Corporate Restructuring

2018 CNIE Tutorial Case

September 13, 2018

The companies and circumstances in this case study are fictional and are intended for discussion purposes at the CNIE Tutorial only.

Patricia Marshall, CIRP, LIT

Vice President, Consulting & Deals

PricewaterhouseCoopers Inc.

Case Study

Centre Island
AIRLINES

Bringing you the world from Toronto Island Airport

Case Study
Background

Centre Island AIRLINES

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- Centre Island Airlines Inc. (“**CIA**”) offers “executive class” service at an “economy” fare to business and leisure travellers from the Toronto Island Airport in heart of the city’s downtown.
- The airline was launched in 2010 by Richard Schwartz and initially experienced great success. During its first five years of operations, CIA expanded its fleet to 15 DASH-8 aircraft and added several regional routes beyond the core Toronto / Ottawa / Montreal triangle. However, since 2015, a general decline in the business travel, continuing high fuel costs and increased competition from Air Canada and West Jet have resulted in substantial losses for the fledgling airline. Nevertheless, Mr. Schwartz firmly believes that growing interest in the Toronto Island Airport as alternative to Pearson International Airport will drive passenger traffic up and restore CIA to profitability.
- Mr. Schwartz has approached you, a newly promoted senior manager in the insolvency and restructuring practice of the accounting firm, Debits & Credits LLP, to advise him on how to restructure his airline.
- During your initial meeting with Mr. Schwartz, you learn the following:
  - At the end of 2017, CIA was in violation of the financial covenants with its operating lender, Easy Credit Bank (“**Easy Credit**”). In exchange for the covenant waiver needed by CIA’s external accountant to issue the audited financial statements, Mr. Schwartz gave a limited personal guarantee to Easy Credit.
  - CIA’s relationship with Easy Credit has deteriorated rapidly in 2018 since its drawings on the revolving line of credit began to exceed the borrowing base. The airline is now in covenant default, and Mr. Schwartz was advised by CIA’s account manager that Easy Credit plans to issue a notice of intention to enforce its security today (which, as luck would have it, is Friday).
  - The airline has not remitted GST/HST during the past five months. CRA recently completed an audit of CIA’s books and records. During the audit, CRA obtained CIA’s accounts receivable trial balance and customer mailing list.

Case Study
Background

- The current fleet of aircraft are 20 years old. CIA leases the aircraft from Rusty Capital Partners LLC ("**Rusty Capital**") under a 15-year master lease bearing an interest rate of 18%. The lease provides CIA with an option to purchase each aircraft for $1 at the end of the lease. Mr. Schwartz believes that he can renegotiate the terms of the airplane leases with Rusty Capital. As the investment managers at Rusty Capital are currently preoccupied with other companies who have filed under the CCAA and Chapter 11, Mr. Schwartz anticipates that the renegotiations may take up to nine months to complete.
- Hawk Equity Fund ("**Hawk Equity**") holds an unsecured convertible debenture. Hawk Equity has demanded that CIA pledge the airline's working capital and fixed assets as security for the debt. CIA has not yet signed the requested documentation. Hawk Equity is calling Mr. Schwartz four times daily, and Mr. Schwartz is contemplating signing the documentation just to stop Hawk Equity harassing him.
- The aircraft require a specialized lubricant for the engines for which there is only one supplier in North America, Greasy Wheels Lubes Ltd. ("**Greasy Wheels**"). CIA currently owes $2 million to Greasy Wheels, and Greasy Wheels is threatening to cease supplying to CIA.
- Quick Snacks Ltd. provides in-flight catering services to CIA under the terms of an exclusive contract which expires in three years. The contract may be terminated early by CIA on payment of a penalty of $1 million. Mr. Schwartz has reached an agreement in principle with an alternate caterer, which would reduce food service costs by 50%.
- The Toronto Port Authority ("**TPA**") leases space in the airport terminal as well as a hanger on the island to CIA. CIA is in arrears with TPA. TPA has received an expression of interest from West Jet to takeover CIA's space at the airport.
- Mr. Schwartz is the sole shareholder and sole director of CIA.

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- Mr. Schwartz appreciates that he may lose his investment in CIA if the airline fails. While Mr. Schwartz has other investments (including a 49% interest a newly formed U.S. Company called Trump Fence Builders LLC), he advises you that he does not have any funds readily available to provide additional liquidity to CIA.

- For the past two months, CIA has purchased $10,000 worth of lottery tickets each week through one of Mr. Schwartz's close friends, Ron Undertable, the financial controller at Ontario Lottery and Gaming Corporation. From his recent conversation with Mr. Undertable last week regarding the patterns of the winning numbers, Mr. Schwartz is confident that his lucky numbers will come up on October 25, 2018. Mr. Schwartz plans to use the jackpot winnings to CIA to help alleviate the airline's current liquidity situation.

Case Study

Unaudited Balance Sheet

As at August 31

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ASSETS		LIABILITIES AND EQUITY	
($000's)		($000's)	
Accounts receivable	8,435	Trade accounts payable	11,750
Spares, rotatables, other inventory	4,250	Easy Credit	10,135
Other equipment	2,350	Hawk Capital (debenture)	10,000
Maple Leafs season tickets	25	Equity	1
Goodwill	15,000	Retained earnings	(2,326)
	30,060		29,560

Case Study
6 Week Cash Flow Forecast

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($000's)	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Total
Receipts							
Passenger receipts	1,000	1,000	1,500	2,000	3,000	4,000	12,500
Lottery winnings	-	-	-	-	-	30,000	30,000
	1,000	1,000	1,500	2,000	3,000	34,000	42,500
Disbursements							
TPA rent	-	1,250	-	-	-	1,250	2,400
Fuel	575	575	600	600	600	575	3,525
NAV Canada	-	350	-	-	-	350	700
Other operating	175	225	250	275	375	125	1,425
Payroll	1,250	1,250	1,250	1,250	1,250	1,250	7,500
Payroll taxes	-	-	-	-	-	-	-
Management bonus	1,000	-	-	-	1,000	-	2,000
Interest	250	100	-	-	-	250	600
Lease payments	-	-	-	-	875	-	875
Other	250	250	250	250	250	350	1,600
	3,500	4,000	2,350	2,375	4,350	4,150	20,625
Net cash flow	(2,500)	(3,000)	(850)	(375)	(1,350)	29,850	21,875

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Case Study

2018 Turnaround Plan

(fully documented on a cocktail napkin bearing a few red wine splotches)

Established core business

- Business travel to and from downtown Toronto to major business centres located in Eastern United States and Canada (such as Ottawa, Montreal, New York and Lynchburg)
- Core business expected to grow as business travel increases

Growing interest in Toronto Island Airport offers unique opportunity to expand services and grow business

- Improved access and convenience to the island once City of Toronto completes construction of a connecting passenger tunnel
- Untapped market for executive class holiday travel to Caribbean and other North American sun destinations
- Competitive positioning by offering new CS100 jet service to premium locations with convenience of downtown location

Acquisition of new jets to supplement / replace aging fleet timed to match completion of tunnel construction