

THROWING A LIFELINE

CVAs MAY BE INFREQUENTLY USED, BUT THEY CAN HELP COMPANIES THAT HAVE HIT THE ROCKS, SAYS **RICHARD FLEMING**

Latest figures from the Insolvency Service paint a none-too-rosy picture for corporate Britain. In the first six months of this year, there were more than 2,300 administrations recorded in England and Wales, 30% higher than the same period in 2008. And from what we can see, there will be no let-up in corporate failures over the next two years, despite fragile signs of recovery.

But the insolvency statistics did reveal an interesting trend – that of the increasing use of company voluntary arrangements (CVAs).

According to the figures, there were 313 CVAs put in place in the first half of 2009, compared with 271 over the same period last year; a 15% increase. There have been a number of high profile CVAs announced recently – sports retailer JJB [see box on the next page], caravan business Discover Leisure, both supervised by KPMG, and DIY retail chain Focus DIY to name but three.

But the number of companies pursuing a CVA as a form of corporate rescue remains very low compared with formal administrations.

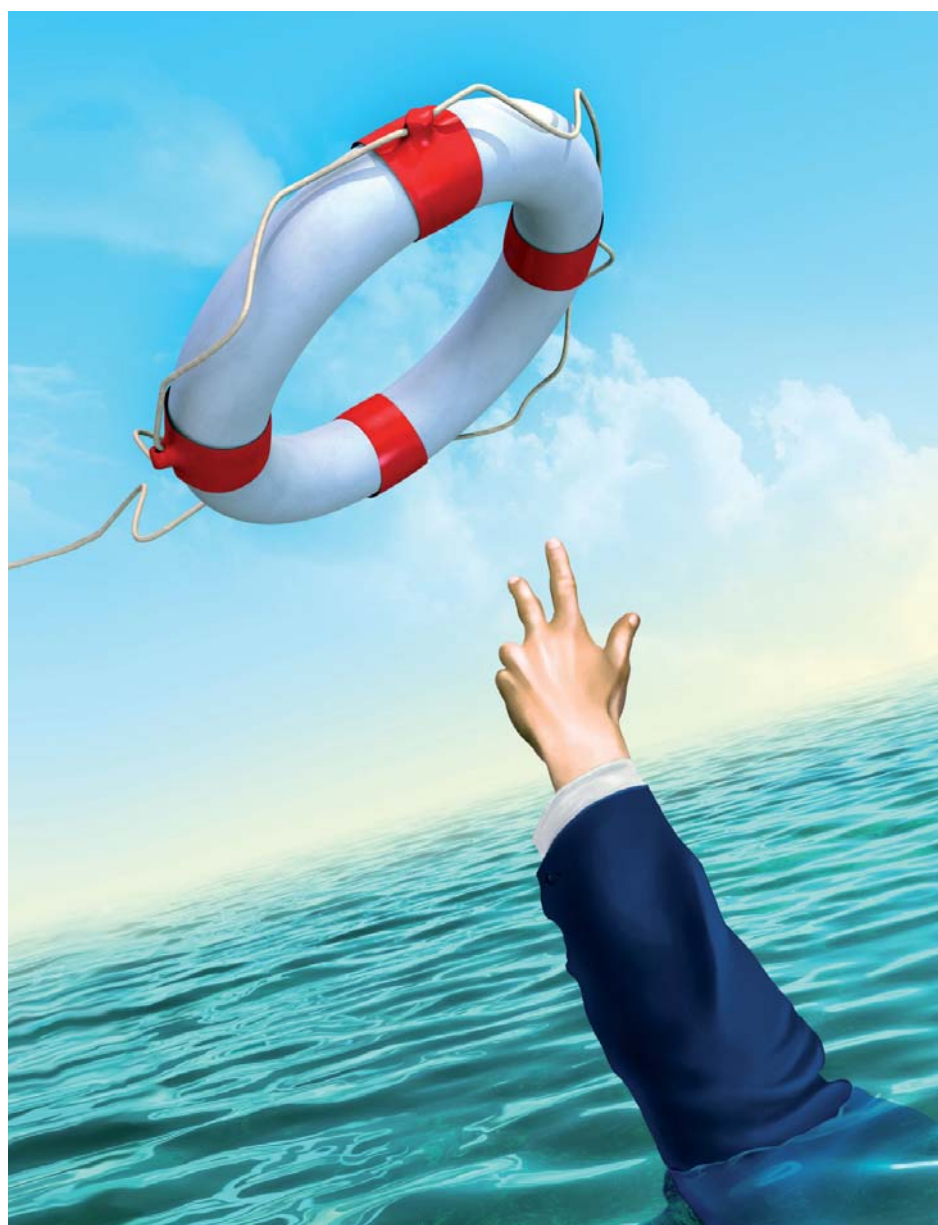
This is ironic – for a company that has hit the rocks, a CVA could prove an attractive option, offering a better outcome for the business and its creditors than other insolvency processes.

But if proposals put forward by the Insolvency Service to improve the process are adopted into legislation, then the number of CVAs could be expected to rise markedly.

DAMAGE LIMITATION

A CVA is a flexible, inclusive and legally-binding means of managing the debts of unsecured creditors. The arrangement needs creditor support to work – at least 75% of unsecured creditors by value must vote for it – but if it achieves this backing it can have significant benefits. Contracts and suppliers often fall away when a business goes into administration. But with a CVA, this is less likely – the company is retained as a legal entity and, importantly, creditors can help solve any operational issues that are affecting performance and are able to recover at least some of their money.

Directors of the business stay in control, and there is a



CASE STUDY: GIVING JJB A SPORTING A CHANCE

In April this year, JJB, the UK's largest sports retailer, faced the very real prospect of administration. Over the course of almost 40 years, the business had grown from a single store to a listed 250-store group, with 55 fitness clubs and an additional 140 closed stores. The senior management team had a series of critical issues to resolve. Cash requirements, unprofitable divisions, unprofitable stores in otherwise profitable areas and a lack of a long-term sustainable strategy put the business's viability in doubt.



JJB and KPMG worked together to avoid administration, maintain the business as a going concern and save more than 7,000 jobs. KPMG advised the management team on managing and generating working capital, modelled a long-term sustainable debt position, negotiated standstill arrangements with lenders and secured new funding. The firm also helped the JJB top team review and close the group's unprofitable divisions in a controlled fashion.

Perhaps the most complex part of the plan was to find an answer to the rental liability for the group's closed stores: an annual sum of some £17.3m. On KPMG's advice, JJB proposed a CVA to landlords, under which the terms of the store leases would be varied so that it could pay its rent monthly. The CVA received overwhelming support from landlords who appreciated its fairness and transparency. As a result of the CVA being accepted, JJB was able to secure a £25m short-term loan with Barclays and a medium-term £25m working capital facility with Lloyds.

The deal marks a breakthrough in corporate history – it was the first time a fully-listed plc had gone through insolvency without its shares being suspended. But, just as importantly, it highlights the effectiveness of CVAs as a corporate rescue tool and their potential to preserve corporate value and assets in the downturn.

less damaging impact on the business than if there were an administration order sitting over it.

But the CVA is not used as often as it could be because many fear the risk of creditor action – an administration offers that protection; a CVA, apart from when it is applied to small businesses, does not. This is perhaps why we have seen many pre-packaged administrations. 'Pre-packs' have been criticised, on the whole unjustly, as unsecured creditors can be excluded from negotiations. A CVA, on the other hand, actively requires the support, and therefore the engagement, of such creditors.

This is where the Insolvency Service proposals could prove key to the increasing use of CVAs.

In its consultation document, *Encouraging Company Rescue*, it proposes, among other things, the extending to medium and large-sized companies the option of a moratorium against creditor action so they can benefit from a breathing space while they try to agree with their creditors a company rescue through a CVA.

NO-BRAINER

This seems a no-brainer, providing systems are put in place to ensure the process is not abused by company directors hoping for an indefinite stay of execution. Such a move would appear to have widespread support – the Association of British Insurers, some of whose members provide trade credit insurance, has welcomed the proposal, saying that a properly supervised system would be transparent and fair to all creditors.

However, another proposal considers providing greater security to repayment of monies loaned post CVA or administration, to allow firms in difficulties access to the funding they need to get back on track. The proposals, which include the super-priority of rescue finance in administration expenses and a greater ability to create new secured charges in an administration,

have attracted some negative comments. It is difficult, however, to recall a situation where funds have not been forthcoming after the appointment of administrators for a legitimate need.

Contracts and suppliers often fall away when a business goes into administration

One has to hope that concerns raised over this issue do not prevent the early introduction of a CVA moratorium. If such a moratorium is accepted into legislation, then we can expect the number of CVAs to increase significantly. And the insolvency statistics could begin to take on a different shape.



Richard Fleming is UK head of restructuring at KPMG