



SMITH HANCOCK

INSOLVENCY NEWSLETTER

May 2006

An Increased Level of Enquiries

Notwithstanding the strong rates of growth in the Australian economy over the past one and a half decades we continue to receive an increased level of enquiries from directors whose businesses are experiencing financial hardship. The spectre of upward movements in interest rates will add further to the pressure being experienced by many in small to medium sized businesses.

Although it is difficult to single out any particular industry segment, there is little doubt that the slow down in the residential property market, increased fuel costs, and structural change within the manufacturing sector have impacted negatively on a wide range of the building and transport segments.

In this Newsletter we discuss the object of a Voluntary Administration ("VA") and provide a summary of how the VA process recently assisted a medium sized manufacturing business to trade out of certain failure.

Recent VA Turnaround Case

The objective of the VA provisions of the Corporation's Act ("the Act") is for the business, property and affairs of an insolvent company to be administered in such a way that maximises the chances of the company's business continuing in existence and/or provides a better return for the company's creditors and members than would result from an immediate winding up of the company.

A partner of Smith Hancock was recently appointed Administrator of a medium sized manufacturing business in Western Sydney, which we will call XYZ Pty Limited ("XYZ"). XYZ fell into difficulties after experiencing strong competition from cheaper international markets that reduced profit margins, a reduction in product quality as a result of production problems, and some poor investment strategies.

The appointment of an Administrator arose as a result of the company's cashflow being insufficient to meet its current liabilities particularly to the Australian Taxation Office ("ATO"). The ATO had issued Director Penalty Notices to the director pursuant to Section 222AOE of the Income Tax Assessment Act 1936. The director of XYZ was initially reluctant to appoint an Administrator as he had established his business and traded it for approximately 29 years. However, he was keen to see the company survive.

Shortly after the commencement of the Administration, an external consultant was engaged to manage and restructure the manufacturing and operational side of the business whilst the Administrator traded the business and dealt with its day to day running paying particular attention to its financial trading performance and market position.

The Administrator worked closely with the director and the consultant to establish strategies which would provide a sustainable turnaround of the poor performance the company had been experiencing for several years. These strategies included changes to the company's operational structure, financial management and performance monitoring.

The director submitted his proposal to the Administrator for the company to enter into a Deed of Company Arrangement ("DCA") with its creditors which included a restructure of the company. The restructure was to take place over a period of up to six (6) months and included the following:

- Reassessment of production costs.
- Increasing revenue sources.
- New business practices relating to improvements in debt collection and cashflow.

The DCA offered a return of approximately 15 cents in the dollar to be paid over a period of eighteen (18) months. The funds for the DCA were to be generated from future trading profits from the

company's business. If the company was liquidated creditors would have received a dividend of less than 3 cents in the dollar. Other benefits in accepting the DCA included the protection of the existing premises lease, the continuation of employment for the company's workforce, and creditors were able to maintain a market for their products/services.

A condition of the DCA was that the director and his relatives deferred any claims they had until the terms of the DCA were satisfied. This improved the return to creditors. Put simply, the benefits of the DCA were more attractive to creditors than the outcome of a winding up of the company.

Creditors accepted the terms of the DCA and to date we are encouraged to say that the company has been compliant with its obligations under the DCA. This includes monthly payments to a Deed Fund and submission of monthly management accounts to the Deed Administrator.

If any of your clients are experiencing difficulty in meeting their current liabilities and are seeking relief from creditors constant demands, then the appointment of an Administrator to deal with the company's business, property and affairs and allow the director a period of at least three (3) weeks to prepare a Proposal to be put before creditors may be appropriate.

For example, the appointment of an Administrator can assist a company in the following ways:

- The Act provides that all debts against a company are frozen as at the date of the Administrator's appointment pending the outcome of the proposal meeting, generally held within twenty-eight (28) days from commencement of the Administration;
- The Act provides that creditors with personal guarantees against the director(s) of a company are prevented from taking action to enforce those guarantees whilst the company is in Administration;
- The Act provides that an Administrator is not liable for rent or lease obligations, that a company may have, for the first seven (7) days of the Administration, thus allowing the Administrator time to consider and assess such obligations and determine if there is a benefit in continuing such arrangement;
- The Administrator assumes control of the

company's affairs and can trade the business of the company throughout the Administration whilst the director(s) proposal is being developed;

- The Administrator can assist in planning and implementing a restructure of the business of a company and assist a director in forecasting cashflows.

Smith Hancock has the experience and resources to investigate and resolve most financial problems your clients may encounter.

If any of your clients are experiencing difficulty please do not hesitate to contact us. The initial consultation would be without cost or obligation to your client.

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