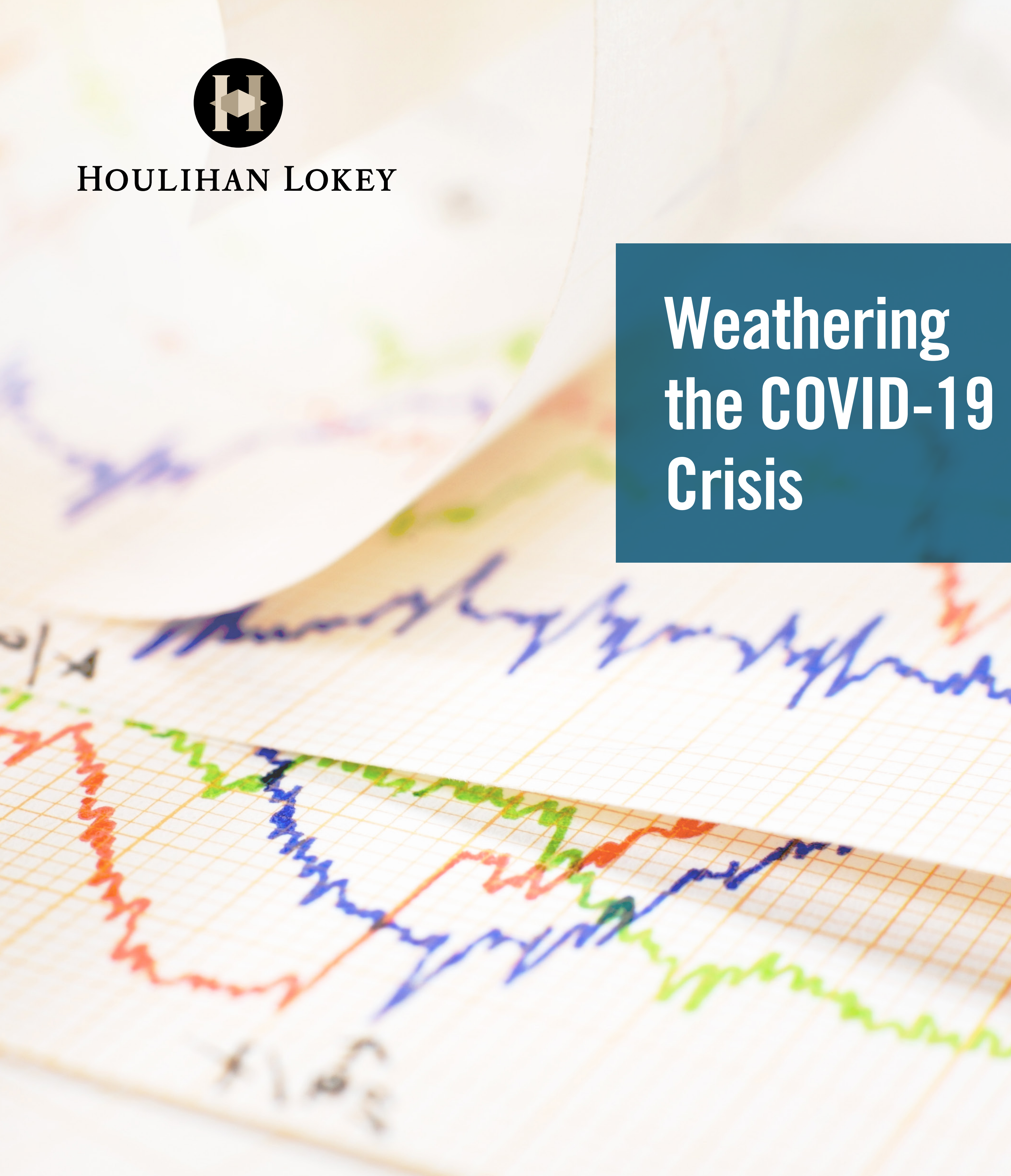
SPOTLIGHT ON **COVID-19**

HOULIHAN LOKEY

Weathering the COVID-19 Crisis



Weathering the COVID-19 Crisis

Turning to Significant Stockholders for Support May Carry Substantial Benefits, but Navigating to a Safe Harbor Requires Careful Steering

The significant economic dislocation and sustained market volatility caused by the COVID-19 crisis are causing certain companies to seek financial support from the most familiar sources—significant existing investors. Amid the current backdrop, such investors may be the only viable sources of critical and timely financial support.

While the COVID-19 crisis presents unique challenges relative to the 2008 financial crisis, certain key themes are likely to reemerge, including an uptick in the following types of transactions:

- Related party financings/recapitalizations to shore up the balance sheet, address liquidity constraints, or pursue opportunistic acquisitions or initiatives
- Related party mergers
- Significant stockholder-led take-privates

Turning to a significant stockholder in the company's existing investor base can be a highly attractive option for a number of reasons. Familiarity with the company limits such investors' need for diligence, bringing unmatched speed and efficiency, as well as lower execution risk, to the equation. In addition, continued economic and market turmoil will limit the potential for alternatives available to the company as many capital sources remain on the sidelines. Finally, significant stockholders typically have the most proverbial skin in the game and, as a result, are the most motivated to ensure the company's long-term viability. This can be a helpful consideration to keep in mind, particularly in situations where stockholders retain equity.

That said, related party transactions raise the specter of potential self-dealing and, with it, increased risk of litigation and judicial scrutiny. Other stockholders, especially with the benefit of hindsight, may contend that the significant stockholder exploited temporary market volatility to extract overly favorable terms.

As fiduciaries of unaffiliated stockholders, directors must create a process to oversee this type of transaction that allows for both thoughtful engagement in the balancing act between addressing near-term challenges and preserving long-term shareholder value, as well as objective decision-making.

A process that most effectively accomplishes these objectives, while also mitigating litigation risk, typically starts with the formation by the board of a special committee solely composed of independent directors to oversee a related party transaction. The special committee should be appropriately compensated for the time its members will need to devote to proper oversight and should be fully empowered to retain its own legal and financial advisors to assist in establishing a record of a deliberate, careful, and fair process.

Specific considerations that independent directors face in the current environment include:

- Is now the appropriate time to engage in a transaction, or are there other alternatives that should be considered (i.e., asset sales, cost-cutting measures, etc.)?
- How do you assess whether deal economics are consistent with “market” given substantial volatility, the meaningful increase in yields, and limited precedents in the current environment?
- What other challenges do business, economic, and market dislocation create in the context of valuation or appropriate economic terms (i.e., developing financial projections, etc.)? What specific creative structuring mechanisms can help address valuation uncertainty in your particular situation?
- Does a potential proposal from a significant stockholder trigger presigning disclosure obligations (i.e., amendment to 13D filing), and if so, how can these disclosures impact the stock price and negotiations?
- Does it make sense to condition a related party transaction on giving unaffiliated stockholders the right to participate or a vote of a majority of unaffiliated stockholders, or does it make more sense to effectively trade procedural protection for better economics and/or expedited execution?
- How do you set an appropriate procedural record when time is of the essence?

These are among the many questions that special committees must navigate in conflict-prone situations amid the significant uncertainty and rapidly evolving dynamics surrounding transactions. Houlihan Lokey has significant experience advising boards and special committees across cycles and stands ready to assist you or answer any questions that you may have.

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