Case Study

Business Rescue License

Question Read the background provided and complete the 20 Multiple Choice Questions on the online portal. Choose the ONE best answer.
Mark: Total marks for the study case: 20. 1 per question.
Policy Open book policy applies.
Time 2,5 Hours.
Case Study Subject Cloud9 Airlines Limited. 4 Pages.

Background

Cloud9 Airlines Limited ("C9A") is a company operating in the South African airline sector and has done so for several decades. It operates a very successful low cost airline and which caters to the "no frills" sector of the South African airline market. In 2018, C9A made good profits and was seen as a "high flyer" in the airline industry.

Towards the end of 2019, C9A began to incur losses in that there was a marked drop in demand for airline tickets and due to ongoing constraints in the consumer market brought about by the start of a recession in South Africa. The airline has a large staff complement and which includes pilots, cabin crew, engineers, maintenance and service support, financial and other general support staff.

The company has a head office in Kempton Park and runs the company through its board of directors consisting of a Chief Executive Officer (Mr A Loft), a Chief Financial Officer (Mrs F Igure) and three other executive board members.

C9A has expanded aggressively over the last decade. Over the last 10 years it acquired an airline catering company, entered into a joint venture with a baggage handling company, increased its headcount by almost 250 employees (increasing its wage bill with an additional R45 million/month), expanded its operations into Africa (which has proved to be quite profitable), were also flying to 6 South African airports outside the Golden Triangle (Johannesburg, Cape Town and Durban) , acquired 5 airplanes and were leasing an additional 5 airplanes to add to its fully owned fleet of 10 aircraft. The airline flies 20 airplanes in total.

As a result of the aircraft all being acquired offshore, the company required and obtained significant loan capital from its bankers and which loans were all based in USD demoninated loan facilities. The company's bank was happy to provide such loan capital on the basis that the existing fleet of 10 aircraft would be registered as security in favour of the bank, and in terms of an aircraft security mortgage bond.

Due to ever downward valuation of the South African Rand to the US Dollar, coupled with the bank loan and interest repayments, C9A was all but breaking even over the last year (2019).

Due to ever increasing financial pressure, in early 2020, C9A employed the services of a firm of restructuring experts (RE) who, supported by the company's bank, would attend to an informal restructuring of C9A both financially and operationally.

Under the guidance of the RE, C9A proceeded to raise equity capital from its shareholders, on the basis that C9A's proposed aggressive strategy in 2020 would see increased revenue from airline ticket sales, a renewed up tick in the South African economy, and as a result, significant dividends flowing to its shareholders once the bank loans were paid off. The equity capital raised from shareholders was only sufficient to pay arrear interest on the loans owed to the Bank, nevertheless, as long as C9A could continue to operate it was solvent and liquid (at least on its balance sheet).

In February/March 2020, the RE was busy negotiating payment holidays and reduced interest rates with the company's bank, its aircraft financiers/lessors, and other creditors as part of the restructuring of the airline.

On 26 March 2020, The President of South Africa announced a State of Disaster under the Disaster Management Act 57 of 2002 and due to the onset of the COVID-19 pandemic. Under the lockdown restrictions, C9A would no longer be allowed to operate domestic or international flights and as a result all potential revenue from flying operations came to an immediate halt. Cash shortfalls are predicted to be in the region of R45 million in the next 6-month period. It also appears unlikely that the company will be able to pay its employees at the end of March 2020.

Further, the company is in arrears with its overdraft facility with its bank (operating account) and is being placed under pressure to meet its obligations in the near term. The bank has a general notarial bond (GNB) registered as security over certain of the assets of the company (mainly equipment used to service its aircraft). Such GNB had not been perfected in court.

Although the company was no longer able to operate under current restrictions, it was still required to pay for the maintenance, service, storage and insurance of their 20 aircraft. It was also required to service the loan repayments and, at the very least, the wage bill. Of course, other critical creditors, such as the Civil Aviation Authority (CAA) and the various Airports have to be paid. C9A had been served with a summons from the lessor of one of the hangers in which it stored its aircraft, and also received a statutory letter of demand from a small, but rather aggressive, trade creditor (supplier of on-board drinks) who was threatening to institute a liquidation application against C9A. Further, another aircraft lessor AEGE Aircrafts (Pty) Ltd (AEGE) has threatened to cancel its lease due to non-payment of its lease obligations.

Despite all of this, shortly after the imposition of the lockdown restrictions, C9A received a serious expression of interest from an investment consortium, who had expressed an interest in acquiring a controlling stake in C9A through the investment of a combination of debt and equity capital into C9A. The consortium is also willing to put up post-commencement finance (short term bridging finance) . This expression of interest also contemplates a compromise of concurrent creditors' claims, and the possibility of renegotiating credit terms with existing aircraft financiers and new lease terms with aircraft lessors. The detail of such prospective transaction still needs to be negotiated.

The board of directors of C9A concluded that the company could no longer continue trading in the ordinary course and that it had become financially distressed. Consequently, the board of C9A passed and filed a resolution for the commencement of voluntary business rescue proceedings. C9A is placed under business rescue proceedings on 30 April 2020 and one of the members of the RE, Mr C Flight (a member of SAIBA) is appointed as business rescue practitioner (BRP).

It transpires that Mr C Flight, unbeknown to the board, has been found guilty in disciplinary proceedings brought against him by SAIBA.

Immediately upon his appointment as BRP, Mr C Flight begins to investigate the affairs of the company. In discussions with the company's bank, the BRP establishes that the CEO, Mr A Loft has bound himself as surety for the debts of the company in an amount of R100 million. Further, it appears that the CFO, Mrs F Igure is married to the BRP's brother. Lastly, it is apparent that Mr O'Mally, one of C9A's senior executive board members, has been involved in shady dealings with VR Airlines prior to the commencement of the business rescue proceedings.

The BRP also wants to urgently cancel certain prejudicial contracts that are hindering his efforts to rescue the company, such as the airline catering and baggage handling contracts.

In addition, the BRP is considering downsizing the aircraft fleet by cancelling certain expensive aircraft lease agreements, and mothballing the balance of the fleet while South Africa awaits the lifting of the lockdown period and which will enable the airline to resume operations.

The BRP immediately attends to the following-

1. Meets with the banks and shareholders to establish if there is available post- commencement finance;
2. Engages with the employees and creditors of the airline;
3. Hires a corporate finance firm to consider potential offers for the airline;
4. Investigates the reasonable prospect of rescuing the airline;
5. Meets with the board and management to discuss the future prospects of rescuing the airline; and
6. Convenes a first meeting of creditors to, inter-alia, consider the reasonable prospect of success of the rescue of C9A and to consider creditors' claims;
7. Begins preparation and drafting of a business rescue plan for consideration by creditors at a section 151 meeting of creditors.

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