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CASE STUDY:
COVID-19 BUSINESS SOLUTION

DEED OF COMPANY ARRANGEMENT

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Manufacturing business

This manufacturing business was operating profitably before COVID-19, however, following the crisis, its revenue has decreased by around 50 percent. The director has done everything right: reduced expenses; got JobKeeper; negotiated rent-free periods and deferred rent amounts; attained an ATO repayment agreement; and negotiated new payments terms with suppliers. The new projections say they will now survive on a break-even position until *25 September 2020.

However long-term cash flow projections tell a different story. After 25 September 2020 revenue will be insufficient to repay the deferred debt and new debt. The business cannot survive.

This is where the company could appoint a voluntary administrator to assist in a formal restructure through a Deed of Company Arrangement (DOCA) proposal. Once appointed, the administrator would:

- **secure the business assets**
- **trade on the business**
- **consider whether the ongoing trading of the business is viable**
- **determine what recoveries would be made in a liquidation scenario (to qualify the DOCA viability for creditors).**
- **assist the directors in formulating a DOCA proposal.**

So, what is a DOCA? A DOCA is a proposal put forward by company directors to provide creditors with a return that would be better than a winding up scenario. In avoiding the company being placed into liquidation it provides the opportunity for the company to continue to trade with control going back to director.

This case study gives a concise overview of the following factors for directors and their advisors to consider:

- **Business assessment**
- **What the numbers mean**
- **DOCA proposal**
- **DOCA benefits**

*Government COVID-19 relief and measures ends on 25 September 2020.

Business assessment

The directors and their accountant meets with Worrells to discuss some options for how to assess the business position and the option of considering a formal restructure through a Deed of Company Arrangement (DOCA).

Here are is an overview of the basic numbers they discussed.

As at June 2020.

MANUFACTURING BUSINESS	BOOK VALUE	LIQUIDATION	DOCA
ASSETS			
P&E	150,000	75,000	
Office equipment	20,000	10,000	
Stock	50,000	10,000	
Debtors	150,000	150,000	50,000
DOCA contributions			300,000
Insolvent transactions recoveries		-	
TOTAL RECOVERIES	370,000	245,000	350,000
VA liquidator costs		125,000	-
VA/DOCA costs			75,000
Available funds for employees		120,000	275,000
Less employee redundancy costs		250,000	50,000
AVAILABLE		-	225,000
Creditors		350,000	350,000
DIVIDEND RETURN		-	64%

What the numbers mean

Assets

The actual value of any assets in a liquidation scenario, is often quite low, but given the current economic environment, it is likely to be worth less than before.

Debtors

The debtors would be recoverable in full in a liquidation scenario.

Insolvent transaction recoveries

The administrators will also look at whether or not there's any potential voidable transactions that may be recovered in a liquidation scenario.

Given the manufacturing business was trading profitably and therefore not insolvent before COVID-19, the administrator would quickly determine that there are no voidable recoveries that could be identified should the company be placed into liquidation.

Employees

The employee figure is very high in a liquidation scenario as it is expected that the company would cease to trade and all employees would be terminated. Therefore significant redundancy costs would be incurred.

DOCA Proposal

The administrators will then work with the directors to formulate a proposal for a Deed of Company Arrangement (DOCA) to provide creditors with a better outcome than that of placing the company into liquidation. In doing this they will consider the current company position including whether or not it's trading and what profits, if any, it is currently making.

The administrator would then prepare the cash flow projections of the business over the coming months and even years to determine what profits the business would be capable of producing during that time. It is with these numbers that the proposal for a DOCA would be presented to creditors to consider.

DOCA proposal

A proposal for a DOCA is completely open as to how it can be formulated. It could be an upfront lump sum payment for creditors, a regular payment over time, or a percentage of the net profit the business generates.

In this case study the following proposal was formulated:

- **$50,000 of the debtors would be used to pay the small number of employees that are being made redundant now, otherwise they would not receive any funds for a period of at least 12 months as *FEG doesn't apply in a DOCA scenario.**

- **No payments made by the company until February 2021. This time period would allow the company a moratorium period to focus on improving the revenue of the business rather than be preoccupied with how they are going to pay the old debt. It would also assist them in getting through the Christmas period where revenue is seasonally lower.**

- **From February 2021 the company would pay 50% of all net profit generated for the following 18 months. In this example, this is an amount of $300,000 over the 18 months.**

In this example, as shown the financial analysis on page 3, this would provide creditors with a return of 64 cents in the dollar.

Compared to a liquidation scenario where unsecured creditors would get nothing due to the high redundancy costs that are incurred if the company was to terminate all employees.

*The government's Fair Entitlements Guarantee (FEG) provides financial assistance to cover certain unpaid employment entitlements to eligible employees who lose their job due to the liquidation or bankruptcy of their employer.

DOCA benefits

- The company has identified that in the long term it will be unable to survive and pay down the old debt—the business would have closed eventually.
- While there is protection in place currently for any directors that are trading on insolvently, that protection will end on 25 September 2020 in which case if any directors trade on insolvently after that period they can be held personally liable for that debt.
- If such a proposal is accepted it critically blinds all creditors to the agreement. This gives the directors comfort and certainty that the future of the business will not be derailed by old debt.
- The company knows that it can afford to pay the old debt through the DOCA as the contributions are directly linked to its net profits.
- The business continues to operate.
- Employees keep their jobs.
- Creditors keep a customer.
- A landlord keeps a tenant.
- A DOCA agreement gives creditors comfort that while they will not be paid immediately, they will receive their money or at least a large portion of it over time.
- If such a proposal was not to be accepted by creditors the company would then be placed into liquidation.

A voluntary administration process that results in a DOCA appointment can be actioned in as promptly as four to five weeks, which leaves a minimal disruption as possible on the business.

This formal restructure process is specifically aimed at those businesses that have taken all the steps and found that the business's long-term viability may be a challenge without taking further proactive steps.