

Let's Make a Deal – Issues Related to Buying a Business

Presented by:
GYF A&A AND TAX SERVICES GROUPS

GYF Annual CPE Day – November 9, 2023



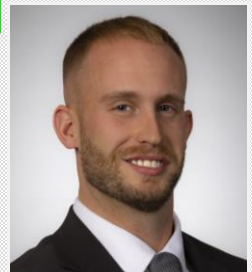
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Issues Related to Buying a Business

Introduction

- **Two sessions**
 - *The Price is Right* – Issues related to **buying** a business
 - *Let's Make a Deal* – Issues related to **selling** a business
- **Recurring fact pattern:**
 - *The Target company is a manufacturer organized as a corporation*
 - *Recurring revenues are \$10m with net income of \$1.4m*

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Deal Type – Important on the Buy AND the sell side

- **Stock (equity) Deal vs. Asset Deal**
 - *Generally, the buyer wants an asset deal*
 - *Generally, the seller wants a stock (equity) deal*
 - *Sometimes, an asset deal is not feasible (contract, customer etc. issues)*
- **Hybrid Approach**
 - *Via special tax election, or*
 - *Purchasing an LLC or a disregarded entity*

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Issues Related to Buying a Business

Critical Points

- Legal Issues
- Reporting and Regulatory Issues
- Tax Issues
- Valuation
- Purchase Accounting

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Big Picture – Planning

- **What steps are critical before you purchase the business?**
 - *Build a team (internal and external)*
 - *Assess value*
 - *Deal structure (stock vs. asset; earnouts; management retention)*
 - *Financing*
 - *Evaluate opportunities and risks – Diligence*
 - Accounting
 - Legal
 - Environmental
 - Other

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Big Picture – Common Problems

- **Common accounting problems and how to avoid them**
 - *Poor accounting records and procedures*
 - *Lack of sufficient talent in the accounting function*
 - *Large working capital adjustments*
 - *Closings on dates other than traditional period ends*

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Due Diligence – (prior to closing)

- **Objectives**
 - *Quality of earnings*
 - *Identify potential issues and opportunities*
 - *Identify negotiation points*
 - *Assess seller team/culture*

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Due Diligence

- **Common Procedures – Accounting Diligence**
 - *Review external financial statements and related reports*
 - *Inquiries of external accountants*
 - *Summarize accounting policies and practices*
 - Focus on significant accounts (balance sheet and statement of operations)
 - Identify deviations from GAAP
 - Identify significant estimates and changes over time
 - Identify related party transactions

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Due Diligence

- **Common Procedures – Accounting Diligence**
 - *Analytical procedures (identify potential EBITDA adjustments)*
 - Revenue, COGS & GP
 - Operating expenses
 - Balance sheet
 - *Summarize and assess working capital (develop proposed target)*
 - *Quality of earnings analysis*
 - Procedures above feed this analysis
 - EBITDA and pro forma adjustments
 - *Tax diligence*

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Due Diligence

- **Examples of findings**

- *Seller accounting has been tax motivated, impacting EBITDA and carrying value of inventory*
- *Shift in reserve approach from conservative, quantitative assessment to qualitative assessment impacting EBITDA*
- *Revenue recognition... impacts of deviations from GAAP*
- *Lease accounting standard not adopted; potential impact on covenant targets*

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Due Diligence

- **Examples of findings (continued)**

- *Basis for ERC filings; potential impact on buyer in stock deal*
- *Unrecorded product liability or warranty matters*
- *Pension obligations*
- *Nonrecurring expenses*
- *Seller lifestyle expenses*
- *Old receivables/inventory*
- *Deferred CAPEX*

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Due Diligence

- **Quality of Earnings Report**
 - *Seller proposed adjustments*
 - *Diligence adjustments*
 - *Pro forma EBITDA*

\$(000's)			TTM	YTD
	2021	2022	Jul 2023	Jul 2023
Unadjusted EBITDA	\$ 1,570	\$ 2,560	\$ 3,105	\$ 2,232
Seller Proposed Adjustments				
LIFO adjustments	29	143	148	100
Executive compensation adjustment	240	240	240	140
One-time implementation costs	-	44	10	-
Legal and professional fees - restructuring	-	-	83	58
Total Seller Proposed Adjustments	269	427	481	298
Seller Proposed EBITDA	\$ 1,839	\$ 2,987	\$ 3,586	\$ 2,530
Due Diligence Adjustments				
CFO and Sales Manager salary adjustments	(180)	(180)	(180)	(105)
Rent - fair market value adjustment	(60)	(60)	(60)	(35)
Allowance for bad debt	-	-	(22)	(22)
Diligence related professional fees	-	-	-	17
Total Due Diligence Adjustments	(240)	(240)	(262)	(145)
Pro Forma EBITDA	\$ 1,599	\$ 2,747	\$ 3,324	\$ 2,385

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Accounting and Reporting – Post Closing

- **What are accounting/reporting “must do’s” after a purchase?**
 - *Accounting integration (teams/process & systems)*
 - *Develop realistic performance expectations*
 - *Execute synergy opportunities*
 - *Purchase accounting (to be discussed in later session)*
 - *Working capital settlement*
 - *Bank compliance*

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Important Tax Considerations

- **Due diligence process – what TAX issues am I concerned with?**
 - *Very different concerns if I am acquiring “stock”*
 - Unreported or understated tax obligations (primarily state tax related)
 - Tax attribute matters (what am I getting?)
 - S corporation matters (busted S corporation status)
 - Don't forget about non-income taxes (SALES TAX)
 - *If you buy the stock, you are on the hook for tax issues from day one!*
 - *Are there PPP or ERC issues?*

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Important Tax Considerations

- **Due diligence process – what TAX issues am I concerned with?**
 - *What are my concerns if treated as an “asset sale”*
 - Unreported or understated tax obligations – *NOT AN ISSUE*
 - Tax attribute matters (what am I getting?) – *NOT AN ISSUE*
 - S corporation matters (busted S corporation status) – *NOT AN ISSUE*
 - Don't forget about non-income taxes (SALES TAX) – *CAN BE A CONCERN*
 - *If you buy the stock, you are on the hook from day one! – NOT AN ISSUE*
 - *Are there PPP or ERC issues? – NOT AN ISSUE*

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Important Tax Considerations

- **The acquisition process:**

- *Stock sale:*

- More due diligence is generally needed
- Tax attributes carryover from old company
- More legal work is required for a “stock” acquisition

- *Transaction treated as an asset sale:*

- Need to ensure that title to the assets are free from liens
- Need to understand the market value of the assets acquired
- The allocation of the purchase price is important!

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Important Tax Considerations

- **Post acquisition tax matters:**

- *Stock sale:*

- Buyer steps into the shoes of the seller
- Short period returns may be needed depending on the buyer
- Understanding large timing differences between book and tax reporting

- *Transactions treated as an asset sale:*

- Properly allocating the purchase price among assets

- *Ensuring that both the buyer and seller complies with the purchase document with regards to future reporting*

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Closing Thoughts

- **Important to anticipate and avoid common issues**
 - *Post-transaction timing issues (reporting, filings)*
 - *Non-compliance with the purchase document*
 - *Unexpected tax reporting/filing matters*

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Thank you for your attention!

Please contact the presenters directly with questions:

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