What You Need to Know About Business Reviews

Licensed Insolvency Trustees

MNPdebt.ca/Corporate

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Introduction

Business in Financial Distress?

When a business is dealing with more debt than it can manage or struggling to keep up with financial obligations, it may be time to seek assistance. Having a full understanding of what options are available can be challenging. Should it be restructuring? Receivership? Liquidation?

MNP LTD.'s Corporate Recovery and Restructuring team works collaboratively with businesses and creditors to develop effective strategies to meet the needs of all stakeholders.

Our team is agile and responsive

As one of Canada's leading firms in Corporate Recovery & Restructuring, our team understands when a business falters, it's important to identify all options as soon as possible so the stakeholders can choose the best course of action moving forward.

We recommend customized approaches

We provide a customized approach to every engagement, helping our clients and their organizations overcome the challenges they face by developing strategies that meet the expectations of all stakeholders and are aligned with the objectives of the business.

We know what works and doesn't work in your industry

Each industry is complex and comes with its own nuances. For that reason, we continually invest our time and resources into fully understanding the key industry segments our clients operate in.

And within MNP we have an extensive network of specialists we can draw upon in numerous industry and specialty groups including: Aboriginal, Agriculture (crops to livestock), Auto Dealers, Forestry, Manufacturing, Mining, Oil & Gas, Private Enterprise, Professionals, Public Companies and Real Estate & Construction.

We've helped people from across Canada

Strategically located in both rural and urban communities from coast-to-coast, MNP's comprehensive suite of professional and advisory services and local market insights ensures we are able to provide the in-depth expertise needed to develop the most effective solutions available.

Financial Crisis Resolution

MNP can assist businesses in crisis with strategies that allow them to achieve a positive resolution.

The Crisis Meter

When Do You Call for Help?

Crisis Management

MNP LTD. team can assist in identifying the crisis, remapping and changing the course to remedy the crisis.

Identify the Crisis
- Management may be unaware of crisis, or is refusing to deal with it
- MNP LTD. called to assist
- MNP team identifies potential crisis

Remap
- MNP team helps management to identify alternatives to resolve the crisis, and develop proactive decisions, before outside parties react

Change the Course
- MNP team assists companies in changing the course to deal with the crisis

External parties who have an interest in company become aware of potential crisis.

Call of the Lender/External Stakeholders
- Lender takes action,(i.e. special loans)
- Confidence may be lost by lenders and alike
- Opportunity for voluntary restructuring may be lost
- Company still has time to develop corrective action

Immediate Restructuring

External parties start to develop strategies to protect their interest in company assets.

Business Review
- Lender / debtor appoints external Trustee to assess business

Monitor
- External monitor to review results, and reports to the lender/debtor
- Decision to continue may be lost

Proposal under the Bankruptcy & Insolvency Act (BIA) or the Companies' Creditors Arrangement Act (CCAA)
- Formal proceedings required to bring confidence back with external parties
- Last chance to get issues resolved

Corporate Liquidation

External parties have lost confidence in the company and management, and move to protect their interests.

Receivership/Agency
- Assets sold off to satisfy secured claims
- Company not likely to continue

Receivership and Manager
- Assets sold off to satisfy secured creditor's claim
- Company not likely to continue

Bankruptcy
- Too late for the company to resolve issues

Business reviews

What is a Business Review?

This type of an engagement involves a comprehensive review of a company's current financial position and future business prospects, including an analysis of the status and priorities of secured and unsecured creditors. This type of review (also referred to as a Look-See or Viability Assessment) is conducted as an initial first step to developing a restructuring or recovery plan and is helpful to both the company and its secured lender(s) in arriving at a mutual arrangement for moving forward.

The engagement is generally initiated by a secured lender in connection with a debtor who appears to be in financial difficulties: has breached covenants: is out of margin; has defaulted on payments: and communications and discussions between the lender and the borrower are strained and/or are no longer productive.

The engagement could also be initiated by a debtor who is experiencing financial difficulties and is completed prior to approaching their lender for additional support or concessions.

Occasionally, the engagement is requested by another stakeholder, like a shareholder, who has concerns regarding their investment.

The scope of the work to be conducted is dependent on the terms of the Engagement Letter – it can be limited and highly focused or could be broad and expansive. Typically, a secured lender is most interested in an analysis of their security position, but can also have an interest in the viability of the business generally.

Purpose of a Business Review

The purpose of a Business Review is generally to obtain financial and other information concerning the debtor's situation, which may include past, current, and future projections. It is an independent and unbiased assessment of the debtor's situation along with the possible options that are available to resolve the financial difficulties for both the lender and the debtor.

The Business Review provides the engaging party with recommendations and the necessary information to make an informed decision and take an appropriate action to ensure the best possible outcome is achieved.

Benefits of a Business Review

The Business Review provides the engaging party with the necessary information to make an informed decision and take the appropriate course of action.

Even if it is the lender that engages the Trustee, there are also direct benefits for the debtor, which could include:

- The preparation of financial projections to budget, plan and then monitor;
- Opportunity to gain new insight into their business and financial activities;
- Identification of problems, and the reporting requirements for the lender; and
- Recommendations to address issues raised.

Lender's Options & Course of Action

At the conclusion of the Business Review, the lender may decide to:

- Inform the debtor to find alternate financing;
- Support the debtor through a restructuring or repayment plan;
- Enforce and realize on its security;
- Require a capital injection;
- Allow for the status quo; or,
- Require the debtor to enter into a Forbearance Agreement with the lender.

Forbearance Agreements

Many times, at the conclusion of (or prior to) the Business Review engagement, the lender will request the debtor agree to terms of a Forbearance Agreement.

A Forbearance Agreement typically includes an acknowledgment by the debtor of its default under the terms of its lending agreements and the bank agrees to forbear, or hold off, enforcing its security under strict and certain conditions, such as:

- A consent to judgment and/or a consent to the appointment of a receiver, should the terms of the agreement be breached
- An agreement not to enter formal insolvency protection, such as filing a Division I Proposal under the BIA or a CCAA proceeding
- A requirement to sell certain assets
- A requirement to submit cash flow statements prepared with the help of the Trustee (ongoing third-party monitoring)
- A requirement to obtain appraisals
- A reduction in operating expenses
- A reduction in the operating line of credit or overdraft
- Pledging of additional collateral
- Payment of a Forebearance Fee(s)

Scope of Work for Business Reviews

The scope of work for a Business Review is dictated by the extent and nature of the lender's concern(s), the amount of the indebtedness, the level of financial sophistication of the debtor company and its management, and the nature of its assets and operations.

The Business Review can be very limited and focused, such as a review of the status of a particular class of inventory, or broad and expansive to cover all elements of the business and its operations.

Typical scope items:

- **Security position review** – Assess and estimate the net realizable value of the underlying assets covered by lender's security, net of priority payables, a prior ranking secured debt, realization costs, etc.;
- **Limited security position review** – Assess and estimate the net realizable value relating to a specific category of the underlying assets covered by lender's security (e.g. collectability of accounts receivable, realizable value of the inventory);
- **Compliance and accuracy of borrowing base/margin reporting, including** including an evaluation of priority payables vis-à-vis the credit facilities' terms
- **Business viability** – Review and assess the debtor company's past, current and projected future financial performance, which would include a detailed review of the debtor company's financial projections (integrated financial model - projected balance sheet, income statement, and cash flow statement), operational restructuring plans, etc. for reasonableness or plausibility;
- **Limited business viability** – Limited to the review of financial projections (integrated financial model);
- Other matters the lender may consider important or necessary.

Business Review Report Elements

Subject to the scope of work required as determined by the lender, a Business Review report could cover the following:

- Company history and background, ownership and management organizational structure, causes of the debtor company's financial difficulties;
- Assessment of management, including adequacy and/or competency of key management, management remuneration, succession issues (if applicable);
- Review of operations, including past operating results, market/industry factors and risks, dependency issues, related party activities;
- Review of assets and liabilities, including inventory, accounts receivable and accounts payable composition and concentration issues, capital asset review, shareholder and related party accounts, etc.;
- Analysis of the debtor company's financial projections (which may include assisting the preparation of same) and an assessment of the company's ability to return to profitability, it's viability, the reasonableness of assumptions, and possible "what if" scenarios or sensitivity analyses;
- Security position and borrowing base/margin review to determine the estimated net realizable value of the lender's security, as well as the past margin reporting to the lender
- Conclusions, options and recommendations on courses of action to be considered.

Priority of all claims

The order of payments to creditors from the liquidation of business assets is based on legislation and evolving jurisprudence.

The priority system is complicated and there are exceptions to the rules, but generally the priorities are:

1. Trust claims
2. Secured creditors claims
3. Preferred creditors claims (in a bankruptcy pursuant to Sec. 136 of the BIA)
4. Unsecured creditors claims
5. Shareholders interests

Trust Claims

Two main types seen in insolvency proceedings are statutory trusts (trust relationships created by law – e.g. employee withholdings or GST/HST) or express/true trusts (trust relationships created by agreement and maintained in accordance with trust law).

Trusts are usually the first to be paid because trust property is not considered to be property of the debtor company. Trust property is merely property held by the debtor on behalf of a third party (eg. the government, a beneficiary etc.).

Statutory trusts often state that all of the debtor's assets are impressed with a trust.

In a receivership proceeding, government claims for statutory trusts created by unremitted GST/HST and employee payroll source deductions rank ahead of secured creditors. The trust claim for GST/HST can be reversed (meaning the secured creditor is paid first) if the debtor company also becomes bankrupt.

Secured Creditors Claims

Secured creditors claims generally are by way of an agreement (e.g. loan, mortgage, debenture, etc.), but can also be created by statute or legislation (e.g. Wage Earner Protection Program Act (WEPPA), Builders' Lien Act, Warehousemen's Lien Act, Income Tax Act, among others).

The security can be over specific property (like a mortgage over real property, or a lien against a financed vehicle) or can be over all of the debtor's assets in the form of a floating charge or general security agreement.

There is a ranking (or priority) as between secured creditors. As a general rule, if more than one party has security over an asset, absent a priorities agreement between secured creditors, the first to perfect will get paid first, then the second, and so on.

In addition to the government claims noted earlier that rank ahead of secured creditors, are WEPPA claims - employees of a company that is undergoing a formal insolvency proceeding that are owed eligible outstanding wages, are secured, in priority to general secured creditors, against all current assets to the maximum of $2,000 per employee.

An exception to the priorities scheme for secured creditors are Purchase Money Security Interests (PMSI). A PMSI is a special type of security interest, such as a capital lease. An example is where a lender advances funds to a debtor specifically for the purpose of purchasing a new piece of equipment. A prior existing secured lender may have already had a general security interest, or floating charge over all present and after acquired property, but due to the unique principals of a PMSI interest, the secured creditor advancing funds for the sole purpose of purchasing this new machine will have priority on this item. This is in contrast to a secured creditor who agrees to provide an operating line of credit, or an overdraft to the debtor and takes back a general security interest in all the debtor's present and after acquired property as security for the operating line or overdraft.

About MNP LTD.

MNP Ltd. is one of Canada's leading firms in corporate recovery and restructuring. For more than 50 years, we have served and responded to the needs of numerous businesses and their creditors. Through a diverse range of services, our team of insolvency and restructuring professionals have the experience and expertise to develop recovery and restructuring strategies that meet the needs of all stakeholders.

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