CORPORATE ADVISORY NEWS

MARCH 2018

INTRODUCTION

Welcome to our latest edition of Corporate Advisory News. As Editor, it struck me that the diversity of articles we have for this issue is indicative of the breadth of services our Corporate Advisory Services team offers, incorporating both corporate finance and corporate restructuring expertise. We hope they provide you with useful information and an insight into ways in which we may be able to assist you and your business in future.

During the course of last year, we were privileged to be able to advise and assist a distribution company struggling with disruption to their business. Like many other businesses, they had become victim of technological advances which had altered the course of their core operations. Fortunately when the company reached a crisis point they took early action in seeking advice. Whilst the situation initially looked bleak, there were positive opportunities and we looked for a solution which would bring these to the fore. Here, we provide a detailed case study, which shows how a business facing a changing landscape was able to adapt to protect value and jobs.

Mike Orton provides the merits of vendor assistance and vendor due diligence, advising stakeholders to take more control when selling their businesses. Mike outlines how this can improve the prospects for a higher selling price, reducing the risk of uncertainty for the buyer, whilst also creating less disruption for the business as it continues to trade.

Steve Smith and David Hadley join forces to bring us information on the new legislation surrounding disguised remuneration schemes in their article on Employee Benefit Trust (EBT) loans. They outline HMRC's stance and the need for a proactive plan if it is believed that tax may be due.

Chris Laughton and Tom Pollard look at the Accelerated M&A process and how this can be used to secure the successful sale of the business in challenging times.

Finally, I hope our articles provide you with useful information and stimulate thought at whatever stage you are at in your business lifecycle. If you read anything here which resonates with you and you require further information, we would welcome you to get in touch.

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IN THIS ISSUE:

DISRUPTION IN DISTRIBUTION

WITH THE ADVENT OF VIRTUAL CONTENT, LOGISTICS FIRMS ASSOCIATED WITH THE STORAGE AND DELIVERY OF PHYSICAL ENTERTAINMENT MEDIA CAN FIND THEMSELVES LEFT BEHIND. THE PROBLEMS FACING CERTAIN PARTS OF THE MARKET WERE LAID BARE DURING A RECENT ASSIGNMENT CONDUCTED BY OUR CORPORATE ADVISORY TEAM.

SUMMARY OF COMPANY POSITION	
UK Entity Turnover:	£22.8m
UK Employees:	272
Estimated deficit to creditors:	£21.3m
Anticipated distribution rate:	0.2p in the £
Subsidiaries in France and Germany	

The company's circumstances included break up of the associated European group (insolvency proceedings were opened for group companies in Germany and France), loss of a major contract (65% of UK turnover), accumulating historical losses, and reliance on a contracting market sector (the distribution of physical entertainment media).

On losing the contract, the directors recognised the risk of insolvency and the need for specialist advice on how to act in the circumstances. We were retained as the company's restructuring advisers with, amongst other instructions, a brief to consider the implications of commencing administration and the impact on the creditors of such a decision.

"ON LOSING THE CONTRACT, THE DIRECTORS RECOGNISED THE RISK OF INSOLVENCY AND THE NEED FOR SPECIALIST ADVICE ON HOW TO ACT IN THE CIRCUMSTANCES"

Crisis management and accelerate business review

The initial task was one of crisis management, to stabilise operations while sufficient information was gathered to allow for rational decisions to be made in respect of the directors' continuing to trade in the short term.

The threat of insolvency, creditor enforcement, and cashflow constraints (not least as a result of the European group companies freezing intragroup payments) all added to the pressure the directors were facing in the immediate aftermath of the announcement that the contract would not be renewed at the end of its term.

As is almost invariably the case with financial crisis management assignments, cash is king. The immediate concern was whether there was sufficient cashflow to continue to trade on a day-to-day basis. If cash could be managed to allow for continued trading, the directors needed to demonstrate that continuing to trade would generate an enhanced realisation for creditors.

If the immediate threats were manageable, an accelerated business review would be able to identify business strengths and opportunities which, although requiring further exploration, could provide benefit to the creditors.

The opportunities included lucrative transition rates for the managed transfer of stock to a new provider; the possibility of protection of employment and the transfer of associated employee liabilities; and the potential to extract value from the group's reliance on an IT department necessary for the trade (albeit within insolvency proceedings) of its larger European counterparts.

Contractual insolvency breach clauses threatened the company's ability to benefit from the transition of stock, as well as weakening the protection of employment rights. The potential impact on the estate was material, and it was imperative to ensure the actions taken by the directors were in the interests of creditors.

Our review identified business strengths, including, cheap warehouse premises; accessible location; local and industry brand strength; and a dedicated, skilled, and loyal workforce; all of which could provide value to the business and improve the position of creditors.

The decline in the distribution of physical media, thanks to improved broadband and on-demand in-home streaming services, has been evident for a while (as Blockbuster found out to its cost). But disruption in associated industries, including retail and public services, provides prospective growth areas for a flexible, adaptable logistics business.

The exponential growth of the huge online retailers means that demand for storage and supply of millions of products, requiring delivery from a central warehouses to end users, continues to grow. The contraction of the public sector also sees a requirement for external storage and delivery of product to substantial public sector organisations such as the NHS, local authorities and the Ministry of Defence; all of which provide further opportunities for a progressive logistics business.

Crisis stabilisation

Stabilising the cash crisis through immediate negotiations with the exiting client to secure premium rates (and a short term payment horizon) during the termination period, was therefore of paramount importance.

It was evident that a managed process, spanning a period of trading prior to opening formal insolvency proceedings, with continuity through to a sale of the business, provided the directors with comfort that they were acting in the interests of the creditors.

The crisis focused on cashflow but the outcome was reliant on adding value for the creditors by harnessing the business' strengths, maximising the immediate opportunities, and highlighting the market potential to interested parties.

No one wanted to be associated with a business continuing to trade post insolvency, without a documented plan to improve the return to creditors.

> "IT WAS EVIDENT THAT A MANAGED PROCESS, SPANNING A PERIOD OF TRADING PRIOR TO OPENING FORMAL INSOLVENCY PROCEEDINGS, WITH CONTINUITY THROUGH TO A SALE OF THE BUSINESS, PROVIDED THE DIRECTORS WITH COMFORT THAT THEY WERE ACTING INTHE INTERESTS OF THE CREDITORS."

Managing cash, maximising realisations, and minimising liabilities

The threats to the business and legacy issues arising from the break-up of the European group meant that it was unlikely the company could be saved as a going concern.

However, after stabilising the business through management of the immediate cashflow issues, a five pronged business improvement plan was initiated:

1. Achieve the benefits of transition through the continuation of trade during the termination period.
2. Organise the employees to deliver the contractual wind-down services, and maximise Transfer of Undertakings (TUPE) protection.
3. Compartmentalise and sell the IT division to the larger German counterpart.
4. Approach market specific competitors to test the industry's appetite for a pre-administration sale.
5. Undertake an Accelerated M&A (AMA) assignment, in conjunction with appropriate agents, to identify potential business acquirers.

Negotiations on transition rates and payment terms were successful, not only delivering timely ongoing cashflow but also generating a profit, reducing the deficit to creditors.

Ongoing provision of service to the major client ensured that the employees working specifically on its contract at the transfer date benefitted from employee protection and transfer rights. The transfer of several employees was accepted by the new provider, while a considerable number accepted a Union-approved compensation payment.

The expected return to the creditors as a result of continuing to service the contract until the transfer date increased dramatically.

The sale of the IT business unit prior to formal insolvency proceedings also generated cash and transferred employee liabilities to the acquiring party. The receipt of a lump sum of cash improved the position of creditors, while the transfer of employees to the new business reduced claims in the overall estate.

The initial aspects of the value enhancement plan proved successful and improved the expected return to the creditors. During the transition period, approaches were made to industry competitors, the only parties who may have been interested in a share acquisition. As was anticipated, none of those approached were interested in progressing a pre-insolvency transaction because of the historic liabilities to which they might become exposed.

The solution

The direct approach to competitors and the wider AMA assignment had confirmed that the problems facing the company prevented a non-insolvency transaction being completed.

However, the exercise highlighted a number of interested parties and once the benefits of the transition and disposal of the IT unit had been realised, a post administration sale could be pursued.

Trading continued for some 16 weeks in administration in order to achieve the best available sale of the business and assets. The creditors approved the strategy set out in the administrators' proposals, following which a sale of the business was concluded.

The sale continued the theme of minimising liabilities and maximising realisations, seeing the novation of client contracts (avoiding non-performance claims against the estate), protection of employment (removing employee claims from the estate), maximising the realisation of book debts, and generating consideration for the business, both immediately on completion and through a deferred payment schedule.

CURRENT EXPECTED OUTCOME:	
Jobs preserved or settlements agreed:	232*
Revised expected deficit to creditors:	c.£2.7m
Anticipated distribution rate:	up to 29p in the £

*a total of 15 redundancies followed appointment. Several employees resigned or otherwise left the business during the intervening period from initial instruction.

Don't panic!

Changing industries need adaptable businesses. It can be difficult to keep up with the pace of change while facing financial stress but not adapting can prove fatal.

Providing a business with the breathing space to assess threats and identify opportunities, as well as to build on strengths and react to weaknesses, will allow the directors to navigate their business during difficult periods.

Financially and operationally stressed businesses, trading in sectors facing disruption, need to seek advice focused on a rigorous and disciplined proposal to protect the interests of the creditors.

In this instance the directors were focused on the protection of creditors through the commencement of an administration process, but administration at the outset would have been hugely value destructive. By managing the immediate cashflow threat, undertaking a business review, and setting out a value enhancement programme, the deficit to creditors fell dramatically, culminating in the approval of the administrators' proposals and conclusion of the sale of the business.

> "CHANGING INDUSTRIES NEED ADAPTABLE BUSINESSES. IT CAN BE DIFFICULT TO KEEP UP WITH THE PACE OF CHANGE WHILE FACING FINANCIAL STRESS BUT NOT ADAPTING CAN PROVE FATAL."

IF YOU WOULD LIKE TO DISCUSS ANY OF THE ASPECTS RAISED IN THIS ARTICLE, PLEASE GET IN TOUCH.

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VENDOR ASSISTANCE AND VENDOR DUE DILIGENCE

VENDOR ASSISTANCE AND VENDOR DUE DILIGENCE CAN PROVIDE SELLERS WITH MORE CONTROL OVER THE SALE PROCESS THROUGH ADDRESSING THE KEY CONCERNS AND ISSUES THAT MAY BE RELEVANT TO A PURCHASER. ULTIMATELY THIS CAN HELP TO PROTECT VALUE OR EVEN SECURE A HIGHER PRICE FOR THE BUSINESS.

Vendor assistance and vendor due diligence can provide sellers with more control over the sale process through addressing the key concerns and issues that may be relevant to a purchaser. Ultimately this can help to protect value or even secure a higher price for the business.

In recent years vendors have taken a greater degree of control when selling their company (or selling off certain parts of the wider business) leading to vendor assistance and vendor due diligence becoming increasingly common as part of the transaction process.

Vendor due diligence is commissioned by the vendor with the output being an in-depth report on the business' financial health and its future prospects. As the report is available to prospective purchasers with a duty of care given to the ultimate purchaser, it has many benefits for both the vendor and the purchaser.

For the vendor, it can give more control over the sale process and the timing of sale as well as reducing disruption to the business. It adds credibility to the facts, figures and information provided to prospective purchasers and can lead to the early identification of value-critical issues which can be addressed before going to market.

With regard to purchasers, the information and analysis enables them to make a more informed decision. Purchasers have greater certainty over the nature of the business, its financial health and future prospects helping them with pricing decisions. In addition as they can rely on the vendor due diligence report this removes the necessity for 'full scope' buy-side initiated financial and tax due diligence. This can reduce uncertainty risk for some buyers, potentially leading to higher offers.

Our corporate finance specialists work alongside the management of the company, with a high level of involvement from our most senior people. Our approach is flexible so that key areas are prioritised meaning that opportunities and issues are understood and addressed early on.

Vendor assistance is potentially more suitable in situations where the likely purchasers are trade buyers and it can be less time consuming that full scope vendor due diligence. The key difference is that vendor assistance is provided for the benefit of the vendor only.

> "ULTIMATELY THIS CAN HELP TO PROTECT VALUE OR EVEN SECURE A HIGHER PRICE FOR THE BUSINESS."

AT MERCER & HOLE WE HAVE THE EXPERIENCE AND EXPERTISE TO PROVIDE VENDOR ASSISTANCE AND VENDOR DUE DILIGENCE, PLEASE CONTACT ME OR A MEMBER OF OUR CORPORATE ADVISORY TEAM IF YOU WOULD LIKE TO DISCUSS THIS IN FURTHER DETAIL.

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EMPLOYMENT BENEFIT TRUST (EBT) LOANS

IN JULY 2017, THE SUPREME COURT GAVE THEIR DECISION ABOUT THE DISGUISED REMUNERATION SCHEMES USED BY RANGERS FOOTBALL CLUB. DISGUISED REMUNERATION SCHEMES USUALLY INVOLVE AN EMPLOYER PAYING THE PERSON THROUGH A LOAN FROM A THIRD PARTY (USUALLY AN EMPLOYEE BENEFIT TRUST- "EBT") THAT IS UNLIKELY EVER TO BE REPAID. THE OBJECTIVE OF THESE SCHEMES IS TO DEFER OR POSSIBLY EVEN AVOID HAVING TO PAY INCOME TAX AND NATIONAL INSURANCE.

In their decision, the Supreme Court ruled that Rangers should have deducted income tax and national insurance contributions from payments they made to the scheme. HMRC's opinion is that the principles set out by the Supreme Court apply to a wide range of disguised remuneration schemes. In addition new legislation has been introduced to put beyond doubt that income tax and national insurance is payable on these arrangements.

New loan charge in 2019

Under new legislation introduced last year HMRC will be able to tax any outstanding loans made on or after 6 April 1999 via an EBT on the basis that a non-repayable loan is not a loan, but is disguised remuneration. Thus many employers may find themselves with significant liabilities in 2019 that they cannot afford to pay.

Settlement agreements

HMRC has announced a new Settlement Opportunity for EBT loan schemes ahead of the new loan charge being introduced on 6 April 2019. Taxpayers must register their interest by 31 May 2018. They must then provide all information to HMRC by 30 September 2018. The settlement opportunity will often cost less than waiting for the 2019 charge to arise.

Transfer of liability to employee

Where income tax and national insurance becomes due on disguised remuneration it is the liability of the employer. HMRC intends to use the PAYE regulations to transfer the outstanding tax liability (but not NIC) to the relevant employee where the employer is unable to pay.

Duty to provide information to HMRC

All individuals, regardless of whether they are a current employee, who have received a loan, or quasi-loan, from a disguised remuneration scheme must usually provide additional information before 1 October 2019 to HMRC.

Settling with HMRC

The delay in settling the tax and national insurance due to HMRC is like a ticking bomb. The debt will need to be paid relatively soon and if it isn't HMRC's actions could lead to the winding-up of the employer or the bankruptcy of the employee.

Whereas there are likely to be restructuring remedies to both tax payers using an insolvency process, refinancing and restructuring the tax payers' finances is likely to be much more palatable. The lending arena has become more competitive and diverse in recent years, with specialist lenders prepared to finance part of a borrower's requirements under specific arrangements carved out of the trade or of personal assets. Alternatively, there may be opportunities to reschedule existing debt as part of a programme of refinancing to allow the amount owing to HMRC to be paid. Conveying appropriate restructuring and refinancing initiatives will assist with the settlement negotiations with HMRC, particularly if there is a requirement for them to also join in.

SHOULD YOU REQUIRE ADVICE ON THE PROCEDURES HMRC HAVE SET OUT FOR COLLECTING THE TAX THEY BELIEVE WILL BE DUE, OR OTHERWISE WISH TO CONSIDER RESTRUCTURING AND REFINANCING OPTIONS AS PART OF A NEGOTIATED SETTLEMENT WITH HMRC, PLEASE GET IN TOUCH.

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ACCELERATED M&A

EVEN THRIVING AND DYNAMIC BUSINESSES CAN FACE PERIODS OF STRESS, OR DISTRESS. THIS COULD BE THE RESULT OF CASH FLOW PRESSURES, FUNDING CHALLENGES, OPERATIONAL OR MARKET ISSUES, OR THE VARIETY OF OTHER THREATS ENCOUNTERED IN A COMPETITIVE BUSINESS ENVIRONMENT.

When a business faces instability, a tailored strategy supported and implemented by specialists, such as the Mercer & Hole Corporate Advisory Services team, can preserve and realise value for stakeholders. The preservation of value may involve pursuing a transaction that results in the sale of the business and assets. Key to maintaining value in these circumstances is an accelerated M&A process, exploring whether value breaks in the equity, and realising that value, in the limited time available before cash runs out.

THE PRESERVATION OF VALUE MAY INVOLVE PURSUING A TRANSACTION THAT RESULTS IN THE SALE OF THE BUSINESS AND ASSETS.

Accelerated M&A requires a sensitive approach whilst understanding that speed and managing uncertainty is critical if business value and viability is to be preserved. Typically a transaction which focuses on the rapid sale of the business as a going concern is completed within weeks, sometimes in days, but rarely in months. The combined experience of Corporate Finance and Corporate Restructuring specialists, and access to support from transactional experts in tax and business services, assists with devising and implementing an effective M&A process. Often the sale is run in parallel with other potential solutions to ensure that all options are thoroughly considered and explored.

Our team regularly acts for both buyers and sellers involved in an accelerated M&A process and we are able to provide bespoke advice and support. A prospective purchaser is likely to require assistance with valuing the business, undertaking detailed due diligence, assessing funding requirements, identifying areas of potential risk and/or negotiation support. A seller is likely to require assistance with identifying and engaging with potential purchasers, establishing market value whilst generating a competitive environment in order to maximise realisations, liaison with key stakeholders, ongoing advice and support for the management team and, if a pre-pack is an appropriate part of the mechanism, implementing an administration.

In our experience, accelerated M&A, particularly when used as a consensual solution, will lead to a successful sale and result in the preservation of jobs and survival of the business.

IF YOU WOULD LIKE MORE INFORMATION ON HOW WE CAN ASSIST, PLEASE GET IN TOUCH.

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'TAKE 5' WITH HENRY PAGE

HENRY IS A CORPORATE ADVISORY PARTNER. HE IS BASED AT THE FIRM'S LONDON OFFICE AND IS A QUALIFIED CHARTERED CERTIFIED ACCOUNTANT AND LICENSED INSOLVENCY PRACTITIONER. HENRY HAS EXPERIENCE OF ALL TYPES OF RESTRUCTURING WORK, EXTENDING TO BOTH COMPANIES AND LLPS, WHETHER DOMESTIC OR OVERSEAS. OUTSIDE OF WORK, HENRY ENJOYS SPENDING TIME WITH HIS YOUNG DAUGHTER AND IS A TOTTENHAM FAN. HENRY ALSO LIKES RUNNING AND HAS COMPLETED BOTH THE LONDON AND PARIS MARATHONS.

1. What made you choose a career in corporate restructuring?

It seemed an interesting option! Getting involved in the nuts and bolts of a business and trying to add value at times of distress can be very rewarding.

2. What is the most common piece of advice you share with your clients?

Breathe. What is the cash situation and what are the immediate pressures facing the business? You can't solve everything on day one but you can assess how much time you have got to plan a way ahead.

3. How do your colleagues inspire you?

The depth of experience and knowledge in the team is phenomenal; there is always someone who has 'been there, done that' and is more than willing to provide guidance.

4. What gives you a sense of achievement?

Preventing the need for a formal appointment. It sounds counterproductive for an insolvency practitioner but if we can preserve an ongoing trading business then the satisfaction is massive. It might not be as remunerative but it is actually what we try to achieve.

5. What sporting ambitions do you have for the future?

Cycling is taking my focus outside of work at the moment. The ultimate goal is to cycle to Paris to watch the final stage of the Tour de France. Whether I make it this year or not will depend on how much time I can get to train at the weekends (without my daughter, Poppy, in the babyseat behind me)!

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