

ESOP considerations in the COVID-19 environment

Capital market agnostic solutions to mitigate the current economic disruption and provide a creative approach to corporate sustainability and long-term growth

Given recent events around COVID-19 and accompanying unprecedented market turbulence, Deloitte Corporate Finance LLC's ("DCF") ESOP ("Employee Stock Ownership Plan") Corporate Finance team thought it beneficial to highlight insights into issues surrounding the novel coronavirus and key trends that have been affecting many existing ESOP companies since the U.S. emergence of COVID-19. As a member of the largest professional services firm in the world, Deloitte Touche Tohmatsu Limited ("Deloitte"), DCF is committed to providing real-time updates on market-changing phenomenon and their impacts on existing ESOP companies from insights gathered across the Deloitte network.

The COVID-19 effect

The COVID-19 pandemic is a global crisis without modern parallel. A black swan event so broad in its impact across geographic, demographic, and economic sectors lacks precedent, and explains why many public and private sector organizations were already becoming strained before the World Health Organization officially declared a pandemic on March 11, 2020. DCF and the broader Deloitte network are dedicated to [publishing a series of thought leadership](#) pieces to help both large and small businesses examine and seek to mitigate the potential impacts of COVID-19 on their organizations. Executives should be prepared to assess COVID-19's impact on their businesses as near-term liquidity constraints, working capital and supply chain shortfalls, and mandatory debt and capital adjustments become a reality. Now more than ever, many companies face exceptionally challenged operating conditions that threaten to disrupt the entire value chain of their operations, from customers to suppliers. In order to combat these conditions, management teams around the world should proactively address this volatility by stress testing and challenging current business assumptions while simultaneously leading from the front to reassure employees that actions are preemptively being taken to mitigate impact of COVID-19 on their organizations.



A guide for Senior Executives

Deloitte has identified five fundamental qualities of resilient leadership that distinguish success as they guide their enterprises through the COVID-19 crisis.

- 1 Design from the heart... and the head**
Resilient leaders are genuinely empathetic with employee and customers. Yet resilient leaders must simultaneously take a hard, rational line to protect financial performance and corporate sustainability.
- 2 Put the mission first**
Resilient leaders are skilled at triage, able to stabilize their organizations to meet the crisis at hand while finding opportunities amid difficult constraints.
- 3 Aim for speed over elegance**
Resilient leaders take decisive action—with courage—based on imperfect information, knowing that expediency is essential.
- 4 Own the narrative**
Resilient leaders seize the narrative at the outset, being transparent about current realities—including what they don't know—while also projecting a compelling view of the future that inspires others to persevere.
- 5 Embrace the long view**
Resilient leaders stay focused on the horizon, anticipating the new business models that are likely to emerge and sparking the innovations that will define tomorrow.

Key business considerations around COVID-19

While there is no proven playbook for this COVID-19 crisis, DCF believes that a typical crisis plays out over three time frames:



Respond in which an organization deals with the present situation and manages continuity.



Recover during which an organization learns and emerges stronger.



Thrive where an organization prepares for and shapes the "next normal."

Managing cash flow during a period of crisis

The saying goes "Cash is King," and has never been more evident as organizations scramble to free up cash flow to fund business operations that are being severely disrupted by COVID-19. This [Deloitte Insight](#) provides 15 real-world solutions that seek to manage cash.

Managing supply chain risk and disruption

China's dominant role as the "world's factory" means that any major disruption puts global supply chains at risk. This [Deloitte Insight](#) has 25 findings to help businesses both large and small seek to mitigate COVID-19's supply chain impact.

Credit solutions for companies with urgent cash flow needs

COVID-19 has caused many businesses to lose revenue permanently, putting unanticipated pressure on working capital lines and liquidity. This [Deloitte Insight](#) discusses credit solutions for organizations with urgent cash needs due to the COVID-19 outbreak.

Key ESOP trends around COVID-19 (details on following page)



ESOP repurchase obligations and funding management



Offensive and defensive buy-side opportunities



Communication with key stakeholders



Capital structure review



Extended enterprise risk mitigation



Board-level strategic review

COVID-19 Update: Existing ESOP Companies

Deloitte Corporate Finance LLC

Key ESOP trends around COVID-19



ESOP repurchase obligations and funding management

- Prior ESOP repurchase obligation studies may become out-of-date in the context of an economic shock, including share price considerations, human capital considerations, and capital sustainability to ensure obligations are met.
- In uncertain times, it is imperative to model a few scenarios related to cash flow management and potential retirement and layoff scenarios, and the effect on the company's cash position.
- If there are significant cash constraints, proactive measures to create flexibility should be considered.



Communication with key stakeholders

- Employees are the foundation of any business, and this is especially true with an ESOP where employees may own between 25% to 100% of the company's common stock.
- During volatile economic periods, developing a proactive employee communication plan regarding key corporate issues such as financial security, employee safety, proactive business measures, and stakeholder communication may engender trust and allow for creative solutions.



Extended enterprise risk mitigation

- One of the most critical and overlooked aspects of the corporate infrastructure is a company's supply chain, which are both essential for business continuity and highly susceptible to significant economic disruption.
- Given the inherent global nature of the COVID-19 pandemic, businesses should perform a wholesale review of their supply chain and partner network to ensure they have an understanding of Tier 1 suppliers and their respective supply chains, adequate supplies are in place to fulfill medium-term demand, and the credit risk of the supply chain.



Offensive and defensive buy-side opportunities

- Companies with strong balance sheets can consider both defensive and offensive buy-side opportunities to exit this period of volatility with enhanced competitive positioning.
- This can include accelerating ongoing discussions, shoring up the supply chain, or entering a new market segment.
- Concurrent with conversations, it is important to engage lenders regarding capital availability.



Capital structure review

- Reviewing current debt arrangements (including flexible covenants and line of credit availability) and 13 week cash flow modeling in conjunction with existing lenders will strengthen relationships and reduce unwanted surprises for all parties.
- In addition, it is important to assess the availability of refinancing existing high-cost debt (such as seller notes), changing cash interest payments to payment-in-kind ("PIK"), or recapitalizing the balance sheet to provide more flexible debt capital or equity capital to provide greater cash flow flexibility over the medium term.



Board-level strategic review

- As the real-world impact from COVID-19 continues to impact organizations across a range of sectors, ESOP companies should consider conducting corporate board-level strategic reviews related to current capital markets conditions, industry performance and near-term expectations, and ESOP-specific sensitivity analysis. This analysis should also include the relative costs and benefits of pursuing a range of alternatives, including buy-side or divestment strategies

COVID-19 Update: Existing ESOP Companies

Deloitte Corporate Finance LLC

DCF has successfully advised multiple ESOP companies across a variety of market cycles. Even during the COVID-19 pandemic, ESOP companies are still gaining capital market interest, with a variety of current DCF engagements showing signs of market resilience. Below is a snippet of lessons learned over the past few weeks in the capital markets.

- 1 Existing ESOPs showing signs of market resiliency**











 - DCF is current advising several ESOP companies on a full array of transaction alternatives.
 - ESOPs have shown greater resilience to market disruption due to their tax-advantage structure and inherent alignment of interests between the employees and the company.
- 2 Continued capital market interest in existing ESOP companies**

 - DCF is progressing on a sell-side engagement with a provider of design and installation solutions, receiving multiple bids over the past few weeks, despite many of the acquirors facing heightened uncertainty due to COVID-19.
 - Despite the current environment, there remains market interest for companies that have developed leading positions within their industry.
- 3 Existing ESOP show interest in reviewing strategic alternatives**

 - DCF is currently engaged with a manufacturer of electronics to provide a full scope of the current capital markets environment and potential strategic alternatives available to the company.
 - DCF's client is particularly interested in evaluating alternatives regarding value maximization and corporate sustainability.
- 4 Acquisition opportunities available to ESOPs in strong positions**

 - DCF is currently under engagement with a large engineering and construction firm that is evaluating acquisition opportunities.
 - Despite COVID-19, the company is progressing to the stage of making final bids on two separate targets as it continues to search for companies at dampened valuation multiples given current market conditions.

Representative past successful DCF existing ESOP engagements

 <p><i>has acquired</i></p>  <hr/> <p>Deloitte Corporate Finance acted as exclusive financial advisor to The Branch Group, Inc.</p>	 <p><i>has completed a recapitalization with</i></p>  <hr/> <p>Deloitte Corporate Finance acted as exclusive financial advisor to Airborn, Inc.</p>	 <p><i>has been acquired by</i></p>  <hr/> <p>Deloitte Corporate Finance acted as financial advisor to Elkhorn Holdings, Inc.</p>	 <p><i>has been acquired by</i></p>  <hr/> <p>Deloitte Corporate Finance acted as exclusive financial advisor to Plastic Packaging, Inc.</p>	 <p><i>has been acquired by</i></p>  <hr/> <p>Deloitte Corporate Finance acted as financial advisor to Konikoff Dental Associates, Inc.</p>
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