



COVID-19 Action Center
An ESOPTM Association Webinar



How The Pandemic Might Affect Repurchase Obligations



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Agenda

- How the current economic disruption may impact repurchase obligation and company's ability to afford
- Available options / decisions to be considered
- Impact of near-term decisions on long-term repurchase obligation



Covid-19 Pandemic Affects Many of the Components of Repurchase Obligation

Repurchase Obligation Components

General Concerns:

What matters?

- Shares eligible for distribution
- Distribution timing
- Value of stock distributed



General Comments

- Turnover:
 - May be high (layoffs/ furloughs/ shutdowns)
 - Early retirements to “lock in” a stock price
- Distributions:
 - Prior fair market value that does not consider the pandemic
 - Recent trend to shorten distribution timing
 - CARES Act in-service distributions may be requested



Using a special, interim valuation may lower stock repurchase cost and help remaining participants– but there are risks.

Pandemic Impact on Repurchase Obligation is Company-specific

- Varied types of companies
 - Strong/ healthy
 - Moderate/ managing
 - Vulnerable/ suffering



Strong Company – Characteristics

- Not materially affected, or temporarily impacted
- Strong cash flow, modestly leveraged
- Few employees / ESOP participants terminating



Strong Company: Repurchase Obligation Issues

Near- and long-term view?

- Near-term repurchase obligation
 - Number of shares not changed materially
 - Lower valuation makes repurchases cheaper
 - Opportunity to force cash-out of retirees
- Long-term Repurchase Obligation—unchanged



Strong Company – Distribution Policy Analysis

- Lump-sum v. Installment: Installments not needed
- Distribution Timing: Delays unnecessary



Strong Company – Repurchase Method Analysis

- Redeem vs. Recycle: **Same amount of cash used**
- Recycling decision impacted by changing share price
- Redemption decisions likely unchanged



Moderate Company – Characteristics

- Business materially affected though existence not challenged
- Impact likely temporary
- Managing cash flow closely
- Leveraged; potential to violate covenants
- Meaningful layoffs/ terminations
- Participant ESOP eligibility may change



Moderate Company: Repurchase Obligation Issues

Near- and long-term view

- Near-term Repurchase Obligation
 - Significant distributions may be starting
 - Terminated participants who deferred distributions may elect
 - 2020 layoffs trigger large future obligations
 - Effect on diversification elections
- Long-term Repurchase Obligation
 - Have near-term changes created future repurchase obligation issues?
 - Update Repurchase Obligation study for new assumptions, e.g., headcount, stock value



Moderate Company – Distribution Policy Analysis

- Lump-sum v. Installment
 - Does plan provide flexibility for installment payments?
 - Consider installments rather than obtaining interim valuation
 - Distributions at prior “high” value only on 1/5th of shares
 - Can be accelerated if the company has sufficient cash
- Timing
 - Consider delaying payments
 - Alter lump sum threshold distributions/minimum installment amounts
 - Suspend or modify segregation policy, e.g., segregate in installments



Moderate Company – Repurchase Method Analysis

- Recycling
 - Qualified plan limits may limit recycling
 - Could supplement with dividends / S corp distributions
 - May not want to reallocate a large number of shares in one year
- Redeeming
 - Issue promissory note? (lump sum distribution, adequate security required)
 - In recovery, growth accrues on fewer shares outstanding, may impact repurchase obligation timing and amount
 - Higher stock price → more concentrated balances

Vulnerable Company – Characteristics

- Non-essential business
- Significantly affected, existence challenged
- Cash inflows effectively dried up
- Limited cash to meet debt payments and fixed expenses
- Majority of employees laid off/ furloughed
- Concerned about ability to reopen



Vulnerable Company: Repurchase Obligation Issues

Near- and long-term view

- Near-term Repurchase Obligation
 - Current cash obligation
 - Threat of 2020 RO negatively impacting share price and/or company existence
 - Potential RIF impact
- Long-term Repurchase Obligation
 - Long-term impact of current changes
 - Update projections, cash flow assumptions
 - Sensitivity models/ optimistic vs. worst case
 - Evaluate short- and long-term cash flow impact on current year decisions



Vulnerable Company – Distribution Policy Analysis

- Lump-sum v. Installment
 - Change policy from lump-sum to installments
 - Interim valuation with participant option to skip an installment
 - Add year to diversification period
 - PPP Loans to fund payments
- Timing
 - Delay SAFO/lump-sum thresholds
 - Delay until leveraged loan repaid
 - Change segregation policy



Vulnerable Company – Repurchase Method Analysis

- RIF = more shares recycled or redeemed
- Recycling
 - IRS limits and lower eligible compensation
 - Reasonableness of benefit level
 - Short and long-term impact on future RO and share value
- Redeeming
 - Excessive accretion in per-share value?
 - Exacerbate have and have-not's?



Thank You

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