Protect, Restore and Maximise Value

Upside

Autumn Edition

2019

INSIGHTS ON ISSUES IMPACTING UK BUSINESSES

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Acting Global, Thinking Local

The UK has been experiencing one of its most turbulent periods in its post-war history over the last three years. We have seen a wide range of businesses, across almost every sector, struggle with the challenges of Brexit, from indecision over investment to trying to forecast the ensuing nature of the UK's relationship with the EU and prepare for any eventuality.

In the UK, our restructuring and insolvency experts continue to provide our clients with tailored solutions for all their needs, including those unrelated to distressed situations, supported globally by Duff & Phelps' worldwide operations and large suite of services.

We know that many businesses have assets, operations, liabilities and investors across the world. In the UK, our team's role has always been to help organisations overcome financial distress, but the challenges of that process multiply rapidly when a company operates across multiple jurisdictions. Having access to a global team of market specialists means that when our UK team is engaged on multi-market insolvency cases, we can leverage their knowledge of local regulatory environments to secure successful outcomes for all stakeholders.

We have been working across diverse sectors to help businesses of all sizes negotiate the ever-changing economic challenges they face. From securing the successful sale of a printing business in Lancashire to refinancing an award-winning boutique hotel in the Peak District, we are proud to have worked with a wide range of businesses to help them and their stakeholders achieve positive outcomes.

We have also made a number of key appointments in the UK to strengthen our team and expand our expertise to help our clients face the headwinds of Brexit. We have added Ben Collett, Tyrone Courtman and Vijay Merchant to our team in Birmingham, and promoted Simon Shipperlee, Rob Goodhew, Mike Lennon, Mike Parsons and Martin Gray to the role of Director in our Restructuring Advisory practice in both London and Manchester. Our global Restructuring Advisory practice now includes more than 200 restructuring and insolvency professionals, led by the team in the UK and supported by operations stretching from the U.S., Hong Kong, Spain, Ireland and beyond—a truly global footprint.

Jacco Brouwer has also joined the firm as our new head of European Debt Advisory, further strengthening our debt advisory and restructuring offerings. He has extensive experience in helping private equity and corporate clients identify competitive sources of finance and overseeing the debt structuring and negotiation process to secure successful outcomes for clients. He has also helped many clients going through a turnaround find new sources of finance. It is therefore a natural fit for our teams to work together and we look forward to delivering successful projects together.

However, there are challenges other than Brexit facing the restructuring and insolvency industry. The UK Government is reviewing the current legal framework around insolvency, a process that has been in consultation for some time now. I am therefore pleased to say that Emma Lovell, CEO of R3, the Association of Business Recovery Professionals and the leading organisation for insolvency, restructuring and turnaround in the UK, is our guest columnist and outlines what the proposed changes may mean for us all.

Regardless of how the UK Government decides to proceed with its consultation, Duff & Phelps' Restructuring Advisory team has never been in a better position to help serve both its UK and international clients.

Our recent acquisition of Zolfo Cooper Asia, a leading independent provider of restructuring, insolvency, litigation support and forensic accounting services builds on our ability to deliver local expertise and geographic reach to serve clients in the Greater China region and internationally. In addition, the acquisitions of both Forest Partners, a leading Spanish independent provider of restructuring and financial and corporate advisory solutions, and Prime Clerk, a technology-driven claims and noticing administration practice based in New York, greatly enhance our global capabilities and comprehensive service offerings to clients. Cross-border insolvencies are more common than you think, and our multinational operation, led by our team in the UK, enables us to support our clients at a global level.

Whilst the business continues on its geographic growth trajectory, expanding our core UK practice to support the needs of stakeholders in UK corporate businesses is central to our strategy.

With this edition of *Upside*, we provide insights on issues impacting UK businesses and into some of the recent work we have done for our clients.

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The Unlikely Real Estate Investor

In the past three years, an unexpected type of market participant has evolved in UK commercial real estate investment – local authorities.

Outside of the real estate arena, this might surprise many, particularly in times of reported austerity, but local authorities have consistently spent, year-on-year, over £1.6bn on commercial real estate investments since 2016.[1] This equates to almost £5bn over three years and is a significant increase from the £1.2bn spent between 2008–2015.

The reason for the increase in activity is simple – a relaxation in the Public Works Loan Board's (PWLB) rules in April 2016 made it easier for local authorities to borrow from the Treasury at low rates to buy income-producing assets. The spread between the loan rate (typically 2-2.5%) and the return rate on the rental income governs the profit made by the local authority to then spend on local services.[2]

Of course, local authorities notoriously used a not too dissimilar strategy when they placed substantial sums on deposit with Icelandic Banks, with the deposits yielding attractive interest rates creating a spread between the interest income and interest on borrowing commitments. After Iceland's banking sector collapse it took several years for these deposits to be recouped.

Driven by the desire to acquire income producing real estate, many local authorities have purchased assets outside of their administrative boundary. For example, Broxbourne Council (Hertfordshire) spent £17.2m on a Tesco investment in Grimsby and Bracknell Council (Berkshire) bought a £12.2m retail park in Lincolnshire.[3]

However, there appears to be a renewed focus on acquisitions within administrative boundaries, with two significant purchases reported in August 2019 by Wokingham Borough Council (Twyford Waitrose for £14.87m) and Cambridge County Council (Cambridge Tesco for £51.4m).[4,5]

It is notable that Spelthorne Council has been one of the most active participants, currently responsible for £1bn in loans from the Treasury having also made the well-

publicised purchase of BP's office complex in Surrey for £358.5m two years ago. Whilst there have been reports that Spelthorne may have "overvalued" investments, these have since been rebuffed by the Council and, subsequently, it has been reported that Spelthorne Council has changed its strategic focus to affordable housing.[6] Nevertheless, there are very serious questions around how local authorities assemble a diverse and diluted portfolio, which spreads risk and income.

As a result, in April 2018, the UK Government instructed councils to take extra care over investments, particularly given the recent wealth of store closures in the retail sector and because of this, the nature of investment has somewhat shifted. For example, spending on retail assets fell by 34% in 2018 (to just over £400m), while the amount spent on office assets rose 23%, to a record £970m.[7]

Fundamentally, one must query the ability of local authorities to diligently asset manage these acquisitions noting the scale and complexity of their real estate investments going forward. While some will be more straightforward investments with a collectable rent roll year-on-year and no active asset management obligations until lease expiry (10-20 years), others may not be so straightforward. Equally, in instances in which tenants fail to meet their obligations, will these new owners be equipped to practically and proactively deal with the assets to avoid value and income erosion?

There is also the question of long-term plans when, for example, tenants vacate at the end of lease terms or exercise break options. While the investments may seem promising at this point in time – particularly for fully let, new buildings – they could be a resource drain in the future. Inevitably there will be some failed investments, raising questions of the investment decisions made during this cycle, and how this then impacts PWLB borrowing plus, of course, how local authorities will repay these interest-only loans without a need for a sale of the property assets at a future point in time.

Furthermore, there is also the question of pricing and whether local authorities are paying market value to secure these assets. While other investors may only be able to seek a portion of debt on market-facing terms, local authorities are arguably in an advantageous position relative to the general market due to the attractive pricing and structure of the PWLB terms. This means they can potentially pay more and may compete against each other when acquiring assets 'off patch', driving the price higher. With this in mind, it should also be considered whether these values can be achieved again should these assets need to be liquidated due to a change in strategy or wider pressures. Time will tell.

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Corporate Insolvency Framework Reform – The Story So Far

In August 2018, the Government announced reforms which, if introduced, could amount to the biggest shake-up of the UK's insolvency and restructuring framework since the 2002 Enterprise Act.

The package of reforms combines ideas from two different Government consultations: a set of 2016 proposals for boosting business rescue; and reforms from spring 2018, designed to address perceived governance and stewardship failings linked to a number of recent high-profile insolvencies.

The reforms are a mixed bag. Some are welcome; some are good ideas in principle, but require further work; and some need a complete rethink.

When exactly these reforms will be introduced is an unknown. Brexit has seen Westminster's legislative gears grind almost to a halt; the Government says it will put the reforms to MPs "when parliamentary time allows." That could be a long time coming.

In the meantime, however, it's worth looking at the reforms as they are now: what's being considered, and what problems still need fixing.

BUSINESS RESCUE

Starting with the new business rescue tools for corporate insolvencies, they are:

- A business rescue moratorium, to give struggling businesses a 28-day "breathing space," which would allow companies to put in place a turnaround or rescue plan free from the threat of creditor action;
- New measures to allow companies in a rescue procedure to continue to receive essential supplies; and
- A new court-based restructuring tool for both solvent and insolvent companies.

The Moratorium

The moratorium is a good idea in principle, and something R3 has long called for. In the current framework, struggling companies' room for manoeuvre ahead of an insolvency procedure can be limited, with the threat of creditor action

hanging over attempts to restructure. A moratorium could create some much-needed breathing space.

However, the Government's proposals, as drafted, are problematic. There are tight limits on the companies that can use the process (among other entry criteria, the procedure is limited to solvent companies), while the oversight role isn't exactly appealing. At the moment, we may end up with a moratorium which, like the current Schedule 1A moratorium, is little-used.

Encouragingly, the Government has already shown a willingness to be flexible with its moratorium proposal. Since the policy was first proposed in 2016, the Government has shortened the moratorium's length from three months to 28 days (to reduce creditors' risk and to limit the chances of abuse) and has decided to limit the oversight role so that it can only be held by licensed insolvency practitioners. These have been welcome improvements to the original proposal, but more change is needed.

Termination Clauses

In order to ensure companies in rescue procedures continue to receive key supplies, the Government has said it intends to introduce new legislation, which will prevent the enforcement of "termination clauses" in contracts for the supply of goods and services where the clause allows a contract to be terminated on the grounds that one of the parties to the contract has entered a statutory insolvency procedure. While this is perhaps a limited tweak to the rules – it might be easy for suppliers to find other grounds not to supply – going any further may risk unintended consequences. By comparison, the Government's original proposal was that company directors could designate "essential suppliers" who would be forced to continue to supply them in a rescue procedure. This proposal would have headed too far in the other direction, and there would have been a very real risk of abuse.

There are still some problems with the proposal to iron out. For example, licences are exempt from the new rules,

which could spell trouble for companies in the hospitality or care sectors. It's not clear why a company able to meet every regulatory requirement, except for solvency, should lose its licence to operate. It's also unclear how "finance" will be affected by the changes to termination clauses: will things like overdrafts be exempt, or not?

Restructuring Tool

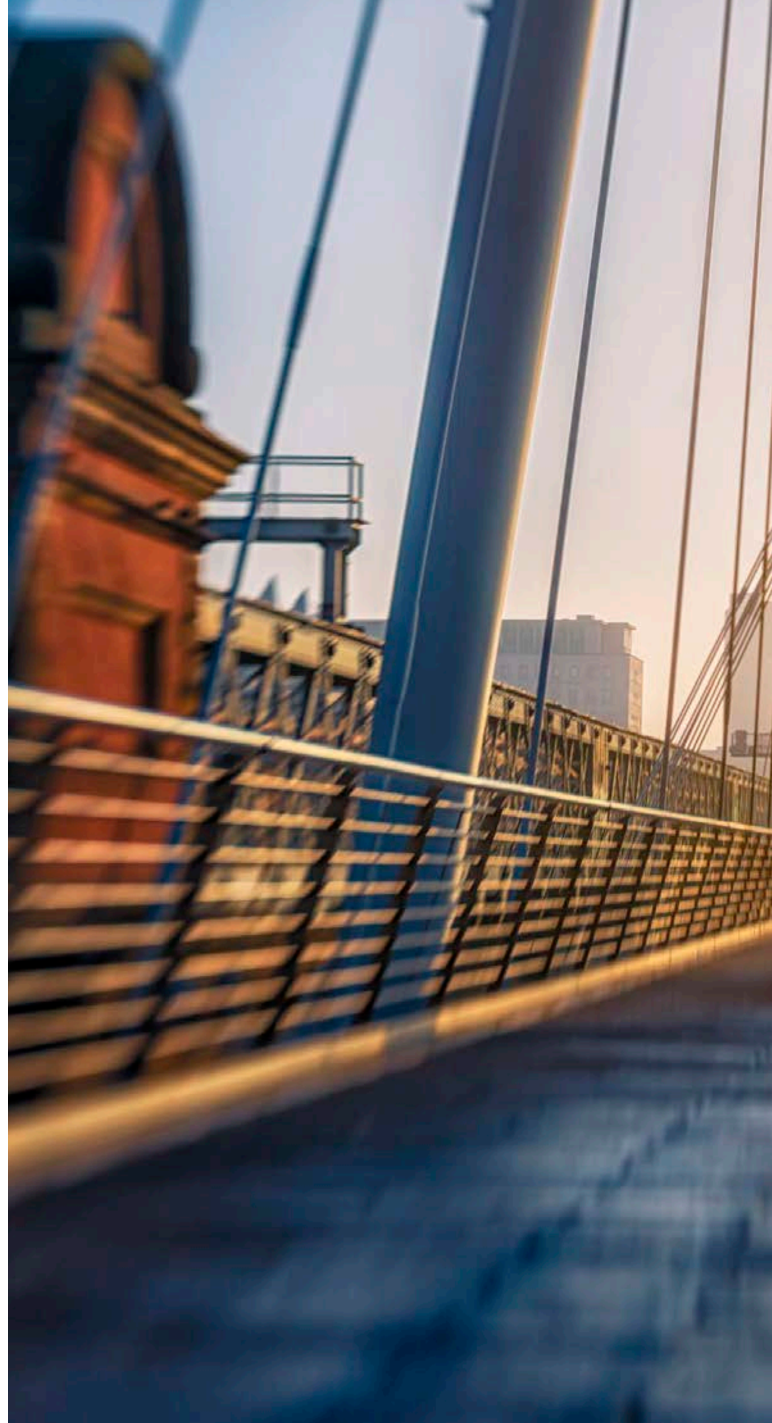
The Government has proposed the creation of a new court-based restructuring tool that will be available to both solvent and insolvent companies. This tool is designed to encourage early action from company directors to address financial difficulties and reduce stigma around insolvency. At first glance, the tool looks like the U.S. Chapter 11 proceedings, but it would be more accurately described as a "copy and paste" of an English Scheme of Arrangement. The new tool is a cross-class cramdown procedure available to any company seeking to bind creditors to a restructuring proposal. Proposals will be reviewed and approved by creditors and the courts.

There will be limited prescription for what the restructuring tool can cover and the changes proposed by the plan can be economic and financial. The Government suggests that, among other things, the plan could be used for debt write-downs, debt postponement, a change in the management team or selling off loss-making parts of the company.

CORPORATE GOVERNANCE

On the corporate governance front, the proposals of direct relevance to the insolvency and restructuring profession include measures to:

- Disqualify directors of parent companies who sold a financially-distressed subsidiary, which became insolvent within 12 months of the sale;
- Review insolvency practitioner powers to undo a transaction, or a series of transactions, which "unfairly" strip value from a company; and
- Extend the director disqualification framework to cover dissolved companies.



Subsidiary Sales

The proposal to disqualify directors if a sold subsidiary becomes insolvent within 12 months of the sale is a less draconian version of the Government's original plan to make directors of parent companies financially liable for creditors' losses if a sold subsidiary were to become insolvent within two years of a sale.

Despite the changes, the new rules could still act as a significant challenge to the UK's reputation as a place to do business. Rather than selling subsidiaries in a "live" sale, parent company directors may find it less risky to simply

close subsidiaries down, or they may opt to sell subsidiaries having first put them into an insolvency procedure. Neither would exactly improve the UK's business environment, and it's not exactly clear what positive outcomes the Government thinks the changes will achieve. While the Government's desire to tackle perceived "reckless" behaviour by directors is understandable, this proposal may end up doing more harm than good.

Value Extraction

Back in spring 2018, the Government proposed new office holder tools to reverse transactions, which had "extracted value" from a company prior to its insolvency. The pushback to this is that office holders already have powers to do this, but that case law, funding issues and a lack of creditor engagement make it difficult for these powers to be used. New powers wouldn't actually fix any underlying problems. Helpfully, the Government has now promised to review office holders' existing powers and look at how these might be improved. This review is welcome.

Director Disqualification

The measure to extend director sanctions to cover dissolved companies is one that R3 supports wholeheartedly. The proposal is designed to tackle situations where unscrupulous directors use dissolutions to avoid the scrutiny of an insolvency procedure. This is welcome, but the Government could go further here. While disqualifying directors of dissolved companies may act as a handy deterrent, it's unlikely to be of much benefit to creditors affected by a director's actions. As well as the expansion of the disqualification framework, the Government should also make it easier to restore a dissolved company so that it can be liquidated, and distributions made to creditors. While dissolution is currently an administrative procedure, restoration requires court intervention – both processes should be the same.

WHAT NEXT?

There are plenty of good ideas in the Government's proposals, although much more work is needed: the good ideas may not work in practice, while the "bad" ideas need further pruning.

It's really important for the Government to get these reforms right. While the UK has long enjoyed a reputation as a global restructuring hub, we can't stand still. Other countries are reforming their own frameworks, and we need to reform our own so that we can stay ahead of the competition. With Brexit presenting a challenge to the ease with which cross-border restructurings can be carried out from the UK, it's now more important than ever that we have an up-to-date insolvency and restructuring framework. The sooner the Government makes progress, the better.

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Flying Off the Shelves – Challenges Facing Supermarket Suppliers in the UK

Fast moving consumer goods (FMCG) are defined as products that are sold quickly and at a relatively low cost. Examples include non-durable goods such as packaged foods, beverages, toiletries, over-the-counter drugs, and other consumables.[1]

Manufacturers and suppliers of these goods will often count supermarkets as their core customers and particularly the 'Big Four': Tesco, Asda, Sainsbury's and Morrisons with both Aldi and Lidl following closely behind. Behind these is a raft of smaller chains and independent buyers.

FMCG suppliers typically operate from the windowless units found on many industrial estates across the UK. They face several challenges in today's marketplace from their customers, their supply chain as well as internal operational and financing issues.

In the battle for market share, supermarkets' single most effective weapon is in product pricing. Aside from driving down prices in real terms, competition has developed into a culture of discounting and double-up promotions. These activities are now embedded into our shopping patterns, with half-price offers and similar expected on most gondola ends.

This has led to 'feast or famine' as deal savvy consumers stockpile goods on promotion - shower gels, toothpastes to name common examples, and await the next offer before refilling their bathroom cabinet. In the last couple of years some supermarkets have tried to establish a regime of price stability and fairer consumer pricing by shifting to 'everyday low pricing' but this has led, in many instances, to lower overall volumes than the 'high low' model in key FMCG categories. Thus, ultimately causing retailers to introduce even deeper price discounts, for example Sainsbury's 'price lock down' and Tesco's push on half-price offers.

Given the imbalance in the commercial relationship between supermarkets and most suppliers, the relationship can feel very one-sided and there is the constant risk of having products delisted by a supermarket chain - which is a big problem if a supplier is reliant on a small number

of large customers. To try to redress the balance, the Government introduced the Groceries Supply Code of Practice and appointed a Groceries Code Adjudicator in 2013 to help prevent small suppliers to the supermarkets with turnover of more than £1bn from being treated unfairly; however, how effective this is remains to be seen, and anecdotal evidence suggests that suppliers are understandably unwilling to snitch on their biggest customers.[2] Manufacturers and suppliers therefore find themselves vulnerable and under pressure to fund supermarket promotional activity, for example, buying premium shelf space or funding discounted products. While there will be a short-term spike in sales, it is inevitably at the expense of overall margin.

With retailers constantly pushing to be the best value in the market, this quickly spirals to a race to the bottom on pricing, predominantly funded out of the supplier's margin.

Furthermore, suppliers have to manage the operational challenges associated with meeting this stop/start demand. This may involve sourcing raw materials which could have long lead times, managing fluctuating warehousing and logistics requirements and irregular shift patterns or staff numbers. While temporary labour can be utilised to meet fluctuations in production demand, that flexibility often comes at a premium, further impacting margin.

In addition to these factors, there is consolidation in the sector. The Tesco/Booker merger and its buying alliance with Carrefour, then the proposed Sainsbury's/Asda merger in which it was announced would pass on £1bn of savings to consumers over the next 3 years and openly stated that this would be achieved by leveraging increased buying power against suppliers.[3] The proposed merger was subsequently blocked by the UK's competition watchdog, the Competition and Markets Authority.

In addition to significant pressure on price, there are also rising commodity costs, business rates, energy costs and national minimum wage increases to contend with; alongside fluctuations in Forex - commentators are suggesting that the value of £1 could fall below €1 in a no deal Brexit scenario.[4] There could also be the additional tariffs to deal with, in the event of a no deal Brexit, which could impact raw materials coming in from Europe.[5]

Uncertainty surrounding Brexit means many manufacturers are having to stockpile both raw materials for production and finished goods to meet customer demand, to ensure product stays on shelves. This is placing a further burden upon precious working capital which is locked up in stock, at a time when investors are cautious about increasing lending.

It is also common to see strategic business decisions such as CAPEX investment being placed on hold as company directors are 'waiting to see' what happens next with Brexit.[6]

Longer-term productivity levels have experienced a marked decline in growth in the UK since 2008 and with investment in future productivity on pause, companies may be creating problems for the future when UK PLC finds itself improperly equipped to compete in the post-Brexit world.[7]

While there are undoubtedly challenges to be faced, there are also opportunities and a well-capitalised business with the right funding structure can take advantage of gaps left on the shelf. Of course, negotiating with supermarkets will always be difficult for smaller suppliers, but with insurgents like Aldi and Lidl growing their market share, and online shopping growing in popularity, suppliers at least have a greater range of options outside the traditional 'Big Four.' With clarity coming imminently on the nature of the UK's future relationship with the European Union, FMCG businesses should be able to start making plans for investments in driving productivity and adapting to the UK's new business landscape.

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Continued Regional Focus

As you will have read in the introductory piece from David Whitehouse, our international reach continues apace. While it's fantastic news that we're building out our international practice, we remain as focused as ever on delivering solutions for our clients in the UK.

Integral to that has been the recent appointment of a number of new faces to the ever-expanding UK Restructuring Advisory team. Ben Collett and Tyrone Courtman have both recently joined the firm as managing directors, focusing on advisory services for corporate clients across the Midlands, UK and Europe and Vijay Merchant has joined as a director.

Ben will share his time in our Birmingham, Manchester and London offices, primarily focusing on assessing and driving strategic change programs involving restructuring, turnaround, profit improvement and mergers and acquisitions for clients in both underperformance and growth situations. Prior to joining Duff & Phelps, Ben was Director of Strategic Projects at IMI PLC, where he led cost reduction, operational change, strategic growth and acquisition integration programs.

Tyrone is based in our Birmingham office and will focus on developing the firm's restructuring advisory service for corporate clients in the East Midlands. He joins Duff & Phelps from PKF Cooper Parry, where he was head of the firm's Business Transformation, Turnaround, Restructuring and Insolvency Services practice.

Vijay is also based in our Birmingham office and will focus on business turnaround, restructuring and advisory, particularly for corporates in distressed scenarios. He joins Duff & Phelps from KPMG, where he worked in the Restructuring team.

The Midlands team was engaged on a number of assignments in the first half of 2019. A large proportion of these are confidential assignments where we are working with owners and managers to navigate challenging financial situations. We have recently been engaged in the construction, retail and care sectors, but generally continue to work across a spectrum of business sectors.

We have seen a notable increase in formal insolvency work in recent months. Oddbins Wine Merchants, Briers Gardening Products and Woods Haulage were all dealt with by the team earlier this year. In addition, we were also appointed Administrators of Accessible Transport Group, which amongst other activities, is responsible for the West Midlands Ring and Ride Service (which has over 12,000 registered users) and the Birmingham City Council "Home to School" service which transports nearly 2,000 disabled and vulnerable children to and from school on a daily basis. We are delighted to have recently secured the sale of Accessible Transport Group to National Express. Since the group entered administration earlier this year many people came together and worked tirelessly to achieve this successful outcome of certainty for the future.

In the wider Midlands economy, uncertainty surrounding how the UK will detach itself from the European Union is already evident. Major motor manufacturers are already making plans to scale back production, temporarily close production lines following Brexit or move facilities overseas. The ramifications will be felt throughout the supply chain with the risk of contagion to the wider Midlands economy. Accurate forecasting, planning and embracing of the rescue principles promoted by Duff & Phelps will be necessary to manage a challenging economic period. Duff & Phelps is uniquely positioned to advise stakeholders in a variety of distressed and special situations. Our UK team includes sector experts who were recruited from the industry and have real "workshop floor" experience. With our deep understanding of the challenges being faced, we urge those businesses facing tougher trading conditions to contact us.

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Clearing Out Your Garage – Benefitting from Corporate Simplification

"Any intelligent fool can make things bigger and more complex. It takes a genius and a lot of courage to move in the opposite direction."

Whilst I'm sure Albert Einstein was referring to complex physics when he made this assertion, his words are true for business generally and more specifically, legal entity structures.

Many corporates (not just large multinationals) seem to excel in making things unnecessarily complex by setting up more legal entities than they know what to do with. Of course, it's not always intended to make matters complicated. Often, they were formed for a specific operational or financial reason, or for tax structuring purposes. Alternatively, they were acquired through M&A activity.

Irrespective, it doesn't take long for the group structure to grow and the corporate garage to get cluttered with bric-a-brac.

It's not uncommon for an organisation to have hundreds of companies in its structure. Even when these companies no longer serve an obvious purpose, groups often retain them, leaving them "as-is" rather than toying with the status quo.

Keeping such entities can be costly, risky (for the corporate itself and directors personally) and can hamper the implementation of other strategic initiatives. Consequently, "clearing out the garage" is not something to continually postpone but tackle head-on in the near-term either on its own or as a component of a wider strategic transformation/ reorganisation initiative.

Often, companies will initiate a defined Corporate Simplification ("CS") project to tackle some of these issues. When implemented successfully, execution is well planned, quick and can provide speedy payback. By clearing out the garage, you're not only eliminating unnecessary entities, but also managing risk and making a leaner, more agile organisation to take into the future.

So, what indicators should management look for when determining whether to progress CS efforts? In our experience, there's no specific criteria. If you can't describe your own corporate structure internally, if it doesn't match your organisational culture of transparency, if it takes up a whole wall in your office or if your employees are facing and raising day-to-day challenges caused by the complexity, those are some of the signs.

You'll have senior executives acting as directors of companies they know nothing about, swathes of dormant companies or intermediate holding companies creating unnecessary tiers in the group structure or your finance team (and other functions) spending an inordinate amount of time supporting non-core entities.

The question then becomes whether you have the capacity and energy to clear out the garage. If you do, you'll find lost family treasures and previously unidentified wasps' nests in the process.

As the CFO/Financial Director, you want to avoid being challenged by the board or other senior management on the group structure and having to defend its complexities. Non-executive directors and newcomers to the senior management team may have a different perspective on what "good" looks like from working with other organisations. Furthermore, current and potential investors, finance providers, employees and other stakeholders will all value transparency and a group structure that is easily explained.

Duff & Phelps has worked alongside numerous clients from mid-market to large corporates on CS initiatives. A properly planned and resourced CS initiative can deliver a wide-range of sometimes unexpected benefits (summarised on the right hand side) for your organisation. The trick then is to ensure that those benefits are sustained through making CS business as usual, thereby facilitating long-term entity management.

The moral of this story is prioritise clearing out the garage on your "to do" list – identify where everything is, get rid of unnecessary clutter and put things where you want them. You'll feel good about it, see the value in your achievement and be wary of letting it return to its previous state.

Corporate Simplification ("CS")

BENEFITS SUMMARY

- Reduced audit, tax, regulatory and other compliance costs
- Reduced internal costs associated with maintaining unnecessary entities – Executive, Finance, Legal, Company Secretarial and Human Resources will all benefit from focusing on core activities
- Mitigation of corporate risk and director personal risk associated with compliance failings, fading or lost corporate memory and potential contingent liabilities
- Improved governance and transparency (and therefore reduced impact of disclosure requirements and corporate governance reform) – increasingly valuable in a world that is demanding it with legislation and guidance changing to improve it
- Resolution of issues resulting from unnecessary complexity such as tax inefficiency and dividend blocks
- Releasing capital tied up in balance sheets of individual entities
- Restricted scope and cost of future improvement and transformation efforts
- Synergies achieved through the alignment of the entity structure with operational activities

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Demand in Decline and Supply on the Up for the UK University Sector

Increased competition for students, falling numbers of 18-year-olds and tightened immigration rules impacting the number of international students applying, are all contributing to increased financial pressure on UK universities.

In addition, the removal of the cap on the number of students a university can recruit has opened a new, aggressive market whereby more institutions are lowering entry requirements, according to university admissions service UCAS.

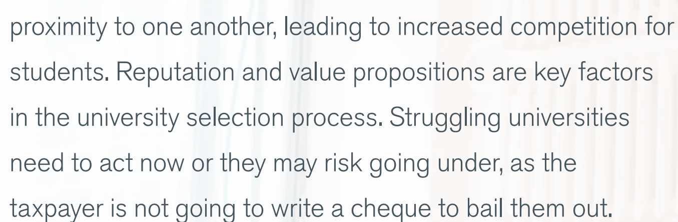
These factors are having an immediate financial impact on some universities, who are directly losing income as a result of lower yearly student intakes.[1]

Revenue from international students is a critical source of additional income for many institutions and has funded several expansions within the sector. Enrolments have plateaued since 2012 when the visa rules were tightened, and again in recent years with the uncertainty caused by Brexit,which has added to the woe.[2]

Contributing to this financial shortfall are a number of internal financial pressures in the sector, not least rising staff costs, including pensions and the apprenticeship levy. International credit reporting agency, Moody's, is reporting that many universities have been investing in new facilities to attract students, but doing so through borrowing, putting further strain on the balance sheet.[3]

Tertiary education is not safe from collapse. The Chairman of the Office of Students – the industry regulator – Sir Michael Barber, has publicly stated that any institution facing bankruptcy will not get a taxpayer-funded bailout.[4]

With reports claiming that there are at least three UK universities on the brink of bankruptcy, some serious questions need to be asked.[5] Many universities are in close



proximity to one another, leading to increased competition for students. Reputation and value propositions are key factors in the university selection process. Struggling universities need to act now or they may risk going under, as the taxpayer is not going to write a cheque to bail them out.

Now is the time to streamline course offerings or even shut them altogether and identify assets to dispose of by paying down borrowings to avoid bankruptcy or seeking professional help from restructuring specialists.

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Rescuing a Lake District Housing Development and Restoring a Historic Monument

In 2017, Duff & Phelps and Investec were appointed as administrators to property development business, Reno Global Ltd.

Together we led the successful restoration and development of the Ironworks site in the Lake District, saving a historic monument and securing the construction and completion of 43 holiday homes.

On the Ironworks site is a Scheduled Ancient Monument (SAM), a blast furnace built in 1711, that's believed to be the only remaining example of its type; it's one of the first charcoal-fired blast furnaces to be built in Cumbria. The SAM was in very poor condition, and the cost of restoring it made the site an unattractive sales proposition. Strict planning restrictions in the Lake District added further complexity to the process of completing the site.

In collaboration with Investec, we proposed a solution to the local council where we would take on the cost of restoring the SAM, and the council would review the planning and sales restrictions. The council agreed, and we worked hard on this substantial restoration project with Investec, who invested £700,000 for the administrators to repair and recondition the blast furnace, thus preserving an essential piece in the history of English innovation that was on Historic England's top 10 list of most "at risk" monuments.

Duff & Phelps worked in partnership with Investec and Indigo Planning to complete the restoration of the SAM and construction of 43 open market apartments, securing a future for the site and ensuring that the development would be completed.

The community also saw meaningful benefits, with a significant construction project providing jobs and revenue to local suppliers, and the conversion of a near-derelict site that had been a blight on the area.

BEFORE

AFTER

This award-winning project is a fantastic example of how a modern development can sit comfortably alongside a dedicated restoration of a national monument. It's rare for us to really say everyone's a winner, but in this case the community has seen a dilapidated eyesore transform into an attractive development and investors have seen a near-failure turned around. Plus, a precious monument has been saved.

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Rolling the Dice: The Stresses and Strains Leaving the Gambling Sector in Peril

The UK has a somewhat unique relationship with gambling. We have high streets full of bookmakers, gambling adverts with Hollywood celebrities during Premier League football matches and national events like the Grand National that are inextricably linked to 'having a flutter.' However, the gambling sector is under unprecedented social and economic pressure.

Public opinion is shifting against an industry often seen as taking advantage of punters. The controversy around Fixed Odds Betting Terminals (FOBT) has led the UK Government to introduce legislation reducing the maximum stake to £2 to reduce the social harm caused by betting machines. While the move has been welcomed by campaigners who assert that the machines encourage reckless betting, it will also have a significant impact on the gambling business.

Industry statistics appear to indicate that gambling firms' high-street betting empires were in decline before the stake cut, as more and more people switch to online gambling, often owned by the same businesses. But this process of migration from off to online is, like so many other industries, putting strain on our high streets and is putting thousands of jobs on the line.

As has been widely reported, Betfred, one of the UK's most prominent bookmakers, warned that it may have to cut 4,500 jobs as 900 of its shops would fail to turn a profit with maximum stakes of £2.[1] Similarly, William Hill may shut 700 stores as it looks to offset an £820m loss from the FOBT reform.[2]

While the gambling industry faces significant financial

risks due to the loss of FOBT stakes over £2, the industry also faces a reputational issue as both regulators and the public appear to believe that it is not doing enough to stop problem gambling. The industry has introduced a number of initiatives to alleviate the issue, such as BeGambleAware,the charity funded by betting companies to promote responsible gambling and to minimise harm.[3]

Another recent step was backing the ban on betting adverts during live TV sports events.[4] Anyone who has watched a Premier League football game will know that before, during and after half time there is a bombardment of gambling adverts offering live odds on the game. This has provoked fears of a significant rise in underage gambling addicts, but the acceptance of the ban from major gambling organisations shows a growing willingness to address negative issues in the industry.[5]

Although the rise of online services has been largely detrimental to the UK high street, the gambling sector has caught the online wave and surfed it to success. While the number of betting shops on the high street declined by 1.8% between March and September 2018, the total gross gambling Yield (GGY) rose 4.5% from March 2017 to March 2018, highlighting that online gambling has really hit the jackpot. The total GGY for the remote gambling sector, primarily encompassing online betting, rose 13.7% from March 2017 to March 2018, and now represents a 37.3% market share of the sector.[6]

The gambling sector faces an uncertain future. From the financial implications of the FOBT stake reduction legislation to the banning of advertising during live TV sports events, there are some serious challenges that the sector needs to overcome. However, the sector has also made a largely successful transition to an online model, and while this may have an impact on its high street presence, online and remote gambling may present a route for successful, sustainable growth.

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Crown Preference Returns?

In a return to the pre-Enterprise Act 2002 era, Chancellor Philip Hammond announced in the 2018 Autumn Budget that HM Revenue and Customs' (HMRC) preferential creditor status in insolvencies will be restored from 6 April 2020 onwards.

HMRC's preferential creditor status was abolished as part of the Enterprise Act 2002, a measure that was part of a number of reforms introduced by the then-Labour Government to encourage business rescue and to make the insolvency process fairer on unsecured creditors.

Under existing legislation for insolvency processes, HMRC's claims for unpaid taxes are unsecured and rank below floating charge holders and preferential creditors for the proceeds from the sale of floating charge assets such as stock, non-assigned debtors and plant and machinery.

This ranking has allowed lenders to businesses, in particular asset-based lenders (ABLs), to rely more readily on floating charge assets for security. This ultimately has enabled ABLs to offer higher levels of funding in support of a borrower's growth or turnaround (either via higher advance rates from invoice finance facilities, inventory facilities linked to changing stock levels and, in some cases, 'cash flow' loans). It has also afforded ABLs greater flexibility when a borrower needs additional support.

As part of the proposed legislative changes, the Chancellor announced that HMRC would revert to secondary preferential status in all insolvency processes commencing after 6 April 2020 for those taxes collected on its behalf, which are limited to:

- Value Added Tax (VAT)
- Pay-as-you-earn tax (PAYE)
- Employee National Insurance Contributions (NICs)
- Construction Industry Scheme (CIS) Deductions

The new legislation will not impact taxes collected directly from a company such as Employer NICs and Corporation Tax, which will remain as unsecured claims in insolvency processes.

These changes will deplete the security pool available to lenders that are reliant upon floating charges to collateralise their lending facilities. Where an ABL is particularly reliant upon floating charge assets, they may be forced to reduce or even withdraw existing facilities.

The move is likely to have a significant impact on the funds recovered from insolvency processes by both secured floating charge creditors and unsecured creditors and, by extension, business rescues and the availability of funding as well as the pricing of that funding.

The Government's consultation regarding the proposed legislation closed in May 2019, during which many in the ABL community and restructuring profession lobbied for the repeal of these proposed changes.

In addition to requesting for the full repeal of the proposals, the ABL and restructuring professions suggested various alternative arrangements in the event that the proposals are still enforced, such as allowing for a cap on the age of tax debts eligible for preferential status and/or that the proposals should only apply to tax debts arising and floating charges created after 6 April 2020.

However, the Government rejected this widespread feedback and has confirmed that the proposed changes will proceed, with the only minor amendment following the consultation process being that tax penalties will not form part of HMRC's preferential claim.

The Government anticipates that this measure will achieve additional recoveries from insolvency processes after April 2020 of approximately £185m per annum and that the proposals will not "lead to any particular difficulties."

However, in our view, it does not appear that sufficient consideration has been given to the squeeze on floating charge related lending facilities, and therefore the overall impact upon business rescue and funding. Preferential claims are in addition to the Insolvency Service proposing an increase in the 'prescribed part' – money which would otherwise be paid to floating charge holders, but which is ring-fenced for unsecured creditors – from a maximum of £600,000 to £800,000. Whether this move was coordinated or not, floating charge realisations available to floating charge holders and unsecured creditors will be further reduced.

If your business is currently funded by any form of ABL facility, and especially if you benefit from either a high invoice finance advance rate (85% plus), stock facility or cash flow loan, we recommend undertaking an urgent review of your existing facilities.

Duff & Phelps can assist in this regard. The review is time efficient and low cost and will benefit both your business and your funder. We can advise on any likely adverse consequences of the HMRC rule changes and also what actions can be taken to mitigate their impact. This could include changes to facility types or structural changes that separate collateral assets and preferential liabilities, thus safeguarding facilities in their current form.

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UK Shops Lie Empty

According to figures released under the Freedom of Information Act (FOI), 15.9% of all shops and retail outlets in the UK now lie empty. These figures quantify the scale of the challenge facing the UK high street after one of the toughest trading periods since the 2008 recession.

Getting an accurate picture of the real health of the high street is difficult, but through the use of FOI, we managed to gain valuable insight into what local authorities are experiencing. With a total of 418 councils in the UK, our mean average indicates that the total number of retail units that now lie empty stands at 50,578, or an average of 121 empty retail units per council.

There were 319,000 retail businesses in 2018 according to the ONS.[1] Given this figure, we believe that the void rate now stands at 15.9% of the total.[2]

Our figures are in line with those released by the retail analyst firm Springboard, which found that vacancy rates are now running at around 10%.[3] Our figures differ in that local authorities under FOI have released them, so arguably they should be more reflective of the reality on the ground, as an empty retail unit does not necessarily mean it's vacant and available for lease. However, the Springboard figures do point to a more alarming trend with retail footfall continually declining, with it recently announced that the retail sector had experienced the worst footfall figures in six years.[4]

Retail is one of the most important markets in the UK, with its economic output in 2017 equating to £92.8bn, employing some 2.8mn people and comprising of some 319,000 businesses.[5] But 2018 turned into the "year of crisis" for the retail sector. In the first 100 days of 2018, some 18 mid- and large-sized retailers collapsed, impacting more jobs than in the entire year prior – and this has appeared to be the trend during 2019.

It is estimated that business rates are the equivalent of 2.3% of overall business costs for a traditional brick and mortar retailer, compared to just 0.6% for pure-play online retailers.[6]

The impact on local government cannot be underestimated either. FOI also identified that 91% of UK local authorities are retail landlords in their own right. Empty units mean lost rental and business rates income, all at a time when many local authorities are reporting increased financial pressures.

The old financial model of the traditional brick and mortar retailer – based on a high street or shopping centre built around them in the post war era – was centred on regular increases in sales and 25-year leases with upward rent reviews only. As a result, it has meant high rents and occupancy costs. This has blown apart as a result of both the discounters and the dramatic uptick in online sales. The question is whether this picture continues for the remainder of 2019 and if so, at what speed?

For a detailed look at the methodology used in this article, please see the Appendix on page 30.

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A Brighter Future Here in the North West

One of the most rewarding parts of the job is seeing the outcome of the positive work we do, and this holds particularly true for our work in the North West and the city of Manchester.

In recent months, Duff & Phelps has successfully negotiated and secured a stream of multimillion-pound refinancing deals throughout the region, putting a host of well-known and well-loved businesses on a brighter path for the future.

Duff & Phelps' Debt Advisory team has led the way on a number of deals in the North West, including two of the most iconic hotels in the region – Bredbury Hall near Manchester and Losehill House Hotel and Spa based in the Peak District.

First opened in 1812, Bredbury Hall is set on seven acres of private grounds in Goyt Valley, just over two miles from Stockport town centre and under ten miles from Manchester Airport, with motorway links to the major northern cities. The deal – secured with Allied Irish Bank (AIB) has enabled the hotel to continue a major refurbishment programme to the benefit of guests and employees alike.

Losehill House Hotel and Spa, winner of The Sunday Times "Country House Hotel of the Year" award, has also secured a multimillion-refinancing deal through working with our Debt Advisory team.

The team has also secured a seven-figure refinancing package for Springfield Day Nurseries, a family-run business providing the highest-quality childcare in the County of Conwy and a full member of the National Day Nurseries Association (NDNA).

But our work does not stop there. The team in Manchester has been leading the way when it comes to giving back to our community. For the second consecutive year, we supported children's charity, *When You Wish Upon a Star*, at a black-tie event, which raised a staggering £30,000.

This brings our fund raising in support of the charity over the last 12 months to over £50,000.

The Duff & Phelps Charitable Foundation, which was launched in 2018, announced its first Manchester-based grant being presented to The Mustard Tree, a deserving charity that focuses on improving the lives of those experiencing the struggle of poor mental health, homelessness and poverty in Greater Manchester.

As an employee-directed fund, the Manchester team was keen to recommend The Mustard Tree for a grant. It's a fantastic charity that does amazing work in the local community and it's great to be able to give back to an organisation that the team here feels very passionately about.

The charity was one of 11 organisations in the UK that was selected to receive a grant from the Foundation, which has granted nearly £40,000 to deserving causes in the UK and more than USD $500,000 worldwide since its founding.

APPENDIX

Methodology

Freedom of Information

The Freedom of Information Act 2000 provides public access to information held by public authorities. It does this in two ways: public authorities are obliged to publish certain information about their activities; and members of the public are entitled to request information from public authorities.

UK Local Government

There are a total of 418 local authorities in the UK, comprising:

England (353 total)

- 27 County Councils (upper tier)
- 201 District Councils (lower tier)
- 32 London Boroughs (unitary)
- 36 Metropolitan Boroughs (unitary)
- 55 Unitary authorities (unitary)
- 2 Sui Generis authorities – City of London Corporation and Isles of Scilly (unitary)

Wales (22 total)

- 22 Unitary authorities (unitary)

Scotland (32 total)

- 32 Unitary authorities (unitary)

Northern Ireland (11 total)

- 11 Unitary authorities (unitary)

For this research, a total of 70 local authorities were requested to release figures under Freedom of Information on the number of retail voids in their area. A total of 47 responded within the proscribed legal framework, representing an 11% sample of the total number of local authority bodies in the UK.

Average void rate per council stands at 121 per authority. Assuming an equal pattern across the UK, the nation void rate stands at 50,578.

According to the ONS there were 319,000 retail businesses in 2018.

National void rate therefore stands at 15.9%.

Retail Administrations in the UK 2008-2018

Year	Company failures	Store numbers	Employee numbers
2008	54	5793	74539
2009	37	6536	26688
2010	26	944	10930
2011	31	2469	24025
2012	54	3951	48142
2013	49	2500	25140
2014	43	1314	12335
2015	25	728	6845
2016	30	1504	26110
2017	44	1383	12225
2018	38	2892	43292

(Source: Centre for Retail Research)

COMPREHENSIVE SUPPORT, OBJECTIVE GUIDANCE AND SUPERIOR EXECUTION WHEN DEALING WITH DISTRESSED TRANSACTIONS AND SCENARIOS

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