Mercer & Hole Corporate Advisory Services

Introduction

We are focusing on the options available to businesses and directors when considering a route to the future. The current crisis will subside and, having reacted to the initial business impact, now is the moment to plan a way forward.

This message of moving forward with a focus on future recovery chimes with the Chancellor's press conference on 20 April, during which he outlined a strategy for the UK's recovery centred around initiatives such as the Future Fund and support for innovative businesses, a summary of which is included within the enclosed Survive to Thrive article.

Peter Godfrey-Evans considers how a business can continue to trade through uncertainty, including the use of cashflow forecasts and profit and loss projections to assess the extent to which a company can afford to take on and repay government loans and deferred liabilities.

Dealing with historic and accumulating debt caused by the current crisis may be resolved through the use of a Company Voluntary Arrangement ("CVA"). Steve Smith presents a Case Study of how the use of a CVA, as an alternative to liquidation, has delivered a successful outcome for one of his clients, which is continuing to trade.

Dominic helpfully provides a second article which considers survival techniques and the concept of business hibernation in order to re-animate trading when sunnier conditions return.

Mike Orton what short- and longer-term considerations should a business be thinking about now if it is not only to survive lockdown but also to have funding in place to deliver profitability once the crisis is over.

Chris Laughton looks at changes to insolvency law which might just provide directors of viable companies with sufficient breathing space to seek professional advice and propose sensible, sustainable, business plans, allowing creditors and other stakeholders to support them through the immediate situation.

If you are unsure of the best route to take to future-proof your business the Mercer & Hole Corporate Advisory team are here to help. Our corporate restructuring and corporate finance specialists combine expertise to support your business with transaction, financing and restructuring services. Please speak to me or Steve Smith, Chris Laughton, Peter Godfrey-Evans, Dominic Dumville or Mike Orton .

Henry Page
Corporate Advisory Partner
020 7236 2601
henry.page@mercerhole.co.uk

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Continuing to trade through uncertainty – it's time for directors to think ahead

As the UK enters a further period of lockdown there may be the beginning of some positive messages on the horizon.

The benefits of the government's measures, such as Coronavirus Business Interruption Loans and funding for furloughed staff, are starting to filter through to businesses. Now is the time to think about the future and how your business can move forward. As part of that exercise it is important that you bear in mind your ongoing duties as a director of your company.

Proper financial planning when making material decisions about your business is critical. Cashflow forecasts and profit & loss projections are essential to allow directors to identify and assess areas of concern, including the business' ongoing viability during and after the coronavirus disruption, however difficult forecasting may be.

When considering any forecasts, it will be essential to document the rationale for your decisions and note any assumptions you make. This will help you in the future if questions are asked about why further credit was incurred while the business was struggling.

Even if you have previously done so, take a look at the assistance currently available. Both the terms on which assistance is being made available and your own financial position will be changing. Our website has dedicated pages with detailed up to date information about the loans, grants and assistance available. Consider whether any of the support on offer could alleviate some of the issues you have highlighted in your review of your business. It is worth noting that a number of the measures, such as the payments to furloughed staff, are only available for a restricted time period, so it is important to get on with this as soon as you can.

However just because a form of support may be available it doesn't always mean you should be taking it. Directors will need to be satisfied that there is a commercial way forward and that taking on extra debt (even if on favourable terms), for example, is in line with their duties. Can the future business afford to repay the debt taken on? And what are the consequences of failing to repay?

Whether you decide to make use of the assistance being made available by the government or not, it is important to remember that directors remain subject to their fiduciary duties. At a time when the company's solvency may well be in question and as a result your duty of care is to the company's creditors, it will be important to ensure the steps you are taking are in the creditors' interests.

If you think we may be able to help you access the financial measures available or advise you about your company continuing to trade, please do not hesitate to contact one of our Corporate Restructuring team.

Peter Godfrey-Evans
Corporate Advisory Partner
020 7236 2601 / 01908 605552
peter.godfreyevans@mercerhole.co.uk

The CVA – a useful tool for a healthy business with a COVID-19 problem

A skilled Insolvency Practitioner looks at each case in isolation, identifies the business' strengths, its opportunities and the problems, and then assists the directors in identifying the right solution, using Insolvency Act processes only if necessary.

The CVA, or Company Voluntary Arrangement, has long been a useful tool in the armoury of an insolvency practitioner. It is particularly useful in circumstances where an underlying healthy business is facing a hurdle that it is struggling to get over. This hurdle could be a large bad debt, a change in legislation, the loss of the biggest customer or, an unexpected short term drop-off in turnover.

To state the obvious, the COVID-19 pandemic and its effects on the economy is now a hurdle for many businesses of all shapes and sizes. Some business are configured in such a way that they can be quickly scaled down, literally turning off the lights until a more favorable trading environment returns, while others have sufficient cash reserves which, combined with cost savings and the government's financial support schemes, will see them through a difficult patch. However, as more and more businesses do scale down and hang on to their cash, other less agile businesses with large fixed costs which are dependent upon that cash will find themselves approaching a cliff edge.

The Restructuring and Insolvency Partners at Mercer & Hole believe that the versatile nature of the CVA legislation could prove to be the right solution for some businesses facing the reality of running out of cash, businesses which were anticipating a long bright future but for the sudden, drastic and hopefully short term contraction in the economy. It's also worth noting that there's a lot of goodwill out there. People are pulling together and making sacrifices for the greater good. It's possible that a sensible and well put together set of proposals has a good chance of being approved by sympathetic Creditors who knew what the business looked like before the crisis and are happy to keep trading with it when it's all over.

At Mercer & Hole our Corporate Restructuring team have a wealth of experience in helping rescue distressed businesses.

> *"It's also worth noting that there's a lot of goodwill out there. People are pulling together and making sacrifices for the greater good."*

Dominic Dumville
Corporate Restructuring Partner
020 7236 2601 / 01727 869141
dominic.dumville@mercerhole.co.uk

COVID-19 Business Support: Relief through Insolvency Law Changes

Insolvency Law to create breathing space

Business Secretary Alok Sharma announced on Saturday 28 March 2020 that insolvency law will be amended to give companies breathing space and keep trading while they explore options for rescue. Legislation to introduce these changes will be introduced in Parliament at the earliest opportunity.

The measures announced include:

- the introduction of a new moratorium to help business rescue. This will give those financially distressed companies which are ultimately viable a period of time when creditors (including secured creditors) cannot take action against the company, allowing it to make preparations to restructure or seek new investment;
- prohibition of enforcement by a supplier of termination clauses in contracts for supply of essential goods and services on the grounds that a party has entered a formal insolvency procedure, the new moratorium or the new restructuring plan;
- creation of a new restructuring vehicle that would include the ability to bind dissenting classes of creditors who vote against it; and
- temporary suspension of the wrongful trading provisions to give company directors greater confidence to use their best endeavours to continue to trade during this pandemic emergency, without the threat of personal liability should the company ultimately fall into insolvency. Existing laws for fraudulent trading and the threat of director disqualification are to continue to act as an effective deterrent against director misconduct.

The detail

The measures to create breathing space for businesses will require detailed legislation setting out how they will work. Those details are yet to be published.

Some insight is available from the government consultation and response on a review of the corporate insolvency framework produced in 2016 and 2018. This deals with the new moratorium, termination clauses and the new restructuring mechanism. Temporary suspension of wrongful trading is a new proposal.

Next steps

Our Corporate Restructuring and Insolvency Team, who are specialists in advising on response to a financial crisis. They will advise on and use existing tools and, when they are introduced, these new measures.

If you require advice on any of the issues raised in this article, please contact one of our Corporate Advisory partners.

Chris Laughton
Corporate Advisory Partner
020 7236 2601
chris.laughton@mercerhole.co.uk

Survive to Thrive: The Future Fund and support for Innovative businesses

Rishi Sunak announced on the 20 April 2020 the launch of two new funds; The Future Fund, to provide matched funding in the form of convertible loans of between £125k and £5m to UK registered early stage companies.

£250m is being made available to the Future Fund. £550m is also being made available to customers of Innovate UK, the national innovation agency and the agency will accelerate a further £200m of grant and loan payments to its customers.

These announcements look beyond initial preservation funding through the CJRS and CBILS schemes to the future, in an attempt to reverse the economic nose dive which has occurred since the start of lockdown.

As the Chancellor said, 'It is critical that we don't just maintain companies and jobs that already exist but we must also encourage businesses, jobs and technologies of the future. Innovation and entrepreneurship have powered growth in our country for centuries and it is what will drive our growth as we recover from this crisis.'

Please click here to read the initial paper on the Future Fund and the government's news story can be read here.

If you think we may be able to help you access the financial measures available or advise you about your company continuing to trade, please do not hesitate to contact our Corporate Restructuring team have a wealth of experience in helping rescue distressed businesses.

Henry Page
Corporate Advisory Partner
020 7236 2601
henry.page@mercerhole.co.uk

An alternative to winding up

A Company Voluntary Arrangement (CVA) or an administration may be required, but these can be temporary procedures. They can allow a company to emerge with value remaining in its business and assets.

Crucially, agreement will need to be reached with creditors for this approach to work. If there is really no prospect of creditors supporting a proposal despite the loss of value that liquidation would entail, forced sale asset realisation and complete loss of shareholder value may be difficult to avoid.

A company that can be made profitable and cash generating when relieved of its debt burden may well benefit from a CVA. If creditor pressure is severe – but negotiable – the CVA may need to be preceded by administration. In such circumstances the purpose of the administration is to gain protection from individual creditor actions with a view to having the company continue as a going concern. The exit route from administration would be through the CVA.

If a winding-up petition has already been presented, the administration may need to be opened by a secured creditor (if there is one with a qualifying floating charge) or by an application to court. Either way it may not be too late to save the company if the situation is addressed quickly.

> *“The key to this successful rescue was the director’s ability to persuade a sufficient majority of creditors to accept a CVA proposal.”*

Insolvent Company Rescue –a case study

In this example, we successfully arranged an administration and a CVA for a company that a creditor was petitioning the court to wind-up. The result was that the company survived and is now trading normally.

The directors of the FCA registered company had been trying to defend a winding-up petition, but saw they could not put off the petitioning creditor any longer. When they contacted Mercer & Hole we identified that they should seek to use the moratorium provided by putting the company into administration to protect the value of the company’s business and assets.

The company had only very limited tangible assets, a few unlisted shares and some potential income under informal agreements. Its valuable asset was its FCA registration.

We established an administration strategy to rescue the company as a going concern through a CVA. One of the directors was interested in refinancing the company and anticipated being able to negotiate with sufficient creditors to persuade them to accept a CVA proposal. Given the apparent depth of the company’s insolvency, this appeared ambitious, but it was the only way to generate sensible realisations from the company’s

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assets. The FCA registration could not be transferred and would only have value to the company itself. Any exit mechanism from administration other than a CVA would lose the value of the principal asset.

In order to preserve the registration, it was necessary for the company’s registered activity to continue and, by using the directors’ knowledge and experience and by subcontracting operations to a related company, we were able to undertake sufficient activity to satisfy the FCA. Naturally, a good deal of work went into ensuring compliance with FCA regulations, but it did eventually pay off as the business generated a modest income and we were successful in retaining the FCA registration.

It became necessary to raise further funds by selling the company’s residual assets (again to the director’s related companies) and this was done with the specific agreement of the creditors’ committee. They recognised that any strategy other than seeking to maintain and extract value from the company’s FCA registration would lead to there being no return at all to creditors. The negotiations to persuade creditors to accept the CVA proposals were protracted and the administration lasted almost two years. Finally, we paid a lump sum to those creditors who were not prepared to exchange their claims for equity.

The key to this successful rescue was the director’s ability to persuade a sufficient majority of creditors to accept a CVA proposal. This is the basis of any CVA, but in this case the negotiations were facilitated by the administration moratorium. It prevented certain initially aggrieved creditors from taking action against the company. Two years was a long breathing space during which the company was restructured financially, but the company has now concluded its CVA and is trading normally once again.

If you require advice on any of the issues raised in this article, please contact one of our Corporate Advisory partners.

Steve Smith
Corporate Advisory Partner
020 7236 2601 / 01727 869141
steve.smith@mercerhole.co.uk

Thinking beyond the here and now

In these unprecedented times there has been great focus on the support available for businesses to help navigate through the economic impact of COVID-19. But equally business owners and management teams need to be proactive in planning beyond the pandemic.

The present

Over the recent weeks the UK government has announced a number of government backed schemes to support businesses and the economy. At Mercer & Hole we have created a COVID-19 Business Support Hub, with our primary focus being on supporting our clients through these uncertain times. .

Being a corporate financier, of particular interest to me and my clients, has been the Coronavirus Business Interruption Loan Scheme (CBILS), this scheme has been set up to support SME businesses to access lending during the Coronavirus pandemic. Like with any new government backed lending scheme the client experience and the ease that facilities are being agreed is still evolving.

My key tips to help clients secure the funding they need are:

- keep the application concise and easy for the bank to understand
- demonstrate the business is 'viable': the borrower needs to convince the lender that the business was viable before the crisis and that it has the ability to be so after
- show all other forms of relief have been used (for example the Coronavirus Jobs Retention Scheme)
- focus on business critical payments: these are loans to cover costs of keeping a business alive rather than a grant
- demonstrate how the business will operate out of the crisis when restrictions are lifted and that the loan can be repaid

A final key point on CBILS, it appears that currently the banks are still focusing on applications from existing clients. Therefore, it is extremely important to get the application right first time. That being said we have a wide network of contacts and can introduce clients to other potential lenders, be it other main clearing banks, ABLs, or alternative lenders

We are supporting clients in many ways regarding CBILS, including:

- initial assessment to help clients understand if they are eligible
- modelling assistance and support/challenge on key assumptions in financial models
- assisting with the preparation and completion of the application

For assistance with applications to the CBILS scheme or discussions about ongoing funding requirements please do not hesitate to get in contact.

Thinking beyond the here and now

Whilst the government backed schemes will support businesses in the short term, business owners and management teams also need to be proactive in planning beyond COVID-19.

As the country prepares for an easing of lockdown over the coming weeks, a return to partial trading and gradual withdrawal of government support initiatives, could be a period which is equally tough to finance. We are working with clients to ensure that, as far as possible, their businesses are financially prepared to capitalise on opportunities that present themselves.

In order to achieve this, one of the many challenges business faces is the ability to look beyond the immediate financial and operational challenges to plan for the medium to long term. This includes developing realistic forecasts and models which can be adjusted to reflect potential 'new normal' scenarios, to ensure that funding gaps are highlighted, and finance sought which is sufficient to overcome the challenges which will arise over the medium term.

Should you need help to consider the medium-term plan for your business, to build or assess financial models, or to consider how to fund projected shortfalls identified in your business model, we are here to help.

"The impact of COVID-19 on businesses will not just be felt in the short term. We can help business owners plan for the challenges they may face in the medium to long term."

Mike Orton
Corporate Finance Director
020 7236 2601 / 01908 605552
mike.orton@mercerhole.co.uk

A practical guide to hibernating your business

Since early March when the first few cases of COVID-19 were reported in the UK, I suspect there is not a business in the country that has not been affected by what followed.

Be it an immediate drop off in turnover, problems further up the supply chain or employees not able to perform their function, almost all businesses will need to do something if they are going to come out the other side in one piece.

Many Directors' instinct will be to quickly contract or 'mothball' the business; stopping all payments, locking up and leaving a 'back in June' sign on the door. My fear is that directors who don't take a moment to think through some of the consequences may find themselves in more difficulties down the line.

With a little planning and thought however, directors can to put the company into a state more akin to hibernation. This more measured and planned approach will minimise the mess to be dealt with when the time is right to 'come alive' again.

This article is the Mercer & Hole's practical guide for business owners looking to do exactly that, hibernate their business.

Have perspective

Everybody has been impacted in some way. It is imperative therefore that you stop to consider the world-view of those that you will be talking to over the next few weeks; being overly bullish with people who are grappling with their own problems might not get the outcome you're hoping for.

Negotiate

There is little precedent as to what should normally occur in these circumstances. I see this as a good thing; it's an opportunity to negotiate, be creative and find novel solutions. Consider the position of those you are negotiating with, be they employees or customers, and establish what are their needs and priorities. Where both negotiating parties want the same thing (to survive) there doesn't need to be a winner and loser. Explore new terms, offer an incentive, can you make payment in kind? Is the something you can give at minimal immediate cost to your business but with high perceived value? Landlords for example have their own expenditure to meet so may struggle to give you a rent-free period, but on balance they may prefer to give some sort of discount now and keep a good tenant, perhaps with a tweak to the lease in their favour.

Slowing liabilities

A director's instinct may be to hang on to cash, but they shouldn't overlook the opportunity to slow accruing liabilities. Plan now to avoid coming back to a mountain of bills that could choke the business. Are there costs which can be paused entirely or reduced during this hibernation period: hire charges, subscriptions, retainers, security, IT, advertising or maintenance. Rather than not paying suppliers thereby delaying the problem and eroding goodwill you may have built up, have a conversation now.

Talk to your employees

For businesses where the wage bill is one of its largest expenses, managing the expectations of your workers will be critical. This is a very delicate issue particularly as what is good for your business is not necessarily what is good for your employees; some may like the idea of being designated furlough, taking three months in the garden on 80% of their salary but you may need them, or some of them to keep going. Just because you have entered into a contract of employment doesn't mean a solution cannot be found. A little legal advice may be necessary to formalise what is agreed.

For those employees staying on, can you agree to defer part of their wages in return for a bonus later in the year or another benefit? More holiday allowance or increased pension contribution? As I have said, there is little precedent for circumstances like these so be a creative as you need to be.

Government support

The government has announced a number of generous financial support measures ranging from emergency loans to business rates grants and job protections schemes. I won't go into detail here but business owners should do some investigation as they may prove invaluable. A CBIL loan could be a lifeline for a well hibernated business, enabling it to continue to pay those liabilities that are still accruing as they become due.

Take advice

My final recommendation is to take advice. As corporate advisory professionals we have made business out of solving problems with the right tools. Any director who feels they are out of their depth trying to keep the business going while solving it's financial problems should not hesitate to get professional help. This could be the difference between a right or wrong decision or a successful or unsuccessful negotiation.

It may be that one of the existing or newly announced Insolvency Act tools is the key you need to unlock the rescue of your business.

If you require advice on any of the issues raised in this article, please contact one of our Corporate Advisory partners.

Dominic Dumville
Corporate Restructuring Partner
020 7236 2601 / 01727 869141
dominic.dumville@mercerhole.co.uk

London
020 7236 2601
london@mercerhole.co.uk

St Albans
01727 869141
stalbans@mercerhole.co.uk

Rickmansworth
01923 771010
rickmansworth@mercerhole.co.uk

Milton Keynes
01908 605552
miltonkeynes@mercerhole.co.uk