

# GOODBYE, CAPITAL GAINS TAX! IS 2021 THE YEAR TO SELL?

Presented by Bob Hild, Chairman and CEO, ACT Capital Advisors  
Tuesday, May 4<sup>th</sup>, 2021

## ACT Capital Advisors Panelists:

John Norton, Managing Director

Mike Vanderslice, Managing Director

Matt Latimer, Managing Director & General Counsel



**Is 2021 the Year to Sell?**

# Takeaways from Today

1. The current state of M&A
2. Proposed tax changes and their impact
3. Why your business may be worth more post-pandemic
4. Value enhancing preparations
5. Panel discussion / Q&A

# Historical M&A Activity

- Steep decline in 2020-Q2 M&A volume due to COVID-19 pandemic
- Strong recovery in 2020-2H
- Historic 2020-Q4
  - 5,136 deals (global)
  - \$1.2 trillion (global)
  - 49% Increase (global)
  - 1,469 deals (USA)
  - \$544.2 billion (USA)
  - 77% increase (USA)

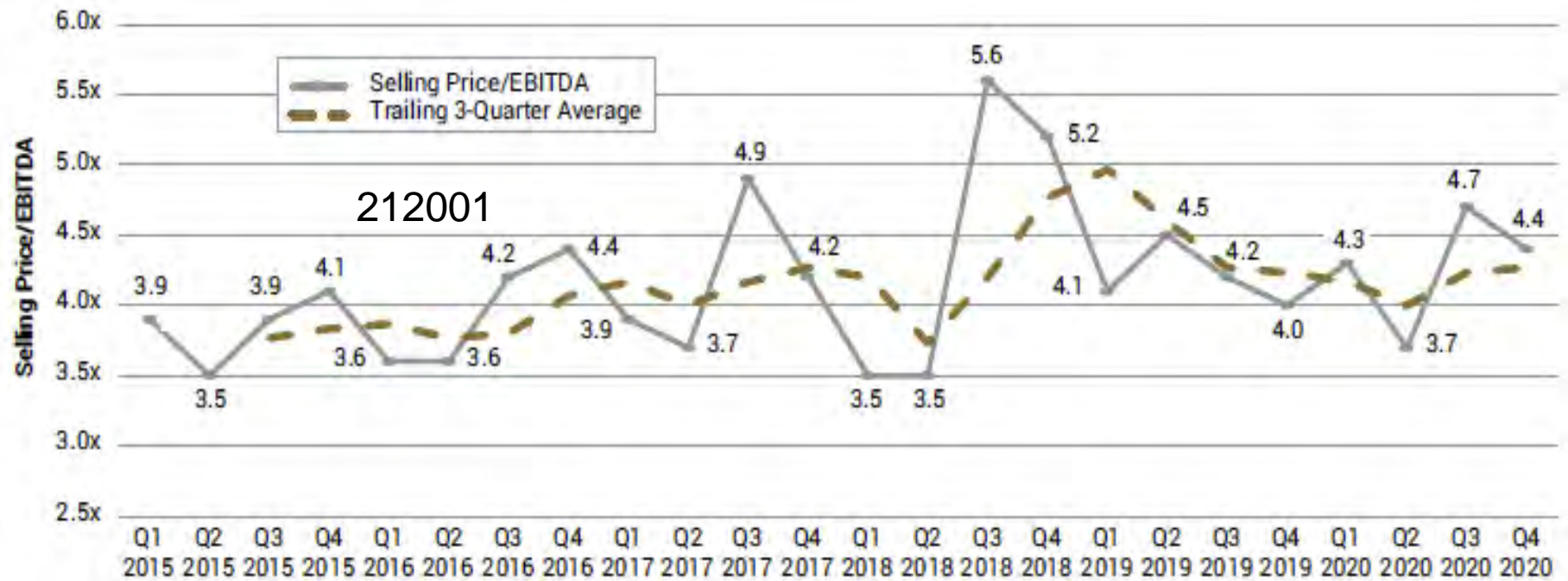
M&A activity by value Q3 2015 – Q4 2020

Target location: Global Bidder location: Global Sectors: All Sectors



Source: White & Case

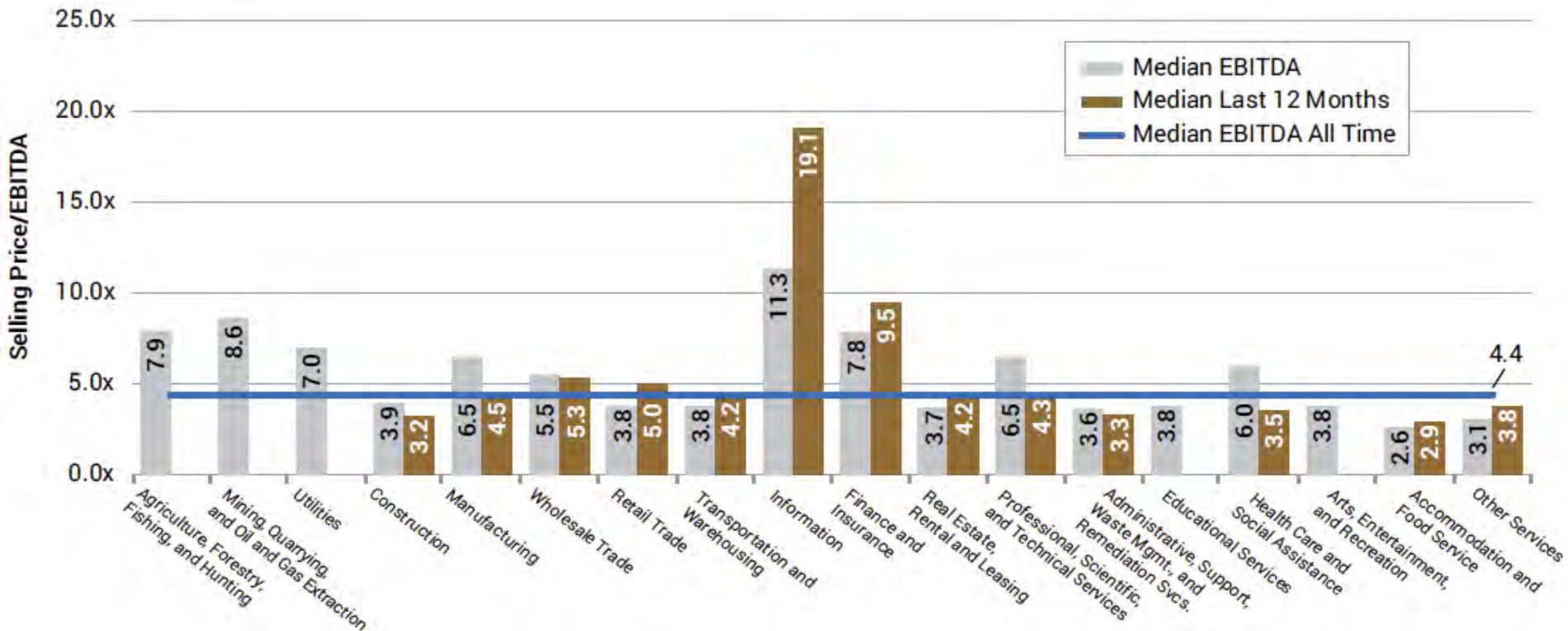
# EBITDA Multiples Rebounded in 2020 (Q3-4) (Revenues \$5MM-\$50MM)



Source: BVR Deal Stats



# EBITDA Multiples by Industry



Source: BVR Deal Stats

# Factors Driving the Market

1. Improving Economy Post-Pandemic
2. Private Equity \$1.7T “Dry Powder”
3. Corporations \$4.0T – Excess Cash
4. Fed’s Low Interest Rate Policy
5. Aging Baby Boomers

# Quotes from Experts – 2021 Forecast

*“I’m bullish about 2021, especially for companies that performed well through COVID.”*

-Stewart Kohl | Co-founder, Riverside Companies

*“The baby boomers have lived through three cycles, this pandemic included... They are ready to sell. COVID is getting would-be sellers off the bench.”*

-Heather Madland | Partner, Huron Capital

*“I have a positive outlook for private equity and M&A activity...The amount of investable capital out there is a gigantic catalyst that is not going away. The scarce resource is the number of deal opportunities that are worthy of institutional private equity capital.”*

–Graeme Frazier | Partner, Private Capital Research



# M&A “Headwinds”

1. Taxes – Increase Corporate Tax
2. Taxes – Increase Individual Tax
3. Taxes – Elimination of Capital Gains



## Tax Changes

The effect on a typical transaction

# Proposed Tax Changes

	Current Law	Biden Plan
Corporate Tax Rate	21%	28%
Individual Tax Rate	Top rate is 37%	Raise top rate to 39.6% for income over \$400,000
Capital Gains Rate	Top rate is 20%, plus 3.8% Net Investment Income Tax (NIIT) over \$200,000K (single) and \$250,000 (married)	Remove preferential rate for capital gains for taxpayers with income over \$1,000,000, taxed at ordinary rates. 3.8% NIIT remains

# Effect on a \$10 Million Transaction

	Current Tax Rates	Biden Plan
Sales Price	\$10,000,000	\$10,000,000
Basis	\$1,000,000	\$1,000,000
Proceeds Subject to Capital Gains	\$9,000,000	\$9,000,000
Capital Gains Tax	\$1,800,000	\$3,564,000
Net Interest Income Tax	\$342,000	\$342,000
<b>Total Federal Tax</b>	<b>\$2,142,000</b>	<b>\$3,906,000</b>

Increase under the Biden Plan is \$1,764,000. That's 82% more!

# Effect on a \$10 Million Transaction

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Basis	\$1,000,000	\$1,000,000
Proceeds Subject to Capital Gains	\$9,000,000	\$9,000,000
Capital Gains Tax	2,142,000	3,906,000
<b>Net Proceeds – After Tax</b>	<b>\$7,868,000</b>	<b>\$6,094,000</b>

Deal proceeds decrease by 22.5% under Biden Plan, totaling a whopping \$1,764,000.



# Tax Increase Hit to S&P 500

Estimated S&P 500 earnings impact based on Biden's proposals

Industry	Tax Impact on Valuations
Technology	down 9.2%
Health care	down 8.4%
Communication services	down 8.2%
Consumer discretionary	down 7.5%
Financials	down 6.5%

*Source: BofA Securities*

<https://www.cnbc.com/2021/01/08/how-joe-bidebsproposals-also-have-the-potential-to-affect-holders-of-stocks-and-bonds.html>

# Update: Washington State Lawmakers Approve Bill to Impose Capital Gains Tax

**On April 25<sup>th</sup>, the Washington State Legislature approved a bill to impose a capital gains excise tax, which is now heading to Washington Gov. Jay Inslee's office for his signature.**

- 7% Tax -gains on sale of stocks, bonds and other high-end assets exceeding \$250,000.
- Exemptions
  - Real Estate
  - Livestock, Timber, Commercial fishing Privileges
  - Retirement accounts
  - Small Family Business
- Small Family Business Exemption
  - Less than \$10MM revenue year before sale
  - 5+ years of ownership
  - Active in business 5 of last 10 years.

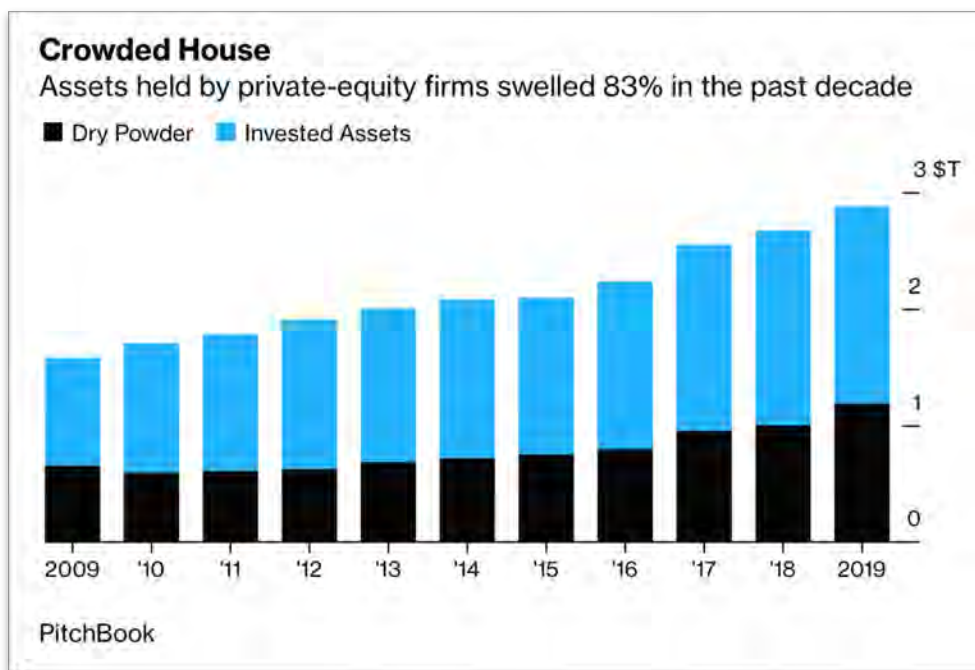


Why might my company be worth more post-pandemic?

Simple: Supply and Demand.

# Demand Side of the Valuation Equation

As of mid-2020, Private Equity has \$1.7T in dry powder



## Insights:

- **72% of business executives believe M&A will be a leading strategy for growth post-pandemic. Up from 32% prior to COVID-19**
- **89% of PE firms will be just as aggressive (if not more) post-pandemic.**
- **Corporations have \$4 trillion in cash to deploy**

# Supply Side of the Valuation Equation

- Fewer Quality Companies - Many on sideline
  - Pandemic Impact
  - Wait and see approach
    - Economy recovers
    - Valuation multiples
    - Business Recovery
  - Belief that only desperate companies are in the market
    - Buyers are only looking for heavily discounted deals
- Capital Gains Tax Elimination – will tip “vacillators into sellers.”





What makes a “Quality Company?”

The Buyer’s Perspective

1. Strong management team
2. Growth potential / scalability
3. Barriers to entry
4. Increasing margins and profits
5. Minimal customer concentration
6. Recurring revenues
7. GAAP prepared financials



What Questions are Buyers Asking?

Make sure to have answers.

- What did you do to strengthen your company?
- Are you flexible and able to pivot?
- Are you innovating?
- Are your customers and suppliers solvent?
- Any supply chain interruptions?
- Can you isolate the pandemic's impact on your financials? ("EBITDA-C")
- Do you have employee issues?
- What is the status of your PPP loan?
- Do you have clarity on your post-pandemic business plans?



# Case Study

Starfish



# Case Study: Starfish

- Consumer Products Company
- Owner is 55 years old (Wife would like him to retire)
- \$2.1MM EBITDA
- Strengths
  - Diversified Customer Base
  - EBITDA Margins 50%
  - Scalable
  - GAAP Prepared Financials
  - No COVID-19 Impact
  - Intellectual Property - Patents
- Weaknesses
  - Secondary Management Team

# Score Your Business

How does your business score?  
 (This worksheet is available on the Vistage website)

Value Category	Needs Work												High Value
Financials	Internally Prepared	1	2	3	4	5	6	7	8	9	10		Reviewed or Audited by external CPA
Team	Owner Dependent	1	2	3	4	5	6	7	8	9	10		Owner Independent
Growth and Scalability	Early Stage/Customer problems	1	2	3	4	5	6	7	8	9	10		Established/large clients
Barriers to Entry	Low barriers	1	2	3	4	5	6	7	8	9	10		Strategic barriers in place
Margins and Profits	Below average margins and profits	1	2	3	4	5	6	7	8	9	10		High margins and profits
Customer Mix	Customer concentration	1	2	3	4	5	6	7	8	9	10		Diverse customer base
Recurring Revenues	One time projects	1	2	3	4	5	6	7	8	9	10		Contracted/recurring revenue

Total Score = 52 out of 70

- How does the Starfish story end?
  - Engaged on June 1<sup>st</sup>
  - By June 21<sup>st</sup>
    - 28 NDA's
    - 6 Indications of Interest (IOI's)
    - Valuation range \$6MM - \$15MM
  - July 15<sup>th</sup> accepted \$18MM (8.3x EBITDA)
    - All Cash
    - 50% premium over-estimated market value.
    - Strategic Buyer
- Why?
  - Supply and Demand
    - Quality Company – Strategic Buyer

1. Taxes will impact value and after-tax proceeds.
2. Be a quality company.
3. Have a clear post-pandemic strategy.
4. If you are considering selling in 2021...need to start now.



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