M&A Brokers: Lower Middle Market Investment Bank

Equity Rollover

How $9M of Rollover Equity Can Become $35M+ at Exit

Agenda

- Introduction
- Options in Business Sales
- What is Rollover Equity?
- Rollover Math
- After Tax Total Return Scenarios
- Benefits for Buyers and Sellers
- Tax Issues
- Summary & Conclusions

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ABOUT

SCOTT MASHUDA

Founding Partner, REAG

- Lead the firm's growth and strategic vision with 25 years experience in M&A and business valuation.
- Faculty at The Exit Planning Institute; taught the M&A process 2020 - 2024.
- Chair of M&A Source in 2023; Board of Governors member 2017 - 2023.
- Recognized as a top M&A service provider in "40 Under 40" by The M&A Advisor 2013.
- Active in Cleveland's Association for Corporate Growth; former adjunct professor at Duquesne University.
- Co-founded REAG in 2004; previously a senior valuation analyst at Ernst & Young.

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ABOUT

Aaron Stremick, MBA, CEPA

VP, REAG

- 25 years of experience in professional services including Tax, Finance, Real Estate, Law, and Bankruptcy
- Lead transaction strategy and execution for lower-middle-market owners, with a focus on maximizing total enterprise value.
- Advise on complex deal structures — including rollover equity —to optimize risk, liquidity, and second-exit outcomes.
- Work alongside private equity sponsors, strategic acquirers, and advisors to align capital, growth strategy, and owner goals.

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About REAG

- Boutique investment banking firm specializing in lower-middle market M&A advisory
- Deliver institutional-grade execution to lower-middle market transactions
- Bring clarity and confidence to business owners as they transition their legacies
- Human-centered M&A firm

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Our Target Market = LMM

Revenue

Up to
$250M

EBITDA

Up to
$25M

Geography

United
States

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Our Purpose

To combine deep financial acumen, sector insight, and a human-first approach to deliver winning outcomes to business owners in the LMM.

Business Sales Transaction Structures & Terms

- **Earn-out:**
  - A contingent payment where a portion of the purchase price is paid based on financial or operational goals (e.g., revenue/EBITDA targets) post-closing.
  - Bridges valuation gaps and rewards the buyer for future performance.

- **Seller Notes / Seller Paper:**
  - The seller acts as a lender, financing a portion of the purchase price.
  - The buyer pays the seller principal and interest over a set period
  - Often subordinate to bank financing.
  - Helps bridge gaps when the buyer cannot secure full financing at closing.
  - Communicates confidence in the business to the buyer.

Business Sales Transaction Structures & Terms

- **Equity Rollover:**
  - The seller does not cash out completely
  - A portion of their equity is "rolled" into the new, combined entity.
  - Allows the seller to benefit from the future growth of the company ("second bite at the apple") and keeps them invested in future success.
  - Common in Private equity deals, where the seller retains a minority stake (often 20-40%).

- **Other Key Deal Terms:**
  - **Rep & Warranties (R&Ws):** Statements of fact about the company's health (e.g., "no pending lawsuits") that the seller promises are true
  - **Escrow/Holdback:** A portion of the purchase price is held in a third-party account for a set period to cover potential breaches of representations and warranties.
  - **Working Capital Peg:** An agreed-upon amount of operating capital left in the business at closing to ensure it can continue operating smoothly.
  - **Cash-Free/Debt-Free:** A common transaction structure where the seller keeps the cash but must pay off all debt before the sale.

What is Rollover Equity?

- Instead of selling a business all at once it is sold in two increments.
- The percentages may vary from 20% to 40% of the equity in the new entity post transaction.
- For example, 70% stake is sold with a 30% stake rolled forward
- The typical buyer hold period is anticipated to be 3 to 5 years
- The future exit multiple for the larger combined company is expected to be higher
- The subsequent sale of the rollover equity following a growth period at a higher multiple significantly rewards the seller.

Concepts Over Assumptions

- Core Assumptions that Drive Cash Outcomes
  - 10 Million in EBITDA
  - Initial multiple of 5x
  - A multiple of 8x on a second sale after 5 years of growth

- **What We're Ignoring (On Purpose)** This example ignores transaction costs, Net Working Capital, and financing to isolate the economic impact of rollover equity. It assumes no distributions during the holding period. All net operating cash is reinvested in capex, debt service, and growth. All debt from acquisition is paid off during the 5-year growth period.

Initial Sale of 82% Equity

- In the initial sale the seller takes meaningful liquidity while retaining upside.
- Wealth concentration risk is reduced
- Investment diversification is increased

EBITDA	$	10,000,000
Multiple		5.00
Value	$	50,000,000
Equity Sold		82%
Purchase price	$	41,000,000
Capital Gains Tax	$	(8,200,000)
Net Proceeds	**$**	**32,800,000**

Rollover Equity Is Bigger Than It Looks

Sellers Equity		Share of Capital Stack
82% Equity Sold	$41,000,000	82%
Seller's Rollover Equity	$9,000,000	18%
	$50,000,000	

Not This

NewCo		Capital Stack	Equity Share
Buyers Equity	$21,000,000	42%	70%
Seller's Rollover Equity	$9,000,000	18%	30%
Debt	$20,000,000	40%	
	$50,000,000		

This

At the time of the first sale 82% of the equity is sold and 18% is retained.

The seller's 18% equity in the acquisition capital stack becomes 30% of the equity in the post acquisition entity.

In the second sale the proceeds are allocated by the 30% of the equity, not by the 18% of the capital stack.

The debt leverage benefits the seller's rollover equity.

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Tracking the $9M Rollover Post-Close

- Two factors Drive Equity Valuation
- One: Multiple Expansion
  - Larger enterprises over $100M in TEV enjoy a **2.8x Higher Multiple**
  - Subject to the Industry and company performance, the EBITDA Break point may be $15 to $20 Million
- Two: Growth
  - For all PE-backed companies, annual EBITDA growth averages 8%

GF Data's Q3 2025 M&A Report states that the valuation spread between small sub-$100 million Total Enterprise Value(TEV) and large platform buyouts of $100 million to $500 million TEV **expanded to 2.8x** in the first nine months of 2025.

Larger platforms are now commanding average valuations of **9.8x** trailing twelve-month (TTM) EBITDA, while smaller platforms are trading at **7.0x**; a difference of **nearly three full turns of EBITDA**.

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Projected EBITDA in Year 5

	EBITDA by Year		Growth
2026	$	10,000,000	
Year 1	$	10,800,000	8%
Year 2	$	11,700,000	8%
Year 3	$	12,600,000	8%
Year 4	$	13,600,000	8%
Year 5	$	14,700,000	8%
EBITDA at Second Exit	**$**	**14,700,000**	

Multiple Expansion

EBITDA	$	14,700,000
Multiple		8.00
Value	$	117,600,000
Rollover Equity		30%
Rollover Exit Value	**$**	**35,280,000**

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The Second Bite: The Same Business. Two Exits. One Strategic Choice.

- **$9M Rollover Equity grew to approx. $35M**
  - A 31.4% annual IRR
- **Total Gross proceeds in excess of $61 M**

82% Equity Sale	$	41,000,000
Capital Gains Tax	$	(8,200,000)
After Tax Proceeds	$	32,800,000
30% Equity Sale	$	35,280,000
Capital Gains Tax	$	(7,056,000)
After Tax Proceeds	$	28,224,000
Total Cash	$	61,024,000

Transaction Comparison with and without a Rollover

Sale Without Rollover		
100% Equity Sale	$	50,000,000
20% Capital Gains Tax	$	(10,000,000)
After Tax Proceeds	**$**	**40,000,000**

	Sale With Rollover	
82% Equity Sale	$	41,000,000
20% Capital Gains Tax	$	(8,200,000)
After Tax Proceeds	**$**	**32,800,000**
30% NewCo Equity Sale	$	35,280,000
20% Capital Gains Tax	$	(7,056,000)
After Tax Proceeds	**$**	**28,224,000**
Combined Net Proceeds	**$**	**61,024,000**

- Without Rollover Equity the Owner's after-tax proceeds leaves $21 Million on the table
- Rollover Equity is a strategic choice

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Hypothetical Client Net Worth and Return Scenarios

Client Financial Statement	
Unrealized Business Value	$50,000,000
Diversified Portfolio	$10,000,000
Combined Net Worth	**$60,000,000**

Sale Without Rollover		
100% Equity Sale	$	50,000,000
20% Capital Gains Tax	$	(10,000,000)
After Tax Proceeds	$	40,000,000
Diversified Portfolio	$	10,000,000
Combined Net Worth	**$**	**50,000,000**

First Sale With Rollover		
82% Equity Sale	$	41,000,000
20% Capital Gains Tax	$	(8,200,000)
After Tax Proceeds	$	32,800,000
Rollover Equity	$	9,000,000
Diversified Portfolio	$	10,000,000
Combined Net Worth	**$**	**51,800,000**

- Initially there is a $1.8 M Capital Gains Tax Savings
- Long term outcomes discussed on the next slide

*Both scenarios assume a 6% after tax return on a diversified Portfolio

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Hypothetical Client Net Worth and Return Scenarios (Cont.)

Portfolio Growth Without Rollover	
Beginning Balance	$50,000,000
Year 1	$53,000,000
Year 2	$56,180,000
Year 3	$59,550,800
Year 4	$63,123,848
Year 5	**$66,911,279**

Portfolio Growth With Rollover	Diversified Portfolio	Rollover	Net Worth With Rollover
Beginning Balance	**$ 42,800,000**	$ 9,000,000	$51,800,000
Year 1	$45,368,000	$ 9,000,000	$54,368,000
Year 2	$48,090,080	$ 9,000,000	$57,090,080
Year 3	$50,975,485	$ 9,000,000	$59,975,485
Year 4	$54,034,014	$ 9,000,000	$63,034,014
Year 5	$57,276,055	**$ 28,224,000**	**$85,500,055**

*Both scenarios assume a 6% after tax return on a diversified Portfolio

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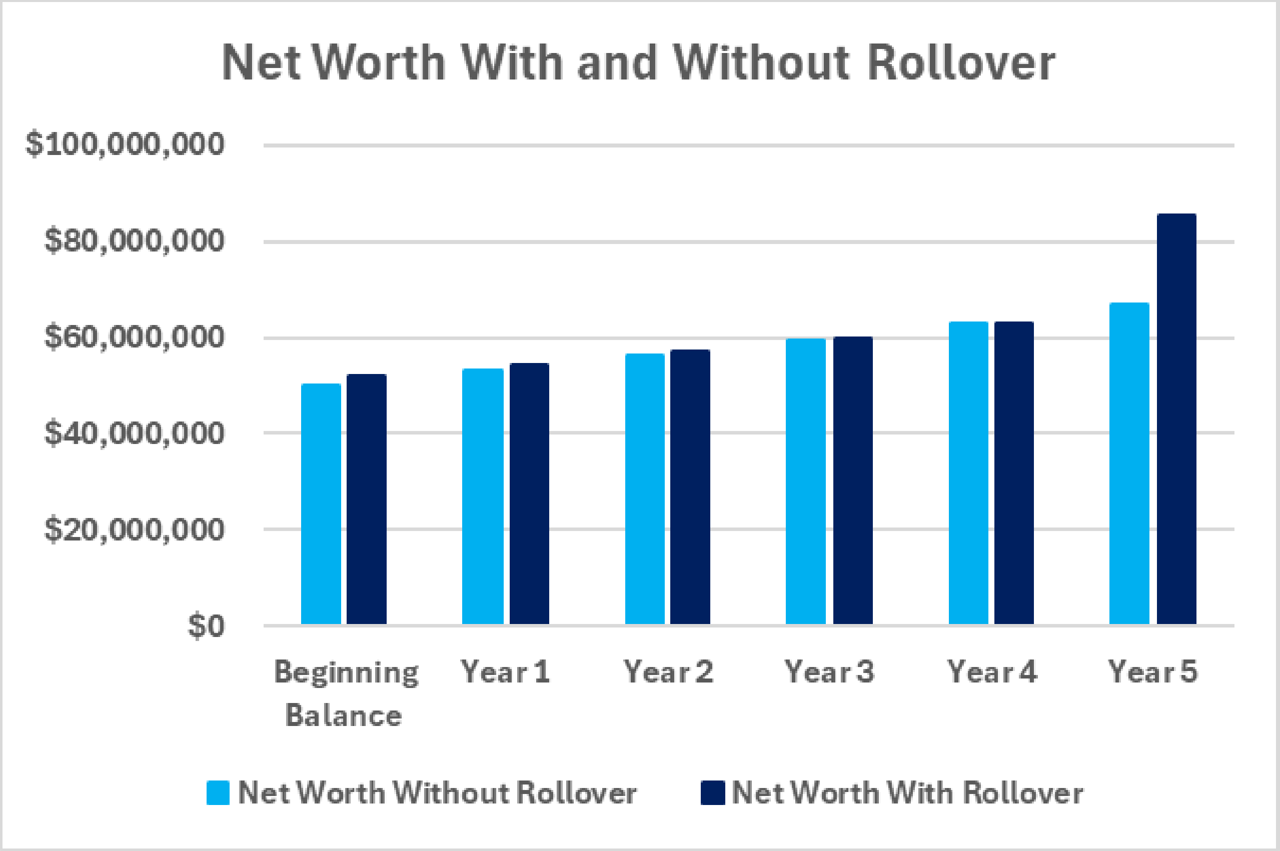
Hypothetical Client Net Worth and Return Scenarios (Cont.)

- Rollover Equity is Tax efficient
- The Rollover Equity Scenario produces a $18.6 Million after tax total net worth benefit. A 28% increase in net worth
- Both scenarios assume a 6% annual after tax return on a diversified portfolio



Benefits of Rollover Equity for Buyers

- **Because the seller stays invested → execution risk drops:** Rollover equity reduces risk for buyers by **aligning the financial interests** of the seller and buyer and reduces the Buyer's cash investment requirement.
- **Management Continuity:** Rollover Equity eases the transition. It incentivizes key personnel to remain with the company, preserving institutional knowledge, and critical customer relationships that might otherwise be lost.
- **Confidence:** A seller's willingness to roll equity signals confidence in the future of the business and demonstrates commitment. This reduces the buyer's fear that the seller is hiding operational flaws.
- **Operational Alignment:** The Seller's payout on rollover equity depends on growth and a successful second exit, ensures motivation to meet growth targets and operational milestones.
- **Managing Valuation Expectations:** Rollover equity solves valuation gaps and gives a seller the opportunity to participate in the upside at a higher second exit multiple.

Benefits of Rollover Equity for Sellers

- **Diversification:** Reduce Concentration risk and improve personal financial diversification in the first sale while keeping upside.

- **Growth:** Sellers get the opportunity to participate in the upside growth that comes from partner resources. This can take the form of capital investment, financial & operational expertise, and sales and marketing.

- **Multiple:** All things being equal a larger company in the same industry sells for a higher multiple than a smaller company. The seller benefits from the growth and at a multiple.

- **A fresh outlook:** Bringing on a private equity or strategic partner allows the owner to focus on the aspects of the business that they enjoy. Many of the administrative tasks that owners did not want to deal with might be addressed by the buyer's team. Many sellers find this re-energizing.

Rollover Equity and Tax

- Reinvest sale proceeds into buyer equity without tax consequences during the initial sale for the rollover equity
- Defers capital gains on the rollover equity portion until a future liquidity event
- Structured under IRC §721 / §351
  - provide tax-free treatment for contributing property in exchange for ownership interests in partnerships and corporations
- This is a broad overview. Individual situations and tax consequences may vary. You should seek the advice of your tax CPA.

Other important Tax Considerations

- Vesting and Employment Terms: If rollover equity is tied to continued employment (vesting), it may trigger immediate, ordinary income taxation under §83, requiring a timely §83(b) election to manage the tax burden.

- Taxable "Phantom Income": Sellers may be allocated taxable income or gains from the new entity (especially partnerships/LLCs) even if they do not receive cash distributions, requiring careful review of operating agreements to ensure sufficient distributions cover tax liabilities.

- Entity Classification: The tax treatment depends heavily on whether the buyer is a partnership, LLC, or C corporation, affecting the application of IRC Sections 721 or 351

- This is a broad overview. Individual situations and tax consequences may vary. You should seek the advice of your tax CPA.

Timing

- In our example the first sale may take up to a year, the second sale may take a year, plus the 5-year growth period and the total timeline may be 6 to 7 years.
- If an owner is thinking about selling in the future; preparing and understanding the options as early as possible is the best path to a satisfactory outcome.
- Waiting until retirement age approaches often limits the seller's options and the ability to maximize the price.

Rollover Equity Works Best When

- EBITDA is $5M–$25M
- The owner plans to stay involved 3–5 years
- There is a credible growth or acquisition thesis
- The buyer brings scale and operational leverage, not just capital

Takeaways for owners

- Rollover equity is not a concession — it's a value multiplier
- Selling less can produce significantly more total proceeds
- Rollover Equity is a powerful tool to leverage sale proceeds into a much larger exit.
- The market rewards scale, growth, and acquisition strategies

- This analysis should drive a mindset of Value Creation, Growth, and Acquisition.

Takeaways for CEPA Advisors

- Rollover Equity
  - A Tax Efficient tool
  - Maximizes total after tax net worth
  - Rollover Equity is a portfolio management tool, tax strategy, and asset class
  - Allows owners to participate in the post acquisition upside from growth and Multiple Expansion

- **Join REAG at the EPI Summit in Nashville April 18 to 21**
  - Sign up for the Sunrise Table Talk 7 to 8 AM on April 21
  - https://exitplanningsummit.com/sessions/sunrise-table-talks

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For More Information Contact:

Scott Mashuda, CPA
Founding Partner and Managing Director
Direct: (440) 915-3082
SMashuda@REAG.com

Aaron Stremick, MBA, CEPA
Vice President
Direct: (520) 842-6057
AStremick@REAG.com

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Scott Mashuda
Co-Founder

Aaron Stremick, MBA, CEPA
VP, REAG

REAG.COM
833-333-REAG