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Bankruptcy & restructuring

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David Bryan is a founding principal of Bryan, Mansell & Tilley LLP and a hands-on senior financial manager with extensive experience working with international and UK companies in restructuring and improvement. He has operated at CFO level in large and SME companies in the UK, US and Europe, and has many years experience with public and private equity-owned businesses. His industry experience includes automotive supply and commercial vehicle manufacture, industrial systems and services.

Q. Reflecting on the last 12-18 months, how would you characterise the UK in terms of failing businesses and bankruptcy filings?

BRYAN: Formal insolvencies in the UK have been low for many years. The latest figures for Q1 2018 show a small uptick, but though percentages can look high they are from a low base, and the figures are broadly stable. The 'Red Flag' report for Q1 2018 on companies in significant financial distress shows a 33 percent year-on-year increase from 2017. The most noticeable adverse trend is in consumer-facing businesses. Political uncertainty and changing shopping habits have created falling demand for traditional retailers and this, coupled with a variety of increased costs, is causing difficulty for those businesses that rely on consumer spending.

Q. Could you outline the primary macroeconomic trends currently affecting businesses? Are any particular sectors demonstrating structural weaknesses, resulting in distress?

BRYAN: The economic background has not changed that much in the last year. Modest but slowing growth and very low interest rates seem the norm. Inflation had risen rapidly, mainly as a result of the pound's fall after the Brexit vote, but that seems to be subsiding. Wage growth has been low but is now rising and we have recently seen growth in real wages for the first time in a few years. All of this has been against the backdrop of Brexit and other major geopolitical uncertainties. Consumer-facing sectors are facing challenges, with retail and most recently casual dining, experiencing difficulties. There has been a flurry of restructurings in the last year where retail and dining businesses have been closing underperforming outlets and attempting to shrink their business back to profitability, almost all through the use of creditors voluntary arrangements (CVAs). The other headline area has been construction, where the structural issue of multiple layers of sub-contractors operating on low margins and lengthy payment terms has proved too challenging for many businesses to survive.

Q. Have any recent bankruptcy or insolvency cases in the UK captured your attention in particular?

BRYAN: The insolvency of Carillion has captured much attention. It was a large firm involved in construction and the provision of outsourced services for the public sector. It has raised questions about many things, from audit quality to directors' conduct, to pension schemes, and has further stirred the debate about whether a more Chapter 11-style regime could have led to a less chaotic situation and a consensual solution to the business problems. The common ability of a party to a contract to terminate it on the insolvency of the other party has particularly harsh consequences in a contract-based business such as construction. The insolvency of Monarch airlines in late 2017 also raised a number of issues with the insolvency system. Some 110,000 people were stranded abroad and had to be repatriated, largely at the taxpayers' expense. Again, this has raised questions about whether the insolvency regime could be improved and comparisons to more orderly airline insolvencies in the US under Chapter 11.

Q. How easy is it to renegotiate existing debt in the current market? Is there funding available to support distressed companies and finance restructurings?

BRYAN: The legal frameworks are very supportive of renegotiating debt and there are a number of tools available to assist. In general, lenders are more than capable of seeing the merits of a debt restructuring, as opposed to a value-destructive insolvency, where a good business case is presented which addresses the operational turnaround, as well as restructuring the balance sheet. The growth in alternative lending and non-bank sources of debt is also helpful and gives restructurings more options. There is, however, a lot of money chasing yield, and debt multiples are rising. The six-times EBITDA limit suggested by regulators for banks is being breached and does not apply to non-bank lenders. There has also been a big increase in covenant-light lending. I cannot help but think the lessons of the past are being forgotten and the increased risk associated with high yield will cause problems in the future.

Q. What trends are you seeing in the market's appetite to purchase troubled assets? How would you describe recent distressed M&A activity?

BRYAN: There is a huge amount of money looking to buy troubled assets but relatively few deals are being done. The sale of debt portfolios has largely stopped in the UK so most activity is in single ticket deals. Buyers are bemoaning the lack of deal volume and the highly competitive market, and are complaining that prices are too high, yet they are not prepared to adjust their own risk appetite. What we are seeing at the moment is an increasing focus on trade buyers purchasing stressed rather than outright distressed assets. These have less insolvency risk and enable the buyer to sort out operational problems and add new products, customers and geographies. They require significant post-acquisition integration efforts and may involve changing management, but done right it can provide excellent returns to the buyer.

Q. Could you outline some of the personal risks facing D&Os of a company that nears insolvency or enters bankruptcy in the UK?

BRYAN: The UK has a clear regime, and directors are required to file when it is clear there is no reasonable prospect of recovery based on what they knew at the time. If directors have taken good advice and can demonstrate the rationale for their decision making there should be no personal risk. It is clear though that some directors have been pushing at the limits of this and recent high-profile cases have resulted in a consultation on proposals to tighten the rules. The proposals cover dividend decisions, asset stripping, selling a business recklessly knowing it is likely to fail and dissolving a company to avoid debts and misconduct claims. Greater powers to investigate directors are proposed, as well as possible claw-backs where directors are seen to have acted wrongly or profited at creditors, employees or a pension scheme's expense. It should be noted that these measures are all directed at misconduct or reckless behaviour and honest directors should have nothing to fear. I think these proposals will come into law. The parliamentary committee looking at the collapse

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of Carillion concluded that the board presided over a "rotten corporate culture" and was culpable for its "costly collapse". Action seems certain.

Q. How do you expect restructuring and bankruptcy activity in the UK to unfold for the remainder of this year, and beyond?

BRYAN: I do not think there will be major change in the next year. The pressurised sectors of retail, construction and casual dining will continue to suffer insolvencies, but I doubt we will see a sharp increase from current levels. Interest rate rises, when they come, will be the eventual trigger for more distress and insolvency. It seems likely that rate rises will be gentle so this may cause just a moderate uptick in distress over time. Beyond that, the bigger issues will be what comes out of the various reviews of insolvency in construction and airlines, directors' conduct, the competition issues around the big-four accounting firms and possible changes to pension funding regulations. On a more general level, the proposals to create a new pre-insolvency regime more akin to Chapter 11 have been stalled for a while but will almost certainly come back to the table fairly soon. How all this will knit together will be very interesting to see.

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