CVAs 2020 and Beyond

CVA+

Act Now To Recover

pwc

A brief overview of a Company Voluntary Arrangements 2019 vs 2020

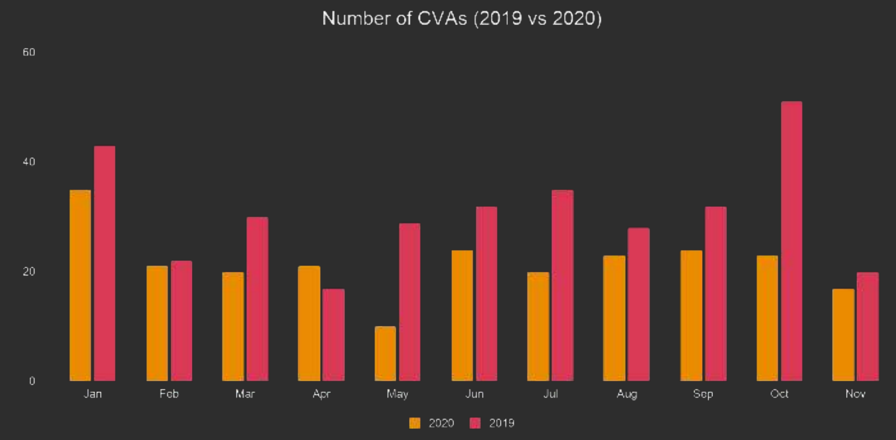
The number of CVAs in 2020 has fallen vs 2019 as a result of government financial help packages and the suspension of landlord winding up petitions to support companies through the enforced lockdowns due to COVID-19.

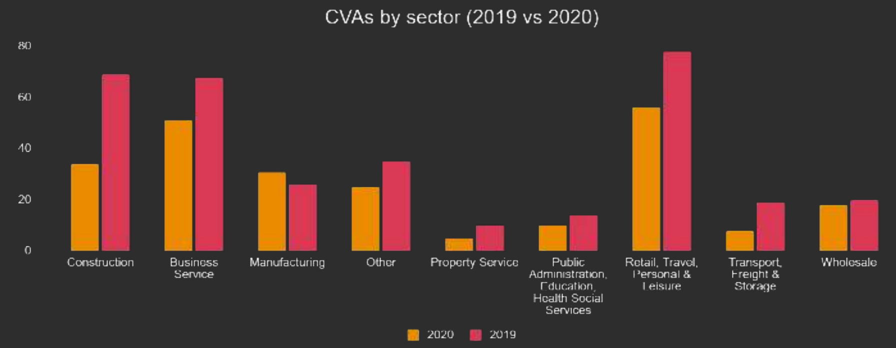
CVAs in 2020

- During 2020 there have been 238 CVAs (Jan – Nov 2020) in England and Wales[1], with 76 seen in the first quarter, which were therefore not related to the pandemic
- In the same period in 2019 there were 339 CVAs. The lower number in 2020 highlights in part the impact of the government led support measures and protections introduced in response to the pandemic
- However, there have been more CVAs used by larger companies (those with >£25m turnover) as shown in the following table.These larger CVAs have received significant press coverage and public interest during the year

	2019	2020 (Jan to Nov)
Number of large company CVAs	13	25
RCHL sector	7	19
RCHL sector %	53.8%	76.0%

- CVAs continue to be used across a variety of sectors but in both 2019 and 2020 the most were in the retail, consumer, hospitality and leisure ("RCHL") sectors. Post COVID-19 it is these CVAs that have generated significant and sustained external debate, highlighting both the immediate impact of the pandemic alongside some of the headwinds that already existed in these sectors
- Temporary restrictions on winding up petitions and evictions continue to protect companies but CVAs have been and continue to be launched. Since the pandemic triggered a UK lockdown in March 2020, 19 high profile CVAs had been launched by the end of October 2020 with proposals for six more launched in November
- We have focused our research on these CVAs, which we refer to as COVID era CVAs, analysing 17 of these to form a view of how COVID has impacted these businesses – and how in response they have sought to use a CVA to restructure



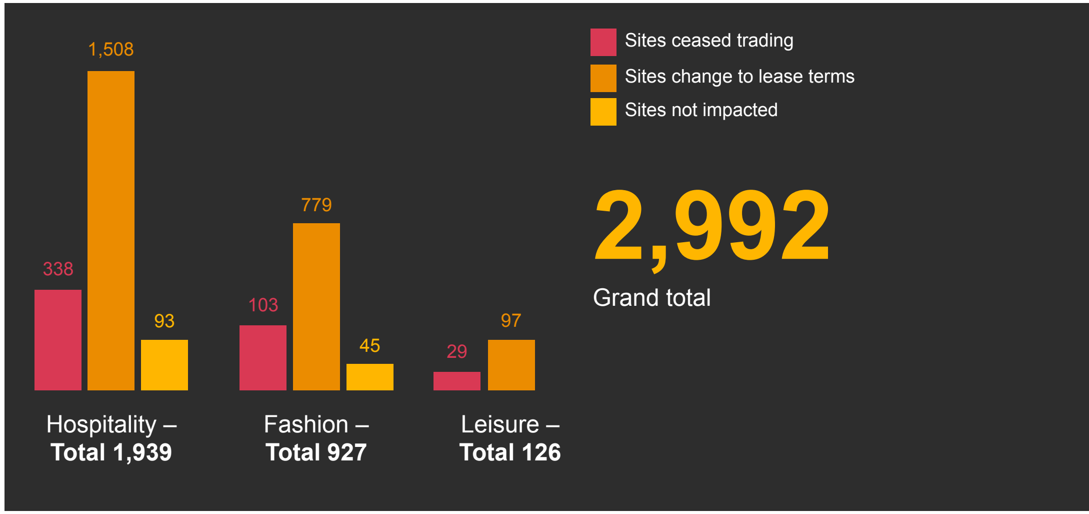


Largest COVID era CVAs

COVID's impact on the high street has resulted in a large number of companies using a CVA as a means to survive via measures including injecting new money, rent reductions and reducing property portfolios.

CVAs in 2020

- We have analysed 17 of the COVID era CVAs launched between June and October 2020. These CVAs have impacted 2,992 sites across the UK, with the Greater London area being most impacted – 776 sites, 25.9%, followed by the South (ex. London) 608 sites, 20.3% and the North 559 sites, 18.6%
- Top 5 cities impacted by these COVID era CVAs are:
  1. London 19.9%,
  2. Birmingham 2.9%,
  3. Edinburgh 2.0%,
  4. Manchester 2.0%, and
  5. Newcastle 1.7%.
- Unsurprisingly, hospitality has been the most affected sector with 1,846 sites impacted in some way by CVA terms (61.7% of analysed sites), followed by fashion retailers with 882 sites affected (29.5% of the total)
- In total, only 138 sites (4.6%) were not affected with the vast majority of sites (79.7%) having their lease terms altered. Across the remaining 15.7% of sites, companies planned to cease trading and ultimately exit the site
- For 79.7% of sites where changes were proposed these included:
  - transition to turnover-based rent,
  - rent reductions,
  - write off of arrears, and
  - changes to payment terms – often a shift from quarterly to monthly rent payments.
- Within the three RCHL categories (hospitality, fashion and leisure), hospitality was the category with the largest proportion of sites (17.4%) where trading was ceased
- The key terms of these 17 COVID era CVAs have been analysed overleaf



U.K. sites: Heatmap by region

A deep dive into COVID era CVA proposals

Our analysis suggests that following COVID most companies are using CVAs as a broader restructuring tool, often compromising multiple creditor groups alongside new funding from either lenders or shareholders.

Rent reduction vs turnover rents vs closures

- From the 17 CVAs analysed covering 2,992 sites, the statistics have shown that businesses seek to reduce fixed costs and in particular rent liabilities via:
    1. Rent reduction 33.1% of sites,
    2. Shift to turnover rent 31.8% of sites, and
    3. Ceasing trading from site 15.7% of sites
- The reduction of rent to nil with the intention to exiting via a CVA process remained at relatively similar proportions for CVAs we analysed previously in 2019 (13.9%) vs. COVID era CVA (15.7%)
- For the remaining sites, 64.9% of rents have been compromised via rent reductions or changes to turnover rents. We have combined this analysis as a shift to turnover rents in most cases also represents a rent reduction, although this is clearly linked to trading levels
- Only a small proportion of sites 4.6% have seen no change to lease terms (“not impacted”) – in stark contrast to 42.8% of an equivalent sample of pre-COVID era CVAs analysed previously in September 2019

Which creditors are impacted?

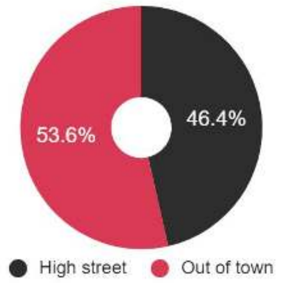
- Historically, critics of CVAs have argued that some companies used CVAs solely to get out of leases they didn't want to continue with or to reduce the rent and therefore only impacting landlords, with other creditors such as trade creditors, pension funds and HMRC not impacted at all. COVID era CVAs appear to compromise a wider range of creditors
- From the 17 CVAs analysed, breakdowns reveal most incorporated a wider restructuring of the company with the following breakdown of stakeholders impacted:
    - 16 (94%) of the CVAs included an injection of new money from either lenders or shareholders
    - All 17 CVAs affected multiple creditor groups, not just landlords. However for a number of these, the only other creditors impacted were intercompany.
    - 8 (47%) included a write off of some debt by either lenders, shareholders, or intercompany loans.
    - Only 1 CVA compromised HMRC

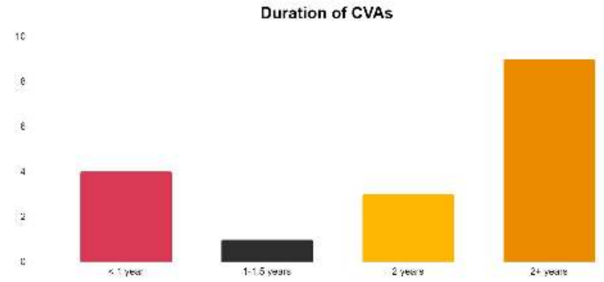
Location of CVAs

From the 17 CVAs analysed there is a close split of ‘out of town’ and ‘high street’ sites where trading was ceased. ‘Out of town’ sites continue to be the larger % of sites to be vacated, consistent with our previous analysis

Length of CVAs

Of the CVA’s analysed the majority sought concessions from creditors lasting 2 years or more. As can be seen on the right many compromised more than one creditor category but the duration often reflects the period over which landlord concessions were requested.





Conclusions and post COVID outlook

Looking Back – 2020

- The number of CVA's approved in 2020 has fallen although for larger companies (with turnover >£ £25m) there has been an increase, reflecting both the structural challenges in certain sectors and the impact of COVID
- Since June 2020 there have been a number of CVAs in the RCHL sectors all with the overarching objective of giving the company the best chance of continuing as a going concern in light of the immediate challenges presented by COVID. Some of these delivered a full restructuring with various stakeholders 'shouldering the burden' and new funds being injected while for others landlords were the only external creditor group compromised
- The impact on landlords has varied from those that are untouched through to those where arrears and future obligations are fully compromised. In some cases there has been a preference to move to turnover rents, thereby sheltering businesses during periods of enforced closure
- CVAs are however an Insolvency Act process squarely in the public eye. While, undoubtedly preserving businesses, they can impact brand and reputation in some cases, in addition to sometimes triggering insolvency clauses in contracts
- As a result many businesses will have chosen to negotiate directly with landlords and other creditors and remain out of the spotlight. The recent extension of a moratorium protecting tenants from the threat of eviction from commercial landlords until 31 March 2021 provides further breathing space for any such negotiations to take place
- Many of the Covid era CVAs have not attempted to compromise HMRC debt, often citing the support already provided by HMRC as a reason not to compromise arrears. From 1 December 2020 certain HMRC debts have a secondary preferential status in the event of insolvency meaning these debts can no longer be compromised through a CVA. Consequently, any support from HMRC to enable the company to survive will need to be negotiated directly outside of any process (e.g via a Time To Pay arrangement).

Looking Forwards to 2021

- The use of CVAs to compromise debts will certainly continue in 2021, especially in the period up to 31 March, when the moratorium on landlords evicting commercial tenants remains in place. Companies will often have built up significant liabilities – especially rent, that may need addressing to enable companies to survive. Others may view that changing the structure of the business and cost base is key for survival
- The use of a CVA following a Moratorium, the new process introduced in the Corporate Insolvency and Governance Act 2020 to provide protection from insolvency whilst a restructuring is planned and then seek to ensure survival of the Company, seems inevitable. More Companies will consider this as an option once the government imposed moratorium on creditors issuing winding up petitions expires (currently on 31 March 2021)
- Cases where the landlords are compromised in isolation will continue to have an air of injustice
- CVAs disclose both the current status of the business, how creditors are to be treated and what the outcome could be if the CVA is rejected. This disclosure highlights to all creditors how acute the outlook is, why creditors are treated differently and seeking to justify those creditors being compromised
- Such transparency gives the Company the chance to highlight the key benefit of a CVA – restructuring to drive the best chance of survival – but also exposes the weakness of the current position and is open to challenge by creditors.
- Creditor challenges are rare as there is often no incentive to challenge (if that would lead to company failure). Any challenge process can be both costly for the creditor and takes time
- Exposing the situation of the company also presents the opportunity for others looking to exploit this (such as targeting shareholders and / or offering creditors a better deal)
- Actions like this could present a greater incentive for creditors to challenge what are likely to be an increasing number of CVAs through 2021

Methodology

COVID era CVAs

Leveraging our extensive data analytics capabilities, we analysed the impact of CVAs proposed by 17 companies, all of which were approved by creditors. The report was completed in December 2020.

These CVAs covered **2,992** sites.

Our store-level analysis categorised sites based on proposed treatment under the CVA and mapped them to locations. This data enables us to understand the key themes of these CVA's including the impact on trading sites and leases, highlighting which areas have most benefited and which have been impacted by the CVA, using visualisation tools used to help clients quickly understand the impact across their portfolios.

Further local and sector insight information is available. Please contact David Baxendale or your relevant contact across PwC's nationwide Business Restructuring Services network.

CVAs in 2020

Data based on 238 CVAs lodged in England and Wales by companies operating across the U.K. However NI and Scottish data is not included due to different measuring parameters.

CVAs: What are they?

Company Voluntary Arrangements ("CVAs") are an insolvency process which allow a company to negotiate with its unsecured creditors.

What are they?

- Company Voluntary Arrangements ("CVAs") are an insolvency process, specific to the UK
- It is a debtor-in-possession process with minimal court involvement whereby the directors of the company stay in control of the business
- The purpose of a CVA is to allow a company to negotiate with unsecured creditors, including but not limited to suppliers, HMRC (for certain liabilities only after 1 December 2020), employees and landlords, with the purpose to generate liquidity whilst maintaining the business as a going concern

How do they work?

- As it's an insolvency process, the company must be insolvent or contingently insolvent to be able to implement a CVA, and CVAs must be overseen by an Insolvency Practitioner
- As part of the process, all unsecured creditors are allowed to vote on the CVA proposal and in order to proceed it must satisfy two criteria:
  - 75% of creditors (by value of claim) who vote must approve the CVA
  - No more than 50% of unconnected creditors may vote against the CVA
- However, even if a CVA is approved, creditors may within 28 days of the vote challenge the CVA on two potential grounds, i) "Unfair prejudice" or ii) "Material irregularity"
- Unfair prejudice implies that the CVA treats different unsecured creditors in different ways and whether it is fair depends on the overall effect of the CVA. It is uncommon for challenges on this basis as the evidential burden is high, negative PR and the alternative (liquidation) is in most instances a worse outcome
- Creditors may challenge the CVA on the basis of material irregularity if they can persuade the Court that the procedure for implementing a CVA was not correctly followed. It's important that any proposal can demonstrate that a CVA process is the best option and will guarantee a greater return than an alternative insolvency process

Advantages and risks

Advantages

- An incredibly flexible restructuring tool, allowing a company to restructure its cost base, right-size the business and provides flexibility on which creditors to compromise
- It is a corporate led process, meaning the company and directors remain in control
- CVA route does not require companies to be insolvent meaning actions can be taken during early signs of distress and/or as a way to deal with built up liabilities as a result of COVID-19
- As a corporate led process, with some court intervention, it may be a cheaper alternative to other restructuring (and insolvency) processes

Risks

- CVA must be able to demonstrate it is in the best interests of creditors
- Can be challenged within 28 days of the filing of the report on the outcome of the creditors and members meetings
- If it fails, insolvency may be the only option
- Public process with a high level of disclosure in the Proposals which are shared with all creditors
- Unless the Company specifically seeks to enter a moratorium process there is no protection from creditors whilst the CVA is being negotiated

Stakeholders and process

Stakeholders

- Directors
- All creditors and shareholders
- Employees (to the extent they are owed monies)
- Other group companies
- DB pension schemes
- Landlords
- HMRC
- Banks

Process

- Engagement with Insolvency Practitioner ("IP")
- Engagement with key shareholders and creditors
- Preparation for moratorium (if planned to provide protection and criteria for entry can be met) and CVA
- Formal CVA proposal process
- CVA proposal voting
- Challenge period
- CVA implementation
- Exit

What makes a CVA successful?

A standalone CVA, when combined with a wider financial and operational restructuring, is an extremely effective tool in achieving a business turnaround and transformation.

A successful CVA needs to be part of a wider restructuring solution to ensure the underlying business issues are addressed for the longer term. This may include changes to strategy and operating model to adapt the business, review its cost base and boost its financial health.

Financial restructuring

- Undertaking detailed review and analysis of financial forecasts and business plans, with specific analysis on cashflows, liquidity, funding and sensitivities on covenants
- Understanding and managing key stakeholders/ decision-makers (including lenders, credit insurers, shareholders, pension trustees and The Pension Regulator, suppliers and landlords)
- Providing routes to new money through new capital providers and supporting these discussions
- Advising stakeholders on expected returns and recoveries of from different proposals
- Providing restructuring solutions to help stabilise and/or facilitate rapid transformation of a business through CVAs (and other restructuring/insolvency tools if applicable)

Operational restructuring

- Reviewing and implementing steps to right size a business (e.g. locations / portfolio size, workforce, stock /inventory mix, central costs base, supply chain et al)
- Rapid cost reduction/prioritisation through activity and spend data analysis, efficiency identification and hands on implementation
- Designing and implementing a competitive and right sized organisational structure
- Rapid cash generation through working capital management (supply chain and inventory management, AR terms review, process improvement) and improved cash flow forecasting
- If needed, appointing a Chief Restructuring Officer or PMO to drive turnaround through effective stakeholder management, governance, oversight and challenge

Commercial sustainability

- Reviewing of the competitive landscape (direct and indirect) and the key sources of differentiation
- Understanding the addressable customer segments and how best to serve them (especially during and post the COVID-19 restrictions)
- Designing the appropriate store portfolio (number, locations and format)
- Assisting considerations of the the investment requirements to stabilise and grow the business
- Considering the outlook for the relevant markets (size, growth, price vs volume, category mix, channel evolution), preparing a business for the future

Why now?

Given the current economic backdrop and the COVID-19 pandemic, CVAs will become increasingly important in helping businesses get back on their feet. Combined with the new moratorium regime, these insolvency mechanisms are well-positioned to give businesses a genuine chance of restructuring to recover from the economic impact that COVID-19 has had-. CVAs also provide a route for businesses to find a firmer, and more sustainable, financial footing than before.

Thank you

pwc.co.uk