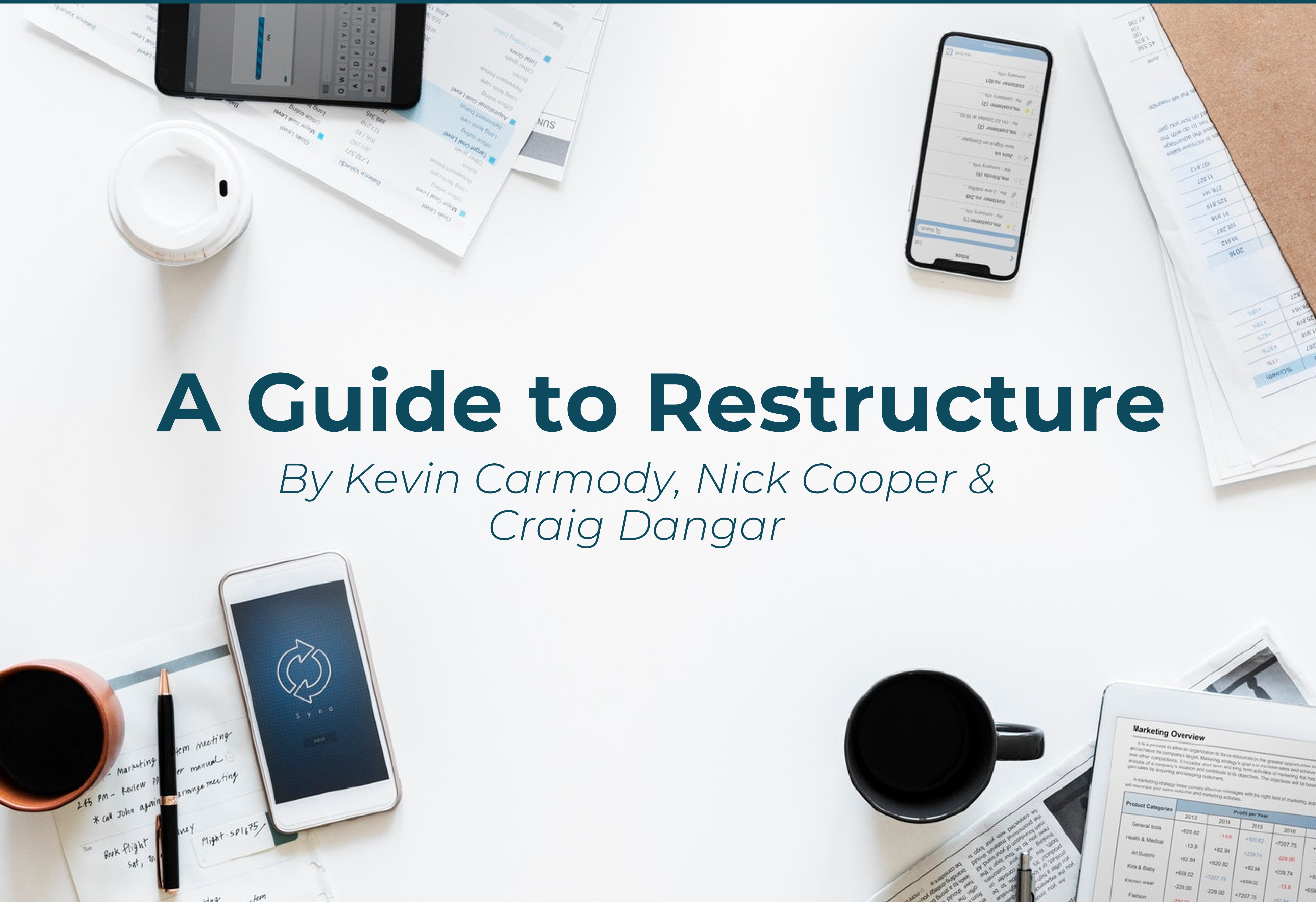
C&D Restructure and Taxation Advisory



A Guide to Restructure

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Restructure and Taxation Advisory

Foreword

The restructure process is one in which no situation is like another. Each business is different and what needs to be done will not follow a simple course. Undertaking a business restructure can be a difficult and stressful time, particularly as there tend to be trying conditions and years of work at risk.

At C&D, we solve problems.

At C&D Restructure and Taxation Advisory we use the "RATE" approach, being Review, Analysis, Tactics and then Execution. There is no hard and fast rule as to how long each step will take. Often times it is a moving target as information comes to hand and solutions are developed. We will walk you through the process, helping you not only in a technical sense, but will be on the ground as a sounding board to support you through the change.

Review
Analysis
Tactics
Execution

In this e-book we explore some of the more practical aspects of a restructure and what they mean for you, as either a business undergoing the process or someone that is looking to understand what will happen if you refer someone to our team.

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Chapter 1

Why Restructure?

By Craig Dangar

This often asked question has a few answers. Restructuring may become necessary due to:

- Financial difficulties
- Succession planning
- Changing structures and taxation
- Preparation for sale
- Asset protection

The decision to restructure is often one that will be recommended by a professional advisor and reflects an appreciation that the current structure may not be appropriate for the situation at hand. Restructuring is not a dirty word and for many businesses it will be the stress valve that will not only protect the business, but also the business owner that is suffering through the process.

Case Study

John owns his business via a discretionary trust and is concerned about asset protection. The discretionary trust owns not only the business but a few investment properties.

If John's business were to be sued, the other assets of the trust would potentially be at risk. Transferring the properties from the trust would result in substantial capital gains tax and stamp duty.

The optimum solution for John may be to corporatise the business and sell the shares of the business to a related entity.

For John, this transaction will involve (potentially) small business tax concessions, capital gains tax, stamp duty on the sale of business, communication with lenders and suppliers to the business, staff being re-employed and new contracts being put in place. Simple?

Case Study

Wilma's business is currently undergoing financial difficulties and she is concerned over its long-term viability. She owns the business via a company, but has provided personal guarantees and caveatable interests to business suppliers. Wilma owns her own home.

The value of Wilma's business is in her client base, and she wants to protect this asset where something goes wrong. The value of the client base in only where she is involved in the business, so to an incoming purchaser it would not have value.

For Wilma, a restructure may be the establishment of a new business, acquiring the client base from the existing company, working with her suppliers and creditors to manage her debts and undertaking an insolvency event to manage the process. As Wilma's personal assets are at risk, this may require protective structure as part of the restructure process.

Chapter 2

When to Restructure

By Craig Dangar & Kevin Carmody

If there are significant business difficulties, the earlier the better. In a lot of cases restructures are left to the last minute, which can be problematic. The earlier the process starts, the more likely that a business will be able to trade out of its position and negotiations can start with stakeholders in order to improve the overall picture.

The decision to undertake a restructure is one that can be tough for business owners. We find that often the hardest part is the decision to start the process, rather than the process itself.

Many business owners wait until there is a garnishee notice or a wind-up application before seeking advice about restructuring. It becomes harder and harder the further down the track you are. The “Ostrich” approach to restructure is never successful and the quicker you have a plan, the more likely you will have a business that is able to be protected.

Example

Fred has just received a garnishee notice for his bank account from the ATO. This has also been served on his four largest customers and requires that they pay 30% of their outstanding invoice direct to the ATO.

On receipt of the garnishee notice, Fred’s bank freezes his account, Fred is subsequently unable to pay suppliers and all direct debits are dishonoured.

Fred’s clients immediately cease their contracts with him. Fred’s business is decimated as a result of a garnishee notice, but these things do not come out of the blue. The garnishee notice generally comes at the end of the process, rather than the start and reflects a long-term taxation debt.

Acting early means that this will be less likely to occur.

Chapter 3

How Restructuring Works

By Craig Dangar

A restructure depends on a lot of circumstances, but for most business owners this will involve a business change, negotiating with creditors (and clients), negotiating with landlords, the potential sale of the business and often times insolvency at the end of the process.

We follow our RATE process where a lot of time is invested in understanding the situation and determining a course of action to achieve the best possible result. This process starts at our first meeting and finishes six months after the conclusion of the restructure to ensure that you are on your feet and your business is trading well.

At each step of the journey we will work with your existing advisors to keep them abreast of the circumstances and where things are up to. We have a team of professionals we work with closely if you need additional support or advice.

Depending upon the path chosen, it will determine what and how things work, this depends on a lot of variables and can change depending upon factors such as:

- Creditors
- Landlord involvement
- Personal exposure
- The viability of the underlying business
- Finance and the ability to access capital

Chapter 4

The First Meeting

By Nick Cooper

At our first meeting we will try to understand the overall picture and what needs to occur. This meeting will generally be a reconnaissance mission, finding out as much as we can as quickly as possible and then plotting a chart.

The first meeting can often be pretty tough for business owners and it is generally a time to face that there are problems within the business. We try not to sugar coat our initial observations during this meeting and will be as direct as possible so that you are aware of what needs to happen to fix the situation.

We recommend bringing your professional advisors to this meeting to answer any specific questions and to be a part of the restructure process. It can make it easier to have someone to talk to after the meeting to understand what the future may look like.

At this meeting we like to grab the whiteboard and run through the options that are available for you, working through some preliminary solutions and how the structure may play out.

In preparation for this meeting, we generally undertake searches on the company structure. Having access to some form of financial information prior will make it a more productive meeting.

At the end of this meeting we have generally determined a preliminary approach and will be able to start formulating a plan. We ask people to sleep on it before making the decision.

I’ve said yes, now what?

We will immediately move to the “Review” stage of our RATE process. This will be a data collection process and will involve your professional advisors.

We find that the first week is pretty tough and can be up close and personal. It’s not uncommon to have a thousand questions and we do our best to answer as much as we can. Time is at a premium and we are often dealing with lots of little fires and limited time to deal with them, so we try and bring as many things under control as quickly as possible.

Chapter 5.1

Review

By Kevin Carmody

The start of the restructure process is understanding what the situation is and what is there, why you have come to us and what problems you think we may be able to solve. In this time, we look at the business as it is and what the threats are that predicate a potential need for change.

We will undertake an external review, generally before the first meeting, in order to try to understand what is happening in the public forum and if this will impact what we are going to deal with.

Timing is important and we form a calendar during the review process to try to make sure that key milestones are met and that there is no risk of things slipping through the cracks.

When we start the review process, we will also try to understand the wider financial group, in order to understand the role of each of the stakeholders and what their influence will be during the process.

If the situation is acute or in need of immediate crisis care, we use this meeting to articulate this, and if necessary, will take steps to assist you on an urgent basis. It is not uncommon for us to drive overnight to be on the ground the following morning if the situation dictates.

Understanding the basic picture before we jump into the analysis gives us the ability to structure a plan to manage the process. This means the more we know earlier, the easier it will be.

Chapter 5.2

Analysis

By Craig Dangar

Gathering data and information is an important aspect of any restructure and we prefer more information than less. This will include...

Recent and historical financial information:

- Profit and loss
- Xero or MYOB files
- Tax Portal
- Creditor and debtor listing
- Recent bank statements

For exposure and to understand the risk profile of the business we ask for:

- Loan statements
- Loan agreements
- Terms of trade
- Personal guarantee documents
- Supplier agreements
- Franchise agreements
- Equipment finance agreements
- Leases

If there are litigation or claims:

- Copies of court documents
- Copies of claims

Ownership information

- Copies of entity returns
- Copies of entity documents (such as trust deeds or constitutions)
- Title searches

Personal information

- Copies of personal guarantees or a list of them
- Loan agreements in which business assets are cross-collateralised

Business information

- Budgets or financial analysis
- Business summary

This information forms the base for the review process and following our first meeting we take this information and start to understand the basics of what is going on in the business. Once the preliminary review is complete, we start to analyse the core data provided and try to understand what the true picture is.

What have you signed?

Business owners are often shocked to understand the depth of obligations that they have committed to. It is not uncommon to have multiple personal guarantees or financial undertakings, and very soon these can be a crippling appreciation, as things are worse than originally thought. Often it is understood what you are liable for, and who is liable for this as well. It is not uncommon to have family members or perceived family assets exposed as a result of a business transaction.

We find that the analytic process will give an understanding of what has been happening in the business and why you are in the situation that you are. It is through the analytic process that we will also quantify personal exposures, whether there is cross-collateralisation, what the opportunities are and if there are solutions to core issues.

During the analysis we will often ask for additional information or clarification if things are not complete. As it is a data-heavy time, we aim to work closely with your accountant or bookkeeper to clarify issues.

We often find things during the analysis process that were not instantly obvious or identifiable. It is not uncommon to find that there are additional loans or outstanding amounts, agreements that are in breach or obligations that have not been satisfied. It is during this time that we try and complete the picture so that the tactics that we undertake are going to be as comprehensive as possible.

We dissect the financial information of the business and try to understand the flow of money, the trading business and what is underpinning the financial outlook or situation. It is often during this process that we find out more about what is going on and can determine an appropriate course of action. At the conclusion of the analysis component we will meet with you and start the tactical element of the restructure.

Example

Barney is a Builder and operates as a partnership with Betty. Betty doesn't work in the business, but they were set up as a partnership for tax reasons. Barney has been sued. Betty as a partner is personally liable for the debts of the business, including any financial agreements undertaken by Barney. Betty had always assumed that she was not responsible for the actions of the business as she never worked in it.

Example

Oliver owns the business through a company, the shares are owned by the family trust, but he has signed a cross-collateralisation agreement including the assets of the trust unbeknown to the other trustees of the trust (and unbeknown to him). Gathering this information means that there is an opportunity to scrutinise the agreements and the due diligence undertaken by the impacted lender.

Chapter 5.3

Tactics

By Craig Dangar

Our tactics or game plan are determined by understanding the complete picture and what the landscape looks like.

Fundamental questions that are asked during this process are whether there is a viable business at the end of the process and what this would look like. Our principle is that we will not continue a business that is simply unable to survive, as it may be better to draw things to a close rather than fighting a losing battle. If a business is marginal or simply going to continue to suffer, we will work towards a logical shut down or finalisation.

In the analysis we look at the underlying issues that have created the immediate problem. If these are systemic, are there plans to change anything that will improve the situation? If the business has a level of viability, we will be attempting to make the necessary changes in order to allow it to continue. Keeping the doors open for continued pain is not the business we are in.

Selling Assets

We often see situations where a recommendation is that business assets are sold to a related party and a "new" business immediately established. This is generally considered phoenixing and has significant ramifications.

We recommend against this, and if there is an opportunity to sell assets, this always needs to be done at arm's length and with consideration paid at market value. Undertaking such an approach requires specialist advice and always needs to be done carefully.

Negotiating With Landlords

Negotiating with landlords is part of any tactic and it needs to be considered from both sides. A landlord wanting rent may expect that you pay any outstanding rent in order for them to continue dealing with you. Practically, this may not be possible (given the financial resources needed) and so it is a case of finding common and practical ground. The groundwork during this time may involve determining if you can find a suitable replacement location (if the situation allows) or demonstrating that the location will suffer a significant time to re-let.

Case Study

We worked with a commercial landlord that owned multiple properties, he always held the view that should the tenant fall over that they would be easily replaceable.

Over the last ten years the lending to these businesses cut from 75% on the value of the lease to 0% and a requirement for real property security. As tenants asked for rent reduction, he would just turf them and find a new one. This started to be problematic as there was a dearth of replacement tenants and he ended up running a quarter of his outlets.

We analysed that the average loss to him was $350,000 each time a tenant failed and that he would be better placed to negotiate for a reduced rent and a retained tenant. Despite an internal fight, he could see the better outcome was retention.

Preparing for the Future

A complete picture will consider not only the business as it is now, what it will look like and what the personal exposure is. Each part of a restructure will generally feed into another, so that a decision is not made in isolation, there will be a consequence for the overall restructure each time a decision is made. As the restructure progresses, each variable will have an impact on the rest of the process; it is a moving feast.

Case Study

Tony and Joanie owned several retail outlets that due to a dispute needed to shut. Due to substantial litigation they intended to shut the business down and liquidate, however the core remaining asset of the business was unable to be sold or transferred and in liquidation would be lost. The initial plan of appointing a liquidator (recommended by a liquidator) needed to be revised upon receipt of legal advice and the business be placed into administration.

Gaming Out Variables

During the painting of the picture, we run through multiple scenarios both internally as a team and with you to try to work out where the risks will be. No restructure will run perfectly as there are variables, but it is good to stress test what is happening to ensure that we are as prepared as we can be.

The landscape changes for every situation and can be determined by factors such as the relationship with creditors, communication and the expectations of your stakeholders. We are also dealing with emotions, which can introduce an element of irrationality. An example of this is a creditor who will be difficult or unreasonable for no rational reason, often times this will be a small creditor. During the tactical phase we try to defuse as many potential risks to ensure the restructure runs as smoothly as possible.

Case Study

Judy, a business owner, was planning to undertake a restructure, she had a number of debts, including to one supplier who has asked her out several times (and which she rejected). Judy was concerned that Hector would be difficult to deal with, and it was decided that since Hector was a small creditor that it would be better to pay him out than risk him going ballistic. He still attempted to attend the creditors meeting (to cause problems), but because he was no longer a creditor, we were able to have him removed from the meeting.

Case Study

Peter had a great working relationship with his landlord who was supportive of his financial situation, the landlord was, however, approached by a competitor of Peter to terminate Peter's lease. When this was considered as a risk to the restructure approach, a decision was made to enter into a new lease in a new structure, prior to the restructure taking place.

The landscape can be a moving target, initial hostility may calm down, but equally creditors that may feel they have been mislead or given unrealistic outcomes may turn nasty. Communication during this process can be difficult and it can be tough to understand what is happening.

There is a Plan A, B, C, D and a backup plan during the tactics stage, as things can change with a moment's notice. We work on the basis that the worst can happen, and that relying on things to go right is always a recipe for disaster.

Chapter 5.4

Execution

By Craig Dangar

The plans are laid, and it is time to pull the trigger. From here, things will rapidly unfold and communication becomes the key. During the tactical process we will have started to communicate with key stakeholders and will be in a position to manage the process.

Communication

For businesses that will need to shut and sell assets, this is generally a process of ensuring that employees are assisted, and that any closing down procedure is as clean as possible. Assuming that people will work with you can be a problem, especially if you need site access or the cooperation of third parties.

Case Study

We assisted a small business owner that was struggling to pull the pin on a suffering business as he was concerned about the staff that would lose their jobs. We talked to the senior staff and explained the position; they were well aware of the financial difficulties and were only staying to help the owner. We communicated with the owner that it would be better to have them as a part of the restructure process as they had good knowledge and would be able to assist in the closure process.

For businesses that are continuing on, it is important that key stakeholders are involved in the process and that they are able to be involved where necessary. It is often important for the business owner manage the communication process (even if we are assisting you in this). Customers and suppliers need to be managed and it is important to ensure that the messaging is such that they will continue to retain faith in the business despite the difficulties.

Case Study

A business was hit with garnishee notices to customers, this severely damaged the reputation of the business and the customers we reluctant to keep working with the firm. We organised a face to face meeting with the impacted customers and provided them with a copy of the restructure plan. There was a question and answer session about the process, and we had the owner ask the customers what he needed to do in order to keep their business. In each case, the customers were concerned about certainty and the ability to supply. Once they were provided a copy of the restructure plan and could see the business would be viable, this allayed some concerns. Understanding that the business would be making changes assisted in bringing the customers to a better place. The most important thing was that the owner was there, talking to the clients and giving them a clear picture of the future.

Controlling The Message

Failing to control the messaging can make the best laid plans disappear. Taking complaints or criticism personally, reacting to it or engaging with it can snowball and make things a lot worse. Throughout the communication process we provide professional guidance and message management to ensure things are controlled and handled in the best possible manner. It can be an emotional and difficult time and whilst the human response is to react, sometimes it is better to say nothing or acknowledge the problem.

Case Study

Basic public relations dictates that if there is a mistake or error take ownership of it and then deal with it. Attacking criticism or critics never seems to end well. We attempted to assist a business that needed to go into Administration, the owner of the business then decided to handle “communications” themselves. An unpaid staff member made a comment on Facebook which unleashed vitriol from the owner that lacked subtlety, a week later we had a creditor meeting and needed the votes of the employees to support it, needless to say, the employees voted against it and the business was placed into liquidation. The owner couldn’t understand why the employees would prefer to lose their job rather than continue in a job with them.

Dealing With Formal Processes

Depending on the course of action chosen, it may be necessary to engage with third party professionals, and for the uninitiated this can be a stressful and difficult time. Understanding the role of these professionals is a challenge and often the lines are blurred as to their obligations and responsibilities. Understanding the role of an insolvency practitioner is important as it needs to be appreciated that they have a job to do which may not be aligned with your needs; they are there to act in the best interests of the creditors.

Meetings with insolvency practitioners can be tough, and it is during this process that we will work closely with you to handle the communications. We often act as proxies at this meeting. We will often need you to be involved in the process in the capacity of dealing with or negotiating with creditors.

Dealing With Courts

If there are court proceedings afoot, these need to be handled and it cannot just be assumed they’ll go away. The “Ostrich” approach has never worked with court proceedings and ignoring these will not assist in the restructure process. We will assist you in finding a suitably qualified practitioner to assist you in this process, even if it is communicating that you intend to follow an insolvent approach. Litigation is expensive, so if there is an opportunity to avoid it, most creditors will be happier to deal with you.

Chapter 6

What Can Go Wrong

By Nick Cooper

The restructure process is not an exact science and there are a lot of moving parts that will influence what may happen. We never promise a perfect outcome as they rarely occur. There is always something that will challenge what has been the best laid solution.

Controlling events tends to be an ongoing concern, regardless of how good the preparation has been beforehand, and it is often this preparation that makes the difference. Equally, having backup plans ensures there are additional solutions if things change.

Depending upon the creditors, their individual positions and how they have been communicated with can determine a lot of what will happen (and what can go wrong). Forgetting that creditors have a significant level of control can put any proposed solution at risk.

Often times when we start the analysis, we find that there is nothing to protect or save and it is time to take steps to bring the business to an end. Not all situations are salvageable, and it is important to understand that there can be a need to have a tough albeit realistic conversation. If we have reviewed your business and there is no real chance of improvement, we will make that clear and work with you to bring it to a sensible conclusion.

A lot of the time, a restructure involves you as a business owner, and you will need to be invested in the process and the message communication. We have had owners walk into meetings with banks and tell them stories that defied logic. Equally, we have had business owners that have outright refused to work with insolvency practitioners - despite agreeing to appoint them.

At our first meeting we will run through both the good and the bad, and what can go wrong. This is not to scare you, but to give you an insight into what is ahead and what may go wrong during the process.

Chapter 6

About C&D

By Craig Dangar

A bit of background

The C&D team has worked in restructuring for several years and more closely in taxation for the last 20 years. They have seen things good and bad during this time and have been at the forefront of significant change. We have personal experience in restructures and have seen what can go wrong, where advice is lacking or where the interests of the advisors are not the same as the business owner. We pride ourselves on not being aligned with any insolvency firm and will only make a recommendation for insolvency where they are the best fit for a situation.

We have worked closely with business owners in all stages of restructure, had tough conversations and sadly destroyed a lot of dreams to get to practical outcomes. We pride ourselves on under-promising and over-delivering solutions.

We are often described as blunt and direct, this comes from an understanding that the more practical the solution and the more realistic the outcome, the better chance we have of getting to the other side.

The C&D Team

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