How small business restructuring helped a diversified group of related companies ‘right the ship’

It’s not uncommon for related businesses to financially support each other during challenging times, but the upshot is that it can create significant intercompany loan accounts. So, when a business doesn’t recover quickly enough and third party creditors – particularly statutory creditors – begin to increase, that’s where the Small Business Restructuring (SBR) process can be a great solution.

The below case study is a good example of how the SBR process helped a diversified group that found itself in financial distress when one arm of the business had to lean on its related entity to get it through a rough patch following COVID-19 trading restrictions.

Background

Andrew Spring, Jirsch Sutherland Partner

The three companies operated cafes in various locations in NSW but, like many in the hospitality sector, they were severely impacted by the restrictions imposed during the pandemic. All three companies struggled to earn a profit, as they were continuing to pay rent at a time when they weren’t able to trade. However, from the start of the 2022 financial year, business and revenue began to improve for the cafes. In the same financial year, the Group diversified into the fitness industry, investing in two gyms, in Sydney and on the Central Coast. Unfortunately, due to COVID-19 precautions, the gyms experienced slow growth and had no sufficient assets to repay the investment made by the related companies, which had intercompany asset loans.

“The businesses were showing continued signs of improvement and were fundamentally viable, but they had accrued a level of legacy debt that was impeding further growth and threatening to sink them,” explains Andrew Spring, Jirsch Sutherland Partner and Small Business Restructuring Practitioner.

Solution

Following assessment by Jirsch Sutherland, it was determined the SBR process would be the best-outcome solution for all three companies. Each business had been significantly impeded by the trading restrictions and conditions of the COVID-19 pandemic, but they had survived and were showing signs of future success. However, they were debt laden and needed a financial restructure to ensure they had a chance to realise their potential. The combined SBR process for the three companies allowed them to present a complete picture of the past events and future opportunity. This provided a level of transparency that encouraged support for the restructure proposal. The SBR plan was put forward to creditors, which included the ATO, and was accepted by all, enabling it to be put in place.

Result

The SBR external administration period has now finished; however, the companies are still subject to the restructuring plan. They are meeting their obligations, with the first dividend recently being paid. Overall, creditors will receive a return of 21 cents in the dollar. The approval of the restructuring plan has addressed the legacy debt – including the intercompany loan accounts – that had accumulated due to the trading restrictions put in place during the pandemic, and the cafes and gyms are still in operation.

Protecting all entities

Spring says while the SBR process is often a great solution, the eligibility criteria must be taken into consideration.

“It’s important to note that one of the eligibility criteria for engaging a Restructuring Practitioner is that the director (or former director) has not utilised the process previously in any other company during the last seven years,” he explains. “However, there is a 20 business day period from the date of the first SBR appointment, where this restriction does not apply. As such, it is possible to undertake a restructure for a group of companies, as in this instance, to maximise the return to third party creditors while protecting each of the businesses’ ability to continue to trade.

“Taking proactive advice before a creditor sought to enforce against one member of the group, resulted in a more balanced approach to finding a solution.”