CORPORATE ADVISORY NEWS

JULY 2017

INTRODUCTION

Welcome to the July edition of Corporate Advisory News. Since our last issue Article 50 has been triggered and we have been through a snap general election. The uncertainty that preceded these events still remains as the Conservatives have reached a deal with the DUP to form a minority government and Brexit negotiations are in their very early stages. As we said a year ago, uncertainty is our only certainty. So how does this uncertain climate impact on the transactional marketplace and what steps can be taken to make a success of it? Our panel of experts have advice, opinions and case studies to share within this newsletter that we are sure will be of topical interest.

We start with an article by our new Corporate Finance Director, Mike Orton, who joined our Corporate Advisory team in May 2017. Mike provides advice and tips for those considering selling a business.

Despite the economic uncertainty, entrepreneurs are still building business at an impressive rate and Ross Lane has written an article with practical advice on what can be done to help start-ups.

A Company Voluntary Arrangement (CVA) is an agreement to compromise unsecured creditor's claims, allowing a company to continue trading or otherwise and settle debt on deferred terms. Henry Page provides a case study which demonstrates how a CVA was used to good effect and how success can follow from taking decisive action in difficult times.

Phil Fenn examines the alternative sources of funding for SME's to grow their businesses as it has been widely reported that obtaining funds from traditional sources has become more challenging in the current climate.

New legislation affecting tax treatment when winding up a company poses questions that as yet remain unanswered. Cathy Corns highlights the issues and advises on steps which can be taken to put you in a position of strength.

I examine the recast European Insolvency Regulation and what this new piece of European legislation means for UK businesses. Whilst Peter Godfrey-Evans looks at the new Insolvency legislation that was introduced earlier this year, which aims to improve creditor engagement and communication, and to remove the administrative burden throughout.

We hope you enjoy the content and as always, please do get in touch with me or your usual partner should you wish to discuss anything that has arisen here in more detail.

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IN THIS ISSUE:

GEARING UP TO SELL A COMPANY

ACQUIRERS CAN OFTEN BUY BUSINESSES FOR LESS THAN THEIR REAL VALUE BY IDENTIFYING HIDDEN UPSIDES AND ELIMINATING UNNECESSARY COSTS. PREPARING A BUSINESS FOR SALE CAN INCREASE THE VALUATION PUT ON IT BY PROSPECTIVE PURCHASERS AS A SELLER CAN PRESENT THEIR BUSINESS IN ITS BEST POSSIBLE CONDITION.

Sellers should start preparing a business for sale over a period of time, typically at least two years. A relatively straightforward way to enhance the value placed on a business is to cut investment in parts of the business that add little in terms of business valuation and spend more on those that enhance the company in the eyes of a prospective purchaser. In addition, sellers should review the strategic direction of the business so that it is best positioned in the market. These initiatives can improve profitability in time for a sale but also the longer-term strategies should be reviewed which will lead to additional profit by the sale date. Other potential practical issues should be considered and dealt with, such as extracting any assets that will not form part of the sale (e.g. property), how will the business be sold (typically a sale of shares or assets) and carrying out the sale in the most tax efficient way.

> "SELLERS SHOULD REVIEW THE STRATEGIC DIRECTION OF THE BUSINESS SO THAT IT IS BEST POSITIONED IN THE MARKET."

In the lead up to begin a sale process, sellers should consider obtaining an official valuation from an external accountant/corporate adviser in order to understand the realistic value of their business. In addition, the financial and legal records of the business should be reviewed so that they are ready for a rigorous due diligence process. Again, it could be beneficial to engage a specialist adviser to assist the business in preparing for financial and tax due diligence in order to help protect value during the negotiations. Typical areas where a buyer can attempt to erode the valuation is around working capital and the definition of debt like items in a traditional cash-free debt-free deal.

Whether the acquirer is likely to be a corporate, private equity house or management team, our Corporate Advisory team has dedicated corporate finance experts who have experience in helping businesses prepare for sale, the valuation of businesses and the due diligence process. They are supported by the firm's Corporate and Business Tax team, who ensure any potential obstacles are identified and dealt with.

IF YOU WOULD LIKE TO DISCUSS ANY ASPECT OF SELLING A COMPANY, PLEASE GET IN TOUCH WITH MIKE ORTON OR A MEMBER OF OUR CORPORATE ADVISORY TEAM.

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HELPING START-UPS

ACCORDING TO RESEARCH UNDERTAKEN BY THE CENTRE FOR ENTREPRENEURS (CFE), BUSINESS FORMATION REACHED A RECORD HIGH IN 2016 WITH MORE THAN 650,000 NEW BUSINESSES HAVING BEEN STARTED IN THE UK COMPARED TO 608,000 IN 2015.

Furthermore, the UK's small and medium-sized business community is expected to increase its total economic contribution to over £200bn by 2020.

So it is clear that fast-paced, innovative and tech-savvy companies will be at the heart of our future economic growth, but to be successful it is vital that the country's entrepreneurs are allowed to do what they are good at – come up with new and exciting ideas and deliver them to their target markets rather than be distracted by the operational and administrative demands that will inevitably demand their attention.

A range of matters need to be considered from the outset including:

- Choosing an appropriate legal structure - the most common choice is to form a limited company so as to safeguard personal assets, attract available tax reliefs and protect intellectual property. Other structures may be more appropriate depending on specific circumstances so legal and financial advice should be sought.

- Considering fundraising strategies and proposed sources of finance – there is an increasingly wide variety of methods available with which to fund a new venture, including the founders themselves, friends and family, angel investors, banks, corporate investors and crowd funding. Being well networked with the investment community will give entrepreneurs a head-start in getting their venture off the ground.

- Ensuring that available tax reliefs are available to potential investors – tax incentives such as EIS (Enterprise Investment Scheme) and SEIS (Seed Enterprise Investment Scheme) are in place to encourage investment in start-up businesses and provide significant savings on successful exits. However, the rules are complex and tax planning advice should be sought from the very start.

- Ensuring appropriate financial resource to support the business – advances in technology mean that new start-ups now regularly operate with a 'virtual' finance team. A part-time Finance Director with experience of helping start-ups is a valuable way of getting the required advice without having to offer permanent contracts. Many growing businesses also now use a cloud accounting solution such as Quickbooks or Xero to provide real time financial information in order to make timely commercial decisions whilst ensuring that routine compliance matters such as filing annual accounts and tax returns can be dealt with quickly and efficiently.

- Remuneration and reward – in the early stages of a start-up, a lot of blood, sweat and tears will be expended for little or no immediate financial reward. It is therefore important to make sure that key management and employees are suitably incentivised to hit growth targets. Often share options are issued to those key individuals which vest when specific milestones are reached, e.g. a company sale or stockmarket floatation. Most commonly these options are offered under an Enterprise Management Incentive (EMI) scheme and offer significant tax savings if eligible.

At Mercer & Hole we have the experience and expertise in providing advice on all of the above and pride ourselves on matching the energy and enthusiasm of the management team.

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COMPANY VOLUNTARY ARRANGEMENTS: A SUCCESS STORY

OUR CORPORATE ADVISORY SERVICES TEAM APPLIED ITS CROSS DISCIPLINE RESTRUCTURING, TAX AND CORPORATE FINANCE EXPERTISE TO ASSIST A CLIENT TO RESTRUCTURE ITS OPERATIONS IN THE FACE OF DEBTS IN THE REGION OF £3M. IN ADDITION TO CREDITOR PRESSURE, THE BUSINESS FACED THE THREAT OF LOSING SEVERAL SERVICE CONTRACTS WHICH WOULD NOT ONLY GIVE RISE TO SIGNIFICANT CLAIMS AGAINST THE COMPANY, DILUTING THE RETURN TO CREDITORS, BUT WOULD LEAVE THE BUSINESS WITH A MUCH LOWER AND UNSUSTAINABLE LEVEL OF INCOME.

Having worked closely with the board to assess the company's financial position, an initial Time-To-Pay (TTP) arrangement with HMRC was agreed, and replacement finance was sourced to cover an exiting secured creditor. Ultimately the pressure told and cashflow forecasts identified that the company was expecting to breach the TTP, which would prompt HMRC to commence winding up proceedings if no action was taken.

Acting proactively, we were able to advise the directors in relation to their potential exposure to wrongful trading, to assess the options available to the company and ultimately assist with the drafting of a Company Voluntary Arrangement (CVA). It was identified that the CVA could provide the break in creditor pressure and release of cash to implement the reorganisation the directors knew was necessary. A decentralisation of operations, moving from cost centres with centralised overhead, to regional profit centres incentivised to maximise profits and generate additional income, freed local management to realise the potential at a regional level delivering increased profits centrally.

The CVA therefore needed to include an incentive structure for the regional managers which would be palatable for creditors in order for the reorganisation to deliver the benefits which would allow budget forecasts to be achieved. The reduction in head office cost also provided a significant saving to the bottom line.

After reviewing the financial forecasts, and setting out a detailed explanation of the reorganisation and revised corporate structure, the draft CVA was delivered to, and approved by, the board for circulation to the creditors. In order to provide an incentive to the directors and management, the CVA included a 'profit-pool' equating to 15% of the profit after tax from which local management may receive bonuses if budgets are met and the agreed return to creditors achieved. The profit-pool increases where budgets are exceeded and the duration of the CVA period will reduce if payments can be accelerated, resulting in the early repayment of creditors.

With 14 days' notice of the creditors' meeting to consider the approval of the proposals, there was a period during which creditor expectations had to be managed, requiring the business to operate on a cash basis so as to maintain operations but not incur new credit. The company continued to trade through the notice period and over 98% of creditors approved the proposal. The company has enjoyed the support of the existing secured creditor which has continued to provide invoice discounting. In addition, HMRC approved the CVA. The formulation of the CVA and the information provided to creditors clearly set out why the CVA was desirable, realistic and achievable.

The company continues to trade, has retained its service contracts, complied with the terms of the CVA, and continues to work with its accountants to ensure ongoing compliance with the provision of management and annual accounts as set out in the CVA proposal.

Conclusion

CVA's offer the potential for genuine restructuring, approved by the creditors, while directors and shareholders retain control of, and a financial interest in the ongoing entity. The terms of a CVA are bespoke to each client's circumstances, and anticipate a return to creditors which will exceed that they may otherwise reasonably expect. There are clearly difficulties with proposing a CVA, for example winning the support of secured creditors, ensuring that the creditors approve the proposal and continuing to trade through the notice period. However a well drafted proposal will minimise the disruption caused to the business and will maximise the prospect of continuing trade and professional relationships.

Our focus is on preserving, protecting, and maximising value which is often best achieved through the continuation of trade. Where this can be achieved without the necessity of a formal insolvency process we will work to achieve a pre-insolvency solution. However, where circumstances conspire to prevent a solvent turnaround, a CVA is a flexible and proficient tool to be used in delivering value to all affected stakeholders.

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ALTERNATIVE SOURCES OF FUNDING FOR YOUR BUSINESS

AN ESTABLISHED, WELL RUN AND PROFITABLE SME WITH A CLEAR STRATEGY SHOULD BE ABLE TO OBTAIN FUNDING, HOWEVER IT IS WIDELY REPORTED THAT SME'S ARE STRUGGLING TO ACCESS THE FUNDING THEY REQUIRE TO FINANCE GROWTH. THIS MAY BE COMPOUNDED BY THE RECENT GENERAL ELECTION AND RESULTING ECONOMIC AND POLITICAL UNCERTAINTY.

At £1.8 trillion, SME's in the UK contribute almost half of the private sector turnover and provide 60% of employment. Reflecting the importance these organisations have on prosperity, alternative financing sources, including established forms such as lease finance, invoice discounting and new forms such as crowdfunding are gaining popularity. This is because they offer borrowers greater choice and flexibility regarding the source and structure of funding, which traditional borrowing struggles to match.

As interest rates on traditional savings products have plummeted, we have witnessed the rise in prominence of crowdfunding, both as a viable source of finance for businesses and a source of enticing returns for investors. This has led the market to grow to approximately £3.2 billion during 2016.

> "WE HAVE WITNESSED THE RISE IN PROMINENCE OF CROWDFUNDING, BOTH AS A VIABLE SOURCE OF FINANCE FOR BUSINESSES AND A SOURCE OF ENTICING RETURNS FOR INVESTORS."

Crowdfunding, which usually takes place on a website platform, is a broad term which encompasses a number of forms, primarily:

Equity-based
This allows investors to buy equity in a business, from as little as £10, with returns realised through dividends or upon eventual sale of the business. Businesses looking for funding apply to online platforms such as Seedrs, who list the opportunity and administer the process of issuing share certificates, handling voting rights etc.

Debt-based
This works in a similar manner to equity-based crowdfunding, but instead businesses offer investors the chance to loan monies, typically in return for a fixed rate of interest. The online platforms have proved popular as they match investors prepared to accept an element of risk in return for a much higher rate of interest than that offered by banks. The businesses raising finance are typically early stage businesses or SMEs who for various reasons may struggle to raise bank lending.

Other crowdfunding
Although most platforms are focussed on traditional debt or equity opportunities, niche crowdfunding websites are also emerging, including those offering invoice discounting or factoring facilities through to philanthropic sites that provide opportunities to invest in community enterprises and goodwill projects.

Mercer & Hole's Corporate Finance department has a strong network of connections with both traditional and alternative finance providers.

IF YOU REQUIRE ASSISTANCE RAISING FINANCE, PLEASE CONTACT PHIL FENN OR YOUR USUAL MERCER & HOLE CONTACT.

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UNCERTAIN TIMES FOR WINDING UP TRANSACTIONS

THE CURRENT FOCUS ON PREVENTING TAX AVOIDANCE TO MAKE SURE EVERYONE PAYS THEIR FAIR SHARE IS UNDERSTANDABLE BUT ANY LEGISLATION THAT IS DRAFTED ON A WIDE-RANGING BASIS CREATES UNCERTAINTY FOR PEOPLE WHO SHOULD NEVER BE AFFECTED BY THE PROPOSALS. THE NEW PROVISIONS ON LIQUIDATION DISTRIBUTIONS IS A CASE IN POINT. A COMPLICATION IS THAT THE RECIPIENTS OF THOSE DISTRIBUTIONS HAVE TO DECIDE ON WHETHER OR NOT THEY ARE CAUGHT AS THE REQUIREMENT IS FOR THE TAX TO BE PAID VIA THE NORMAL SELF-ASSESSMENT RETURN. THERE IS NO CLEARANCE PROCEDURE AND HMRC'S DETAILED GUIDANCE IS NOT YET PUBLISHED.

The desire may be to stop people running one-person companies for three years with salaries and dividends up to the tax free amount and then winding up with all retained profits being taxed at a 10% capital gains tax rate. However, unfortunately the new legislation catches rather more people than just that group.

Under the new law distributions on a winding up are potentially taxed as income not capital where the company was controlled by five or fewer people; the recipient held at least 5% of the share capital and within two years of the distribution the individual or a person connected with them carries on a trade or activity similar to that previously carried on by the company. Those tests would catch a lot of distributions but at least are factually based so the answer is clear. Unfortunately the final test that provides a let out (or not) is rather more subjective – "it is reasonable to assume that the avoidance or a reduction of income tax is a main purpose of the transaction"

HMRC has offered some examples, details can be found on the ICAEW website.

The best advice is to keep records and evidence. Take minutes of meetings discussing why the company needs to be wound up and the commercial reasons for this. Follow up discussions by email and keep a paper trail – contemporary evidence is much more convincing than unsubstantiated recollections. In addition, take professional advice which also helps to demonstrate that you have done all you can to arrive at the right answer if challenged by HMRC.

"THE BEST ADVICE IS TO KEEP RECORDS AND EVIDENCE."

TO DISCUSS THIS FURTHER PLEASE GET IN TOUCH WITH CATHY CORNS OR YOUR USUAL MERCER & HOLE CONTACT.

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RECAST EUROPEAN INSOLVENCY REGULATION

ON 26 JUNE 2017, A WEEK AFTER THE START OF BREXIT NEGOTIATIONS, A NEW PIECE OF EUROPEAN LEGISLATION TOOK EFFECT IN THE UK AND THROUGHOUT THE 28 MEMBER STATES (WITH THE EXCEPTION OF DENMARK, WHICH HAD OPTED OUT). THE RECAST EUROPEAN INSOLVENCY REGULATION (REGULATION (EU) 2015/848) REPLACES THE ORIGINAL EUROPEAN INSOLVENCY REGULATION (REGULATION (EC) NO. 1346/2000).

What does this mean for UK businesses? Firstly, the purpose of the regulation is unchanged. Insolvencies with cross-border elements, i.e. those with assets or liabilities located in different member states, are recognised and effective throughout the EU. The regulation is the mechanism for achieving this.

The concept of Centre of Main Interests (COMI), which determines which member state's insolvency laws predominate, is changed only in minor detail through setting in statute a definition developed through case law.

Usefully, secondary proceedings (those over foreign branches) no longer have to be winding up proceedings, making it much easier to use administration in the UK in cross-border restructuring. So-called synthetic secondary proceedings, where creditors whose claims would be preferential in local proceedings have those priority rights recognised in the foreign main proceedings, are now universally feasible, rather than only in UK main proceedings. This might help UK-based employees of foreign companies

"USEFULLY, SECONDARY PROCEEDINGS (THOSE OVER FOREIGN BRANCHES) NO LONGER HAVE TO BE WINDING UP PROCEEDINGS, MAKING IT MUCH EASIER TO USE ADMINISTRATION IN THE UK IN CROSS-BORDER RESTRUCTURING."

More significant changes come in the area of group insolvencies, a concept previously unknown in English law. Courts and insolvency practitioners are now required by the regulation to communicate and cooperate in relation to insolvencies of group companies. In addition, the regulation introduces group co-ordination proceedings, where an independent insolvency practitioner is appointed to coordinate the insolvencies of the group companies.

Finally, by 26 June 2018, member states (including the UK) will have to establish and maintain national registers of insolvency proceedings. Brexit seems likely to mean that the UK won't have to connect to the other member states' registers by 26 June 2019!

IF YOU WOULD LIKE TO DISCUSS ANYTHING RELATED TO EUROPEAN INSOLVENCY REGIMES, PLEASE DO GET IN TOUCH.

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INSOLVENCY RULES 2016 - INTERACTION WITH CREDITORS

New Insolvency legislation was introduced on 6 April 2017 with a view to increasing creditor engagement, improve creditor communication and remove administrative burdens for all. What are the key changes to look out for?

The main headline is that Insolvency Practitioners are no longer able to choose to convene meetings of creditors, where creditors can attend in person. However, if sufficient creditors require such a meeting, they can notify the Insolvency Practitioner, who will be required to convene one.

Instead Insolvency Practitioners are provided with a number of decision making procedures which include the use of correspondence, electronic voting and virtual meetings. Virtual meetings, with creditors attending by way of telephone or video conferencing link, will often replace the old 'Section 98 Meeting' in creditors' voluntary liquidations.

Insolvency Practitioners also have the option to pass most resolutions by 'deemed consent', creditors are given a deadline by which to object. If less than 10% of creditors object then the resolution is deemed to have been passed. Certain decisions such as the approval of office holder's remuneration and the voluntary arrangements cannot be done using the deemed consent procedure.

Final meetings at the end of a liquidation or bankruptcy have also been confined to the history books, they are replaced by a final report. The office holder will obtain his release unless creditors make a valid objection prior to the deadline they have been notified of.

Electronic communication is encouraged with an increasing amount being done via websites. Creditors will receive reports via the office holder's website and in due course are likely to have the ability to enter details of their claims with supporting data to the website for consideration. Where debts are less than £1,000 then proofs will no longer be required. Creditors can also opt out of receiving most correspondence should they so desire.

It will be a while yet before we know whether the intended objectives have been met, in the meantime if we can assist with regard to the changes or any other restructuring matter please do not hesitate to contact us.

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