THE INSOLVENCY REVIEW

ISSUE 03 - SEPTEMBER 2021

External Administrations:
June Quarter Review

In Focus:
Provisional Liquidation

Personal Insolvency:
June Quarter Statistics

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WELCOME

Welcome to the September 2021 issue of The Insolvency Review.

As we move toward the final quarter of the year, I'm sure many are hoping that 2022 looks vastly different. As the State and Federal Governments work together to roll out their national vaccination and recovery plans, we're hopeful that with it will come the opening of borders, relaxed restrictions and the ability to travel more freely across our own country and abroad.

Australian businesses have had to tough it out over the last 18 months. Our look at external administrations in this issue provides some assessment on the current climate and insight into what the future may hold.

Also in this issue, Monica Tilbrook from our Sunshine Coast office discusses provisional liquidation and the circumstances where the process is particularly pertinent and the benefits which it offers.

Finally, our review of personal insolvency statistics for the June quarter provides a look at trends across the country and highlights some of the key influences behind a steady increase in numbers since December 2020.

We hope you enjoy this issue.

Terry

Terry van der Velde
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EXTERNAL ADMINISTRATIONS

"The fact remains that there is significant unpaid debt in the economy and, at some stage, creditors are likely to look to recover their debts."

With no immediate end in sight to the ongoing rollercoaster of lockdowns and restrictions, the harsh reality is hitting home that we may be dealing with the pandemic for longer than any of us expected.

Although statistics show a YoY decrease in external administrations of 42% from FY20 to FY21[1], the latest data from ASIC shows a notable rise in the number of external administrations over the June quarter. An increase of over 30% was recorded with 1,269 companies entering external administration compared to 972 in the March quarter (see Fig. 1).

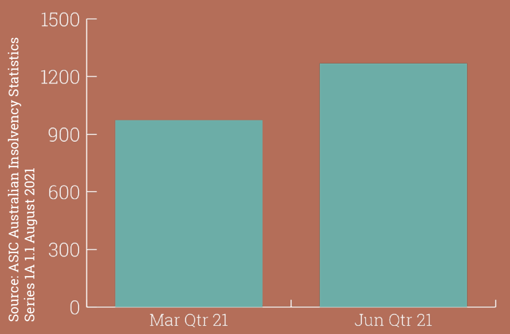
With the dark cloud of lockdowns continuing to loom over businesses, the expectation is that figures will continue to steadily increase for the remainder of 2021.

Across industries, notable increases on the quarter include:

- Accommodation & Food Services with a 65% increase to 190
- A 31% increase in the Construction sector with 293
- Retail Trade seeing a 57% increase to 77[2]

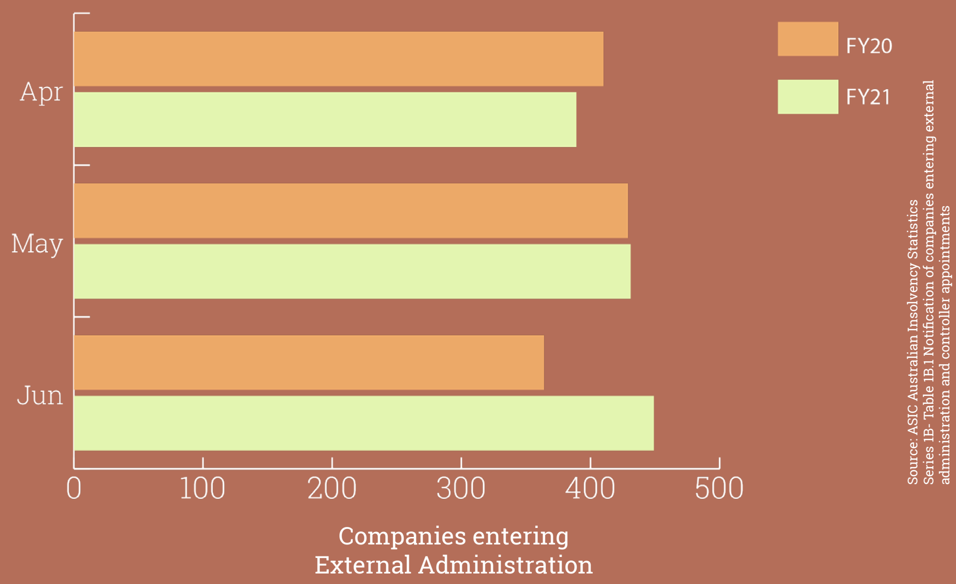
Results from NAB's June Business Survey notes that business confidence has suffered given the recent rise in COVID cases and subsequent lockdowns across the country, and was particularly evident in NSW and QLD.[3]

Fig. 1



Companies entering External Administration

Fig. 2



Looking at performance across key industries, the Education and Training sector has faced significant challenges over the course of the last 18 months. With lockdowns and international travel restrictions affecting international student enrolments, industry revenue is expected to decline 1.9% over the current year.[4]

Many businesses have been forced to adapt to the changing trade conditions brought on by the pandemic through investment in their online trading presence and ramping up of digital sales capabilities. Australians are shopping online more than ever and revenue across the Online Shopping industry is expected to grow by 35% in 2021.[5]

Aided by the continued proliferation of buy now pay later offerings and adoption of these services across younger demographics, sales are expected to continue to grow inline with the increasing role these payment platforms will play in the retail sector.

With the rapid rebound generally experienced when states transition out of lockdowns, the sentiment is that businesses will hopefully continue investing and hiring staff, further aiding economic growth as support measures continue to be wound back. Projections from Commsec estimates the global economy to rebound by 6.8% in 2021 after contracting 2.3% over the course of 2020.[6]

The fact remains that there is significant unpaid debt in the economy and, at some stage, creditors are likely to look to recover their debts. In particular, in our experience, the ATO continues to be one of the larger creditors in any external administration.

With the additional pressures applied by the pandemic, the debts faced by many businesses are likely to be larger than during what we consider as normal business conditions. With a strong indication in June quarter statistics that external administrations are on an upward trajectory, businesses will be feeling the increasing pressure as we move forward towards 2022.

1 ASIC Australian Insolvency Statistics Series 1A 1.3 August 2021
2 ASIC Australian Insolvency Statistics Series 1A 1.1 August 2021
3 NAB Monthly Business Survey June 2021
4 IBISWorld AU Industry (ANZSIC) Report P - Education & Training in Australia
5 IBISWorld AU Industry (ANZSIC) Report X0004 - Online Shopping in Australia
6 Commsec Economic Insights July 2021

IN FOCUS - PROVISIONAL LIQUIDATION

"The role of a Provisional Liquidator includes the preservation and protection of the assets of the Company and maintaining the status quo, during the interim period prior to a winding up application being heard."

Monica Tilbrook
Manager

Caught between a rock and a hard place

Provisional Liquidation can be an effective process to protect your interest in a Company and may be available to directors, shareholders, creditors and other eligible aggrieved parties. A Provisional Liquidator can step in as a caretaker of the Company.

The role of a Provisional Liquidator includes the preservation and protection of the assets of the Company and maintaining the status quo, during the interim period prior to a winding up application being heard. The Company does not need to be insolvent for it to be placed into Provisional Liquidation.

For example, it may be appropriate for a Provisional Liquidator to be appointed in the following circumstances:

- A creditor of the Company (owed a debt by the Company) that is concerned that the Company or its Director(s) may be removing assets or inappropriately dealing with them (such as 'phoenixing' or creating a new entity and leaving behind the old entity and its debts).
- A shareholder who is concerned that the Director(s) may be acting without care and diligence or in their own interests and depleting the Company's financial position.
- A director/shareholder dispute that is unable to be resolved amicably or by agreement and is impacting the Company's business and assets.

In such circumstances, there may be a breakdown of trust between parties and the potential for the assets of the Company to be diminished or divested.

As an aggrieved party you may have valid concerns and feel unable to control the process or prevent any reckless or inappropriate behaviour, before it is too late. The appointment of a Provisional Liquidator may be an appropriate measure to protect your interest in the Company and appoint an independent party to manage the Company's affairs and ensure that its assets are protected.

Generally, a creditor or shareholder may make an application to Court to wind up the Company on various grounds – refer to sections 459Q and 461 of the Corporations Act 2001 (Cth) (the Act). After the filing of the application, you may make an application to Court for a Provisional Liquidator to be appointed prior to the winding up application being heard by the Court.

A Court may make Orders to appoint a Provisional Liquidator where it is satisfied that the Company's assets are at risk of being diminished.

A Provisional Liquidator will have most of the functions of a Liquidator prescribed by the Act, however, as it is an interim appointment, this will not generally include such things as investigating the Company's affairs, recovering voidable transactions or distributing funds to creditors. Generally, a Provisional Liquidator will maintain the status quo and protect the Company's assets until the Company is placed into Liquidation or the reason for the Provisional Liquidation is resolved (such as the shareholders reaching an agreement).

However, a Provisional Liquidator may also have the authority to sell a Company's business and/or its assets. This is in contrast to a Court Liquidation or Creditors Voluntary Liquidation, where the Liquidator will bring finality to the Company's affairs and sell and distribute its assets.

At the hearing of the winding up application, the Court may make orders to end the Provisional Liquidation and return control to the Director(s), wind up the Company or continue the Provisional Liquidation with a view to achieving a certain outcome – such as the sale of the Company's business.

In summary:

A Provisional Liquidation may be an appropriate measure if you have concerns regarding the Company, including the conduct of its directors, the diminishment of assets and/or potential insolvency concerns, where other alternatives to preserve the Company's assets and business have been exhausted.

If there is a saleable business or other assets, a Provisional Liquidation may allow for continuity, including preventing the termination of primary contracts, leases and/or insurances that may ordinarily be terminated by way of a Liquidation.

PERSONAL INSOLVENCY

Australian households have faced significiant financial pressures over the last 18 months. According to NAB, concerns over monthly household expenses and the ability to meet financial commitments has driven an increase in household financial stress for many Australians, particularly lower income earners.[1]

The June quarter has seen a slight increase in the total number of personal insolvencies, up slightly over 5% on the previous quarter to 2,682.[2] This could be an indication that wider debt recovery actions are starting to take affect, forcing many who are no longer protected under temporary debt relief measures to enter into personal insolvency proceedings.

Year on year figures for the June quarter remain down with a reduction of 37.6%. (see Fig. 3). Similarly, annual figures published by AFSA indicate that total new personal insolvencies are down by 49.7% to 10,621. The downward trend continued across all states with Victoria, Western Australia and Northern Territory all posting reductions exceeding 50%.[3]

YoY Key Stats (see Fig. 4) :

- Bankruptcies (Part IV & XI) - 1,738 down from 2,265 in June 2020
- Debt Agreements (Part IX) - 921 down from 1,990 in June 2020
- Personal Insolvency Agreements (Part X) - 22 down from 44 in June 2020[4]

Of the 2,682 bankruptcies reported for the June quarter, 35.3% were business related with 94% of bankruptcies occurring by debtor's petition.[5]

With rolling lockdowns still continuing across the country, provisions have been made by both Federal and State Governments to provide support to those financially affected through further stimulus measures.

The fact is, the government cannot maintain these measures indefinitely. For lower income earners, loss of income due to a reduction in working hours or loss of employment has meant that, for many, savings have substantially declined and subsequently household debt has increased as many use credit cards or alternative solutions, such as loans from family and friends, to help bridge the gap. This will continue to have a lasting impact on financial stability for many Australians as they try to recover, get back into employment and make headway on repaying debts they've incurred over the course of the pandemic.

Fig. 4

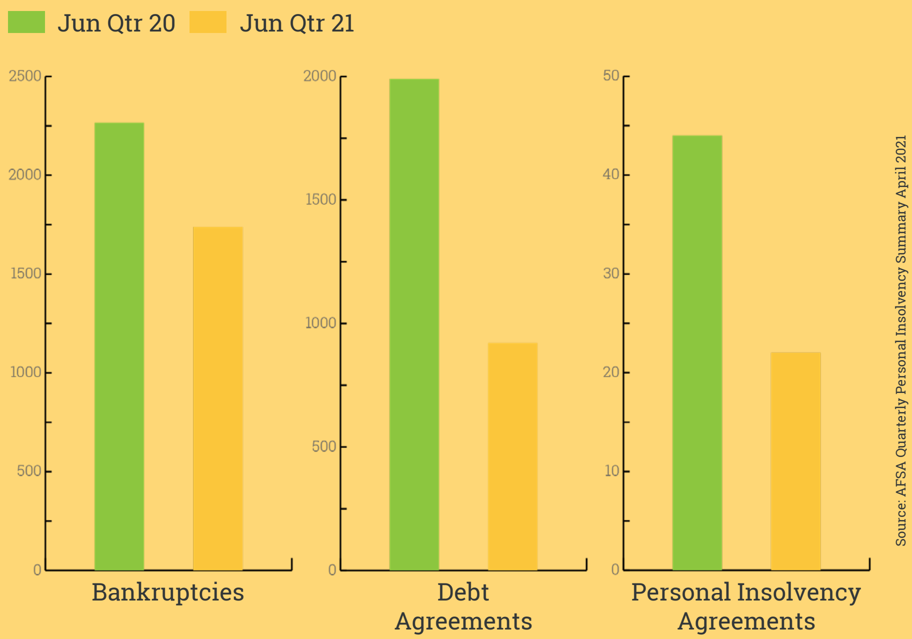
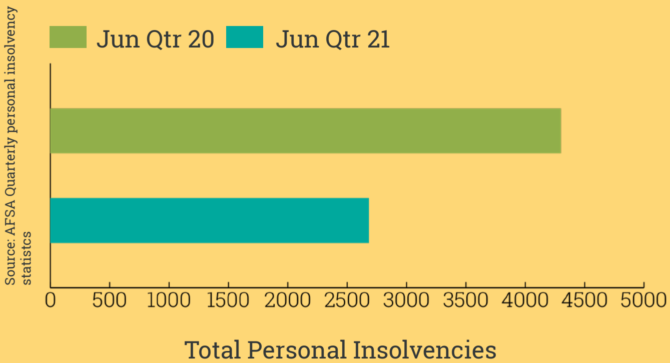


Fig. 3



WHAT IS BANKRUPTCY?

Bankruptcy is a legal process that provides protection to people who are unable to repay their debts or reach a suitable arrangement with their creditors. During a bankruptcy, a Registered Trustee is appointed to manage the bankruptcy process and will recover and sell assets for the benefit of creditors.

1 NAB Financial Wellbeing Survey - August 2021
2 AFSA Quarterly Personal Insolvency Statistics Time Series July 2021
3 AFSA Annual Personal Insolvency Summary - July 2021
4 AFSA Quarterly Personal Insolvency Statistics Time Series July 2021
5 AFSA Quarterly Personal Insolvency Statistics - Media Release July 2021

2682

2682 new personal insolvencies in Australia in June Qtr 2021 **with a total decrease of 37.6% YoY**

On a per state basis, there have been reductions YoY in personal insolvencies across the board over the June quarter, with the exception of Tasmania. The total number of business related personal insolvencies for the June quarter YoY also shows a marked decline, down by 339. There is however a notable increase from the March 2021 quarter, up to 691 from 592.

Key statistics for June quarter 2021 (see Fig. 5):

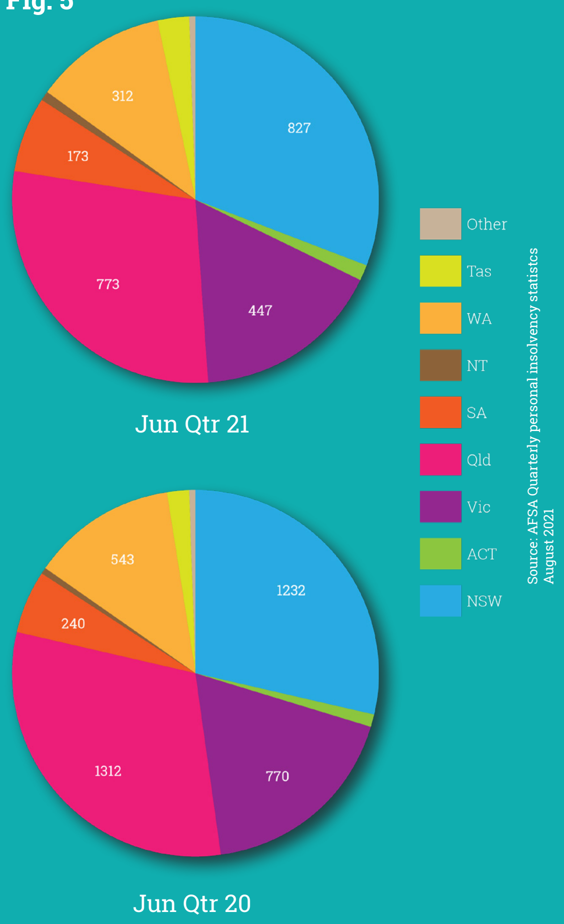
- 827 people entering personal insolvency in New South Wales down from 1,232 in June 2020
- 773 entering personal insolvency in Queensland down from 1,312 in June 2020
- Victoria reported 447 people entering personal insolvency down from 770 in June 2020 [1]

While all of the above reported figures are down YoY, there have been increases across all states on March quarter figures (with the exception of the Northern Territory) and a steady increase in new personal insolvency matters since the December quarter in 2020.

Figures are up 16% to 614 on the March quarter for people entering bankruptcy in business while YoY bankruptcy numbers for the June quarter are down more than 23%.

According to NAB's Australian Wellbeing Survey, many Australians saw a fall in savings in Q2 with nearly 1 in 2 reporting a fall in the last 3 months. Many expect this to continue as the uncertainty around the vaccination roll out, lockdowns and Australia's COVID exit plan continue.[2] The expectation is that personal insolvencies will continue to rise as many face the unfortunate reality of their situation.

Fig. 5



Total Personal Insolvencies By State

1 AFSA Quarterly Personal Insolvency Statistics Time Series - July 2021
2 NAB Financial Wellbeing Survey - August 2021

WHERE TO FROM HERE?

While overall, both corporate and personal insolvency figures remain low, statistics stand in contrast to the number of businesses facing increasing financial pressure.

With Sydney in the throes of its worst outbreak since the start of the pandemic and Melbourne having suffered through more than 200 days of lockdowns, the recent rise in insolvencies is likely to continue toward the end of 2021. Consensus across the industry is backed by research from credit reporting agency Equifax, predicting that insolvencies will likely more than double over the next 12 months.[1]

In March of this year, the Australian Institute of Credit Management (AICM) reported that its members had observed incidences where businesses which were moving toward insolvency in March 2020, but are now close to entering into a formal insolvency process, are showing debt levels 10 times higher as a direct result of the moratoriums.[2]

Additionally, with record low interest rates, asset prices globally continue to rise. Corelogic research shows a 16% increase in housing prices nationally over the past year to July.[3] The surge in prices, underpinned by the record low interest rates, has the potential to have catastrophic effects, particularly if lending standards are weakened.

Many have seized the opportunity to enter the property market however, according to the RBA, the consistent rise in prices may set a precedent that rises will continue indefinitely into the future and subsequently increase risk taking and borrowing spurred on by the low interest rates.

This could potentially lead to a rise above fundamental values and a correction in asset prices exposing lenders to increased debt or significant losses should the income of borrowers fall or be impacted further by events associated with the pandemic.[4]

As we've observed in previous issues of The Insolvency Review, the temporary moratoriums introduced to support businesses through the pandemic have provided much needed support during a tumultuous and challenging time. They have however also had a detrimental effect on many which were already on the cusp of insolvency prior to the COVID-19 pandemic.

For many, the inevitable will materialise over the next 12 to 18 months and, as businesses enter into formal insolvency processes, the pressure will shift to employees and subsequently spur on a rise in personal insolvencies.

Those businesses experiencing short term issues should engage openly with their accountant or lawyer and implement a plan to rectify issues and return to a strong operating position in order to set up the business for success into the future.

Businesses which are not engaging with their advisors may require further nurturing to drive more engagement and realign focus to ensure risks can be controlled and impacts can be limited.

Unviable businesses need to face the reality and be encouraged to engage professional advisors to determine appropriate solutions. Time and again we see businesses who have left it too late. Early engagement means more options and a better outcome.

As difficult as these conversations can be, the alternative is far worse. Being proactive in business is the only way to minimise disruption, stay ahead of the curve and set yourself up for success.

1 Equifax - Insolvencies on the rise - April 2021
2 AICM - Treasury Submission - Increasing the Statutory Demand Threshold
3 CoreLogic - Hedonic Home Value Index - August 2021
4 Reserve Bank of Australia - Financial Stability Review - April 2021

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