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feature

PIE FACE CASE STUDY

Pie Face Deed Administrator, Sule Arnautovic of Jirsch Sutherland, discusses how the Pie Face Group came close to going under before a foreign distressed lender extended a lifeline.

Less than six weeks after signing off on the Deed of Company Arrangement for the Pie Face manufacturing and franchise group, a majority of shareholders expressed their dissatisfaction with one key detail of the DoCA.

On 12 February 2015, at an extraordinary meeting of the company's shareholders, Wayne Homschek, Pie Face's co-founder and chief visionary was forced off the board of directors.

Perhaps it's fair enough. After raising up to $40 million since founding Pie Face in 2003, a radically diminished Pie Face emerged from voluntary administration with Homschek still on the board on 30 December 2014.

Under the terms of the Pie Face DoCA unsecured creditors will get no more than 19 cents in the dollar. Total creditor claims (excluding inter-company claims) stand at approximately $50 million. Homschek's continuing presence on the board no doubt irked the many facing serious losses.

Further undermining his justifications for remaining on the board were the director penalty notices served on him by the Australian Tax Office and Office of State Revenue, which are also creditors. That's quite a burden for someone lumbered, fairly or otherwise, with primary responsibility for Pie Face's spectacular implosion in the latter half of last year.

Publicly, Pie Face's problems appeared to snowball following reports that American casino tycoon Steve Wynne had filed a lawsuit in a Delaware court on 3 October 2014 seeking $US20 million in damages from Pie Face Holdings.

As well as being the parent company of Pie Face Australia, Pie Face Holdings is Wynne's partner in US company Pie Face Holdings Inc. And while this wasn't the first dispute to hit Homschek's embryonic US operations, it was by far the severest vote of no confidence.

PIE FACE'S FINANCES LAID BARE

Behind the scenes though, Pie Face's accounts had for several years been showing the unpalatable truth; significant losses and mounting costs. But its parlous financial position was openly revealed to investors and suppliers only after Sule Arnautovic and Rod Sutherland of Jirsch Sutherland were appointed voluntary administrators.

The Jirsch Sutherland partners took charge of Pie Face Holdings, Pie Face Franchising and Pie Face Pty Ltd on 21 November 2014. Pie Face Holdings owns 100 percent of Pie Face Franchising and Pie Face Pty Ltd.

Their second report to creditors revealed that Pie Face Holdings' fund raising activities were what was keeping the operating companies afloat. And Pie Face Franchising and Pie Face Pty Ltd were failing to generate the returns they and Pie Face Holdings needed to service their obligations.

Pie Face Franchising issued the franchise agreements. Pie Face Pty Ltd made the pies and sausage rolls and supplied the other goods for sale both through Pie Face's 24 company-owned outlets and the 46 franchisee-operated stores. And the latter entity was losing heavily.

'Accumulated losses of the Group arise from the accumulated losses of Pie Face Pty Ltd, which have substantially increased between 2009 and 2012,' the VAs said in their second report to creditors on 18 December 2014.

'It is also evident that the capital raised through Pie Face Holdings had been significantly exhausted through Pie Face Pty Ltd. This is apparent through the loan account from Pie Face Holdings to Pie Face Pty Ltd totalling approximately $33 million as at November 2014.'

HOW THE SECURED CREDITOR UNCOVERED CRITICAL FUNDS

While Wynne's $US20 million lawsuit looked on the surface to have been the catalytic event leading to the appointment of VAs, the truth is that Pie Face's worsening financial position and its funding arrangements with secured creditor Macquarie Bank meant an insolvent restructure was inevitable.

The appointment of the VAs in fact followed an attempt by the board of directors to reach an in-principle refinance of Macquarie Bank, which would have been conditional on a DoCA being later executed.

As Sutherland and Arnautovic's reports show, Pie Face Holdings was indebted to its secured lender for in excess of $4 million. The loan – agreed to in August 2011 – was due to be repaid with interest by February 2014.

Realising at some point last year he would have to bare Pie Face's soul to Macquarie if he was to avert insolvency, Homschek assembled a team of advisors:

- McGrathNicol to prepare a report on whether a solvent or insolvent restructure could save the Group
- Arnautovic and Sutherland to advise on insolvency and restructuring issues
- lawyer Tim Unsworth
- Main Street Capital, a specialist finance broker and adviser, and
- Wellington Shields, a US-based finance broker and adviser, tasked with finding an alternate funder to replace Macquarie.

Homschek wanted Macquarie to agree to a restructure via a DoCA. The promise was that if the lender agreed it would be paid out after the DoCA was accepted.

Homschek was able to make the offer because by this time he had identified a potential source of alternate financing. He had $US4 million sitting in an Australian lawyer's trust account, ready to be released if Macquarie agreed.

But the secured lender wouldn't be rushed. It appointed Ferrier Hodgson to undertake a detailed financial investigation. Arnautovic recalls what happened next.

'There was $3.5 million dollars in a bank account in the holding company [Pie Face Holdings] that would provide all the working capital to see the group through the VA,' Arnautovic recalls. (The $3.5 million was essentially payment in respect of licensing arrangements Pie Face had with parties in Japan.)

'Macquarie then appointed Ferrier Hodgson's Steve Sherman and Peter Gothard as receivers over the bank account,' he said.

SUTHERLAND AND ARNAUTOVIC APPOINTED AS VAS BUT RECEIVERS HOLD THE FUNDS

The appointment of receivers on 18 November 2014 forced Homschek's hand. Three days later Arnautovic and Sutherland were installed as VAs.

'We were absolutely up against it,' Arnautovic admitted. 'We were trying to enter the job with at least $1 million in starting funds to be able to pay the trading costs because you can imagine there were some serious trading obligations in this matter', he said.

'The directors managed to put together about $400,000 as an upfront costs indemnity so we entered the VA underfunded. Ordinarily we would've loved to have advertised the business and gone to the market a lot sooner than we did, but for the first few weeks we weren't sure on a day to day proposition whether we were going to be shutting the thing down or not.'

The way Arnautovic tells it, Macquarie's refusal to buy into the proposed restructure/refinance (subject to a DoCA being executed) fast tracked the involvement of the alternative financier waiting in the wings, US distressed lender TCA Global.

'The talks with TCA became less about refinancing Macquarie after the DoCA and more about refinancing Macquarie first and taking the risk themselves to keep the business trading,' Arnautovic said.

But while scenarios were swapped between hemispheres, Arnautovic and Sutherland and their team were under pressure, trying to operate as a going concern a group of companies losing almost twice as much a week as it earned. They needed a decision fast.

'It took until the 18th of December to get any comforting flow of funds,' Arnautovic said. 'Macquarie and their lawyers were very cautious. They didn't want to touch the cash at bank in holdings even though they had their foot on it because they were concerned about priority employee entitlements in the group.'

TCA GAMBLES ON A DOCA

The VAs advised Macquarie that there were no employees in the holding company, and then the talks with TCA suddenly bore fruit.

'The funder [TCA] paid out Macquarie approximately $4.6 million, the receivers took their foot off the cash, the cash then went partly to us and the balance to the incoming funder. This flow of funds was sufficient for us to keep the thing open,' Arnautovic said.

'About a week to 10 days into it we really had to talk to management and ask what a restructured Pie Face would look like and what had to be pruned. In the end we let go about 150 staff and closed about 20 company-owned stores.'

At the time of the VA's appointment Pie Face had approximately 400 staff, many of them part-time and casuals working in the company-owned stores and at its head office and manufacturing plant in leased premises at Rosehill.

Arnautovic said it was tough but necessary and the trickle of cash at bank funds from the TCA refinance gave the VAs time to consider whether a sale of Pie Face as a going concern was an option for creditors.

'The tricky thing with a sale was working out how to get all these franchise agreements, lease agreements and employee issues worked out in the statutory time frame, particularly given the uncertainty still applying to funding arrangements.

'It became very obvious very quickly that a sale was not a live option. People might buy some equipment, or take over some leases. But there wasn't going to be a global solution that worked for creditors generally, and in particular the secured creditors of the Group being TCA Global and convertible noteholders [owed some $7.5 million].

'So we basically dovetailed the refinance out of Macquarie with TCA into the initial DoCA contributions to save the thing, and TCA obviously wanted some new directors in place, which is always tricky,' Arnautovic said.

'TCA advanced a couple of million US dollars to get the thing out of a pickle and they have now advanced another $US2 million to keep it trading post-DoCA.

'There are some seriously high-net worth investors in the secured convertible note ranks and they really need to get some more funds into the group to get to where they need to get to,' Arnautovic said.

The new board includes representatives of TCA and various convertible note holders. Pie Face has raised more than $30 million from high-net worth Australians including the wealthy Darling family's Alfred Street Nominees, retailer Brett Blundy, Rothschild Australia chairman Trevor Rowe, and Fat Prophets founder Angus Geddes. As part of the DoCA, Pie Face's directors will also pursue a $US10 million capital raising underwritten by Wellington Shields.

But having endured a white-knuckle ride as VA and now in his role as a co-Deed Administrator, Arnautovic isn't letting Pie Face's reprieve obscure the challenges it faces.

'The problem with funding Pie Face is there are no significant tangible assets to secure your money against. There's no real estate, equipment and fitouts are not worth much in a shut-down, and most of the directors didn't want to provide personal guarantees,' he said.

'I was very surprised the TCA deal happened ... but it got done with a hell of lot of effort by all involved. The real challenging aspect of it was the trading risk and exposure that we put ourselves under by believing we could save it.

'There were certainly some tough conversations on the way through the VA between Rod Sutherland and I about what sort of tolerance we would take risk to because there were big numbers accumulating that we were personally on the hook for, with no really obvious parachute.'

Pie face let go about 150 staff and closed around 20 company-owned stores