



COVID-19 Action Center
An ESOPTM Association Webinar



Dealing with ESOP Contributions When Cash Is Tight



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Agenda

- Who is Still an Employee?
- Distribution Policies and Managing Payouts
- Balancing Competing Needs for Cash
- Other Sources of Cash



Who is Still an Employee?

- Terminations, workforce shrinkage potentially impact distribution timing and future repurchase obligations
- Layoffs, furloughs, leaves of absence – who is still an employee and who has experienced a severance from employment?
- Facts and circumstances test
 - Still paid?
 - Health insurance, other benefits in place?
 - Company email still working?
 - The longer unpaid and gone – the more likely there has been a severance from employment



Distribution Policies and Managing Payouts

- Check your plan document and distribution policy – possible changes in **form** or **method** *may* be possible when the goal is to conserve cash
 - Change large payouts from lump sum to installments
 - Convert small balance lump sum to installments
 - Change minimum dollar amount of an installment
 - Eliminate small balance force outs
 - Distribute shares subject to a put option instead of a cash contribution if there are willing buyers for the shares redeemed by the Company
 - Worst case – distribute shares in exchange for a promissory note – collateral and other rules apply



Distribution Policies and Managing Payouts

- Your plan document and distribution policy – change **timing**?
- Need to consider current Plan and Distribution policy language and confirm how long commencement of distribution elections can be delayed:
 - “As soon as administratively feasible” or “no later than” language may provide room for delay
 - If necessary and warranted, commence payment after an interim valuation and updating of participant accounts
 - Fiduciary and other concerns – consult legal counsel



Distribution Policies and Managing Payouts

- **Dealing with Diversifications**

- Optimal document language – the 90 day election period begins after the Employer stock fair market value is communicated to participants
- Dealing with sub-optimal language – the 90 day election period begins on the first day of the plan year



Balancing Competing Needs for Cash

- **Business cash needs**

- Operating expenses
 - Defer A/P; minimize expenses; government assistance loans
- Debt service payments/rent
 - Refinance at lower rates/longer amortization; seek forbearance
- Capital expenditures
 - Lease instead of buy? If 100% ESOP, no depreciation tax savings
- Net working capital
 - Defer A/P, accelerate A/R; expand bank revolver; A/R factoring
- Growth capital (new facilities, acquisitions)
 - Equity/subordinated debt investors are still providing resources for growth investments that provide attractive returns



Balancing Competing Needs for Cash

- **ESOP cash needs**
 - Lending financial covenants and possible impacts on ESOP funding
 - What comes first:
 - Funding for ESOP seller loan repayments, or
 - Funding for ESOP distributions and diversifications?
 - *What if we can't handle both?*



Balancing Competing Needs for Cash

- **ESOP cash needs**

- Eliminate reshuffle / segregation provisions so that funding for segregation is not just another draw on cash
- While these provisions are rare in ESOPs, hardship or participant loan provisions can be eliminated by amendment
- If funding matching contributions in the ESOP, consider temporary match suspension
- If there is cash in the ESOP, use it to pay plan operating expenses (if permitted by the plan)
- Consider elective transfers of 401(k) funds to the ESOP to purchase company stock



Other Sources of Cash – Debt Capital Solutions

- New or expanded debt financing facilities
 - Government assistance loans
 - Economic Injury Disaster Loan Program (\$2m limit, \$10k grant)
 - Paycheck Protection Program (\$10m limit, maybe forgivable)
 - Title IV loans for large and mid-size businesses
 - Bank lenders
 - Increase revolver limit, seek new term loans (expect fully asset collateralized)
 - Non-bank lenders
 - Unitranche, 2nd lien, mezzanine loans, etc. are available for more mature businesses (\$5+ million of EBITDA)
 - Sale leaseback transactions
 - For asset intensive businesses (rolling stock, real estate, etc.)



Other Sources of Cash – Equity Capital Solutions

- Equity investments from former owner(s), employees, management, 3rd parties (private equity, key customer/supplier, etc.)?
 - 100% ESOPs looking to maintain tax exempt status
 - Structured equity (a deeply subordinated loan with warrants) – *either former owner(s) or 3rd parties*
 - Employer/employee contributed 401(k) assets rolled over into ESOP and reinvested into newly issued shares at employer / participant option – *many caveats and considerations apply!*
 - Partially ESOP-owned companies or 100% ESOPs willing to forego tax exemption
 - “Drop-down LLC” structures to maintain passthrough ESOP tax benefit and avoid S corp pro rata distributions (if applicable)
 - Allows direct equity investments and more flexibility



Thank You

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