

ESOPs: Dealing with the Virus and its Economic Impact

Presented by ESOP Builders with Guest Speaker, Dean Ell



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WELCOME

Your Hosts:

- Perry Phillips, CPA, CA, CBV
- Joanna Phillips, CHRL, CVB



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CANADA

Guest Speaker:

- Dean Ell, Controller and ESOP Administrator, iQmetrix

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Introduction

- Share experiences
- Find comfort that others have many of the same questions
- Find solutions that may have not been thought of internally

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Agenda



Company Valuation



Plan Documents



Story: Dean Ell, iQmetrix



Morale and Communication



ESOP company COVID-19 Response
Survey Summary



Government Programs

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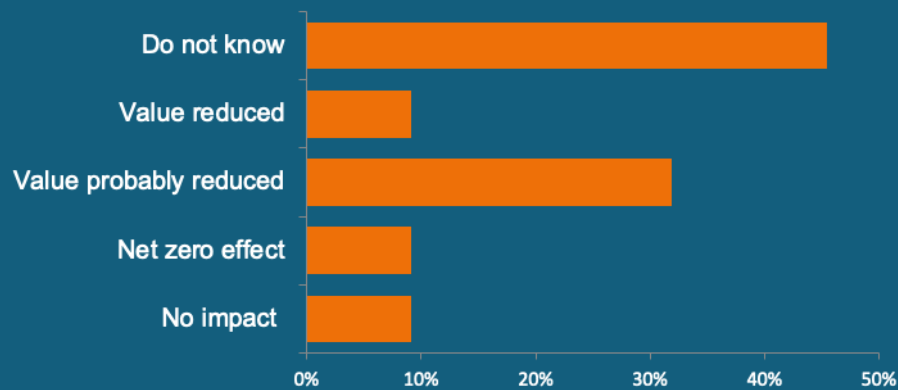
Valuation

What your Business Valuator will consider

- Consensus of valuations globally
- Stock market
- Normalization of earnings
- Forecasts
- Considering the COVID-19 year or not
- Balance sheet strength
- Are interim valuations needed – pros and cons

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Valuation Perceived Impact from the Virus



Based on data from Canadian company survey

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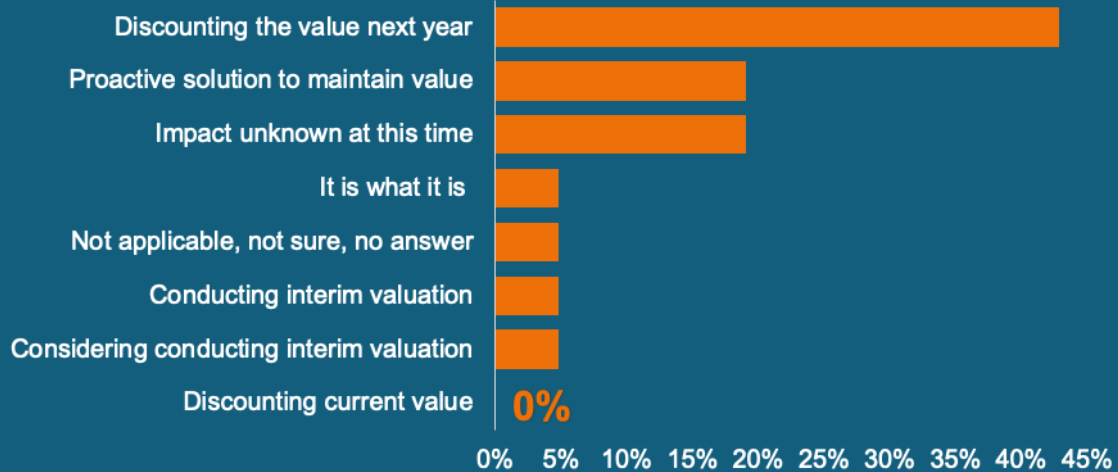
Net zero effect: strong prior year will balance out issues.

Value probably reduced: Will impact 2021 valuation, Expect it is reduce, too early to tell, Likely lower

Value reduced: drop in value/has dropped already

Do not know: N/A, Still evaluating and monitoring, Not yet completed so may change, Not far enough along in the process to know, Too early to tell.

Valuation Response to Impact



Based on data from Canadian company survey

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Proactive measure: Raise EBITDA by increasing revenue per staff

QUESTIONS

Plan Modifications

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Plan Elements Consider Modifications



Share Offering



Funding



Buy-Back

Plan Elements: Share Offering

30%

have not made any changes to the annual ESOP offering

25%

have already deferred their share offering

25%

are undecided about whether to make changes or not

5%

have already offered shares in 2020

- Defer offering,
- Change minimum purchase requirements, and/or
- Keep the offering and allow funding that is more flexible

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Based on survey

Offer deferral is the only area ESOP companies are considering for modification

Plan Elements Funding

- Increase flexibility by adding more options
- Defer or extend payroll deductions
- Pre-tax bonusing/ dividends/ Freeze
Distributing dividends instead of salaries or used as top up, loans – same idea

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Plan Elements Funding



Pre-tax bonusing

- must be done in a very specific way
- must meet certain conditions to comply with CRA rules
 1. Shares must be issued from company treasury
 2. Bonus dollar amount must not be known to the employee at time of subscription
 3. At least one other method of share purchase req by employee

Plan Elements Funding



Company freeze

- freeze the total value of the company, or a portion
- allows employee to continue to purchase at a reduced dollar value


Considerations: impact on current shareholders

Funding mechanisms should be reviewed with legal/tax advisor

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Considerations: all current shareholders will be frozen and receive preferred shares at the frozen value and be paid out by the company over time
They would then purchase common shares at the new value (reduced) and participate in growing the value of those shares moving forward

Plan Elements Buy-Back (Trigger Event)

- Trigger event: company buys back shares directly or through third party when employees leave for different reasons
- Review Payout Terms 
 - Be aware of what they are in case they are needed
 - Layoffs – generally not a trigger event depending on length of layoff and statutory notice period in your province/territory (Dale and Lessmann)
- Buy-Back Protection
 - Protect company in the case of many employees causing a trigger event at once

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AKA trigger events – company buys back shares directly or through third party when employees leave for different reasons

Temp layoffs not trigger event as long as within stat period (differs by province)

Review of payout terms in the case there could be trigger events

What if SHA is silent regarding layoffs – is it a trigger event?

large buy-out scenario - protecting the company if many owners are triggering a buy-out at once

Legal - Generally, in Ontario, a temporary layoff does not constitute termination without cause unless you don't hire back the employee by the end of the statutory layoff period (in Ontario, it's 13 weeks but can be up to 35 weeks if certain benefits are paid) or if the employee challenges the temporary layoff and claims constructive dismissal which is then determined by a court or mutually agreed to be a permanent termination (this is practically unlikely in this climate).

So, at a high level, in Ontario a temporary layoff won't usually be termination without cause and as such there would usually be no trigger right under most ESOP

Shareholder Agreements. If the employee resigns or isn't hired back at the end of the statutorily permitted layoff period, then that is different – it would constitute a resignation or termination without cause . The temporary layoff regime is different in other provinces, so the above (which is my high level, general, view), applies for Ontario.

QUESTIONS

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Dean Ell, iQmetrix

Participative Management: Stories

- ESOP company in previous downturn worked with employees to come up with a plan



74% of ESOP companies said they consulted employee owners to help answer questions on keeping day to day operations on track. Comparing to involving employee on valuation decisions this aspect is at a much high level (58% collaborations and keeping employees informed of valuation issues)

ESOP Case study: from NCEO annual conference in US, trucking 100% employee owned. Had to layoff, who company participated in identifying who in the company could be laid off

Whole workforce accepted it and in 6 months 95% were able to return

Open book management, Ownership Thinking, however you want to define It, compared to non-participative it is a factor of a successful ESOP company

<https://openbookcoaching.com/economic-engagement-dealing-with-a-crisis/>

Case study: Owner came to the realization that they had spent several years getting employees involved in the business as trusted partners, driving and participating in the profitable growth of the company, so why wouldn't they address challenges with the collective insight and wisdom of the team? They stopped telling employees what to do and started asking them what to do

In the end, all the questions had a response and a plan to review them frequently. the odds of survival are substantially enhanced by dealing with the challenge as a team.

Best Practices for Effective Communication in a Crisis

1. Communicate...a lot and be direct
2. Keep channels for communication open (EAP)
3. Company Values alignment
4. Be consistent
5. Employee ownership committee
6. Engage employee owners
7. Focus on opportunities and things that can be controlled
8. Don't focus on the uncertainties and what cannot be controlled
9. Don't use big words and business jargon, know your audience

Based on data from US Experts at the ESOP Association (US) and NCEO presented at a Beyster Institute Webinar

Beyster | Rady School of Management
INSTITUTE | UNIVERSITY OF CALIFORNIA SAN DIEGO

<https://rady.ucsd.edu/centers/beyster/>

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Experts from the ESOP Association (US) and NCEO provide best practices during a Beyster webinar

<https://rady.ucsd.edu/centers/beyster/>

Examples from ESOP Companies

1. Delegation of COVID-19 response responsibilities
2. Establishing COVID-19 Task force/Committee or leadership response group
3. Brainstorming sessions
4. Communicate the need to be proactive
5. Internal surveys and one on one conversations
6. Regular communication-frequent and realistic but positive
7. Frequent highlights of company values and philosophy
8. Offering choices to employees

Based on data from survey of Canadian companies

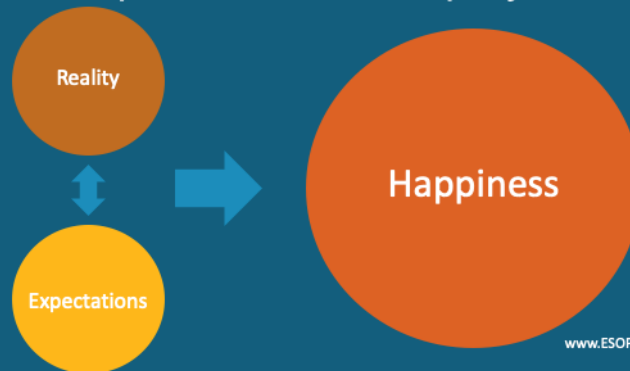


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Take Time to Step Back

- Traumatic events affect how we act during the trauma and after
- Benefits of non-work interactions and activities
- Managing expectations
- Recognize small accomplishments as a company and as individuals



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Non-Work Activities

Games
Recess
Happy hour
Coffee breaks/social hangout
Programs to help the community
Expand company intranet use

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Games – Tree service company, staff try to identify tree disease and take pics to share, house party, share pictures of home office with something out of place and others have to find it. Try to tie it into getting back to work
Intranet used for sharing positive pics and things people are doing at home

Helping the community highlighted in NCEOs blog: King Arthur Flour launched an initiative called [Goodness Bakes](https://www.nceo.org/employee-ownership-blog/response-covid-19-what-employee-owners-are-doing): “a program to keep bakeries running during financially challenging times.” To that end, they’ve directed tens of thousands of dollars to purchase bread and other baked goods from their customers, which they then distribute to areas of need within their local communities—including food pantries, organizations that support unemployed food service workers, homeless populations, and more. <https://www.nceo.org/employee-ownership-blog/response-covid-19-what-employee-owners-are-doing>

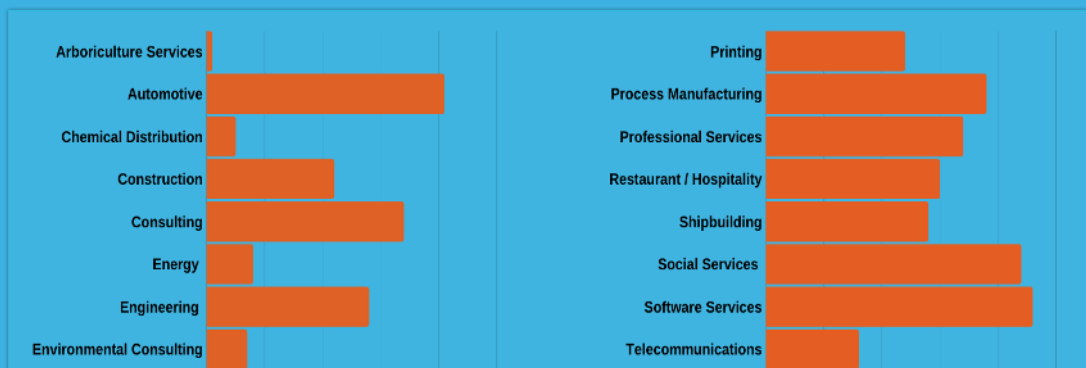
QUESTIONS

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ESOP Company COVID Response – Survey Summary

Industry Representation (%)



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23 Respondents, 20 have an ESOP, 3 are in process or seriously considering implementation

Half established since 2010 and 6 prior to 2000. 5 from 2000-2010 and 4 just this year.

Interesting to note that only 3 ESOPs (out of our respondents) were established within the previous significant financial crisis and only one during SARS (2003) indicating that most respondents have not experienced a serious financial downturn as an ESOP

Industries represented

Canada has 3 main industry types

1. Service
2. Manufacturing
3. Natural Resources

Service industry makes up more than 75% of working Canadians' jobs and is the majority of our respondents. We have separated it more specifically to have a better visual of what types of industries were responding.

ESOP Company COVID Response – Survey Summary

Impact on Operations



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Impact on Canadian economy - 60% have some negative impact

6 Negative: Mandated closure/\$0 revenue

1 Essential business, business is booming

In addition to virus: oil and gas collapse/downturn is negatively impacting operations



Available Programs

1. Temporary 10% Wage Subsidy
2. Canadian Emergency Wage Subsidy (CEWS) - a.k.a. 75% Wage Subsidy
3. Canada Emergency Business Account (CEBA)
4. Canada Emergency Commercial Rent Assistance (CERA)
5. Business Credit Availability Program (BCAP)
6. Work-Sharing Program
7. Summer Jobs Program
8. Deferred Payments
9. Support for Industries
10. Support for Individuals
11. Canada Emergency Response Benefit (CERB)

<https://www.canada.ca/en/department-finance/economic-response-plan.html#businesses>

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Important programs to participate in if you are experiencing negative impacts and may be struggling to keep employees

CEWS – application ready April 27 CRA! up to \$847 per week per employee which is 75% of a \$58,000 salary, no max per employer

Criteria: not a public company, payroll to employees, drop in revenue in March of 15% and April and May of 30% (March vs march or avg Jan Feb 2020, only one format may be used for all periods)

Apply in one period automatically applies it for the next period

Period: March 15-Jul 6

Application: through CRA

Temp wage subsidy for CCPCs, non-profit, charities and individuals, have to have business number and payroll account with CRA on March 18, 2020, pay payroll wages bonus or other remuneration to eligible employees

CEBA – 20-1.5 mill payroll in 2019, \$40k interest free until 2021, if 75% paid prior to Dec 2021 remaining is forgivable otherwise 5 year term with interest

QUESTIONS

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What's up next from ESOP Builders?



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THANK YOU

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You will receive:

The webinar recording and
a free e-book: 8 Ways to Reinvent Yourself in a Crisis



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