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Executive Summary

Realizing an attractive investment return is an objective shared by most private business owners. A healthy return on investment (ROI) is the payoff for years of hard work, sacrifice, and financial risk. Capturing that value is likely to require many of the same attributes that helped you build your business along the way, including experience, commitment, discipline, and timing.

But assigning a value to your business may be challenging. The process involves a systematic evaluation of transaction alternatives based on an objective assessment of the value of capital deployed and invested over time, as well your "sweat equity" in the company's success. Such an assessment should also consider your company's achievements, its expectations, and the depth and breadth of potential capital market interest. The analysis should be conducted with the understanding that nonfinancial and qualitative objectives can often significantly influence transaction alternatives.

This review offers information and insights from investment bankers at Deloitte Corporate Finance LLC professionals who assist entrepreneurs and business owners as they explore strategic liquidity alternatives. The review begins with a discussion of transaction timing, transaction drivers, and the current capital markets environment. We then delve into liquidity, tax treatment of proceeds, and go-forward ownership.

Key points include:

- Perspectives on current economic uncertainty surrounding COVID-19 and the upcoming Senate runoff elections in Georgia, and how current market turbulence may impact the risk/reward of a variety of strategic alternatives for private companies.
- An essential planning tool: a framework for analyzing, preparing, and executing a business plan in a new world order.
- A deeper dive into an employee stock ownership plan (ESOP) transaction and the associated corporate and shareholder benefits, and how those benefits are impacted by potential capital market conditions.

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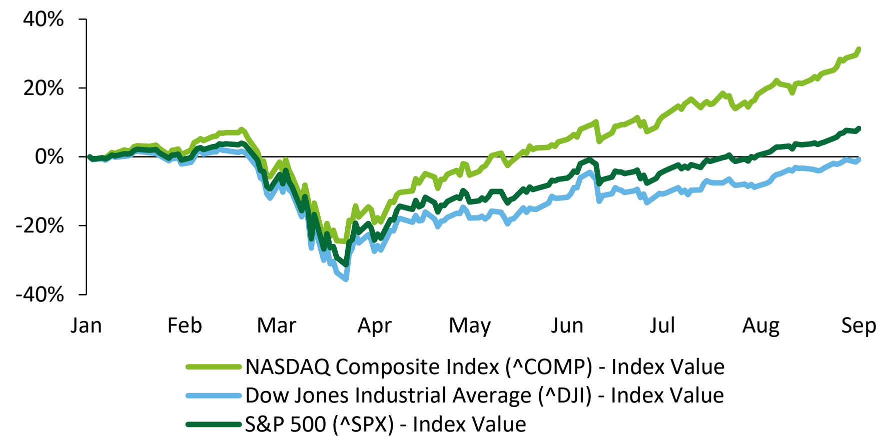
Economic Influences

COVID-19 has disrupted the global economy and changed our understanding of the connection between the broader economy and the stock market.

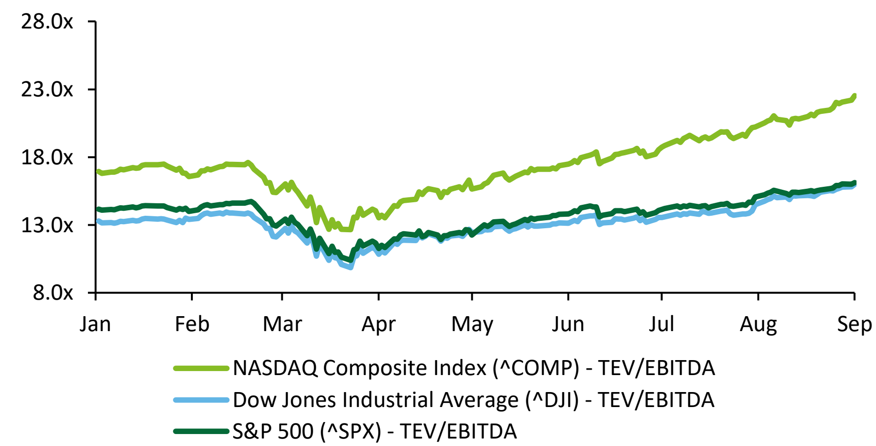
Stock Market Disconnect

- At the beginning of the COVID-19 pandemic, the stock market was adversely impacted. The three major American indices, the Dow Jones Industrial Average, the NASDAQ Composite, and the S&P 500, all dropped sharply.
- Stock prices started falling in late January lasting through the middle of March, with stocks dropping over 33%.(1)
- As the pandemic and the associated economic shutdown halted GDP growth and left millions unemployed, stocks broadly recovered their value, largely due to protective monetary and fiscal policy interventions.
- By the start of September, the S&P 500, the index most attributed to the US economy, had climbed to an all-time high, while other metrics that track broader economic strength were raising red flags. The NASDAQ Composite is now up over 30% on the year, despite dropping over 20% during the height of the crash. From trough to peak, the NASDAQ has grown over 70% in just 5 months.(1)
- EV/EBITDA (Enterprise Value/Earnings before Interest Expense, Depreciation, and Taxes) multiples continue to rise as well. The S&P 500 and the Dow have each seen multiples expand over 2.0x, while the NASDAQ Composite's overall multiple has risen to 22.5x, up from 16.8x at the start of the year and a pandemic-low 12.7x.(1)
- As GDP fell 32.9% in the second quarter of 2020, many have begun to notice the disconnect between the overall U.S. economy and the performance of its underlying stock market. The value placed on liquidity, especially amongst large-cap stocks, is a key factor driving the increased demand that has led to higher stock prices.(2)

2020 Stock Market Performance Amidst COVID-19 (1)



2020 TEV/EBITDA Performance Amidst COVID-19 (1)



Source(s): (1) S&P Capital IQ (2) ABC News

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Economic Influences (Cont.)

Worldwide economic turbulence stemming from the global pandemic has significantly impacted the U.S.

GDP Declines

While the U.S. experienced healthy GDP growth since the end of the global financial crisis, a late-2019 slow back was quickly accelerated by the global pandemic. U.S. Economic activity dwindled to the point that it experienced its worst ever period in history during Q2, as GDP fell 32.9% on an annualized basis. As the economy remains turbulent, it is hard to accurately forecast when a recovery will occur, or what that recovery may look like. But as the drop in GDP is widely attributed to a government-induced shutdown, outlooks remain more positive, and long-term expectations are optimistic.[1]

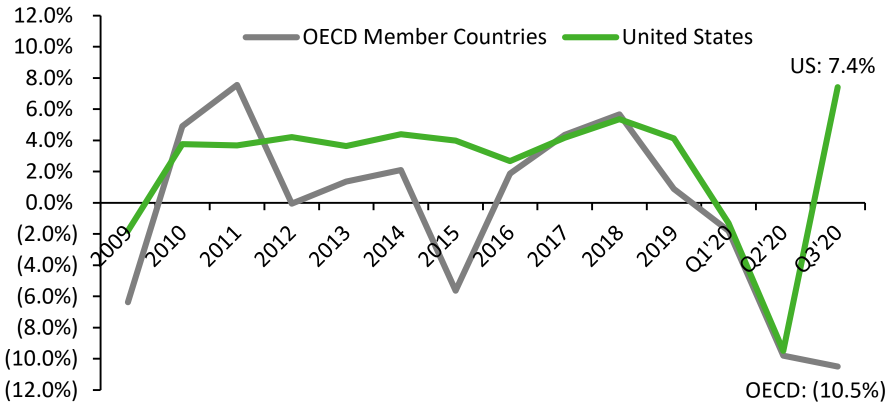
Interest Rates Stabilize

After slight interest rate increases from 2015 through the beginning of 2019, the Federal Reserve ("Fed") noted increased uncertainties in the global economy and cut rates. As we enter Q3 of 2020, rates have been hovering around 0%. In addition to the Fed utilizing its full playbook on monetary policy, government-sponsored fiscal aid is helping to stimulate the economy.[2] At the Fed's annual symposium, they noted that the goal is for inflation to run at a 2% average, versus a concrete 2%, going forward.[3] This signals likely low interest rates for the foreseeable future.

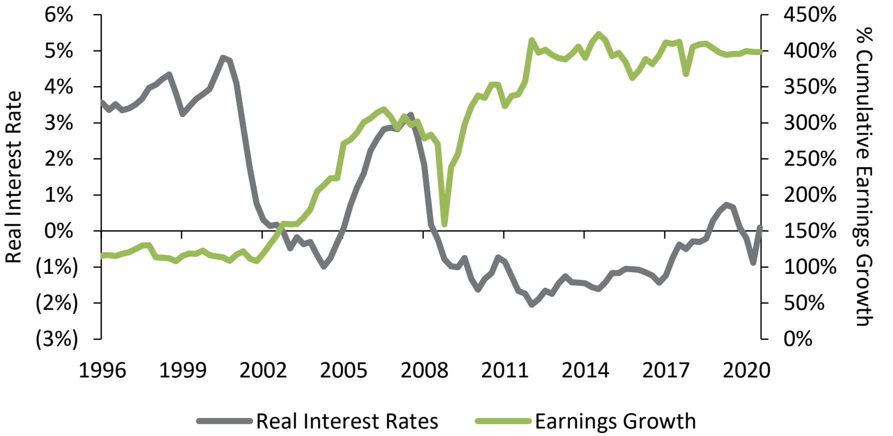
Mergers and Acquisitions

A delay among in-flight deals has spurred many companies to reevaluate their value creation assumptions as supply chains have been disrupted, consumer demand has shifted, and prior workforce models become unattractive. As a result, strategic acquirors are looking to initiate small strategic partnerships to bolster operational and supply chain resilience. We expect this to lead to a rise of new ecosystems to enable reconfigured supply chains and address transformed demand patterns and customer interaction.

Historical GDP Growth [4,5,6,7,8]



Macroeconomic Influences [8,9]



Source(s): (1) CNBC (2) CNBC (3) Federal Reserve (4) Worldbank (5) Worldbank (6) OECD (7) OECD (8) OECD (9) Wall Street Journal (10) S&P Capital IQ

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Economic Influences (Cont.)

Worldwide economic turbulence stemming from the global pandemic has significantly impacted the U.S.

Corporate Profits

Corporate profits have declined 12.0% and 11.1% in Q1 and Q2 2020, respectively, amongst corporations worldwide when measured pre-tax (with IVA and CCAdj.).[1] Domestic corporations fared better, experiencing a Q2 decline of just 8.4% compared to the rest of the world's 20.3% decline.[1] Unsurprisingly, certain industries proved more resilient than others. For instance, profits of domestic computer and electronic products increased 6.6% while those for domestic transportation and warehousing decreased 34.8% in Q1 2020.[1]

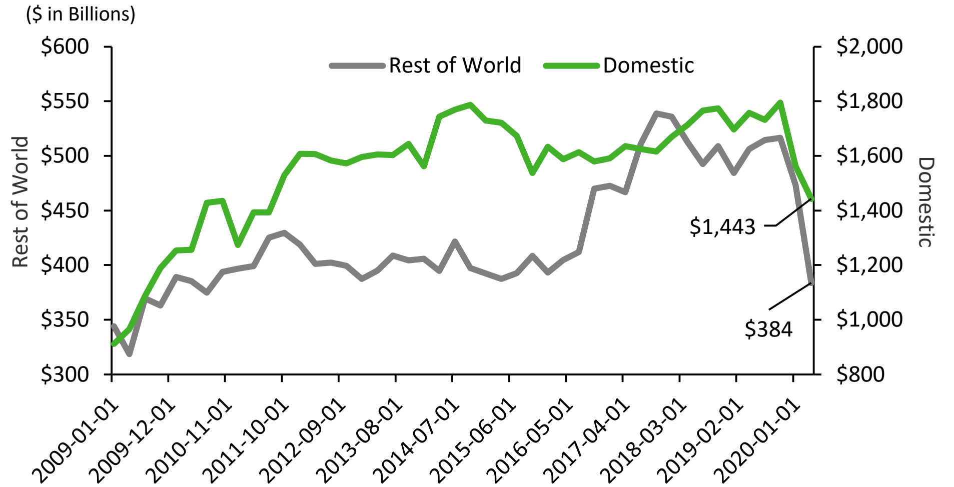
Capital Investment

As COVID-19 has disrupted the economy, middle market executives have become increasingly risk-averse with their capital investments. In the National Center for the Middle Market's Q2 2020 report, only 52% of surveyed executives said they would invest if given an extra dollar; down from 70% of executives surveyed in Q4 2019. The area seeing greatest interest in investment is information technology, followed by new plant and equipment. 32% of executives would choose to hold the extra dollar in cash, while the remaining 16% would hold it for investing.[2]

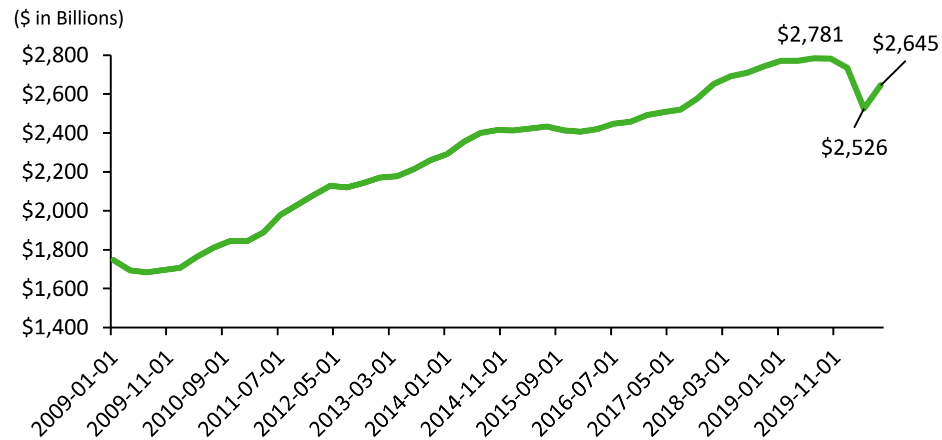
Forecastability

With growing uncertainty in the market, 40% of S&P 500 companies have pulled their guidance altogether.[3] As the pandemic has disrupted forecastability for many companies, it has become increasingly difficult to predict earnings in the short-term. The companies hit hardest by the pandemic have stopped guidance at the highest rates, and have significantly underperformed the S&P 500.[3] A lack of predictability has led to heightened discount rates on the future cash flows forecasted by company executives and their business development teams.

Corporate Profits (With IVA and CCAdj)[4,5]



Real Private Nonresidential Fixed Investment[6]



Source(s): (1) BEA (2) NCMM (3) WSJ (4) FRED (5) FRED (6) FRED

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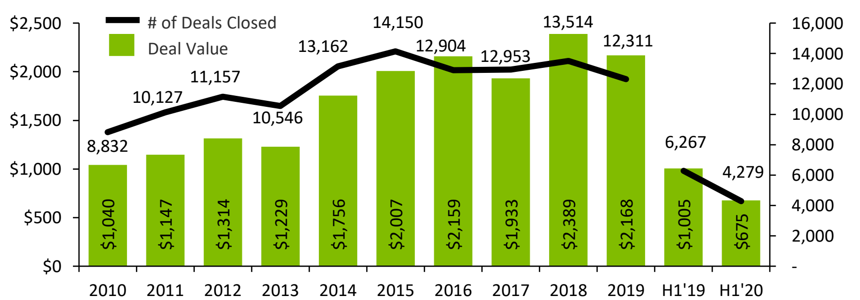
Current M&A Trends

The steady run up in U.S. middle-market ("MM") M&A volume since 2013 has waned in light of COVID-19, while carveout and divestiture activity for MM private equity funds is on track to reach it's highest level in six years.[1]

Decreased volume of M&A activity in the middle-market has largely been driven by acquisition staffs at middle market businesses becoming increasingly conservative with their capital allocation due to lack of near-term business visibility. Further, the select group of deals that are closing in 2020 have been increasingly equitized as lenders place higher scrutiny on underperforming businesses, cautiously underwrite, and increase pricing and LIBOR floors across the spectrum of their lending products. Interestingly, a Deloitte survey highlighted that businesses with less than $500 Million in Revenue were more likely to accelerate their M&A activity in the next twelve months over their larger counterparts.[2]

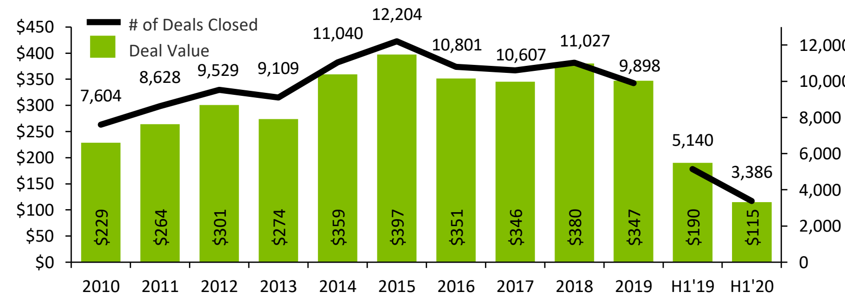
North American M&A Activity
Aggregated Across All Deal Sizes[3,4]

($ in Billions)

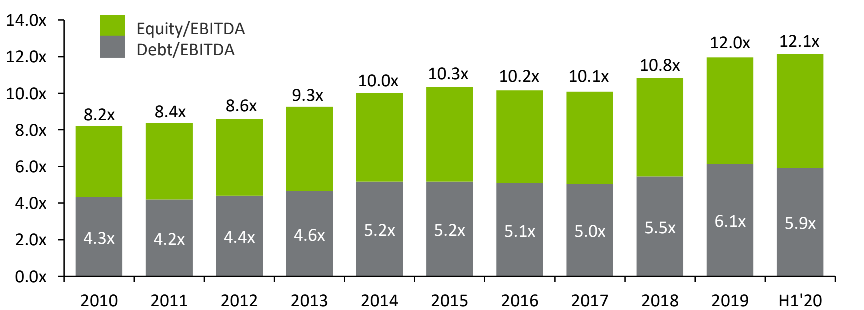


North American M&A Activity
Deals Less than $250 Million[3,4]

($ in Billions)



Rolling Three-Year Median Private Equity
Purchase Price Multiples[1]



Record Valuations and Divestiture Activity

- Record stock prices has coincided with near-record valuations for companies taken private. These valuations (represented in the graph to the left) have seen steady growth over the last five years. Strategic acquirors and private equity ("PE") funds alike have historically competed in the M&A market, tapping into their corporate coffers
  and dry powder to drive up valuations.
- Carveouts and divestitures as a percentage of middle market PE deals increased in 2020 to 13.8%, a level not seen since 2014 and a sign that COVID-19 continues to test the resilience of troubled companies.[1]

Source(s): (1) PitchBook (2) Deloitte (3) PitchBook (4) PitchBook

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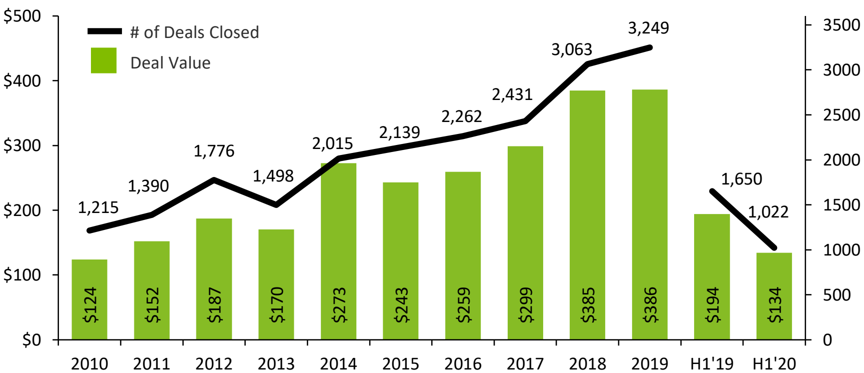
Continued Rise of Private Equity Firms

While most headlines center on Mega-fund transactions, the majority of the deal volume occurs within the core and lower middle market, where 1,022 deals worth over $134 billion were completed in H1 2020.[1]

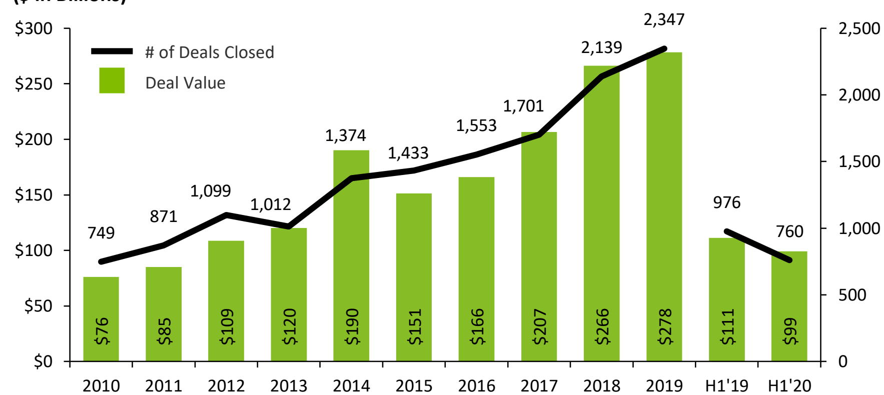
U.S. Middle-Market PE Activity: Deals Less Than $500 Million[1,2]

($ in Billions)



U.S. Middle-Market PE Activity: Add-On Acquisitions[1,2]

($ in Billions)

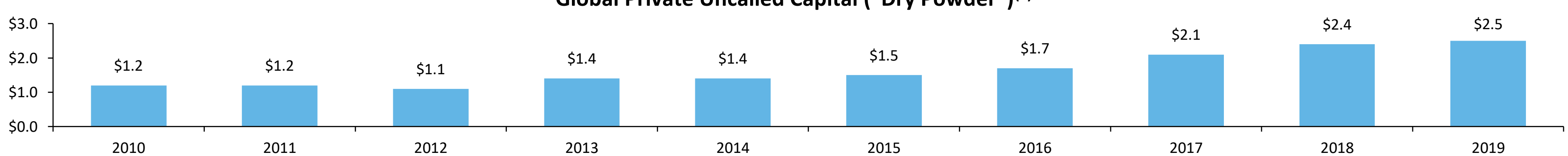


- The past decade has seen private equity become an increasingly important asset class, with the number of active PE firms up 143% since 2000 and AUM growing steadily with more than $3 trillion of private assets held with over $2.5 trillion dollars of private capital available.[3][4][5]
- These trends are underscored by historically low cost debt capital, increasingly sophisticated financial instruments available to private companies, and record levels of allocated but un-utilized PE capital ("dry powder").

- The number of add-on acquisitions as a percentage of total middle-market deal activity has increased over the past decade as private equity firms increasingly utilize buy-and-build transaction strategies, which often result in value-creation through multiple arbitrage. This trend has only accelerated as tighter debt markets hinder capital availability for larger acquisitions.
- Add-on acquisitions contributed 39.9% to total MM deal value in 2010, increasing to 57.3% in 2019; this has spiked to 67.4% of total deal value and 72.5% of total deal volume in H1 2020 in lieu of tighter debt markets.(1)

($ in Trillions)

Global Private Uncalled Capital ("Dry Powder")[5]



Source(s): (1) PitchBook (2) PitchBook (3) PitchBook (4) Pension & Investments (5) Bain & Company

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M&A Market Activity Update

Implications for Middle Market M&A

Acquisition Activity

Timing Considerations: The current circumstances have not changed the fact that many corporations and private equity firms are sitting on **significant amounts of cash** and are motivated to deploy capital and acquire resilient businesses with predictable cash flow profiles. However, the number of new deals entering the market is expected to **decline** in the near-term as both acquirors and sellers alike will be looking for business activity to return to a steady month over month state.

Pricing and Structure: Pricing is dictated by the availability of capital, growth prospects, and the supply and demand for quality businesses. While several private equity firms are in the hunt for a COVID-19 discount, **growing businesses with steady cash flows continue to attract healthy valuations**.

Diligence: Expect **increased scrutiny** in terms of both preliminary and confirmatory diligence. During this time of uncertainty, **acquirors are placing significant focus on cash flow and working capital management**, evaluating and stress testing sellers' businesses under various scenarios with a heightened focus on run-rate performance and stabilization into 2021.

Debt Capital Markets

Availability of Debt Capital: Despite widening credit spreads, **the cost of funds for banks is still at historic lows**, potentially creating more opportunities to invest at reasonable rates alongside reputable sponsors. Conversely, banks have tightened lending requirements and continue to take a cautious approach to underwriting.

Debt Pricing and Structure: As lenders factor in additional risk from market volatility, **access to affordable leverage is expected to contract** in response. While pricing of non-bank financing has increased (approximately **100-200 basis points** along with more material LIBOR floors), total leverage is expected to fall due to lingering economic uncertainty.

Federal Intervention: Payroll protection and main street lending programs coupled with credit market support have calmed the debt capital markets, allowing select processes to **begin ramping up in the second half of 2020**.

Source(s): (1) Bain & Company (2) Deloitte

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Impacts of Potential Capital Gains Tax Changes

As the United States awaits results of the upcoming Senate runoff elections in Georgia on January 5, 2021, the potential for a material change in tax policy and the resulting impact on transaction proceeds should be considered by both buyers and sellers.

- Perhaps more so than in recent years, the Senate election is filled with uncertainty. Of the many policy differences between democrats and republicans, one extremely pertinent one is their stance on the future of U.S. tax policy, specifically, the capital gains tax rate.
- One proposed tax plan includes an effort to increase the long-term capital gains tax rate (for those with adjusted gross income greater than $1.0M) from the current rate of 20.0% to 39.6%.[1] There has been some discussion involving a new plan to lower the status quo, as well, dropping the current capital gains rate slightly.
- As the Georgia runoff elections draw closer, DCF expects potential sellers, investors, and capital providers to be focused on potential changes to tax policy. In many cases, this might involve a heightened sense of urgency when planning a timeline for a liquidity event, pushing for closure before a change to the tax plan can occur.
- For any major changes in the capital gains tax rate to occur, the president, House, and Senate would all have to agree on the nature of the tax rate change, whether that be an increase or a decrease.

Illustrative Example [2]

- Assume Company A sells for 10.0x its LTM EBITDA of $10.0M, with $0 of net debt and a $0 tax basis on its equity.
  - If the capital gains tax rate rises to 39.6%, Company A's Shareholders would receive post-tax proceeds of just $60.4M, while paying 98% more in taxes than they would in the status quo.
  - In order for Company A's shareholders to achieve the same post-tax proceeds as they would have, without the proposed changes, Company A would need to receive pre-tax proceeds of $132.5, meaning a 32.5% increase in Company A's transaction multiple.

($ in Millions) **Potential Impact on Post-Tax Proceeds [1]**

	Pre-tax Proceeds	Tax Basis	Taxable Gain	Capital Gains Rate, %	Capital Gains Tax, $	Post-tax Proceeds	EBITDA Multiple	Multiple for Original Proceeds
Status Quo	$100.0	$0.0	$100.0	20.0%	$20.0	$80.0	10.0x	10.0x
Proposed Scenario	$100.0	$0.0	$100.0	39.6%	$39.6	$60.4	10.0x	13.3x

Source(s):
(1) Tax Foundation

Footnote(s):
(2) Illustrative example displays the impact of raising the capital gains tax rate to 39.6%, which many consider to be the highest it could go, pending results of the Georgia runoff elections.

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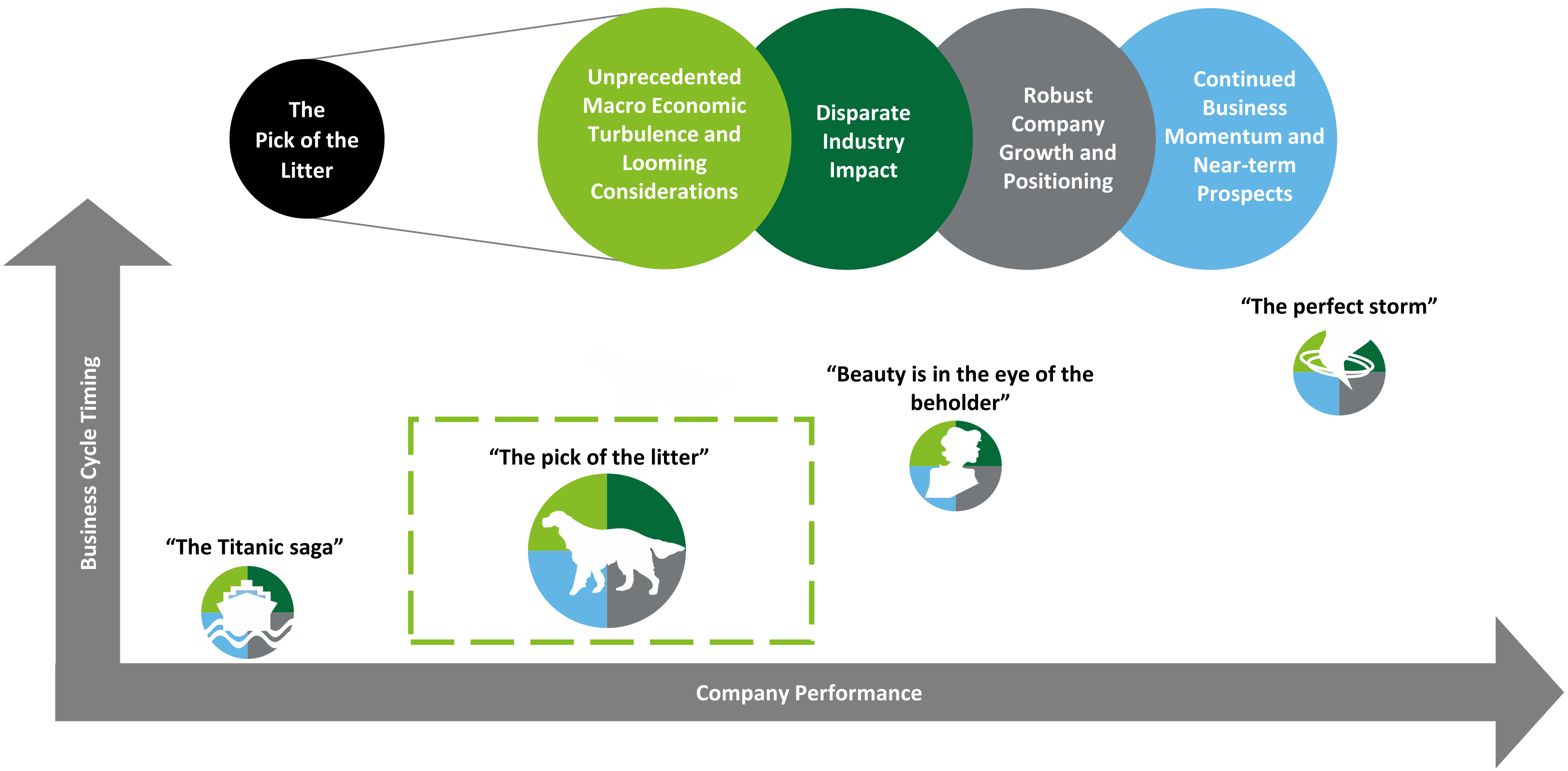
The Current Economic Environment

Transaction timing, more than any other single factor, may impact the value extracted from a private business owner's liquidity event.

- Given the current economic trends, we are currently in the "pick of the litter" stage of the business cycle, giving strong performers a significant leg up when entering the market.
- Given the current market conditions, buyers are seeking companies whose performance has stood out relative to their peers, meaning the companies that have performed well through COVID-19 are in high demand, and will be the "pick of the litter."



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The Pick of the Litter

Transaction timing, more than any other single factor, may impact the value extracted from a private business owner's liquidity event.

Unprecedented Macro Economic Turbulence and Looming Considerations

As of September 1st, there have been more than 7,500,000 confirmed COVID-19 cases and over 200,000 deaths across the US.[1]

Recent economic data and headlines present a grim outlook, showing Q2 2020 GDP figures decreasing at an annualized rate of 32.9%, and unemployment rates as high as 14.7% in April.[2,3]

The country has largely been shutdown since the middle of March, and many workplaces have committed to maintaining their work from home status through the end of 2020.

The federal government provided $1.8 Trillion in relief to businesses and individuals.

Disparate Industry Impact

Every industry has been impacted differently due to COVID-19. Some industries have been battered, while others have flourished.

Some of the hardest hit sectors include oil & gas, hospitality, transportation, and retail.

Meanwhile, companies with a healthcare, online retail, food & beverage, or technology focus have prospered, and may emerge from the pandemic even stronger.

High performers in prosperous industries will most likely be better-suited to capitalize in a tough environment.

Robust Company Growth and Positioning

Many of the top American companies have outperformed their peers during the COVID-19 pandemic.

Across all industries, blue chip companies have outperformed the market during its recovery.

The five largest stocks in the S&P 500 now makeup 23% of the index, up from just 11% in 2015.[4]

The most successful companies have been able to meet their short-term obligations with no trouble, taking advantage of the market dynamics present in the post COVID-19 world.

Continued Business Momentum and Near-term Prospects

As certain companies continue to outperform amidst the post-COVID-19 world, it is companies who have positioned themselves to bolster this growth who will gain favorable attention from investors.

Companies who are not only taking the time to envision the world as it is today, but also where these dynamics might continue to move, will position themselves to continue to build upon the business momentum they are already experiencing.

Source(s): (1) New York Times (2) CNBC (3) FRED (4) Markets Insider

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Business Strategies to Promote Continuity in a Pandemic

Key Business Items	Key Economic Impacts during COVID-19 Pandemic
Employees	• Employees are the foundation of any business, and during times of uncertainty, they **require great leadership and communication from above**. • Management teams should consider investments in collaborative workforce platforms, as a recent study shows employees without productivity tools **feel less connected and supported** by their employers. • Providing **flexible arrangements** for transportation and/or childcare concerns is now a key consideration.[1]
Supply Chains	• Whether you operate a multinational company or a small local business, it is likely that your supply chain has or will **experience some form of disruption**. • Even if minimal or no disruptions are visible today, **situations can change rapidly** with a prolonged shutdown, or if travel between key geographies becomes restricted. Considering the **ability to pivot** accordingly if Tier 1 suppliers experience delays, shortages, or outright cancellations, should be top of mind for management teams. • To the extent possible, **negotiating an extension on payables and diligently managing and expediting receivables** can keep a company's cash conversion cycle from faltering. [2]
Customers	• It is always **important to be in front of your customers** letting them know how you are reacting during times of uncertainty. A recent study found that **~23%** of consumers have based additional purchases on how companies cared for their employees during the current global pandemic. [3] • COVID-19 presents an opportunity for companies to collaborate with their customers in order to tackle tricky situations, which in turn, will **increase the stickiness of these long-term relationships**. • A company's ability to adapt its sales models has become an increasingly important trait to keep sales flowing. A recent study found that more than **90% of B2B companies have transitioned to a virtual sales model,** during COVID-19, by better utilizing the technology available in the market. [4]
Cash Flow Management	• Management should continue to **stay close with its financing partners,** letting them know that you aren't waiting for the market to create liquidity challenges and if required, its important to explore federal government programs. • **Convert fixed costs to variable costs and create cashflow, where possible**. Selling assets and then leasing them back is one way which companies can create quick cashflow and raise emergency cash. • Companies that operate in a **seasonal industry,** in which the next few calendar months are typically key, should **consider workforce management strategies** to allocate resources in the most efficient way.
Forecasting	• Many business owners have told DCF that they **entered 2020 with strong optimism** about the year's prospects, however, most 2020 forecasts drastically changed when the world did. • No forecasting is perfect, but current uncertainty warrants **expansive scenario analyses**, updated constantly for new information as soon as it becomes available. • Utilizing strong **data-backed forecasts,** in tandem with **conservative cash flow estimates,** will allow your company to proactively plan ahead and ultimately buy time to adequately weather any possible storms that lie ahead.

Source(s): (1) Reflektive (2) Deloitte (3) McKinsey & Co. (4) McKinsey & Co.

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Range of Liquidity Alternatives

The dichotomy between achieving various levels of liquidity (cash at close) and retaining control and maintaining corporate governance stability produces creative tensions among the array of strategic alternatives. The below describes some relevant strategic alternatives, in descending order of their capacity to provide cash at close.

Status Quo

Status Quo

This is a benchmark scenario in which the company continues to operate under its current business plan. Shareholders do not pursue a transaction in this scenario, retaining all their ownership in expectation of future value realization. While the status quo scenario is the antithesis of ownership diversification, as investment remains concentrated in one asset, it provides the basis against which all other strategic initiatives can be compared.

Debt Recapitalization

Debt Recapitalization

This strategy provides modest shareholder liquidity, typically 25% to 35% of enterprise value. It is the most straightforward liquidity initiative and rarely dilutes existing shareholder equity. Little governance change occurs related to this transaction.

ESOP Transaction

Employee Stock Ownership Plan (ESOP)

This initiative typically represents a partial liquidity event, generally 30% to 50% of enterprise value. It is the only legislated tax-advantaged sale of equity a private company shareholder can realize. To encourage sharing of future appreciation in company equity with its employees, the ESOP transaction enables shareholders to receive their sale proceeds sheltered from capital gains tax. Also, the company sponsoring the ESOP and supporting the purchase of equity attains a tax shelter on the repayment of debt assumed for share purchase. Little governance change occurs related to this transaction. Currently, there is only nominal potential that ESOP tax advantages will be compromised.

Minority Recapitalization

Minority Recapitalization

A more ambitious shareholder liquidity event, minority recapitalization typically provides cash proceeds of 20% to 49% of enterprise value. It is often pursued in companies with more pronounced need for shareholder equity monetization, insufficient borrowing capacity, or equally critical need for cash to fund both growth opportunities and future operations. Corporate governance will become more restrictive, as minority equity investors will require some board rights and protections as part of their participation.

Majority Recapitalization

Majority Recapitalization

This liquidity initiative will produce a change of control transaction, creating shareholder liquidity of 60% to 80% of enterprise value. Incoming private equity investors will demand board control in exchange for granting existing shareholders the right to monetize most of their current value. Typically, because most of existing shareholders' current value has been monetized, the company's growth prospects will provide them with an exciting opportunity for a "second bite of the apple" without the commensurate investment risk.

Strategic Sale

Strategic Sale

Sale of the company, by nature, creates a 100% liquidity event for existing shareholders. This initiative will generally provide shareholders the highest enterprise value.

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Illustrative Strategic Alternative Case Study

The below outlines some illustrative assumptions regarding a potential strategic alternative event and the effects on net proceeds.

Revenue – Assumes revenue growth of 10.0% per year through 2023(P), stepping down to 7.5% growth throughout the remainder of the projection period.

Cost of Goods Sold ("COGS") – Remains constant at 75% of revenue throughout projection period.

Operating Expenses – Initially 15% of revenue, improving 0.25% each year until reaching 13.8% at end of 2025(P), reflecting economies of scale and operating efficiencies.

EBITDA – Improved from 10.0% of revenue in 2020(A), to 11.2% of revenue by 2025(P).

Capital Expenditures – Remains constant at 1.5% of revenue throughout the projection period.

Net Working Capital – Remains constant at 10.2% of revenue throughout the projection period.

	For the Fiscal Years Ended December 31,					
($ in Thousands)	**2020(A)**	**2021(P)**	**2022(P)**	**2023(P)**	**2024(P)**	**2025(P)**
Total Revenue	**$100,000**	**$110,000**	**$121,001**	**$133,104**	**$143,086**	**$153,819**
Growth %	*N/A*	*10.0%*	*10.0%*	*10.0%*	*7.5%*	*7.5%*
Gross Profit	**$25,000**	**$27,500**	**$30,250**	**$33,276**	**$35,772**	**$38,455**
Gross Margin %	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*	*25.0%*
Operating Expenses	**$15,000**	**$16,225**	**$17,545**	**$18,967**	**$20,032**	**$21,150**
% of Revenue	*15.0%*	*14.8%*	*14.5%*	*14.3%*	*14.0%*	*13.8%*
EBITDA	**$10,000**	**$11,275**	**$12,705**	**$14,309**	**$15,739**	**$17,305**
Adjusted EBITDA Margin %	*10.0%*	*10.2%*	*10.5%*	*10.7%*	*11.0%*	*11.2%*
Capital Expenditures	**$1,500**	**$1,650**	**$1,815**	**$1,997**	**$2,146**	**$2,307**
% of Revenue	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*	*1.5%*
Net Working Capital	**$10,240**	**$11,264**	**$12,390**	**$13,629**	**$14,652**	**$15,751**
% of Revenue	*10.2%*	*10.2%*	*10.2%*	*10.2%*	*10.2%*	*10.2%*

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Comparative Transaction Overview

The information on the following two pages summarizes the key financial metrics most relevant to existing shareholders across six different types of liquidity events, including three unique structures of ESOP recapitalizations.

- DCF has made a number of key assumptions in the following analysis, including:
  - 25.0% (Tax Scenario A) and 45.0% (Tax Scenario B) capital gains tax rates on proceeds to illustrate the tax advantaged nature of ESOP transactions.
  - Each scenario assumes entry and exit multiples of 7.5x EBITDA for the 2020(A) and 2025(P) transactions.
- As part of our analysis, DCF modeled out six scenarios: **Status Quo, ESOP C-Corp (2nd Stage & Sale), ESOP S-Corp, Majority Recapitalization, and Strategic Sale.**
  - **The C-Corp ESOP transaction** assumes that the Shareholders sell a 36.4% equity stake to the ESOP.
    i. The C-Corp ESOP 2nd Stage transaction scenario assumes that shareholders sell their residual equity stake to the ESOP at the end of 2025 in a second capital gains tax-deferred transaction.
    ii. The C-Corp ESOP Sale scenario assumes that shareholders sell their residual equity stake to a strategic or financial acquiror at the end of 2025.
  - **The S-Corporation ESOP transaction** assumes that the Shareholders sell 100.0% of their common equity to the ESOP in 2020(A), financed using third-party debt and seller notes with attached warrants.
    i. This scenario assumes a 100% sale of the Company to a strategic or financial acquiror at the end of 2025.
  - **The Majority Recap transaction** assumes that shareholders sell 80.0% of their common equity to a financial sponsor in 2020(A), financed entirely by third-party debt.
  - **The Full Strategic Sale transaction** assumes the Shareholders sell 100.0% of their common equity to a strategic acquiror in 2020(A).
  - **The Status Quo transaction** assumes the Company maintains its status quo until 2025(P), at which point shareholders sell 100.0% of their common equity to a strategic acquiror.

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Comparative Transaction Financial Metric Overview

Key Sections:	Supporting Commentary
Owner Analysis	▪ Owner Analysis outlines the dynamics of the initial transaction that occurs at the end of 2020(A). ▪ Total consideration for proceeds allocation equals enterprise value (EBITDA x applied multiple), less net debt on the balance sheet. ▪ In the majority recap and strategic sale scenarios, shareholders receive the portion of equity they sell in the form of cash. ▪ In the three ESOP scenarios, shareholders receive cash up to an amount no greater than the value of debt raised (net of fees), with the remainder of proceeds coming in the form of seller notes. Shareholders' total consideration (cash plus seller notes) equals the non-diluted portion of equity they sell to the ESOP. ▪ In the two highlighted ESOP C-Corp scenarios, shareholders are allowed to claim an IRC Sec. 1042 tax election, providing for tax sheltered proceeds. All other scenarios assume shareholders pay capital gains taxes on their cash proceeds.
Ownership At 2025 Exit	▪ Ownership at 2025 Exit highlights post-transaction equity ownership percentages across the existing shareholder base, new investors/acquirors, and the ESOP. ▪ For the two ESOP C-Corp scenarios, existing shareholders own the residual of equity value attributable to the ESOP. The ESOP owns the 36.4% common equity stake they were sold in the initial transaction. ▪ The seller notes resulting from the initial 2020(A) transaction in the ESOP S-Corp scenario have a 15% common equity warrant attached, allowing them to enjoy the right to appreciated future equity value in 2025 despite selling their entire common equity interest to the ESOP initially.
Liquidity At 2025 Exit	▪ Total transaction value for proceeds allocation are calculated the same way at the end of 2025(P) as they are in the initial transaction in 2020(A), with the exception that the outstanding ESOP note is added and the remaining principal of seller notes are subtracted from enterprise value. ▪ Owner's cash at close equals the value of their equity that is sold to a third-party, which is the entirety of their existing equity ownership. ▪ The ESOP C-Corp second stage scenario assumes that the existing owners elect IRC Sec. 1042 capital gains tax shelter, providing for tax advantaged proceeds. The amount of cash received is dependent on the amount of debt raised. The value of their equity value sold less debt raised equals the amount of consideration they receive in the form of newly created seller notes with attached warrants. ▪ Shareholders must pay capital gains taxes on cash received in all other scenarios.
Current Net Proceeds	▪ This section highlights the present value of shareholders' invested cash proceeds from 2020(A) sale, as well as the present value of their seller notes. ▪ Cash proceeds are assumed to earn a market rate of return through the end of 2025(P), and are discounted using the risk-free rate. ▪ Seller notes cash payments are discounted at 12%.
Proceeds At Exit	▪ The cash received by the existing shareholder base at the end of 2025 is discounted to the present day using an 18% discount rate, reflecting the greater inherent risk involved in relying on proceeds from the future sale of a middle-market business. ▪ The second seller note that is issued at the end of 2025, in the ESOP C-Corp second stage scenario, awards shareholders annual cash payments, in addition to proceeds from the sale of their equity stake at the end of 2030(P), which result from the exercise of the warrants attached to the seller notes. These proceeds are discounted 12% annually to the present day.

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Comparative Transaction Overview (Tax Scenario A)

	Status Quo	ESOP C-Corp (Sale)	ESOP C-Corp (2nd Stage)	ESOP S-Corp (100% to ESOP)	Majority Recap	Full Strategic Sale
Owner Analysis:						
EBITDA	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Multiples	N/A	7.5x	7.5x	7.5x	7.5x	7.5x
Enterprise Value	N/A	$75,000	$75,000	$75,000	$75,000	$75,000
Plus: Cash	N/A	2,000	2,000	2,000	2,000	2,000
Less: Debt	N/A	(10,000)	(10,000)	(10,000)	(10,000)	(10,000)
Total Consideration for Proceeds Allocation	N/A	$67,000	$67,000	$67,000	$67,000	$67,000
Rollover Equity	N/A	$42,615	$42,615	N/A	$9,523	$0
Owner's Cash at Close, Gross	N/A	19,385	19,385	19,385	57,477	67,000
Seller Notes	N/A	5,000	5,000	47,615	N/A	N/A
Less: Taxes(1)	N/A	0	0	(4,846)	(14,369)	(16,750)
Owner's Cash at Close, Net	N/A	**$19,385**	**$19,385**	**$14,538**	**$43,108**	**$50,250**
Ownership at 2025 Exit:						
Existing Owners %	100.0%	63.6%	63.6%	15.0%	20.0%	N/A
New Investors/Acquirors %	N/A	N/A	N/A	N/A	80.0%	100.0%
ESOP	N/A	36.4%	36.4%	85.0%	N/A	N/A
Liquidity at 2025 Exit:						
EBITDA at Exit	$17,305	$17,305	$17,305	$17,305	$17,305	N/A
Assumed Exit Multiple(2)	7.5x	7.5x	7.5x	7.5x	7.5x	N/A
Enterprise Value	$129,785	$129,785	$129,785	$129,785	$129,785	N/A
Plus: Cash and Outstanding ESOP Note	$20,579	$19,427	$19,427	$29,714	$6,584	N/A
Less: Debt and Seller Notes	(0)	(15,000)	(15,000)	(46,473)	(942)	N/A
Total Transaction Value for Proceeds Allocation	$150,364	$134,212	$134,212	$113,026	$135,427	N/A
Owner's Cash at Close, Gross	$150,364	$82,750	$49,299	$16,954	$27,085	N/A
Secondary Transaction Seller Notes	N/A	N/A	33,452	N/A	N/A	N/A
Less: Taxes(3)	(37,591)	(20,688)	0	(4,238)	(6,771)	N/A
Owner's Cash at Close, Net	**$112,773**	**$62,063**	**$49,299**	**$12,715**	**$20,314**	**N/A**
Owner's Total Cash Received, Net(4)	**$112,773**	**$81,447**	**$68,683**	**$58,727**	**$63,422**	**$50,250**
Current Net Proceeds:						
Owner's Cash at Close, Net	N/A	$19,385	$19,385	$14,538	$43,108	$50,250
Present Value of Invested Proceeds at Close(5)	N/A	25,237	25,237	18,928	56,123	65,422
Present Value of Seller Notes, Net(5)	N/A	4,384	4,384	28,519	N/A	N/A
Proceeds at Exit:						
Owner's Cash at Exit, Net	$112,773	$62,063	$49,299	$12,715	$20,314	N/A
Present Value of Owner's Cash at Exit(5)	49,294	27,128	21,549	5,558	8,879	N/A
Present Value of Secondary Transaction Seller Notes(5)	N/A	N/A	15,780	N/A	N/A	N/A
Present Value of Proceeds for Owners(5)	**$49,294**	**$56,749**	**$66,949**	**$53,005**	**$65,003**	**$65,422**

Footnote(s):

(1) C-Corp ESOP proceeds are tax-free. All other scenarios assume a 25% capital gains tax rate on proceeds net of any previously-taxed earnings.
(2) All transactions assume an exit multiple equal to the initial transaction multiple.
(3) All scenarios assume a 25% capital gains tax rate. ESOP participants will be taxed at the individual level.
(4) Includes the remaining portion of the initial transaction seller notes.
(5) All scenarios assume a discount rate of 18% for proceeds at exit and 12% for seller notes. Invested proceeds at close are assumed to earn a market rate of return and discount to the present day using the risk-free rate.

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Tax Equivalent Value in a C-Corp. Transaction (Tax Scenario A)

C-Corp. ESOP Stock Structure

Valuation Summary

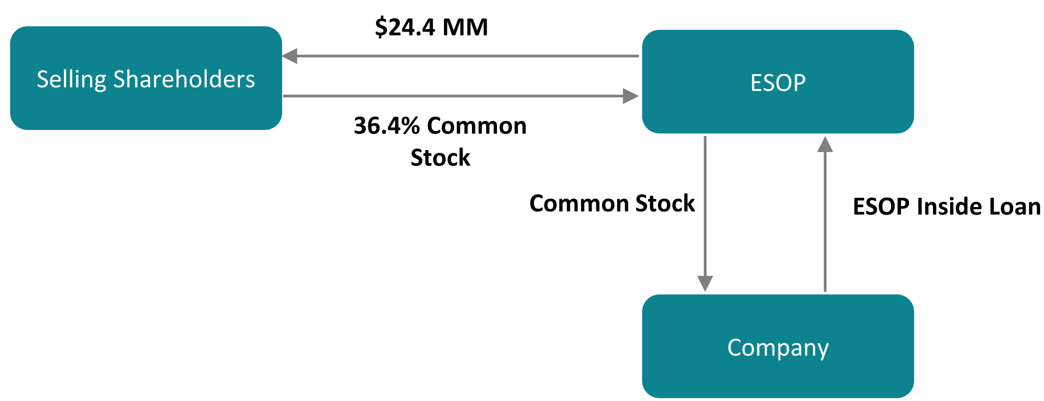
($ in Thousands)

Transaction Example Summary	
Company Enterprise Valuation	$75,000
Company Equity Valuation	$67,000
2020(A) EBITDA	$10,000
Transaction Multiple	8.50x
ESOP Equity Purchase	$24,385
External Debt/EBITDA Leverage	3.00x

ESOP Advantage

($ in Thousands)

Transaction Example Summary	
Company Enterprise Valuation	$75,000
Company Equity Valuation	$67,000
Transaction Value Sold(1)	$24,385
Tax Equivalent Transaction Value(2)	$32,513
ESOP Common Equivalent Ownership	36.4%
Non-ESOP Principal Ownership	63.6%
Tax-Equivalent Equity Value	$89,333
Tax-Equivalent Enterprise Value	$97,333
Tax-Equivalent Enterprise Value Multiple(3)	9.7x



Footnote(s):

(1) Sellers receive $24.4 million (includes seller notes) from sale to ESOP after fees, expenses and net debt repayment.

(2) Sale of shares to ESOP qualifies for capital gains tax deferral (tax equals 25.0%) resulting in tax equivalent sale proceeds of $32.5 million ($24.4/(1 - 25.0%)) = $32.5

(3) $32.5 million in tax equivalent proceeds is generated from 36.4% common equity give up. This is equivalent to an $89.3 million taxable equivalent equity value ($32.5/36.4% = $89.3). $89.3 million plus net debt of $8.0 million divided by $10.0 million of 2020(A) EBITDA results in a 9.7x EBITDA tax equivalent transaction multiple.

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Comparative Transaction Overview (Tax Scenario B)

	Status Quo	ESOP C-Corp (Sale)	ESOP C-Corp (2nd Stage)	ESOP S-Corp (100% to ESOP)	Majority Recap	Full Strategic Sale
Owner Analysis:						
EBITDA	$10,000	$10,000	$10,000	$10,000	$10,000	$10,000
Multiples	N/A	7.5x	7.5x	7.5x	7.5x	7.5x
Enterprise Value	N/A	$75,000	$75,000	$75,000	$75,000	$75,000
Plus: Cash	N/A	2,000	2,000	2,000	2,000	2,000
Less: Debt	N/A	(10,000)	(10,000)	(10,000)	(10,000)	(10,000)
Total Consideration for Proceeds Allocation	N/A	$67,000	$67,000	$67,000	$67,000	$67,000
Rollover Equity	N/A	$42,615	$42,615	N/A	$9,523	$0
Owner's Cash at Close, Gross	N/A	19,385	19,385	19,385	57,477	67,000
Seller Notes	N/A	5,000	5,000	47,615	N/A	N/A
Less: Taxes[1]	N/A	0	0	(8,723)	(25,865)	(30,150)
Owner's Cash at Close, Net	N/A	**$19,385**	**$19,385**	**$10,661**	**$31,612**	**$36,850**
Ownership at 2025 Exit:						
Existing Owners %	100.0%	63.6%	63.6%	15.0%	20.0%	N/A
New Investors/Acquirors %	N/A	N/A	N/A	N/A	80.0%	100.0%
ESOP	N/A	36.4%	36.4%	85.0%	N/A	N/A
Liquidity at 2025 Exit:						
EBITDA at Exit	$17,305	$17,305	$17,305	$17,305	$17,305	N/A
Assumed Exit Multiple[2]	7.5x	7.5x	7.5x	7.5x	7.5x	N/A
Enterprise Value	$129,785	$129,785	$129,785	$129,785	$129,785	N/A
Plus: Cash and Outstanding ESOP Note	$20,579	$19,427	$19,427	$29,714	$6,584	N/A
Less: Debt and Seller Notes	(0)	(15,000)	(15,000)	(46,473)	(942)	N/A
Total Transaction Value for Proceeds Allocation	$150,364	$134,212	$134,212	$113,026	$135,427	N/A
Owner's Cash at Close, Gross	$150,364	$82,750	$49,299	$16,954	$27,085	N/A
Secondary Transaction Seller Notes	N/A	N/A	33,452	N/A	N/A	N/A
Less: Taxes[3]	(67,664)	(37,238)	0	(7,629)	(12,188)	N/A
Owner's Cash at Close, Net	**$82,700**	**$45,513**	**$49,299**	**$9,325**	**$14,897**	**N/A**
Owner's Total Cash Received, Net[4]	**$82,700**	**$64,897**	**$68,683**	**$51,460**	**$46,509**	**$36,850**
Current Net Proceeds:						
Owner's Cash at Close, Net	N/A	$19,385	$19,385	$10,661	$31,612	$36,850
Present Value of Invested Proceeds at Close[5]	N/A	25,237	25,237	13,881	41,157	47,976
Present Value of Seller Notes, Net[5]	N/A	4,384	4,384	21,337	N/A	N/A
Proceeds at Exit:						
Owner's Cash at Exit, Net	$82,700	$45,513	$49,299	$9,325	$14,897	N/A
Present Value of Owner's Cash at Exit[5]	36,149	19,894	21,549	4,076	6,512	N/A
Present Value of Secondary Transaction Seller Notes[5]	N/A	N/A	11,706	N/A	N/A	N/A
Present Value of Proceeds for Owners[5]	**$36,149**	**$49,515**	**$62,876**	**$39,293**	**$47,669**	**$47,976**

Footnote(s):

(1) C-Corp ESOP proceeds are tax-free. All other scenarios assume a 45% capital gains tax rate on proceeds net of any previously-taxed earnings.
(2) All transactions assume an exit multiple equal to the initial transaction multiple.
(3) All scenarios assume a 45% capital gains tax rate. ESOP participants will be taxed at the individual level.
(4) Includes the remaining portion of the initial transaction seller notes.
(5) All scenarios assume a discount rate of 18% for proceeds at exit and 12% for seller notes. Invested proceeds at close are assumed to earn a market rate of return and discount to the present day using the risk-free rate.

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Tax Equivalent Value in a C-Corp. Transaction (Tax Scenario B)

C-Corp. ESOP Stock Structure

Valuation Summary

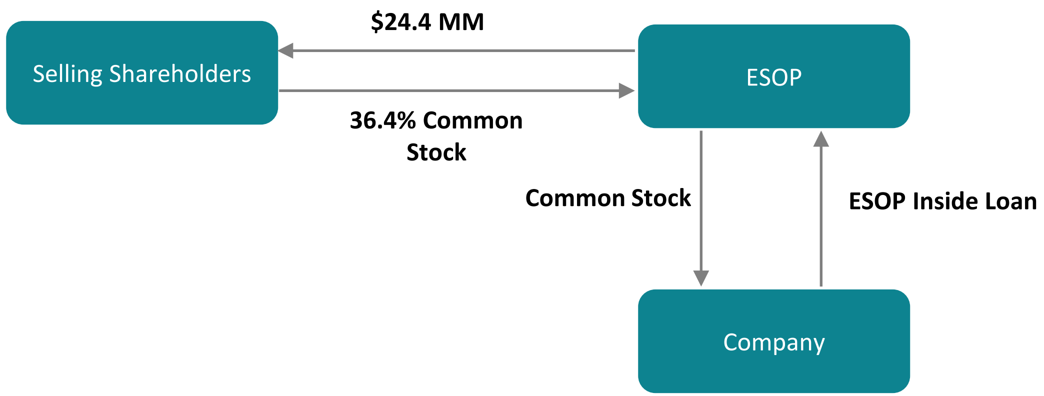
($ in Thousands)

Transaction Example Summary	
Company Enterprise Valuation	$75,000
Company Equity Valuation	$67,000
2020(A) EBITDA	$10,000
Transaction Multiple	8.50x
ESOP Equity Purchase	$24,385
External Debt/EBITDA Leverage	3.00x

ESOP Advantage

($ in Thousands)

Transaction Example Summary	
Company Enterprise Valuation	$75,000
Company Equity Valuation	$67,000
Transaction Value Sold[1]	$24,385
Tax Equivalent Transaction Value[2]	$44,335
ESOP Common Equivalent Ownership	36.4%
Non-ESOP Principal Ownership	63.6%
Tax-Equivalent Equity Value	$121,818
Tax-Equivalent Enterprise Value	$129,818
Tax-Equivalent Enterprise Value Multiple[3]	13.0x



Footnote(s):

(1) Sellers receive $24.4 million (includes seller notes) from sale to ESOP after fees, expenses and net debt repayment.

(2) Sale of shares to ESOP qualifies for capital gains tax deferral (tax equals 45.0%) resulting in tax equivalent sale proceeds of $44.3 million ($24.4/(1 - 45.0%)) = $44.3

(3) $44.3 million in tax equivalent proceeds is generated from 36.4% common equity give up. This is equivalent to a $121.8 million taxable equivalent equity value ($44.3/36.4% = $121.8). $121.8 million plus net debt of $8.0 million divided by $10.0 million of 2020(A) EBITDA results in a 13.0x EBITDA tax equivalent transaction multiple.

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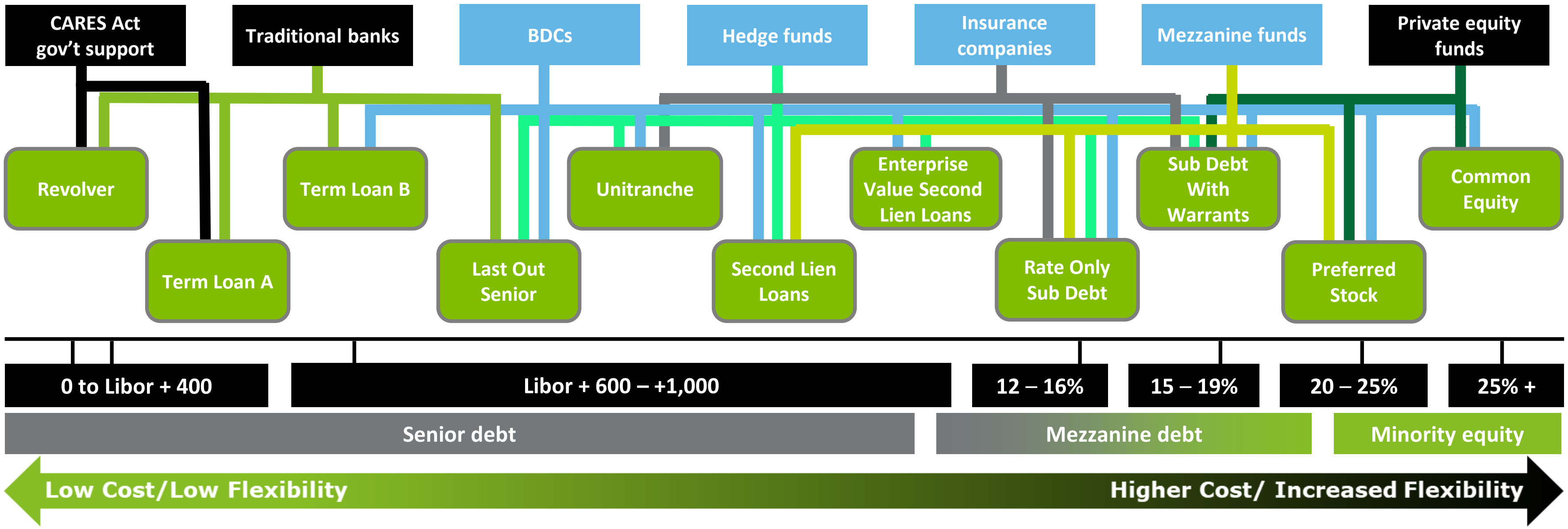
Middle-Market Capital Structures

Increasingly creative structures within the capital markets have resulted in a range of risk and return profiles, tailored to the individual needs of the business.

- Since the credit crisis in 2009, non-bank lenders have provided significant, much-needed financing to middle-market companies. Access to non-bank lenders has become critical for middle-market companies seeking liquidity or refinancing alternatives. Today, it is estimated that over 80% of middle-market lending is provided from non-bank lenders.
- The rise of non-bank lenders has led to a wider spectrum of capital options availability, providing middle-market companies more flexibility in balancing cost and flexibility based on their needs.



Zoom-Out	For private middle-market businesses, credit plays a vital role, not just for financing continuing operations and future expansion plans, but also for attracting significant interest from both financial sponsors and strategic corporations alike. This dynamic can lead to elevated multiples and allow for more shareholder proceeds in liquidity events.

Source(s): S&P Leveraged Commentary and Data; Thomson One.

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Preparing Your Company for a Potential Sale

Preparation prior to a strategic alternative process is key to creating the optimal liquidity event for a company's next stage and to increase the certainty of a successful outcome.

Start Planning Early

Laying out the groundwork prior to planning a sale is key. Potential parties should proactively plan their sale to achieve optimal timing and outcomes. Conducting pre-sale diligence can result in premium valuations by virtue of a streamlined process and the fact that it allows buyers to purchase an asset with its internal controls already vetted.

Human Resources

People related considerations are a common source of failed liquidity events. Issues range from conflicts over the new management's plan for the old management severance packages along with other compensation considerations at close.

Understand Buyer's Valuation Views

By understanding a buyer's external market valuation, the company can position itself in the most optimal way and present to the market both a compelling and rational story about future growth, profitability, synergies and other investment merits.

Form a Strong Transaction Team

Choosing the correct M&A advisor is of utmost importance when contemplating a successful transaction and achieving a premium valuation. The advisor is essential in preparing management to begin planning their sale while also consulting the company on how to fine tune its business plan and understand how investors/buyers will view the company.

Work with Advisors to Create the Optimal Marketing Package

Through the advisors' wide-range of experiences, they possess the expertise to skillfully guide management in preparing marketing materials, which highlight the companies growth story and its potential synergistic fit with buyers. Effectively telling the story is a crucial step and one that can significantly increase the odds of a successful transaction

Tax Considerations and Wealth Management

Tax considerations and wealth management are extremely important in protecting the value generated from a sale. An advisor's capabilities in guiding a company's strategic tax and wealth management planning are essential to maximizing the value received in an organized sales process.

Preparation, know-how, and experience are all necessary components to prepare a company for a sale. A company guided by strong advisors can earn premium valuations in the market.

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Conclusion

Macroeconomic and capital market conditions in 2020 appear to be less favorable than in recent years, as a result of COVID-19 and the upcoming runoff elections in Georgia to confirm the Senate. There are many considerations for a shareholder when thinking about a liquidity transaction, and transaction timing is key. If you decide to explore the many alternatives available for such a transaction, prepare yourself for an exciting but demanding process.

At the same time, if you leverage a disciplined transaction approach, along with the experience and resources of a well-regarded corporate finance adviser, you can address many of the risks that lead to surprises and disappointment. Such an approach can help you gain a clear understanding of what to anticipate from a liquidity event, choose a path that is likely to produce the ROI you expect, and gain insights into important decisions and milestones you will likely face on your path forward.

Key takeaways include:

- Current middle-market M&A activity has been disrupted, but premium valuations remain on the table for strong-performing companies…the "Pick of the Litter".
- Now might be as good of time as ever to harvest your wealth. With Deloitte's abundant M&A and tax experience, they continue to be one of the world's largest and most trusted global advisors.

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