Tailwater Finance Forum
June 12, 2018

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Intro

Biography

Rob Myatt
Partner, Tax Services – BTS

Energy focused (upstream/midstream) tax professional with more than 12 years of public accounting experience in tax consulting and compliance focusing on private-equity backed portfolio companies and their management teams, independent operators, and large family groups.

Brian Reed
Partner-in-Charge, Financial Advisory Services

Financial advisory professional with more than 18 years extensive experience ranging from acquisition due diligence to valuation services.

Brian's diverse knowledge and technical skills allow him to provide comprehensive consulting services to his clients.

Dale Jensen
Partner-in-Charge, North Texas Audit

Responsible for the growth and strategy of Weaver's audit practice in North Texas. Previous experience includes providing services to the U.S. SEC registrants and reviews required for SEC filings. Additionally, as the lead of the oil and gas industry practice, he remained on the forefront of industry regulations and changes and specifically focused on the upstream and midstream sectors.

Matt Federle
Partner, Audit

More than 12 years of public accounting experience in assurance and consulting services focusing in public, private and private-equity funded companies in upstream and midstream oil and gas, oil field services, property and causality insurance and employee benefit plans.

Intro

AGENDA

- **Sell-Side Due Diligence**, Sell-side financial due diligence allows sellers to address concerns and issues that may be relevant to even the most demanding purchaser
- **Buy-side:** buy-side due diligence services are tailored to help both strategic and financial investors overcome certain risks and gain a more complete understanding of a target's financial situation, analyze adjusted earnings, and identify risks
- **Tax Reform and Recent Updates:** Overview of TCJA and implications on the midstream sector and management teams
- **Acquisition and Disposition:** Overview of tax considerations on buy/sell transactions
- **General Discussion:** Take a few minutes to answer specific questions and issues

Due Diligence

SELL-SIDE

SERVICE	BENEFIT
Perform a pre-sale analysis of the seller's financial data………………………	Identify any potential issues in an effort to avoid broken deals or decreased valuations
Assist in the preparation of the information memorandum and transaction data room………..	Facilitate efficiency of the due diligence process
Perform a cost and synergy analysis…………………	Identification of carve-out costs
Maintain a consistent basis of accounting for due diligence information and financial schedules……………..	Create efficiencies during the due diligence process
Respond to buyer's due diligence questions…………….	Provide support to the seller throughout the engagement to streamline the due diligence process

Due Diligence

BUY-SIDE

SERVICE	BENEFIT
Assess quality of earnings................................	Understand normalized earnings and certain GAAP deficiencies
Analyze business driver trends............................	Determine what is driving revenue growth (or decline) and identify main drivers of earnings
Identify and understand balance sheet risks and exposures................................	Reveal unrecorded liabilities or overvalued assets (e.g., obsolete inventory, unaccrued liabilities)
Understand and identify cash flow consideration..........................	Clarify expenditures (e.g., capital expenditures on new equipment) to better assess future cash flows impacting the buyer’s valuation model
Analyze forecast assumptions............................	Understand how current estimates bridge to actual results

Due Diligence

OTHER CONSIDERATIONS

GAAP Financial Reporting Considerations

ASC 606
In Kind NGLS
Non-cash consideration
Principal vs Agent

ASU 2017-01
Screen Test

Corporate Tax Rate

Reduced from 35% to 21%

Appreciated Assets, Lose Capital Gain Treatment	Beneficial in business you are reinvesting proceeds with stock exit	Double Taxation (Effective Rate for pass through 37% and 21, Corporate rate 36.8%)

Partnership structure still most advantageous to midstream

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100% Expensing for Bonus Depreciation

Allows 100% expensing for assets after 9/27/17 through 2022	Can be on both new and used property	On property with recovery period of 20 years or less
Changes annual results (Typical is annual losses, now could be big loss followed by income)	Expect heavy recapture on liquidation	Tax Distributions – Cumulative?

Limitation of Interest Deduction

Limits interest expense to 30% of business taxable income	Disallowed interest carried forward indefinitely

Meals and Entertainment

All entertainment expenses nondeductible, including meals where no business is conducted

50% business meals

Office Parties 100% deductible

50% employee meals (including onsite)

Club Memberships N/D

Qualified Opportunity Zones

Provides temporary deferral for capital gains reinvested in a qualified opportunity fund

Can reduce gain (if held for 7 years) by 15%

Reinvestment eligible for permanent deferral if held for 10 years

Must reinvest original gain in qualified opportunity fund; QOF holds at least 90% of its assets in a qualified opportunity zone

States designate QOZ counties/tracts with approval from IRS; designation good for 10 years

Pass-Through Tax Treatment

Investors in partnerships and S-Corps can receive 20% deduction of taxable income	Response to lower C-Corp rate	Results in approximate 29.6% rate on pass-through ordinary income
Limited to 50% of W-2 wages paid by the pass-through entity or 2.5% of depreciable property		Calculated on entity-by-entity basis; cannot aggregate investments

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Limitations on pass-through losses

Can only deduct up to $500K total of non-passive pass-through losses on annual basis; determined in aggregate

Limits ability to offset other income (wages, dividends, interest, etc.) with pass-through losses

Remainder is carried forward as net operating loss

Will 100% bonus depreciation create problems here?

Consideration for management team with equity investment

Technical Terminations eliminated

Removes partnership requirement to terminate (file final and initial year tax return) if 50% or more of interest is sold

Carried Interest

- Currently viewed as not applicable for portfolio company carried interest
- Changes holding period from 1 to 3 years to gain LTCG treatment
- Could be consideration at the fund level

Due Diligence

RECENT UPDATE

83(b) Election – Individual Return

Requirement to attach 83(b) to your personal return removed

IRS Audit Regs – 2018

Collects tax at the partnership level

Results in partnership paying tax on behalf of partners

Option to push out to partners

Increased scrutiny on partnerships – C vs. Partnership traditionally skewed

O&G sector at risk (book/tax differences)

Due Diligence

ACQUISITION AND DISPOSITION

Midstream Asset Categories

Hard Assets (Pipelines, facilities, easements)

Contracts

Goodwill

Proper analysis required for each category

Due Diligence

ACQUISITION AND DISPOSITION

Entity vs. Asset Sale

- Holding period can guide structuring; If capital has been contributed within 12 months, better to sell assets
- Ordinary recapture either way
- DRE's treated as asset sale
- C-Corporations can complicate things

Due Diligence

ACQUISITION AND DISPOSITION

Holding Period

Capital contributed over time creates new holding period in portion of partnership interest

Pipeline construction over time creates new holding period in portion of hard assets

Contracts executed over time creates new holding period for newly executed contracts

Rapid appreciation in value could mean a short-term holding period in intangible values

Short-term Goodwill if value has escalated over prior 12 months

Due Diligence

ACQUISITION AND DISPOSITION

Purchase Price Allocation

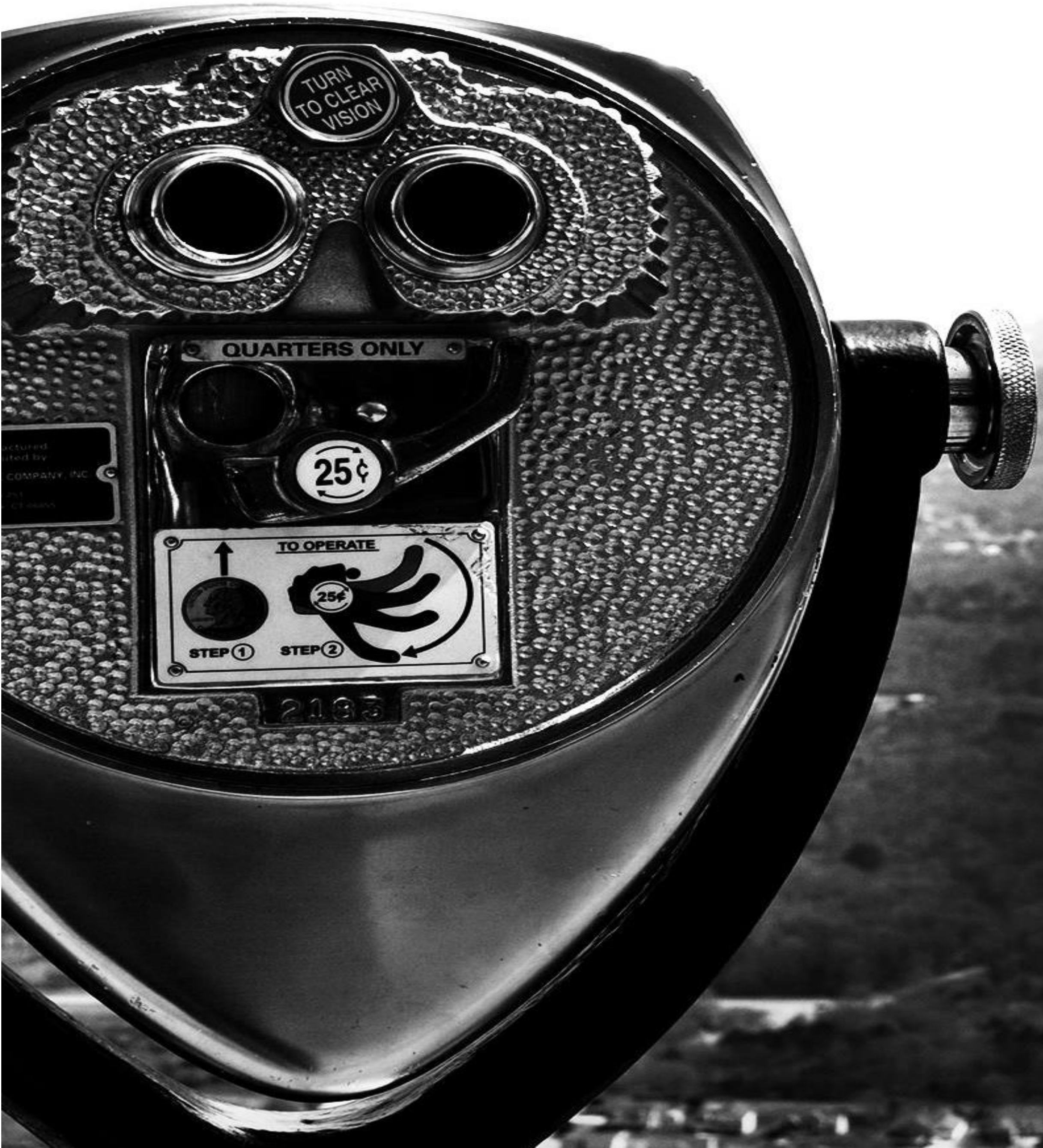
Allocation is necessary in either an entity or an asset sale	Allocation to hard assets will determine recapture	Amount below original cost can minimize recapture Amount above original cost is capital gain except if short-term
Seller typically wants to allocate minimal amount to hard assets to avoid recapture	Amount allocated to contracts may be eligible for capital gain if LT (law unclear)	O&G appraisers typically take position contracts have no value unless they contain above-market terms Beware of non-O&G valuation groups on this
Buyer typically wants to allocate more to hard assets to take advantage of shorter depreciable life (bonus)	Amounts allocated to goodwill generally LTCG	Difficult to determine holding period when sold shortly after first year of operations Buyer side – all intangibles amortized over 15 years

Due Diligence

ACQUISITION AND DISPOSITION

Deferral Opportunities

Installment Sale (includes escrow deals)	Allows deferral of gain to future tax years when cash is received All recapture is triggered Year one regardless
Rollover Equity	Tax-free to extent of value rolled to new equity
Earn-out	Tax Deferred Difficult to gauge value



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