decline in volume for 2022
- % YoY drops ~ 50% to last year
- Wait and See approach from Strategics & Pegs
- Still Integrating 2021 Deals into Portfolio
- Q4 2022 anticipated to improve
- TBD if it will be a “rebound”

*Source: Bloomberg



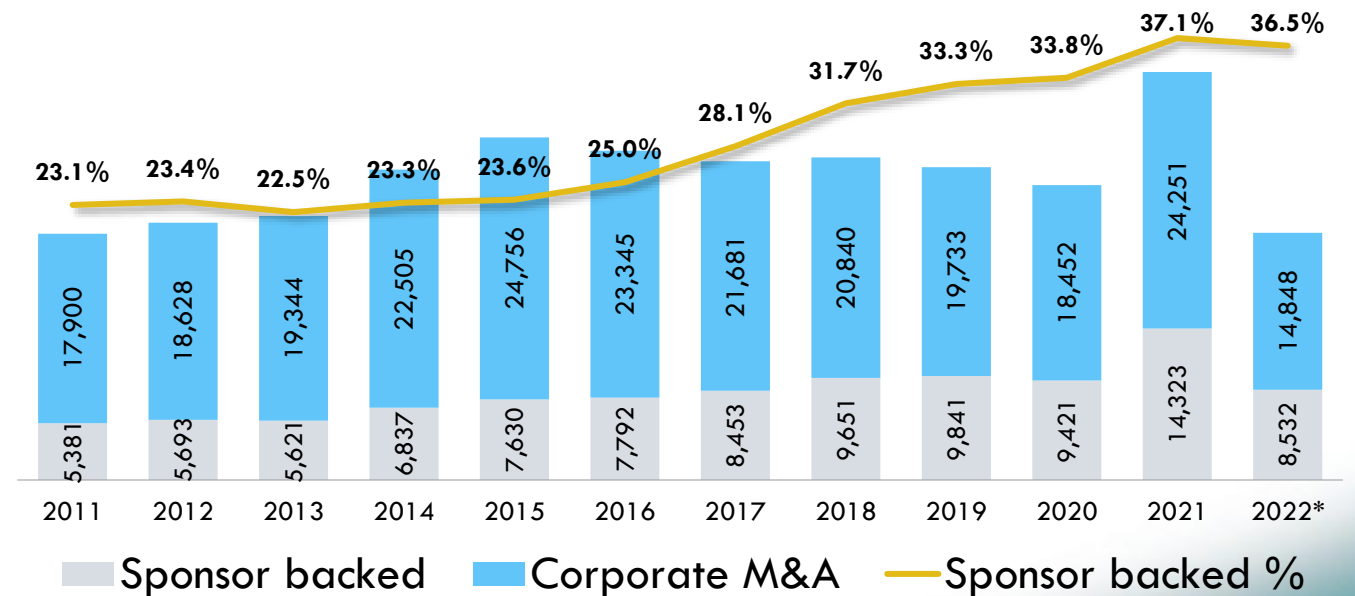
2023 Outlook: Trends and Themes

- Slow and cautious going into the new year
 - Executive confidence will set the tone in Q1, '23
 - Even surveys can be ways off the mark
- Return to pre-pandemic levels (hard to beat records)
- Offers falling short of seller's expectations & more structured deals
- Look for an increase in distressed deals and divestitures
- Disruptive technology (take out costs and appeal to new customer bases)
- Strategics may take more of the deal share (less leverage needed)
- Data Analytics (Big data)



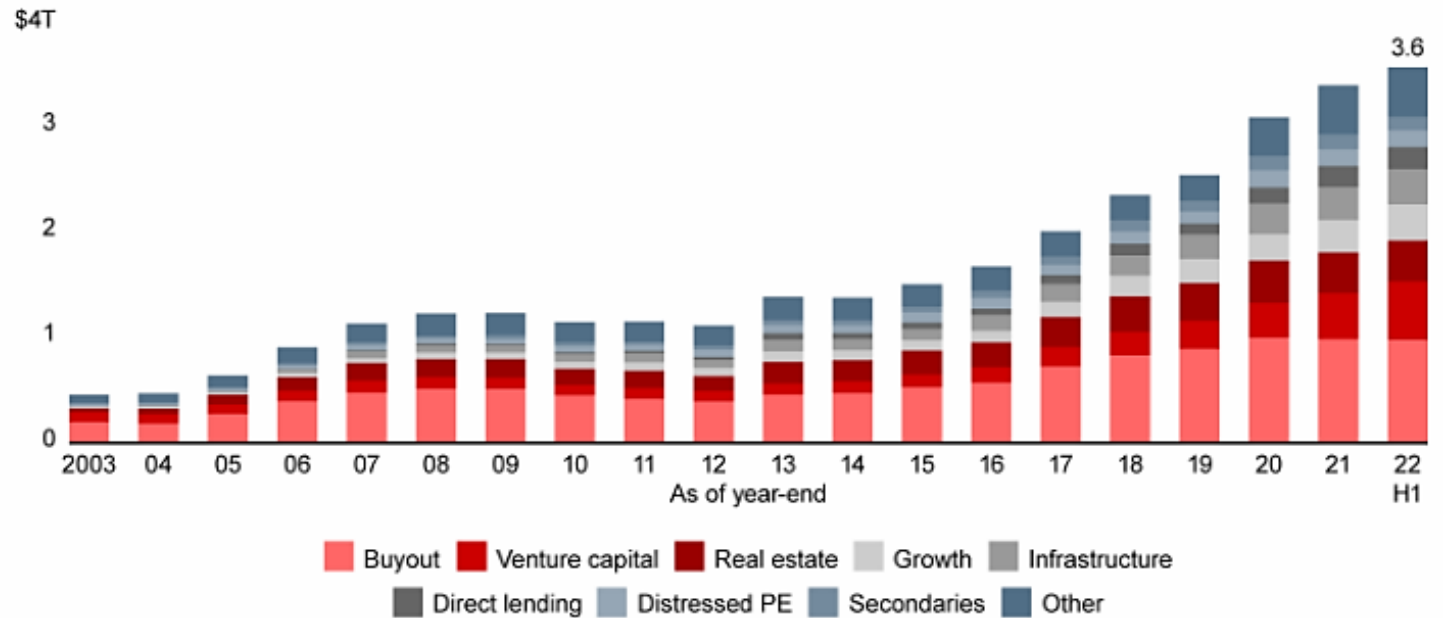
M&A Activity: Strategic vs Private Equity

- Private Equity represents 36% of total completed deals
- Invest across all deal sizes (main street to large cap)
 - Younger, “1st Gen” PE are more flexible on their minimums
 - Some PE will spinoff a sister division for main street
- Most PE platforms will make multiple add-on acquisitions
 - Complimentary, new products, new markets
- Massive dry powder have helped to increase their position



M&A Activity: Private Equity

Global private capital dry powder, by fund type



- Private Equity “dry-powder” is at all-time high
- \$3.6 Trillion

Source: Preqin

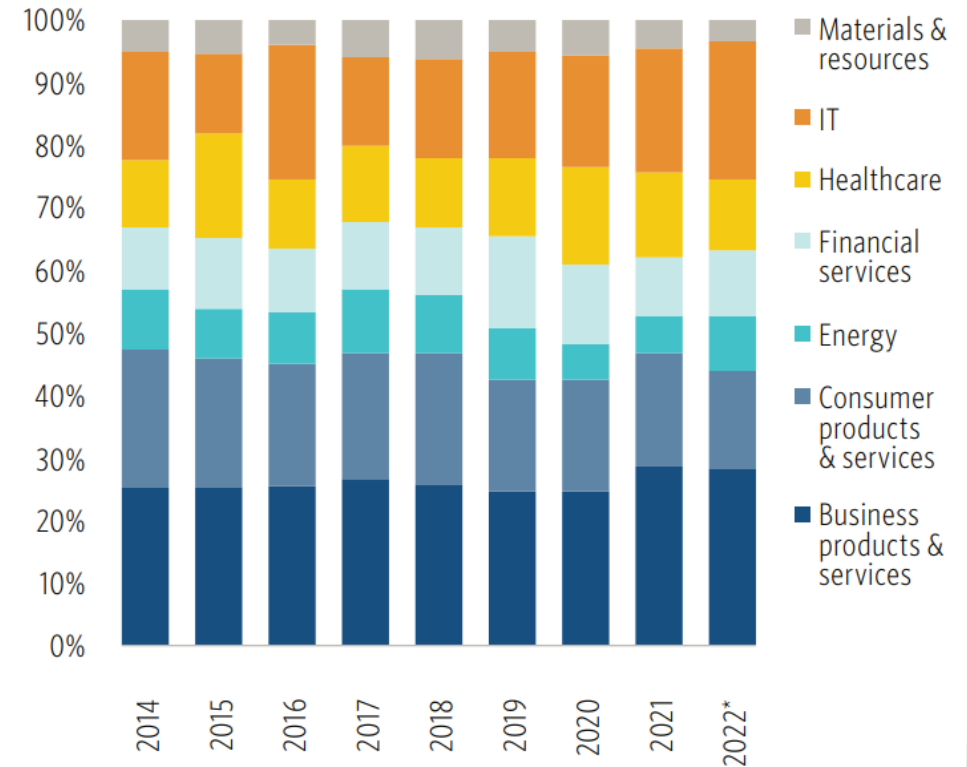


M&A Outlook: Share and Volume Trends

Top Trending Sectors:

- Technology (software & internet)
- Energy (oil and gas)
- Healthcare (pharma / biotech)
- Financial Services
- Infrastructure
- B2B products & services

Share of M&A deal value by sector



Source: PitchBook | Geography: Global
*As of September 30, 2022

M&A Outlook: Company Value Drivers

Attractive Company Characteristics:

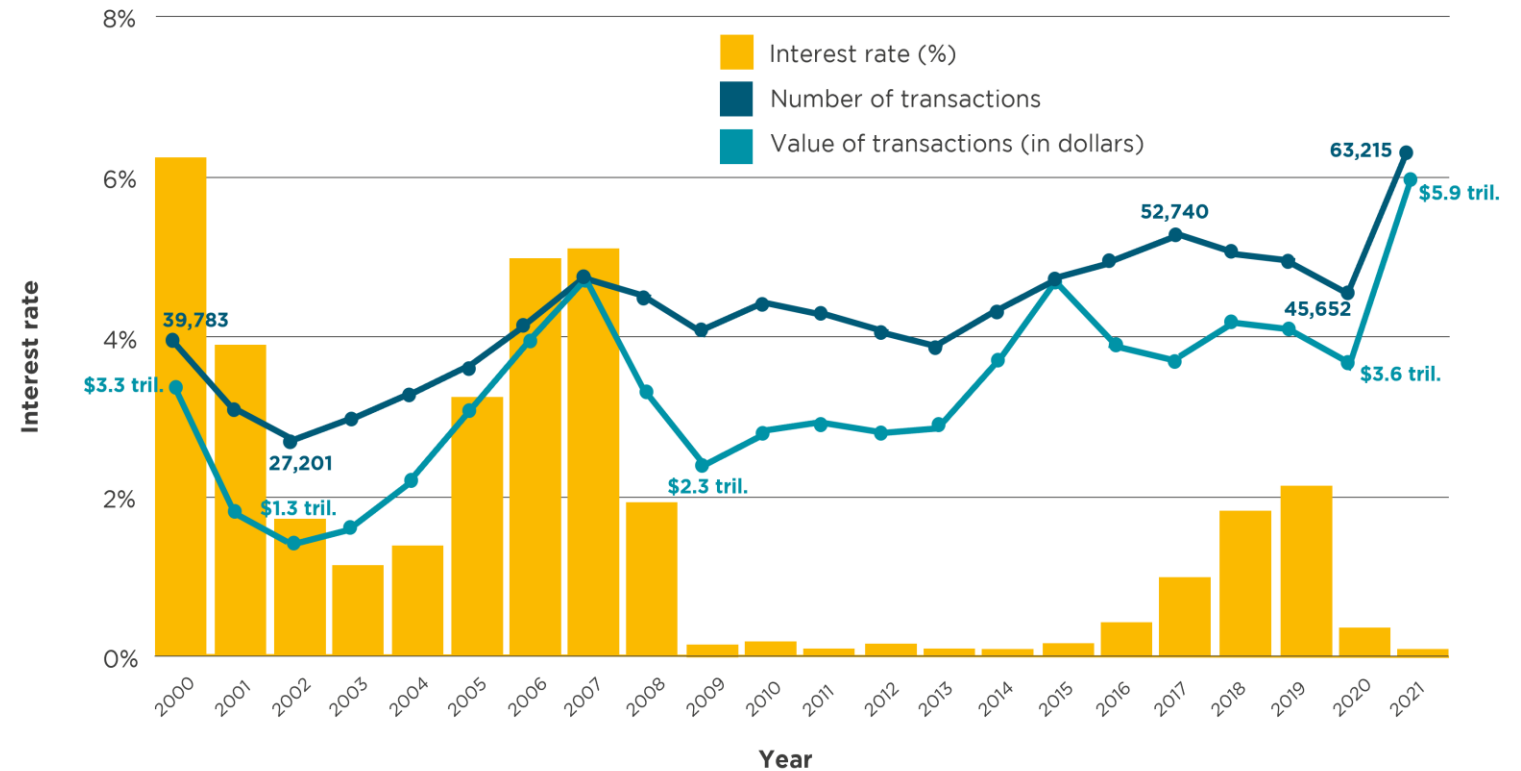
(Including out of favor industries)

- Supply chain resilience
 - Local sourcing & multiple sourcing
 - Working closely with vendors
- Tech-enabled businesses
- Above average margin profile
- Strong management team
- Conservative approach during market expansion

M&A Outlook: Interest Rate & Annual Deal Volume

Interest rates and transactions

- Public companies look to boost profits through divestiture
- Both Strategics & PEGs to be more selective in 2023
- PE firms are now faced with a higher cost of capital for leveraged buyouts (LBOs)
- Rising interest rates will affect PEGs adversely (Large deals affected most)



*Historical FOMC rates, and global M&A by announcement date

M&A Trends for 2023

- **Undisclosed Price Increases** (works both ways)
- **Inventory Issues** (quality of systems & supply chain challenges)
- **Accounts Receivable** (slow pay customers)
- **Cyber Security** (advanced security systems)
- **Third Party Claims** (compliance & systems)
- **ESG Advantage** (Environmental, Social, Governance)
- **Rep & Warranty Insurance** (supporting smaller transactions)



R&W Insurance Trends

- What: Purchased in connection with a M&A transaction
- When: At time of letter of intent with Buyer (more leverage to negotiate)
- Who: Most often paid by Buyer
- Why: Average escrow amount reduced from 12.3% to 2.3%
- Typical Terms:
 - Limits: **10%** of company value; Premium: **2-4%** of limits
 - Retention: **1-3%** of company value
 - Exclusions are common (known breaches, employee payroll & retirement account issues)
- TRENDS:
 - Policy sizes decreasing (<\$50M): more available for most transactions
 - \$10-\$20M deal size not uncommon



Effective Tax Planning in Preparation for an M&A Transaction

- Plan for how the sale will be taxed
 - Will it be taxed as capital gain or ordinary income? Or a combination?
 - Sellers generally prefer to sell stock or partnership interests.
 - Buyers typically want to buy tangible & intangible assets.
 - Consider your business restructuring options early as it may reduce total tax liability related to a sale. It may even affect sale price and the buyer's willingness to close a purchase.

Effective Tax Planning in Preparation for an M&A Transaction

- Structuring Options
 - Be sure to plan ahead!
 - How is the company currently structured?
 - Partnership or LLC?
 - Sale of a partnership interest is a capital asset transaction.
 - In an asset sale, the sales price can be grossed up to cover tax costs associated with the asset sale.
 - C or S Corporation?
 - Some sales are considered stock sales for legal purposes but are treated as asset sales for tax purposes only.
 - Various tax elections are available to please everyone including IRC §338(h)(10), §336(e) and §368(a)(1)(F).



Effective Tax Planning in Preparation for an M&A Transaction

- Purchase Price Allocation
 - This allocation should be discussed early in a deal negotiation. Both sides must agree on the allocation.
 - This gives an opportunity to depreciate asset purchases depending on the sales price allocation.
- Tax Projections
 - Expect for your accountant to work hand in hand with the M&A firm and/or tax attorneys to make sure the deal is as expected.
 - Numerous tax projections should be run; pre-close, at closing and post closing. These can span many months even after the deal closing.
- Fees for the Overall Transaction
 - Depending on the size of the transaction fees can be significant. Like any large transaction you need the right advisors in place to protect your interests.



Will New Tax Legislation Change the Tax Implications?

- \$1.2 trillion Infrastructure Investment and Jobs Act
 - Signed into law by President Biden 11/15/21.
- Inflation Reduction Act of 2022
 - Signed into law by President Biden 8/12/22.
 - IRA of 2022 essentially replaces the Build Back Better bill which could not be passed due to opposition mostly from Senator Manchin.
- Will these Bills affect deal structuring decisions?
 - The Inflation Reduction Act of 2022 - there do not appear to be significant tax changes affecting typical M&A asset sales.
 - It is mostly considered a social safety net bill covering infrastructure funding, IRS funding, child tax credits, EITC, premium tax credits, corporate AMT, and various energy credits.

Will New Tax Legislation Change the Tax Implications?

- Sales of QSBS stock of C corporations unchanged under the Inflation Reduction Act
 - The Build Back Better bill, which did not pass, had placed some limitations on stock sales of QSBS stock under Section 1202. The Inflation Reduction Act left this alone, which is a huge win for those selling this specific type of stock.
- The SALT limitation was NOT modified under the Inflation Reduction Act.
 - Though this was a huge goal of the original legislation it was ultimately left out of the IRA of 2022, leaving the state and local tax deduction at the maximum of \$10,000 for individuals.



Q & A



Thank you!



Contact Your Presenters



Web: lslcpas.com

Pam Bustos, CPA

Email: pam.bustos@lslcpas.com

Phone: (714) 672-0022



Web: plethorabusinesses.com

Robert Fahrenhorst

Email: robert@plethorabusinesses.com

Brandon Lanza

Email: brandon@plethorabusinesses.com

Phone: (714) 255-8862