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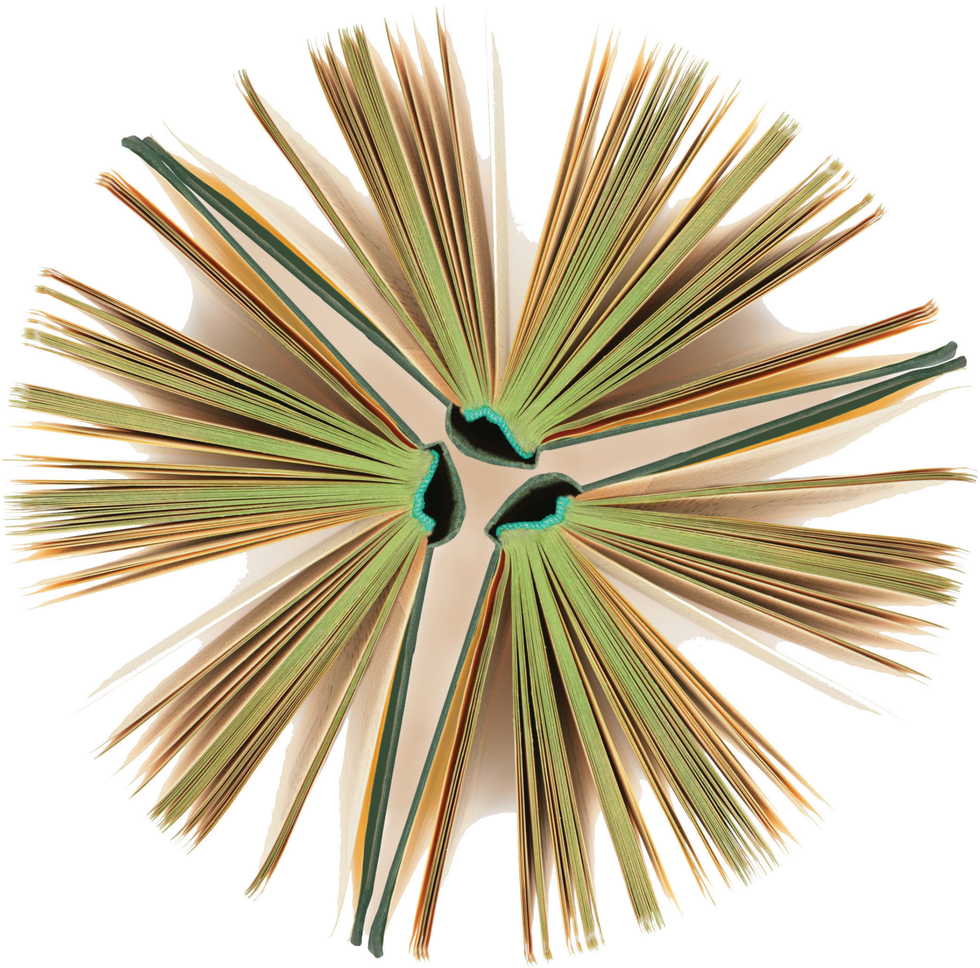


Director Assistance Kit

Deloitte Financial Advisory Pty Ltd

Introduction

At Deloitte, our experienced and dedicated Turnaround and Restructuring Services team offers:

- Lending reviews
- Solvent wind-down and closure support
- Debt and capital restructures
- Commercial restructuring and turnaround services
- Formal insolvency—including liquidation, voluntary administration, receiverships, small business restructuring plans and personal insolvency services.

Deloitte's Turnaround and Restructuring Services team combines expertise across the firm to deliver valuable corporate restructuring and insolvency advice. We have a proven track record in both informal and formal restructuring nationally, from small to medium sized enterprises to ASX listed companies and public sector entities.

This guide will assist you in better understanding the solutions available to you as a director of a company experiencing financial distress, and how it affects you, as director of a company, your staff, and your creditors.

Contents

1 What are your duties as a director of a company in financial distress?

As a director of a company in financial distress, knowing and fulfilling your duties is essential when running a business. While a director's primary duties are to the company's shareholders, when it is insolvent or likely to become insolvent, those duties are expanded to include the creditors (including the employees). The Corporations Act 2001 (the Act) sets out the duties of a director.

These duties include:

01 Exercising your powers and duties as director with the care and diligence that a reasonable person would have. This would include being properly informed about the financial position of the company and ensuring that the company does not trade whilst insolvent

02 Acting in good faith and in the best interests of the company

03 Not to use your position as a director to improperly gain an advantage (for you or another person), or to cause any disadvantage to the company

04 Not to use your position as a director to improperly use information to gain an advantage (for yourself or another person), or to cause any disadvantage to the company

Duty to keep proper books and records (Section 286 of the Act)

Your company must keep proper financial records that correctly record and explain its transactions and financial position and performance to enable financial statements to be prepared and audited (if required).

The financial records must be retained for 7 years after the transactions covered by the records are completed.

For the purposes of an insolvent trading action against you (mentioned below), your company will be presumed to have been insolvent throughout a period where it can be shown to have failed to keep proper financial records.

Duty to not trade while insolvent (Section 588G of the Act)

In addition to the above duty as a director, you also must prevent your company trading whilst insolvent. This means that before you incur any company debts you must consider whether the company is insolvent, or will become insolvent as a result of incurring the debt.

An understanding of your company's financial position at the time you sign off on the quarterly BAS or yearly financial statements is insufficient. You must constantly be aware of your company's financial position.What else should you be aware of?

Illegal Phoenixing

- Illegal phoenix activity typically involves creating a new company to continue the business of an existing insolvent company that has been deliberately liquidated to avoid paying outstanding debts, including taxes, creditors and/or employee entitlements
- Illegal phoenix activity can involve serious breaches of the law including directors' duties, fraudulent concealment or removal of assets and fraud by company officers under the Act
- Penalties include large fines and up to 15 years imprisonment for company directors and secretaries. External advisers who facilitate an illegal phoenix may also be liable
- Disposing of company property for the purpose of defeating creditors is also a breach of the Act and penalties exist for those who engage in or facilitate such dispositions.

Resignation of Directorship

- A company director is not able to backdate their resignation more than 28 days or resign and leave a company without a director
- Directors need to ensure that resignations are lodged with ASIC within the required 28 days or the effective resignation date will be the date the document is lodged. That date can only be "backdated" by applying to ASIC or the Court.

Director Penalty Notice (DPN)

- The Commissioner of Taxation (CoT) is able to levy a penalty against directors personally
- The penalty will be equivalent to any unpaid Superannuation Guarantee Charge (SGC), PAYG and net GST owed by the company
- A DPN has serious ramifications and directors are personally liable for the penalty. Past, present and future company directors may be liable for a DPN.

Some penalties imposed by a DPN are 'locked down' and cannot be remitted (withdrawn).

However, other penalties that are not locked down may be remitted, thereby releasing the directors from personal liability. But there are limited choices to achieve this and it must be done within 21 days. They include:

- Causing the company to pay the associated tax(es);
- Putting the company into Voluntary Administration
- Appointing a restructuring practitioner (only available to 'small' companies) or
- Putting the company into Liquidation

Directors should seek professional assistance immediately to understand your options.

2 How do you know if your company is experiencing financial distress?

How do you know if your company is experiencing financial distress?

Use our checklist below to see what warning signs are present in your company's operations:

- [ ] Ongoing losses
- [ ] Poor cash flow
- [ ] Absence of a business plan
- [ ] Incomplete financial records or disorganised internal accounting procedures
- [ ] Lack of cash-flow forecasts and other budgets
- [ ] Increasing debt (liabilities greater than assets)
- [ ] Problems selling stock or collecting debts
- [ ] Unrecoverable loans to associated parties
- [ ] Creditors having to be paid outside usual terms
- [ ] Suppliers placing your company on cash-on-delivery (COD) terms
- [ ] Having to issue post-dated cheques or dishonouring cheques
- [ ] Solicitors' letters, demands, summonses, judgements or warrants issued against your company
- [ ] Special arrangements with selected creditors
- [ ] Having to put creditors on payment plans
- [ ] An inability to meet commitments or revised commitments with creditors
- [ ] Overdraft limit reached/in excess or defaults on loan or interest payments
- [ ] Problems obtaining finance
- [ ] Inability to raise funds from shareholders
- [ ] Overdue taxes and superannuation liabilities or demands from ATO (including Directors' Penalty Notices)
- [ ] Board disputes and director resignations, or loss of management personnel
- [ ] Increased level of complaints or queries raised with suppliers
- [ ] An expectation that the 'next' big job/sale/contract will save the company

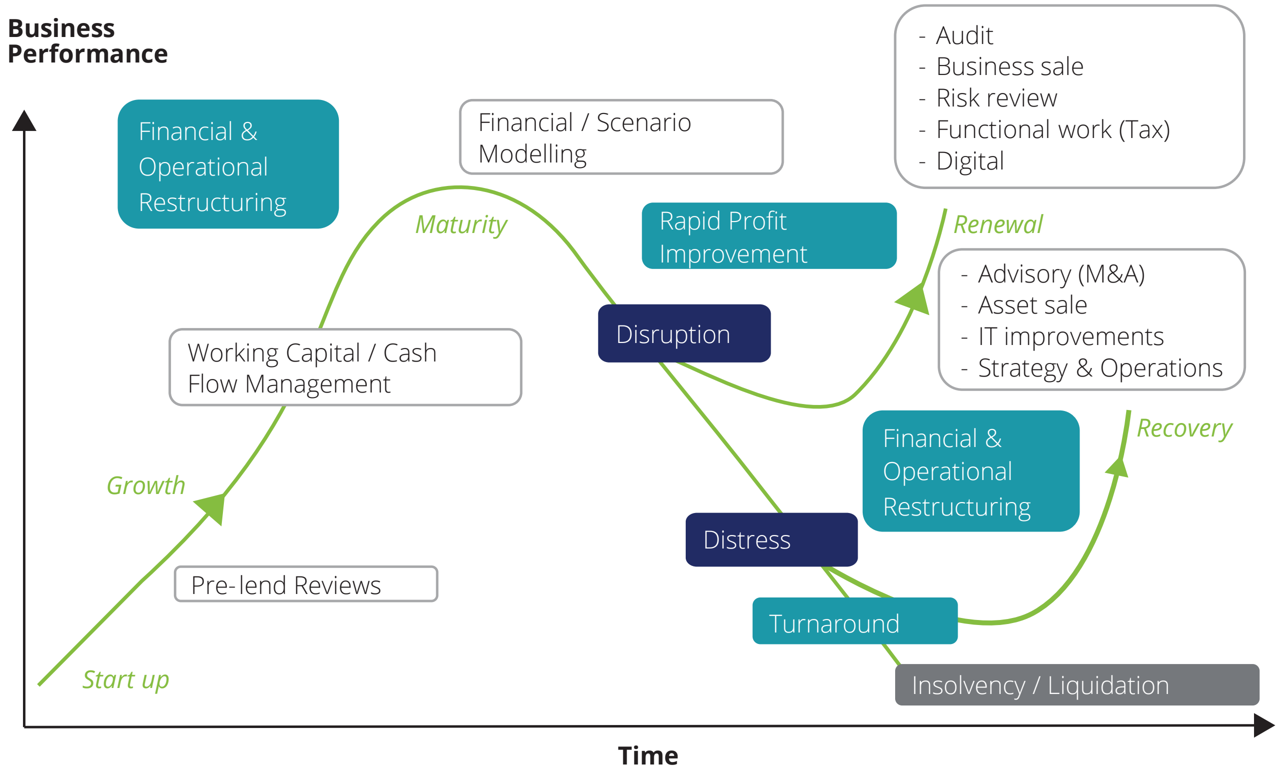
If you answered **yes** to any of the above indicators, read on—you may be facing a solvency problem, the consequences of which could be very serious.

3

Your company has shown one or more indicators of financial distress—what options are available to assist you?

Turnaround and restructuring options available to your company

Below is a typical financial distress life cycle. Where is your business in this life cycle?



Our Turnaround and Restructuring Services team can assist at all stages of your business' life cycle. We also work closely alongside other service lines within Deloitte to provide a full-service offering to ensure your business is on the right track—whatever stage of the business life cycle your business is at.

The key is early intervention. The earlier a financial problem is identified and acted upon, the more options you have.

We can assist you

If your company has shown one or more of the distress indicators, you should contact us as early as possible, as this increases the likelihood of the company surviving. Depending on how quickly you act, you may be able to restructure and turnaround the company's current trading operations.

Scan and Triage

1. We use our scan and triage method

1

Initially, we act to **stabilise** the business in order to preserve value. During this period, we forecast cash flow and liquidity of the business to gain a better understanding of how the business is tracking.

2

We then work to **uncover** the areas in the business that are of greatest liability and use this information to feed into the restructuring/turnaround plan.

3

After gaining an understanding of the financial health of the business and identifying where deficiencies exist in the current operating and strategic structure, we look to **implement** initiatives that address these deficiencies. Examples include revenue increasing or cost cutting activities, redeploying assets (both human capital and physical assets) to divisions that are better suited, and resetting KPIs and business goals.

Scan and triage factors to consider

1. Where are you at?

- Current performance and strategy
- Baseline financials
- Performance 'gap' (EBITDA, Capital, Targets)

2. What's changed?

- Market and stakeholder landscape
- Revenue & margin drivers (products, customers, channels, geographies)
- Cost drivers

3. Why has it changed?

- Structural vs cyclical change
- Consumer, channel and competitive dynamics
- Organisational challenges

4. What are the key addressable areas?

- Strategic tensions (where to play, how to win)
- Business model (how you make money)
- Operating model (how you organise yourself)
- P&L, Cash, Balance Sheet
- Leadership & change

5. What could we do?

- Key strategic choices
- Optimal business configuration
- Size of the prize
- Tactical & structural changes

6. How can we capture value?

- High level initiatives
- Prioritisation
- Key choices
- Roadmap and governance

2. We make sure our recommendations are implemented

- Before exiting the business, we work with you to define reporting systems and ensure that the changes recommended in the restructuring/turnaround plan are institutionalised in the business
- We monitor the business to ensure that the plan is correctly implemented and that any issues that may arise from the structural and strategic changes are dealt with in a timely manner
- We assist with stakeholder management, which is important when you need support for a restructuring plan.

3. We engage in creditor negotiations during the restructuring/turnaround phase

- We will assist with exploring options for debt restructuring with bank/non-bank lenders (reset covenant breaches, defer principal/interest, etc.). This may work better after the business has implemented the restructuring/turnaround plan, as the lender can see your business is stable and looking to grow
- Engage in negotiating payment plans with your creditors and resolve creditor disputes
- Assist in navigating your shareholder/director disputes.

Communication is key! Make sure you are talking to all stakeholders as early as possible. If they aren't responsive during the restructuring process, we can assist.

Safe harbour

How can it protect you from liability for insolvent trading?

As a director, you must prevent your company from incurring debts when:

- It is insolvent, or
- There are reasonable grounds to suspect it is insolvent.

You can be held personally liable by a liquidator, the Australian Securities and Investments Commission (ASIC) or a creditor for unpaid debts incurred in breach of this duty.

Law reforms that came into effective from 1 September 2017 provide you with an option to navigate into a 'safe harbour' during your restructuring or turnaround efforts which protects the directors from insolvent trading liability in certain circumstances.

When does the safe harbour exist?

Safe harbour starts when a director starts developing one or more 'courses of action' which are reasonably likely to lead to a better outcome for the company than immediate voluntary administration or liquidation would.

Safe harbour ends if:

- A director stops taking the course of action or the course of action stops being reasonably likely to lead to a better outcome for the company, or
- After starting to develop a course of action, the director fails to take that course of action within a reasonable period.

There are three phases of a safe harbour restructure:

Where are you now?

Understand the company's current financial position

01 STEP

Where do you need to get to? What is the "better outcome"

Develop and implement a plan to restructure & improve the company's financial position

02 STEP

What is the plan to get there?

Develop the steps to execute the plan for a successful recovery

Leadership and governance during the restructure aligned to "Safe Harbour"

03 STEP

If you would like to learn more about safe harbour and your options in respect to this form of restructure, please contact our team for further information.

Additional ways we can assist your business

Debtors not paying—what can you do?

Send a demand for the outstanding balance owed

A letter of demand acts as a final warning to a debtor that you intend to enforce payment of the outstanding debt. In order to proceed with legal action, you will have to wait until the date for response to the letter of demand has lapsed. By providing the debtor with a letter of demand, you will be able to demonstrate to the court that you took reasonable steps to seek recovery of the debt.

The letter of demand must be addressed to the debtor—either an individual, or the registered office of a company. The letter must be dated and provide a clear repayment date. You must also advise the debtor that if the debt is not repaid by the repayment date, that you may commence legal action to recover the debt.

It is a good idea to make sure the letter is sent by registered post, as it allows you to track when the debtor receives the letter.

Engage a solicitor to demand the outstanding debt

If you do not receive a response to the demand letter, you may consider engaging a solicitor or debt collector to issue a further letter of demand. If no response is received to the solicitor/debt collector's letter of demand, you may consider issuing a statutory demand (only applicable where the debtor is a company).

Note that the minimum debt to issue a statutory demand is $4,000. If your debtor is an individual the minimum debt is $10,000.

Enforce a statutory demand

If there is no dispute that the debt is owing, you can enforce a statutory demand in court and commence proceedings to wind up the company. For this, you will need the consent of a registered liquidator to agree to act as liquidator of the company.

With over 20 registered liquidators and 4 bankruptcy trustees located nationally, we are well resourced to provide these consents where required.

We can manage this process for you. We have good relationships with debt collectors and solicitors who will provide a speedy and low-cost resolution to collect your outstanding debts. This will allow you to keep managing your day-to-day business.

Dealing with financial pressure from your bank? We can assist with this too

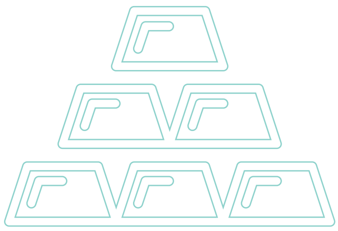
Lender negotiation

When your company breaches or expects to breach its financial covenants or has insufficient headroom on its banking facilities, you will need to negotiate with your lenders. This can be part of an overall turnaround plan or a stand-alone action when operations are sound but your company is highly geared.

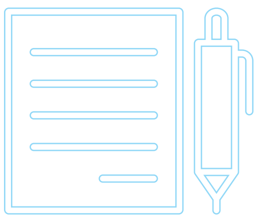
Our team specialises in leading and supporting companies in negotiations with lenders and other key stakeholders. Our strong relationships with and understanding of lenders can assist with these negotiations.

Our team has the expertise to:

Deliver an in-depth diagnosis of your company's financing requirements, including a review of your business plan and an evaluation of stakeholder positions



Provide a comprehensive analysis of your options, appraising achievable alternatives and exploring alternative fund sources



Lead negotiations to agree alternative solutions for your company with creditors, their advisors and supporting lawyers, from initial discussions to full documentation of agreed deals.

Dispute resolution

Do you have an ongoing creditor, shareholder or director dispute?

Our experience working with stakeholders in difficult scenarios has us well placed to assist you with navigating any disputes you may have, to achieve the best outcome for your business. This can be anyone from the Australian Taxation Office (ATO), to suppliers, or even shareholders and other directors in your business.

Have you entered into a lease or contract that is uncommercial?

It is common for many businesses to have entered into a fixed term lease or contract which does not allow for renegotiation when your business is experiencing disruption or a downturn in trade. We can assist in reviewing your current lease/contract and approach the relevant party to renegotiate a better outcome for your business.

Tip: the voluntary administration process (see Section 4 for more information) enables an external administrator to either exit or renegotiate your company's onerous leases or contracts.

Ipso facto clauses—what do these mean for your company if it is in financial distress?

Ipso facto explained

An ipso facto clause is a contractual clause that allows a party to terminate or modify a contract upon the appointment of an external administrator to a company. They are generally regarded as a significant impediment to a successful restructure as they can:

- Reduce the range of restructuring options available to the company
- Be highly destructive to both the value of the company's business and the potential return to creditors (due to the clauses' ability to disturb the business' contractual arrangements and destroy goodwill).

2018 law reform to ipso facto clauses now provides an automatic stay on ipso facto rights triggered by voluntary administration, which means that your main supplier or customer cannot cancel their contract with you just because a voluntary administrator has been appointed to your company. This is dependent on the date of entering the contract.

This law reform could preserve the value of your company and increase the return to your company's stakeholders in a restructure.

4

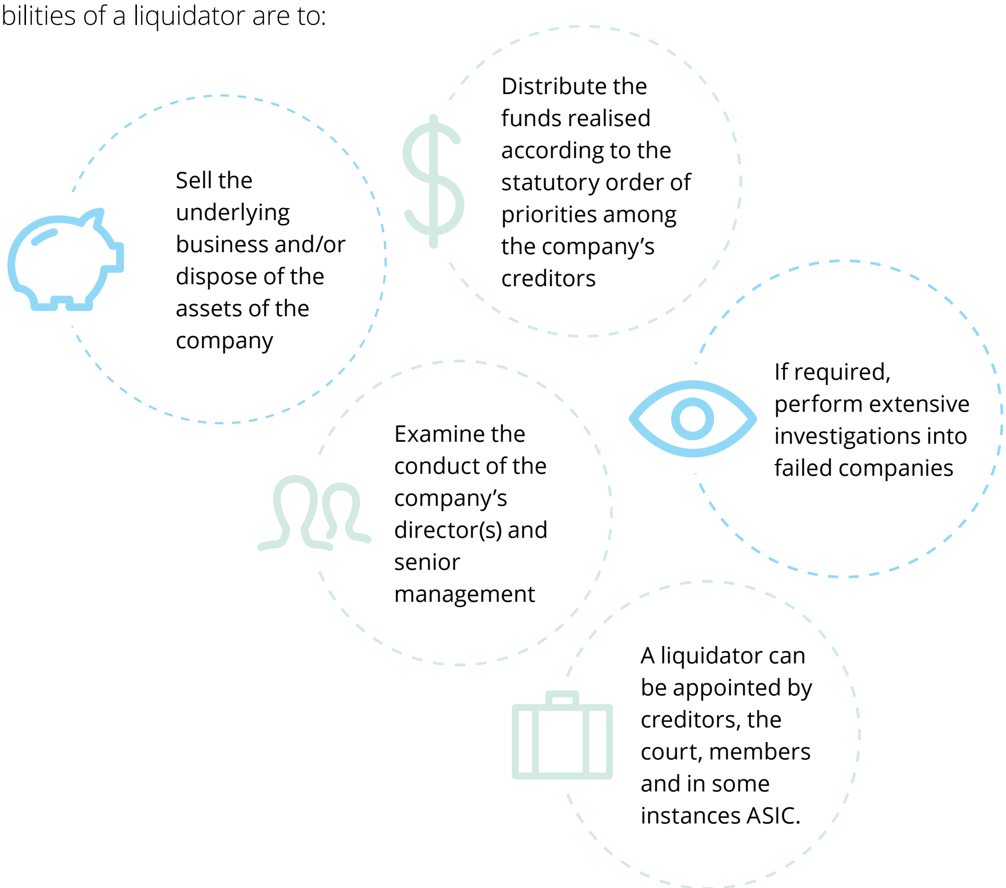
Turnaround and restructuring support not right for your company? External administration may be the answer.

Directors of financially distressed/insolvent companies can appoint an external administrator. There are two types of external administrations available: Liquidation or Voluntary Administration.

Liquidation

A registered liquidator from Deloitte can be appointed to wind up the company. This involves realising the company's assets and disbursing funds to creditors in accordance with priorities set out in the Act.

The responsibilities of a liquidator are to:



Does a director still have duties if a Liquidator is appointed?

Yes, they must:

- Identify and deliver up assets of the company
- Provide books and records
- Provide a Report on Company Affairs and Property (ROCAP)
- Attend on the liquidator if requested
- Keep the liquidator informed of address changes

Creditors’ voluntary liquidation

A winding up process commenced by shareholders of the company in circumstances where the company is insolvent (unable to pay its debts when they fall due).

Simplified liquidation

From 1 January 2021, liquidators appointed to an eligible Creditors’ Voluntary Liquidation are able to adopt a new simplified liquidation pathway that reduces the complexity, time and costs of the liquidation thereby increasing the likely return to creditors and employees. There are several eligibility criteria to be eligible for a simplified liquidation, the main being:

- Total liabilities of the company must not exceed $1million (excluding related party debts)
- No director has been a director of a company that has previously used the simplified liquidation or small business restructuring process (see Section 5) within previous 7 years
- The company’s tax lodgments are up to date.

Court liquidation

A court liquidation is a winding up of a company by the Courts following an application by one or more of the company’s creditors.

A court liquidation can be instigated by creditors, shareholders or other interested parties via a petition to wind up a company due to unpaid debts, or on just and equitable grounds.

Members’ voluntary liquidation (MVL)

A members’ voluntary liquidation is a liquidation process for a solvent company. It is often used to clear up dormant company structures. The process is initiated by the company’s members passing a special resolution.

The director(s) of the company are first required to give a declaration as to the solvency of the company and must file this with ASIC. The winding up resolution must then be passed by the members within 5 weeks of the declaration being made.

Some benefits of voluntarily winding up a solvent company include:

- Group simplification—eliminating dormant legal entities to achieve a more cost-efficient company structure
- Savings in audit and accounting costs
- Savings in management time preparing financial information, tax returns and annual returns.

Voluntary Administration (VA)

The VA process aims to rescue a company or ensure survival of the business as a going concern. This form of external administration allows a period of planning to maximise stakeholder returns, either through a sale of the business by the external administrator or a company rescue through a Deed of Company Arrangement (DOCA).

The VA process

After taking control of the company, the voluntary administrator investigates and reports to creditors on the company's business, property, affairs and financial circumstances, as well as the three options available to the creditors. These are:

1. End the VA and return the company to the control of the director(s)
2. Approve a DOCA (which generally provides for the company paying all or part of its debts in full and final satisfaction); or
3. Wind up the company and appoint a liquidator.

The voluntary administrator must give an opinion on each option and recommend which is in the best interests of creditors. A meeting of creditors is generally held ~25 business days after the voluntary administration began to vote on the best option for the company's future. Tip: this meeting can be adjourned to a later date by the creditors or by application to the court.

During the VA, the voluntary administrator has all the powers of the directors and takes control of the company's business and affairs. The voluntary administrator has the power to sell the company's business or sell individual assets, as well as restructure and/or close down unprofitable parts in the lead up to the creditors' decision on the company's future.

How does external administration affect you (as a director), your staff, and your creditors?

You (director)

Your duties to the company continue after the appointment of an external administrator. You are required to provide assistance to the external administrator when required—this may be the provision of financial records, explaining transactions, and attending meetings of creditors or at the external administrator's request. You will not be allowed to use your powers as a director whilst your company is in external administration, these powers are given to the external administrator instead.

Your staff

Employee claims rank as a priority to general unsecured creditors of the company. In the event the company has insufficient assets, the Fair Entitlements Guarantee (FEG*) scheme acts as a safety net and will pay out employees for:

- Unpaid wages—up to 13 weeks
- Unpaid annual leave and long service leave
- Payment in lieu of notice—up to five weeks
- Redundancy pay—up to four weeks per full year of service.

*FEG is only available when a company is in liquidation. Not voluntary administration. FEG does not pay outstanding Superannuation Guarantee Contributions (SGC), these will be pursued by the ATO.

Your creditors

Creditor claims are 'frozen' meaning they cannot commence legal recovery action unless they obtain leave from court or the external administrator. Instead, creditors will be invited to lodge a claim in the administration and the administrator will keep them informed of the likelihood of receiving a 'distribution'. Generally, there are two types of creditors—secured and unsecured:

- A secured creditor has a 'security interest' (similar to a mortgage) over some or all of the company's assets to secure a debt or other obligation owed by the company. For example, lenders—such as banks—will often require security over company assets when providing a loan to your company. The security must be registered on the Personal Property Securities Register (PPSR). The secured creditor is entitled to be paid first, ahead of all other creditors from the proceeds of the assets that were secured
- An unsecured creditor does not have security over company assets. Employees who are owed entitlements in relation to their employment (e.g. unpaid wages, accrued leave) are granted 'priority' status, which means they are paid first, ahead of all the other unsecured creditors. If there are insufficient non-secured assets to pay employee entitlements in full, employees are given priority over secured circulating assets (e.g. cash at bank, debtors, inventory) and they are entitled to be paid out of the proceeds of these asset realisations ahead of the secured creditor.

What costs are involved?

An obvious concern for any person contemplating the appointment of an external administrator is the question of cost. External administrators usually charge for work performed on an hourly basis, and are paid out of the available assets of the company.

For other restructuring and turnaround services, Deloitte is market competitive. Estimates of cost will be provided in advance and each matter is staffed and tasked appropriately. In many circumstances, turnaround services can be provided on a contingent basis, that is an implementation of a turnaround plan attached to a successful result.

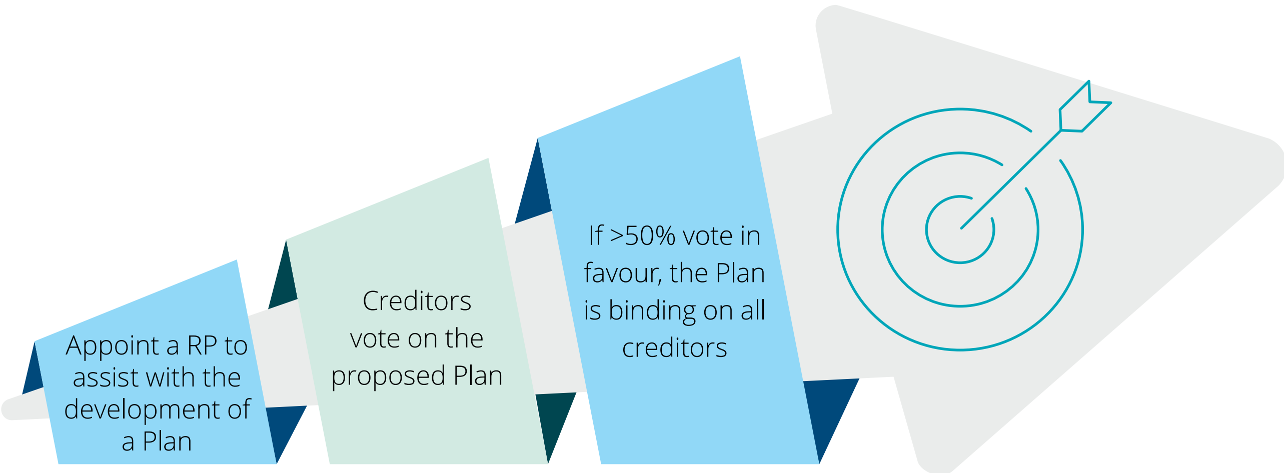
No matter is too small or too large. Our national offices allow us to service all of Australia, both metro and regional.

5 Restructuring plans to support corporate small business

Small business restructuring (SBR)

Introduction

A new SBR regime was legislated with effect from 1 January 2021. It provides a much simpler and cheaper option to restructure. It is comparable to the VA regime but with significantly less involvement by the appointed Restructuring Practitioner (RP).



Eligibility

There are some eligibility criteria and we can help you assess those, however the main requirements are:

- Total liabilities not to exceed $1 million (excl. employee entitlements)
- Tax lodgments must be up to date
- Employee entitlements which are due (excludes accruing leave entitlements) must be paid up to date
- No director has been a director of a company that has previously used the simplified liquidation or small business restructuring process within previous 7 years.

Advantages

- A simplified alternative to the VA process
- Lower costs as compared with a VA
- Control of the business is retained by the directors
- Streamlined process, reduced costs and the restructure and resultant reduction in liabilities improves the balance sheet and increases the opportunity for the company to survive.

Developing the plan

A restructuring plan must provide for a 'plan fund' which is to be distributed equally amongst creditors. In other words, the plan will offer x cents in the dollar. The payments can be in instalments over time, but limited to a maximum of 3 years. Other key features:

- The directors remain in control of their business but can only transact in the "ordinary course of business". Non-ordinary course transactions will require the RP's approval
- The company develops a plan. The RP will assist as much as is required
- The RP has to express an opinion regarding the company's ability to honour the plan and sends it to creditors with the proposed plan for approval
- If ≥50% of creditors in dollar value vote in favour of the plan, it is binding on all creditors
- Related party creditors are excluded and not entitled to vote.

Executing the plan

Once the plan is approved by the required majority the RP must collect and distribute the plan funds in accordance with the terms of the plan. When the plan is successfully effectuated, the company is released from all debts that were admissible under the plan.

If a company's plan is not approved, or the restructuring otherwise fails or terminates, the restructuring ends. There is no automatic liquidation that follows.

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Changes over time

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