COVID-19: PREPARING FOR THE ECONOMIC IMPACTS OF A PANDEMIC

April 8, 2020
M&A and Capital Markets Outlook
COVID-19: PREPARING FOR THE ECONOMIC IMPACTS OF A PANDEMIC

BOB SNAPE
President
BDO Capital Advisors, LLC

With You Today
COVID-19 Impact

**EQUITIES**
- Dramatic sell-off
- Unprecedented volatility
- Earnings guidance withdrawn
- Hardest hit industries down 40%+ from highs
- IPO market dormant

**DEBT**
- Impact not seen since 2008/09
- Rush to fully draw on revolvers
- Senior debt market frozen for new deals
- New issuance reserved for large investment grade companies

**M&A**
- Withdrawn deals spike
- Deal-makers hit pause button
- Pricing of deals next to impossible in short term
## Call to Arms

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<td>▶ CARES Act</td>
<td>▶ Keep the financial system flowing</td>
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<td>▶ Unprecedented liquidity to keep the system moving</td>
<td>▶ SBA</td>
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<td>▶ Unlimited asset purchases</td>
<td>▶ Emergency declarations</td>
<td>▶ Avoid prolonged recession</td>
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Path Forward

Key Questions

- What is the severity of the economic impact?
- When will “stay at home” restrictions be lifted?
- Even without restrictions, have behaviors altered and how severe and long-lasting will the impact on consumer spending be?
- What does the immediate post-crisis environment look like?
  - Is a return to “normal” where we were - or somewhere else?
- How quickly can the economy restart?
- What sectors will struggle to recover and what is the impact / drag on the overall economy?

Additional Stimulus

- CARES Act II
- Infrastructure
- Incentives and tax credits
- Debt forgiveness and restructuring
Evolving Sentiment

**EQUITIES**

- Trade on news / expectations
- Earnings season upon us
- Volatility the new norm

**DEBT**

- Available to best rated, strong issuers
- CMBS, managed assets still unfolding
- Fed support essential

**M&A**

- Seismic shift in leverage from sellers to buyers
- Last market to fully reopen
- Lower multiples
- Lower leverage
M&A Market: Sell-Side Dislocation

## NEW TO MARKET
- Preparations continue albeit slowly
- Monitoring impact on clients, end markets, and supply chains
- Re-pricing
- Debating launch timing
- Wait-and-see

## LAUNCHED
- Hiatus, pause, on-hold
- Proceeding very slowly
- Pulling deals in certain sectors susceptible to top line impact

## LATE STAGE DEALS
- Closed (early on)
- MAE / MAC / Withdrawn
- Financing pulled or dead stop
- Deep dive of immediate impact
- Structure introduced
M&A Market: Buy-Side Bifurcation

Existing Pipeline / Growth M&A
- Proceed cautiously
- Deepen diligence
- Buy time
- Wait-and-see
- Restructure terms

Opportunists
- Vultures
- Turnaround, special situations
- Working capital, liquidity needs
- Bridge financing
- Debt / convertible features
M&A Market: Outlook

Short Term
- Turnaround M&A prevalent
- Consolidation of weak players likely
- COVID-19 impact on healthy business fundamentals
- Valuation: EBITDA adjustment... but projections key focus
- Reset of seller expectations
- Pace and extent of recovery industry specific
  - E-commerce
  - Distribution
  - Supply chain logistics

Longer Term
- Rekindle of withdrawn / delayed deals
- Dry powder
- Low interest rates
- Diligence and positioning never more important to successfully execute
Mitigating Financial Distress and Improving Performance
JEFFREY M. REISNER
Partner
McDermott Will & Emery
Affected Industries

- Travel
- Food & Beverage / Restaurants
- Entertainment
- Real Estate
- Transportation / Shipment
- E-Commerce
- Telecommunications
- Oil & Gas / Power
- Retail
- Pharmaceutical
- Manufacturing
- Healthcare
Business Judgment Rule

- A presumption that in making a business decision the director or officer acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the corporation.

- When directors and officers have fulfilled their duties of care and loyalty in good faith, courts presume, under the business judgment rule, that their decisions are valid.

- The rule protects directors’ and officers’ ability to exercise their discretion when making decisions on behalf of the corporation without fear of a court questioning the wisdom of their decision in hindsight.

- A plaintiff can overcome the presumption of the business judgment rule by showing a director or officer has failed to act with due care or loyalty or lacked good faith in carrying out his or her duties, in which case, the court will scrutinize the challenged transactions substantively.

- The business judgment rule applies whether a company is solvent or insolvent.
Fiduciary Duties

- **Governed by state law**
  - This presentation primarily focuses on Delaware law
  - Other states’ laws are generally consistent with Delaware law

- **Two primary duties**
  - Duty of care
  - Duty of loyalty

- **Directors’ and officers’ fiduciary duties are best understood by considering:**
  - The nature of the fiduciary duties; and
  - To whom the fiduciary duties are owed.
Duty of Care

- Directors must inform themselves of all material information reasonably available to them prior to making a business decision.
- Directors must act in an informed and deliberate manner.
- Directors may rely on information provided by corporation’s officers, employees and other advisors, as long as directors reasonably believe that the information provided is within the scope of the provider’s professional or expert competence, and the person so relied upon has been selected with care.
- Directors must evaluate advice and information critically and investigate further if there are facts or circumstances signaling need for additional information.
- It is important to establish and follow a decision-making process and maintain thorough records to satisfy the duty of care.
Duty of Loyalty

- Duty of loyalty demands requires that directors and officers act in good faith and in a manner they reasonably believe to be in the best interests of a company
  - Directors and officers must exercise disinterested and independent judgment
  - Directors and officers must avoid self-dealing and not abuse corporate opportunities for personal gain

- A disqualifying interest can exist because a director is “dominated” or “controlled” by a party interested in a corporate transaction

- Challenges to conflicts of interest can be cured by showing that an action was approved by a majority of disinterested directors who were properly informed of the conflict

- In addition, an independent director can be added to the Board providing additional guidance and protection

- Engaging with stakeholders is an important part of showing that directors and officers have pursued a good-faith attempt to act in the best interests of a company
JIM LOUGHLIN
National Practice Leader
Restructuring & Turnaround Services
BDO USA, LLP
Survival Mode
IMPLEMENT YOUR OPERATIONAL RESILIENCY PLANS

- Business Continuity
- Cyber Resilience
- Third Party Risk Management
- IT Disaster Recovery
- Insurance
- Crisis Management
- Liquidity Management

COVID-19: PREPARING FOR THE ECONOMIC IMPACTS OF A PANDEMIC
Liquidity Management

01 Create a cash-oriented culture

02 Maintain your liquidity position and manage cash

03 Take measures to reduce operating needs given cash constraints

04 Prepare a robust cashflow forecast

05 Perform multiple financial scenarios and update often

06 Use the Balance Sheet to create cash

07 Utilize the available government economic programs

08 Commence Lender discussions
The CARES Act

Individuals $560B

State & Local Governments $339.8B

Public Health $153.5B

Small Businesses $377B

Midsized & Larger Businesses $500B

Education/other $43.7B

Food Security $26B
Managing Lending Relationships

- Lenders are also in “crisis management mode”
- Open and honest communications are important
- Be prepared - realistic cashflow forecasts and revised business plans, clear requests
- Take action - don’t wait
- Retain professionals - legal and business
- The Challenge = Who will fund the cash needs of the business?
- Collateral, valuation, payment priority
- Negotiations likely will be difficult
- Not everyone will survive
What’s to Come

- After the COVID-19 threat dissipates, recovery likely slow
- The consumer has been severely damaged and likely will limit spending
- Stock market value down approximately 25% in March 2020 - trillions $$ in lost wealth
- The Federal deficit is expanding rapidly - more to come as tax receipts fall
- Slow recovery, recession is likely
Where Are We Going?
Debt Maturity Wall

Speculative Grade Debt maturities to step up as % of corporate debt through 2025 ($bn)

- Hundreds of billions of speculative grade debt will mature between 2020 to 2027
- Given the current credit environment, these companies will find refinancing efforts to be challenging

Source: MarketWatch “America’s ‘fragile’ corporate debt pile faces a massive $4 trillion refinancing test, Oxford Economics warns”
Business Resiliency and Recession Response Strategy
COVID-19 is the Latest Black Swan Event

“If we accept the idea of residual uncertainty, but believe we can survive and prosper by having a deliberate planning process that, over time, develops a set of contingency plans that can be called upon when needed, we have not fully appreciated the nature of the uncertainties we face.”

– Accept Reality and the Agility Imperative; David S. Alberts, Ph.D.; 2010
The Building Blocks of Bouncing Back

- Agility
- Flexibility
- Adaptation
- Innovation
- Prevention
- Responsiveness
3 Stages of COVID-19 Business Resilience
How Deep is the Fall, How Long the Rebound?

**ECONOMIC TIMELINE**

- Financial Performance
- Time

**ECONOMIC TIMELINE**

- Restricted Activity Begins
- "V"
- "U"
- "L"
- Activity Resumes

**PANDEMIC TIMELINE**

**FIGURE 1. Goals of community mitigation for pandemic influenza**

- Slow acceleration of number of cases
- Reduce peak number of cases and related demands on hospitals and infrastructure
- Reduce number of overall cases and health effects
- Pandemic outbreak: no intervention
- Pandemic outbreak: with intervention

Source: [CDC](https://www.cdc.gov)
How to Drive Breakaway Performance in a Downturn

Focus on the Bottom Line for Now

Cost Optimization
- Look for opportunities to negotiate discounts
- Unlock operational efficiencies by simplifying processes and reconfiguring supply chains
- Reduce IT costs by retiring unsupported applications and consolidating redundancies
- Leverage technology to automate processes, reduce labor costs and deploy resources elsewhere
- Avoid significant layoffs that damage morale

Productivity
- Tighten sales processes (filtering, funnel size, close rate, etc.) to improve salesforce productivity
- Financially incentivize and reward high-value employees
- Reduce time spent on admin and unnecessary “busy work”
- Increase internal education and upskill employees
- Take advantage of new digital tools to unlock new levels of productivity
How to Drive Breakaway Performance in a Downturn

MAKING THE RIGHT INVESTMENTS FOR THE FUTURE

Market Opportunity

- Give priority customers the “red carpet” treatment
- Upgrade your talent and make strategic hires
- Evaluate how competitors are performing and opportunities created by underperformance
- Make strategic acquisitions at a bargain
- Harness customer insight to address an unmet customer pain point
- Build brand goodwill by giving back to communities in need

Organizational Agility

- Reevaluate (or build) a future-state model
- Reengineer business processes to better leverage data to inform speedy, insight-backed decision-making
- Cultivate creative problem solving under pressure in leadership
- Train employees to recognize bias and use critical thinking to interpret disruptive change
- Don’t let planning become the enemy of doing
Urgent Tax Issues to Address COVID-19 Related Economic Uncertainty
ANDREW GIBSON
Managing Partner, Tax Technical Practice, Global Employer Services
National Leader
BDO USA, LLP
Agenda

- Coronavirus Aid, Relief, and Economic Security Act (CARES Act)
- Tax Strategies in a Down Economy
Refundable Tax Credit
- Eligible individuals will receive a refundable tax credit against their 2020 taxable income equal to $1,200 ($2,400 for joint filers) plus $500 per qualifying child
- The credit begins to phase out if the individual’s adjusted gross income (AGI) exceeds $75,000 ($150,000 for joint filers and $112,500 for head of household filers)
- The credit will be automatically advanced to eligible individuals based on the individual’s most recent income tax filing (2018 or 2019 tax filings)
- Individuals who have not filed a tax return in 2018 or 2019 may still receive an automatic advance based on their social security benefit statements (Form SSA-1099) or social security equivalent benefit statement (Form RRB-1099)

Waives the 10% early withdrawal penalty for distributions up to $100,000 from tax-qualified retirement plan accounts for coronavirus-related purposes during 2020

Increases 401(k) Loan limit from $50,000 to $100,000 for 2020
CARES Act
SBA LOANS AND UNEMPLOYMENT INSURANCE

► Paycheck Protection Program - Small Business Administration (SBA) Loans
  o SBA Loans for Employers with 500 or fewer employees
  o Up to 2.5 times payroll costs with maximum loan of $10 million
  o Loan is forgivable to the extent employees are still employed at June 30, 2020 and compensation is not reduced more than 25%
  o Many, many unanswered questions - affiliated companies, foreign owners, payroll costs period, impact of rehiring workers

► Unemployment Insurance
  o Many different provisions that provide increased benefits, etc.
CARES Act
CASH FLOW HELP THROUGH PAYROLL

Employee Retention Credit

- Is a refundable payroll tax credit for employers who are harmed by COVID-19, but retain their employees. Equal to 50% of qualified wages (capped at $10,000) paid to employees between March 12, 2020 and December 31, 2020. Maximum available credit is $5,000 per employee (50% of $10,000)

- Employers qualify for the credit if:
  - Their operations were fully or partially suspended due to a COVID-19 related shutdown order, or
  - Their gross receipts for the quarter were less than 50% of the gross receipts for the same quarter in the prior year

- Employers with more than 100 full-time employees (on average in 2019) would only receive the credit for wages paid to employees who are not working. Employers with 100 or fewer employees would receive the credit for all wages paid to employees

- Any employer who receives a PPP loan is ineligible to receive this credit
CARES Act
CASH FLOW HELP THROUGH PAYROLL

Delay Social Security Tax
► Permits employers to defer payment of the employer portion of Social Security tax (6.2%) that would otherwise be due and payable through December 31, 2020
► Employers would be required to pay 50% of the deferred amount on or before December 31, 2021, with any remaining amount paid on or before December 31, 2022
► Self-employed individuals would be eligible to defer 50% of self-employment Social Security tax payments
► Taxpayers who have a PPP loan forgiven are ineligible for this deferral
CARES Act
HELP FOR BUSINESSES

- IRS Form 4466 allows corporations that have overpaid estimated taxes for the prior taxable year to apply for a quick refund of the overpaid taxes where the overpayment is at least 10 percent of the expected tax liability and at least $500
  - Form 4466 is due by the original due date of the corporate return (i.e., excluding extensions)
  - Due April 15, 2020, for calendar-year corporations – the Coronavirus IRS relief does not apply to postpone the due date of Form 4466

- IRS Form 1138, extension of time for payment of taxes by a corporation expecting a net operating loss carryback due by April 15, 2020
CARES Act
HELP FOR BUSINESSES

► 5-year carryback for Net Operating Losses (NOL) in taxable years beginning after December 31, 2017, and before January 1, 2021
  o Carryback from a 21 percent federal rate NOL back to a 35 percent federal rate year (pre-2018)

► Any remaining corporate AMT credit is fully refundable for the tax year beginning in 2019 or a taxpayer may elect to make the credit fully refundable for the tax year beginning in 2018

► Delays the limit on annual deduction for net business losses of non-corporate taxpayers until calendar year 2021
  o Annual maximum for 2018, indexed annually for inflation, is $500,000 for married filing jointly and $250,000 for all other taxpayers
Interest expense deduction limitation relief: Solely for taxable years beginning in 2019 and 2020, taxpayers may deduct business interest expense up to 50% of ATI, an increase from 30% of ATI under the TCJA.

- In the case of partnerships, the increased limit from 30% to 50% of ATI does not apply to taxable year beginning in 2019, but it does apply to taxable year beginning in 2020.
- Also, 2019 ATI can be used for 2020 (Taxpayer friendly since 2019 ATI is likely higher than 2020).

Depreciation “glitch” correction: Qualified Improvement Property (QIP) placed in service after 12/31/17 is treated as 15-year property and eligible for bonus depreciation - was originally 39-year property.

Need to be mindful of:
- Differences between Federal tax rules and State tax rules.
- Tax accounting provisions will be impacted immediately for public companies for many of these items.
- If the partnership has extended its calendar year 2019 tax return, it may file a superseding return until September 15, 2020.
Cash to Employees, IRC Section 139
“QUALIFIED DISASTER PAYMENTS”

**Taxation**
- Federal tax-free to employees with no federal reporting or disclosure
- Deductible by the employer
- State income tax treatment is generally the same as federal, but qualified disaster relief payments may be treated as “wages” for state unemployment insurance tax contributions

- No cap, limit or maximum allowed amount

**Definition:** Payments that are not otherwise reimbursed by insurance made by an employer to an employee that are reasonably expected by the employer to reimburse or pay reasonable and necessary personal, family, temporary living, or funeral expenses incurred as a result of a qualified disaster

**May NOT Include:**
- Wage replacement (such as paid sick or other leave) would not be covered by Section 139, so such payments would still be taxable wages and would remain subject to income and payroll tax withholding and reporting.
- Non-essential, luxury, or decorative items or services

**No written plan is required, but it is advisable**
State and Local Taxes
IMMEDIATE CONSIDERATIONS

► Review for potential overpayment of sales and use tax on purchases that qualify for state and local exemptions from tax
  o Changes in state tax laws, changes in vendors, and changes in Company personnel handling purchases and accounts payable result in overpaid tax
  o Tax rates on purchase costs can exceed 10 percent

► Look for tax credit and incentives opportunities
  o Refundable income tax credits
  o Refund reviews for credits
  o Utility incentives
  o Sales and property tax incentives
  o Cash grants for Training

► Property tax issues
  o 2020 compliance deadline delays?
  o Remaining appeal deadlines
  o Subsequent property tax lien dates
**International Tax**

**IMMEDIATE CONSIDERATIONS**

- Taxpayers that plan to repatriate cash from their Controlled Foreign Corporations (CFCs) will need to review the relevant rules relating to distributions to determine the appropriate characterization of the distribution as well as the corresponding tax implications (e.g., taxable vs. non-taxable distribution, foreign currency exchange gain/loss implications, etc.)

- Taxpayers that plan to have their CFCs make loans to them will need to consider the tax consequences of such loans

- Taxpayers that plan to repatriate cash from their foreign branches or fiscally transparent entities (e.g., foreign disregarded entities) will need to consider the tax implications of such distributions

- Profit Split: Companies employing a profit split methodology typically set transfer prices based on projections and then book a “true-up” monthly, quarterly, and/or at year-end. When actual results differ significantly from projections, true-ups can become significant. This in turn can have a variety of negative effects, including on customs and/or BEAT calculations. Companies should update their profit split calculations as soon as possible to minimize true-ups
Customs and VAT
IMMEDIATE CONSIDERATIONS

- U.S. Customs & Border Protection ("CBP") is accepting requests for duty-payment extensions.

- The U.S. has relaxed tariffs and restrictions on products necessary to combat this outbreak. Some of these exclusions cover medical devices and products, including sanitary wipes, medical gloves, face masks, surgical gowns and other items that are needed in the fight against COVID-19. Along with several other products, these will be exempt from the Section 301 "China tariffs."

- Many countries are following the OECD’s suggestion to allow deferment of import VAT.

- Numerous countries have announced or implemented provisions providing businesses with filing/payment deadline extensions.

- Many countries have announced plans to reduce or waive late filing/payment penalties and interest charges for businesses affected by the crisis in addition to all VAT audits being halted. Poland will also delay the introduction of its SAF-T VAT reporting requirement.
A small number of countries have announced plans to speed up refunds of VAT
- Australia: is allowing businesses that normally file on a quarterly basis to opt into monthly reporting to get quicker access to GST refunds

Many countries have announced VAT rate decreases on certain goods and services to encourage spending by businesses and consumers
- Norway: VAT rate on public transport, cinema, sporting and cultural events will be decreased from 12% to 8%
- China: cut the VAT rate on medical services, medical necessities like masks and protective clothing, catering, accommodation and public transport
- Jamaica: plans to reduce its standard rate from 16.5% to 15%
Financial Reporting Considerations
Financial Reporting Considerations

### Expected Near Term Impacts

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<th>Debt and Debt Related Issues</th>
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| ▶ Update of variable consideration estimates  
▶ Customer collectability  
▶ Material rights | ▶ Long-lived and intangible assets  
▶ Order of testing  
▶ Estimates and forecasts | ▶ Modifications and extinguishments  
▶ Covenant compliance, defaults and classification | ▶ Subsequent events  
▶ MD&A  
▶ Material rights | ▶ Going concern  
▶ SEC filing relief  
▶ Private company financial statement extensions |
LONG-TERM IMPLICATIONS
- Adoption of new standards
- Headcount reductions
- Internal control related impacts

OPPORTUNITIES
- Right sizing of organizations
- Divestitures
- Business combinations
Income Tax Accounting
MICHAEL WILLIAMS
Income Tax Provision Services (ASC 740)
Partner & National Practice Leader
BDO USA, LLP
Income Tax Accounting (ASC740) Considerations

EXPECTED IMPACT TO FORECASTS

▶ Valuation allowance considerations
  o Discrete vs. Annual Effective Tax Rate ("AETR")

▶ Operating losses
  o Possible interim limitation on benefit (eliminated once ASU 2019-12 is adopted)
  o Possible valuation allowance considerations

▶ Losses and gains in different financial statement components
  o Benefit of a loss in continuing operations with a gain in other FS component despite being in a valuation allowance
  o ASU 2019-12 would eliminate this result

▶ Forecasts should be consistent with other areas (e.g., impairment testing)

Note: If adopting ASU 2019-12, would adopt all provisions upon adoption
Income Tax Accounting (ASC740) Considerations

- Potential impacts to foreign earnings and cash flows
  - Pressure on companies’ indefinite reinvestment assertion
  - Potential to record additional foreign withholding taxes, state taxes, and currency impacts of previously taxed earnings.

- Impacts to Annual Effective Tax Rate
  - Impairment charges - discrete vs. AETR
  - Share based compensation - Discrete impact - impact to taxable income projections
  - Jurisdictional losses - Possible exclusion from AETR and separate calc.

- Implications of CARES Act
Income Tax Accounting (ASC740) Considerations

CARES Act - March 27, 2020

- Change in tax law - recognized in period of enactment
- Net operating loss carrybacks
  - Losses generated in 2018-2020 may be carried back 5 years and no (80%) limit
  - ETR vs. discrete?
  - 35% vs. 21%
- Interest deductibility limitation (163(j))
  - Increased from 30% to 50% of “adjusted taxable income”
  - ETR vs. discrete?
- State tax implications - Conformity vs. nonconformity
- “Best Estimate” required - No relief (e.g., SAB 118 - TCJA)
CARES Act Funding
TOM STRINGER
Corporate Real Estate Advisory
Managing Director - Site Selection & Incentives
BDO USA, LLP
How to Access Direct Cash Assistance in the CARES Act

TWO FUNDING OPTIONS

500 Jobs or less (Paycheck Protection Program, PPP)
- SBA 7(a)
- 2.5 times payroll capped at $10 million
- Program is open as of April 3 and run by SBA thru approved banks
- Payroll portion is forgivable upon application
- Requirement to maintain employment through 6/30/2020

More Than 500 Jobs
- Distressed businesses $454 billion in loans from the US treasury
- Not forgivable
- Guidelines anticipated from US Treasury week of 4/6
- Larger than SBA, uncapped
- Requirement to maintain employment through 9/30/2020
Potential State Action

- Likely to be grants or credits for employee retention
- Will be dependent on Federal Aid, CARES Act allocates $125 billion to the states but sets minimums of $1 billion per state with the balance allocated on population.
  - States are likely to exhaust this to cover immediate cash needs (Virus response and budget gaps)
- Second stimulus likely required to back states
- NY - History after 9/11
- AZ, FL, SC, OH, NJ, CA, NJ and PR are all discussing additional business aid