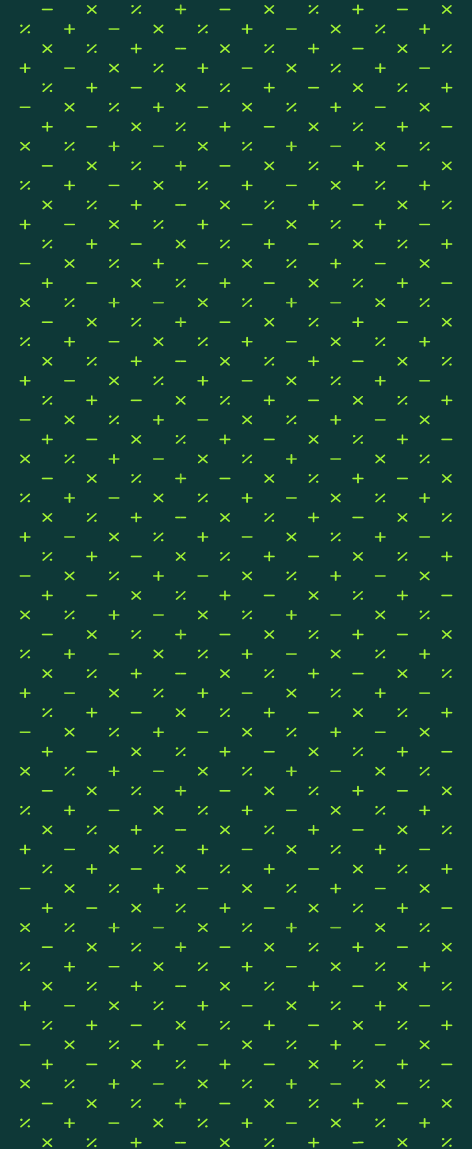




MOSSADAMS

Close Deals and Position Your E-commerce Company for Success

September 2021



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POLLING QUESTION

In the next 6-9 months, where do you plan to be in the transaction process?

- A. Weighing potential opportunities
- B. Conducting due diligence
- C. Actively negotiating
- D. Finalizing a deal
- E. I'd prefer not to say



POLLING QUESTION

Based on the last question, which side of the transaction do you plan to be on?

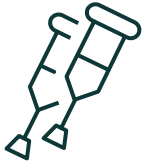
- A. Buy side
- B. Sell side
- C. Both
- D. I'd prefer not to say



Industry Trends & Outlook



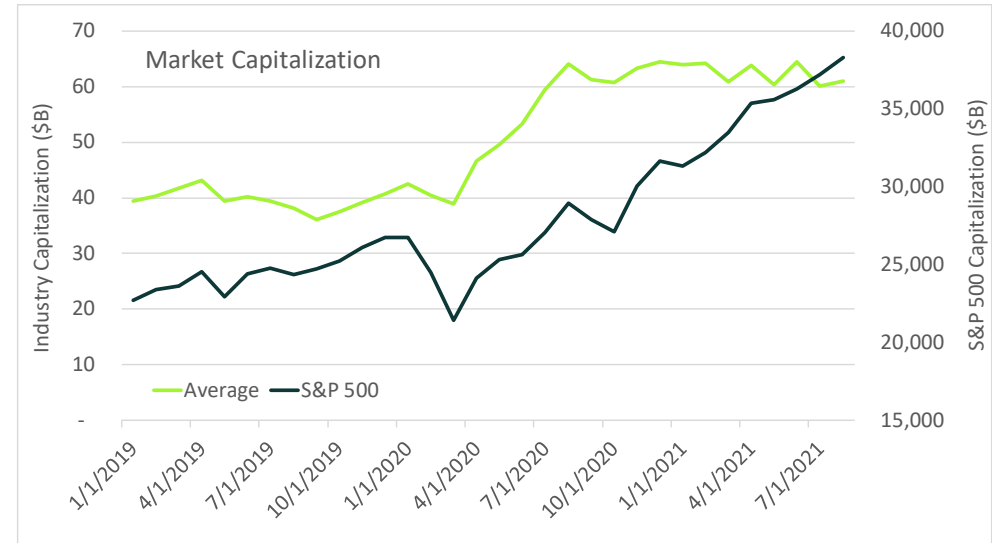
Macro Trends



- COVID restrictions and social distancing
- Transition of essential and nonessential shopping online
- Increasing per capita disposable income



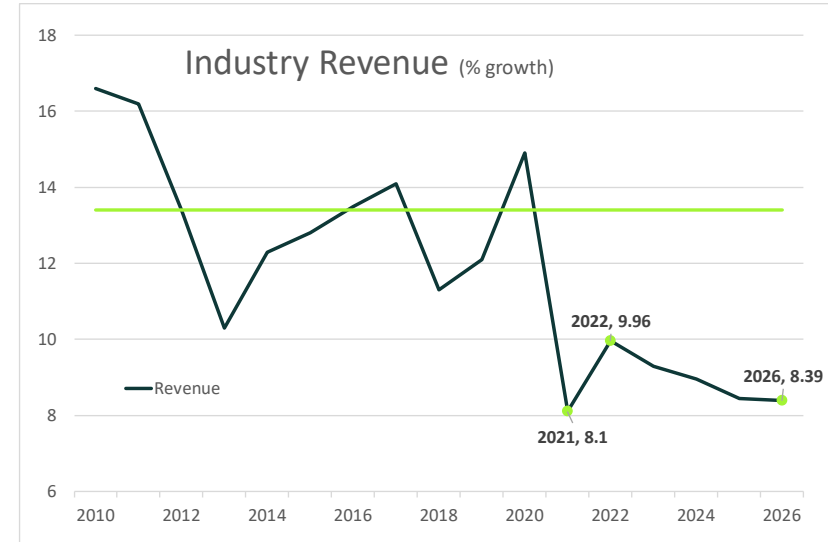
- Supply chain issues
- Wage pressure
- Major player anticompetitive behavior



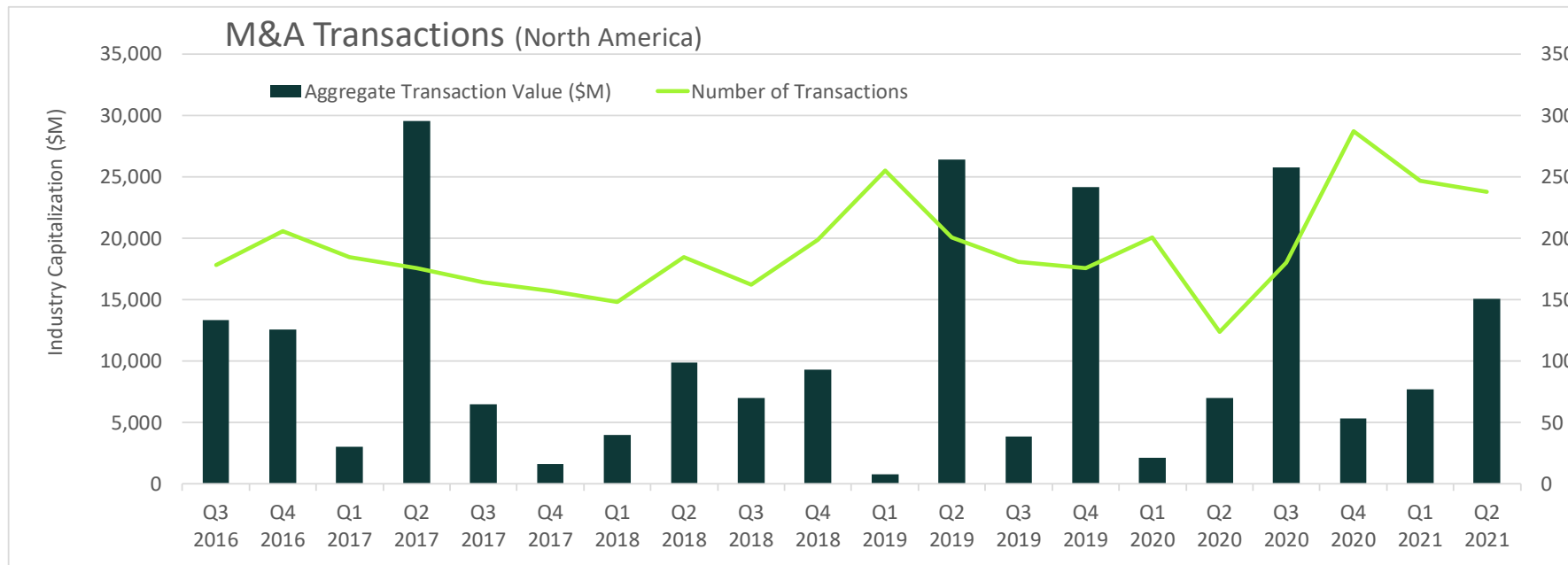
Industry Outlook



- Revenue growth below historical average, but high
- Mobile internet connections approaching saturation
- Continued disposable income growth
- Permanent shifts in consumer behaviors
- Rising competition
- Role of AI development

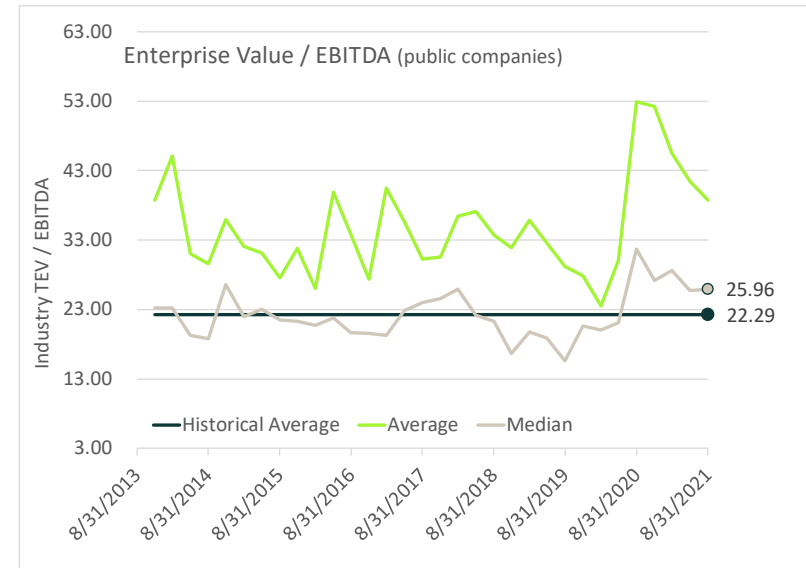
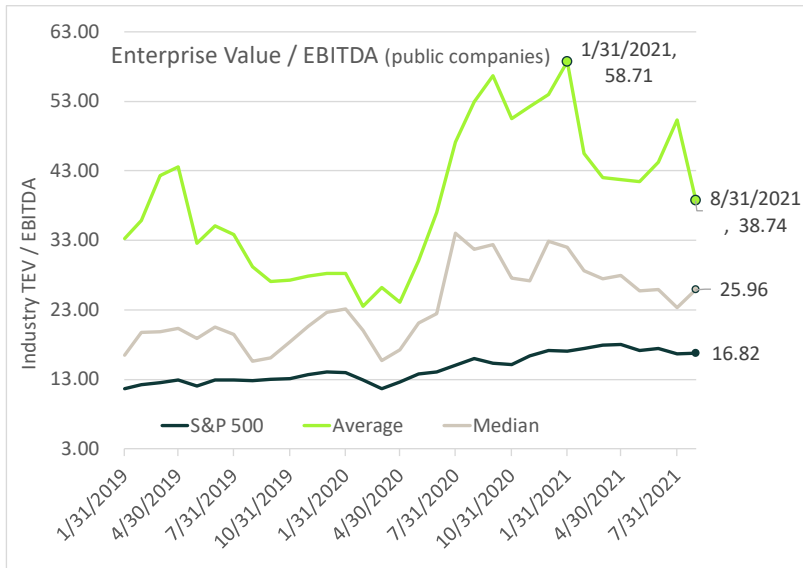


M&A Activity



Valuations

PUBLIC COMPANY VALUATIONS



M&A Insight: The Sage Group











E-commerce Experience: Sell Side M&A









The Sage Group has advised some of the world's leading e-commerce / DTC brands, spanning a variety of consumer verticals.

- 50% of our e-commerce deals involved a strategic buyer.

SELECT STRATEGIC TRANSACTIONS

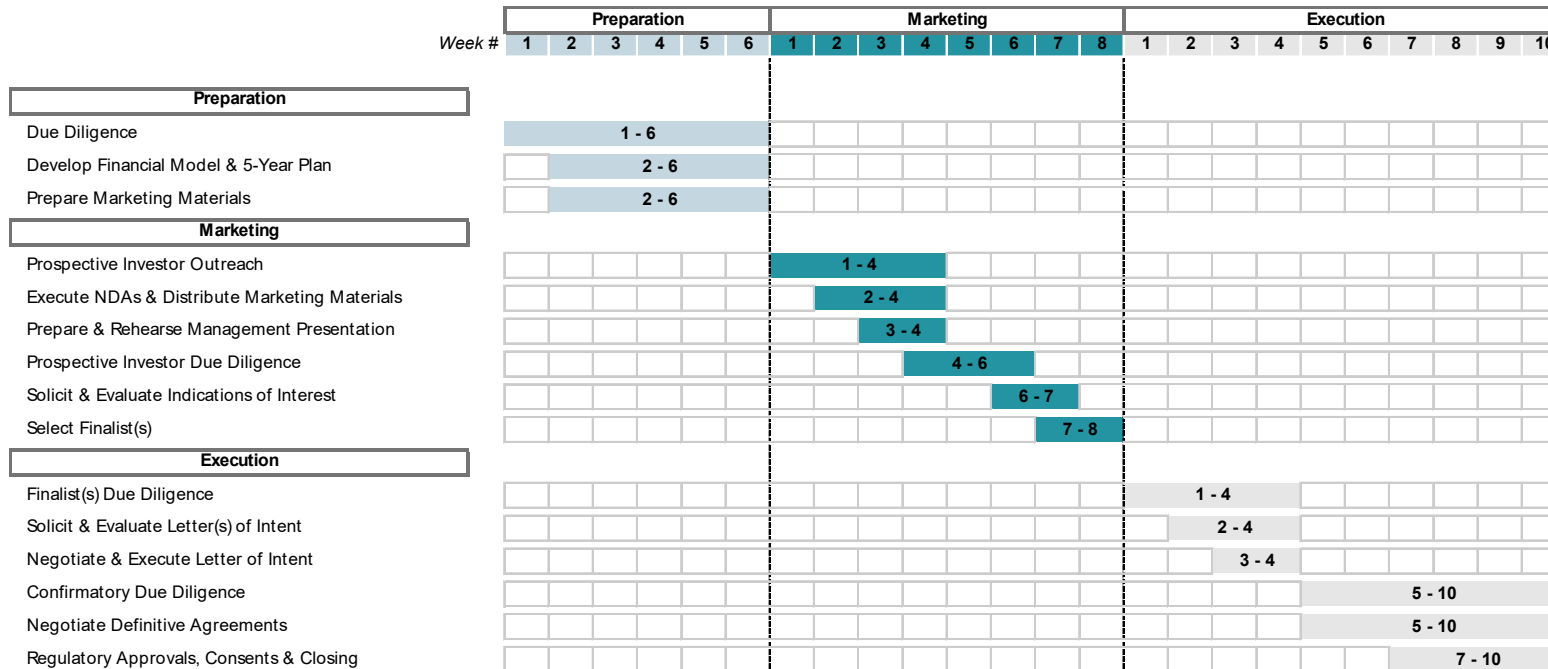
			
Has Been Acquired By	Has Been Acquired By	Has Been Acquired By	Has Been Acquired By
			

SELECT FINANCIAL SPONSOR TRANSACTIONS

			
Received A Significant Investment From	Received A Minority Investment From	Received A Majority Investment From	Received A Majority Investment From
			



Illustrative Process Timeline



Outlined to the left is an approximate road map for a typical process, which averages approximately 6 months from start to finish.

Timing can be impacted by quality of financial information, resources, and ability to satisfy buyer due diligence, among others.



Pre-Marketing E-commerce Diligence to Maximize Value & Certainty of Close

TRANSACTION METRICS

- AOV/UPT/AUR: diligence growth opportunities to offset rising CPA
- New vs. repeat dynamics: do customers spend more or less on subsequent orders?
- Session/conversion data: understand relative impact of each

MARKETING FUNCTION

- Paid function: channels of strength and KPIs/attribution to guide spend.
- Non paid function: organic drivers key to stabilizing CPA over time.
- CPA trends: analyze growth relative to increase in spend/AOV
- First order profitability: key to underwrite positive cash flow

CUSTOMER BEHAVIOR

- Cohort data: critical to investor diligence.
- LTV growth: understand multi-year progression, no foreseeable cap, recent cohort performance
- Retention drivers: how do you stimulate repeat purchases?
- LTV/CAC: measures net profit from a customer relative to CAC

CONSUMER INSIGHTS

- Customer profile
- Demographic / psychographic data
- Leverage survey work to inform decision-making
- NPS & CSAT: collect as much data ahead of a process, as this will be requested by investors

VARIABLE MARGIN

- Understand the variable margin structure of the business, including:
 - Product gross margin
 - Freight-out costs
 - Warehousing
 - Merchant fees
 - Marketing spend
- Higher variable margin allows for more room for marketing spend

INDUSTRY DYNAMICS

- Incumbent players and any lack of digital expertise
- TAM (including new product expansion)
- Credible omni-channel opportunities



Tax Impacts



Transaction Lifecycle

1 Pre-LOI *(1-24 months prior)*

- Assessment of optimal transaction structure.
- Identification of tax opportunities and tax minimization options
- Key employee incentive planning

2 LOI to Signing *(4-8 weeks)*

- Evaluate tax basis step-up opportunities
- Evaluate monetizing transaction and compensation expenses
- Consider impact of purchase price allocation issues (ordinary income vs. capital gain)
- Consider tax implications of working capital adjustments
- Perform due diligence including Federal, state, and international tax analyses, including evaluation of tax exposures, issues to be addressed and planning opportunities

3 Signing and Close *(4-12 weeks)*

- Implement tax structure, PPA, working capital
- Consider impact of rep & warranty insurance related to tax matters
- Consider impact of Golden Parachute issues vis-à-vis acceleration of equity awards

4 Post-Close

- Transaction expense deductions
- VDA's, 382 (tax loss) Studies, nexus studies, IP migration, transfer pricing, etc.
- Legal entity rationalization and simplification



Impact on Individual

- Increased marginal income tax rate for individuals to 39.6%
- Increased capital gains rates
 - Capital gains that used to be taxed at 20% would be taxed at ordinary income tax rates – up to 39.6%
- Net investment income tax continues to apply
 - 3.8% surtax on net investment income (taxable interest, dividends, gains, passive rents, royalties and annuities)
 - Does not apply to owners who actively participate in the business
- Results in the total top rate on long-term capital gains increasing from 23.8% to 43.4%
- Potential state tax increases or limited state tax deductions could further increase tax related costs
- Consider closing in 2021 to avoid to avoid impact of potential tax hikes in 2022
- Planning related to taxation of earnouts payments in 2022 and later years



Impact on Individual (cont.)

Example: Individual A owns a Company with \$50.0 million of EBITDA which is sold for a 10.0x multiple with net debt of zero and tax basis in the stock of \$100 million

Date of Sale	Sale Price	Tax Basis	Taxable Gain	Federal Tax Rate	Capital Gains Tax	After Tax Proceeds
2021	\$600M	\$100M	\$500M	23.80%	\$119M	\$481M
2022 & Beyond	\$600M	\$100M	\$500M	43.40%	\$217M	\$383M

- Results in tax on the gain of almost double what it is currently
- Above example is only federal tax rates, state tax and increases could further exacerbate this issue
- Impact of limitations on state and local income tax (SALT) deductions. Consider SALT workaround being passed by various states.
- Consider impact of state of residency on state income tax costs of sale



Corporate Tax Rate

- Corporate tax rate – increase in top rate from 21% to 28%
 - Still below the 35% rate in effect in 2017
 - Still below typical comparative rate in Europe
- Likely will not have a significant impact on Transactions
- May impact some transaction structuring
 - May further discourage the corporate entity choice in favor of flow-through entities
 - Potentially increase the value of NOLs utilized to offset income at a higher rate
 - Increasing rates may increase the value of tax planning (e.g., tax basis step-up modeling)
 - Increased incentive for C corps to qualify for QSBS exemption.
 - Must setup structure to qualify and then hold for 5 years
- Acquisitions of foreign companies require careful structuring to minimize potential triple tax burden for US acquirers
 - Foreign country local tax and withholding tax on distributions to US company
 - US corporate level tax (subject to partial credit)
 - Tax on distributions to shareholders
- State tax planning and considerations



Tax Diligence Considerations

TYPICAL PROBLEMATIC ISSUES

- Sales and use Taxes
- US reporting of international/foreign transactions and local country tax issues
- Acceleration of incentive awards and other change in control payments
- S corporation qualifications being busted
- Disposition of unwanted assets
- Value of tax loss carryforwards



Proposed Tax Reform

	CURRENT LAW	PROPOSED LAW
CORPORATE RATE	21%	28% after December 31, 2021
INDIVIDUAL ORDINARY RATE	37%	39.6% (with 3.8% NIIT) broadened to apply to all income over \$400K which would bring the rate up to 43.4%)
INDIVIDUAL CAPITAL/QUALIFIED DIVIDEND RATE	20% (plus 3.8% NIIT)	39.6% (43.4% including 3.8% NIIT) on income over \$1M (indexed for inflation after 2022)
SECTION 199A	20% qualified business income	Phase out of 20% pass-through deduction for filers over \$400K in taxable income
CARRIED INTEREST	20% capital gain rate	For an “investment services partnership interest,” ordinary for incomes above \$400K beginning December 31, 2021
EMPLOYMENT/SOCIAL SECURITY TAXES	NIIT does not apply to active owners	All pass-through business income of high-income taxpayers is subject to either the NIIT or SECA tax
QUALIFIED SMALL BUSINESS STOCK (“QSBS”) EXEMPTION	Limited to greater of 10 times Taxpayer’s basis in shares or \$10M	No changes proposed



Key Takeaways

Involve Tax Advisors **early** in the process to:

- Identify structuring opportunities to increase the after-tax value of the transaction
- Identify valuable “Tax assets” which can be potentially monetized
- Address purchase price allocation issues which impact taxation at ordinary vs capital gain rates
- Identify tax exposure areas and develop plans to remediate or mitigate, to avoid surprises and slow down in deal process, and impact on purchase price (e.g., holdbacks, escrows, debt, etc.)



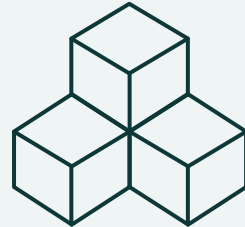
Financial Diligence: Top Issues



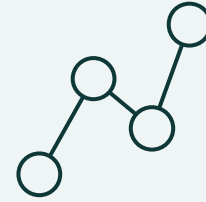
E-commerce Key Diligence Issues



Sales and
Cost of Sales



Inventory
Valuation



COVID and
Supply Chain Delays





Sales and Cost of Sales

BEST CASE

Fully integrated ERP system (eg. NetSuite)

- Perpetual inventory with product cost relieved with each unit shipped
- Sales orders automatically download (eg. from Shopify) to 3PL and recorded as a sale at the time of shipment
- Monthly inventory reconciliations with contract manufacturers



Allows for good monthly analysis of sales and gross profit trends by product/SKU

WORST CASE

Offline inputs into ERP system (eg. QuickBooks)



Poor understanding of margin trends and high likelihood of cut-off errors causing delays and large diligence adjustments





Sales and Cost of Sales (cont.)

REVENUE

- Under GAAP – should technically be when shipment reaches the customer. Practically, many companies record at the time of shipment
- Not acceptable – time of order, particularly if a backlog exists

RETURNS

- Should be accrued at the time of sale based on historical return rates – track actual data
- In a high growth company recording returns as processed will result in a negative EBITDA adjustment

DISCOUNTS

- Best case – track discounts in a separate GL line item – Don't be lazy - buyers will want to understand margin trends

GIFT CARDS

- If sold separately, make sure these are recorded as a liability, not as a sale when sold and the liability offset when orders are fulfilled
- If issued as an alternative to a refund or as a customer concession, record the discount or refund as a credit to revenue when issued with a corresponding liability until such time it expires or is used
- Track gift cards by issue and expiry dates





Inventory Valuation

ASSUMING MOST HAVE OUTSOURCED MODEL

Best Case

- If turn-key, units should be put into inventory at either a standard or average cost
- If own materials but pay a contract manufacturer - best case – do a “unit build” using materials, CM fee any other costs for each unit as it is completed by a contract manufacturer and put into inventory

Worst Case

- Expense all purchases as incurred or value inventory at month end based on a poor inventory count and an estimated cost per unit that is never updated

IN BOUND FREIGHT AND DUTY COSTS

- Many companies expense as incurred. In a high growth company this can cause significant distortion of earnings and cause these expenses to be expensed too soon relative to sales
- Best practice – cost are allocated to the unit costs and expensed at the time of sale. Acceptable –Expense as incurred and develop a method to estimate the amount to include in inventory at month end





Supply Chain Delays/COVID

IMPACT ON INVENTORY

- Normalize working capital
- Lost sales - difficult to quantify
- Most e-com companies have had a favorable impact from COVID
 - Collect data to prove sustainability

EXPEDITED FREIGHT

- Track your use of standard freight separately from air freight to support a potential add back

LOWER EXPENSES – BE REALISTIC

- Travel costs
- Trade show costs
- Office expenses

GOVERNMENT PROGRAMS

- Don't expect to get credit for PPP loan forgiveness if the business was not impacted by COVID
- Track the impact of any payroll tax deferrals



Action Items for You and Your Organization

Think about the four recommendations below before you begin to establish how your business will approach a transaction.

1



Surround yourself with experts and advisors early to prepare ahead of a transaction

2



Understand company differentiators & growth strategy to help sell the business to a Buyer

3



Invest in systems and qualified accounting team to help present your business effectively to a Buyer

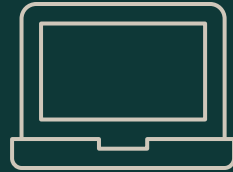
4



Involve tax advisors early to help identify and address key tax considerations of the transaction



E-commerce Series: Up Next



CYBERSECURITY BEST PRACTICES FOR E-COMMERCE BUSINESSES

SEPTEMBER 30, 2021 AT 10AM



➤ QUESTIONS

Let's start a conversation.



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