Amigo Loans

Estimated insolvency outcome for creditors as an alternative to a Scheme

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Scope and approach

- The insolvency estimated outcome statement ("EOS") is an important benchmark as it illustrates the alternative outcome for Amigo Loans Limited ("ALL"), should the proposed Scheme of Arrangement ("Scheme") not be approved. The Explanatory Statement and Scheme document explain the specific funds being set aside for redress creditors if the Scheme is approved.
- In an insolvency there is not expected to be a cash recovery for unsecured creditors, including any valid customer redress claims. No payout can be made to borrowers/guarantors with eligible redress complaints because the bondholder and securitisation facility creditors are entitled to be paid out of the available assets in priority and they are not expected to be paid in full.
- This document has been prepared by ALL, having received advice from our professional advisers. This advice has included legal, Scheme and insolvency matters.
- In the event the Scheme is not approved ALL would likely file for insolvency, shortly after the date of the Scheme meeting.
- With advice regarding the likely strategy taken by an insolvency practitioner, we have modelled a range of EOS scenarios. The estimated outcomes from the two most likely scenarios are shown in this document.
- The starting point for the EOS is our existing financial forecast. This utilises our experience of complaints received to date, the demographics of our customer base and our financial position including a Covid-19 stress factor. ALL's balance sheet has been projected to the closest month end to a likely Scheme meeting date (30 April 2021). From that date, typical insolvency stress has been applied to asset realisation and this has been reflected in the value of assets available to: (i) meet the costs of insolvency; and (ii) distribution to creditors payable in priority to unsecured creditors. Only following these debts being met in full would any additional value be available to unsecured creditors.

Asset position

Using recent month-end balance sheet positions as a starting point, ALL's balance sheet has been forecast to estimate the position at the insolvency date. At the point of insolvency and prior to any realisation activity, it is estimated that ALL will have assets with a net book value of £443m.

- ALL's recoverable assets predominantly consist of cash and the future repayments to be made by customers. This loan book asset is approximately two-thirds of the estimated booked asset value.
- Collection of this major ALL asset would be targeted by the appointed Insolvency Practitioner ("IP") to achieve maximum recovery for creditors - in reality, this consists of securing repayments from borrowers and guarantors. Insolvency would not terminate a borrower/guarantor's obligations to repay a loan and the IP would be robust in pursuit of these collections. The ability of the IP to continue to secure customer repayments will be the key driver of the ultimate return to all creditors. However, the IP would face collection challenges in the form of insolvency disruption and redress offset.
- There would be a balance for the IP to achieve between preserving value through maximising collections over a longer time period, and collecting value at speed at lower recoveries in order to minimise risk and costs.
- The widespread publicity an insolvency of the Company would attract will likely lead to high customer awareness and hence a high volume of legitimate redress claims. This will reduce the value of the loan book asset available for realisation by the IP in addition to insolvency disruption. This is because of the set-off / balance adjustment of redress claims against outstanding loan values recorded in the loan book for current customers.
- The fastest way to realise value from the loan book would be through an immediate debt sale. Whilst the IP's strategy may include a debt sale, it is expected that solely pursuing this would not be the optimal strategy and hence not form a central part of the asset realisation. Customers would still be required to make repayments in any event - either to ALL or the debt purchaser.

Costs

Costs incurred in the course of an insolvency are paid from the value of realised assets, in priority to any distribution to other creditors. These costs are estimated to be £37m for an expected 24 month insolvency process. In an insolvency of ALL, costs would be incurred in two broad areas:

Costs of collection

- This area of costs consists of the expense of realising cash from ALL's major asset - the loan book. It is anticipated that this would require streamlined operation of ALL's existing business model.
- The IP would require the cooperation of existing staff in order to make collections. There will likely therefore be a need for retention and incentive payments to key staff to ensure motivation is maintained during the insolvency process. Other operating costs, not critical to the realisation of loan book value, would be rationalised. Retained non-staff spending areas would focus on: providing continued IT support to the collections activity in the form of a collections platform, technical support and software licences; premises; and outwards communications expenses in the form of e.g. SMS, email and letter contacts with customers.
- As the estimated 24 month insolvency progresses, these costs have been modelled as reducing to a sustainable base to secure collections in line with the insolvency strategy. This sustainable base is 25-50% of pre-insolvency BAU monthly costs. The IP may consider outsourcing the collections activity. Whilst likely to be at greater cost than the in-house option, it would be lower risk.

Insolvency costs

- The IP would incur their own fees and legal fees. These costs would be significant for an insolvency of this type, duration and complexity, and be in addition to the costs of collection. Governance would be provided by the IP, ensuring fair treatment of customers throughout the collections phases.

Bondholders and securitisation creditors

Commercial lending creditors

- ALL has (i) secured bond liabilities as a result of pre-existing commercial lending into the business; and (ii) equitably assigned its interest in certain loans in favour of the securitisation facility creditors and holds the collections received under these loans on trust for them. Upon an insolvency event: (i) the liabilities owed to the bondholders would crystallise and they would submit a claim for outstanding principal and interest to be paid from the assets subject to their security; and (ii) the securitisation creditors would seek to recover in priority on the loans which have been equitably assigned to them, up to the value of the amount outstanding under the securitisation facility. At 30 April 2021, the forecast claims of these creditors are:
    - Secured bonds: £270m
    - Securitisation facility: £54m
- Given that the bondholders and the securitisation creditors each have prior ranking claims to the available assets of the ALL, payment of these parties takes priority over any distribution to unsecured creditors, including redress creditors, except where loan set-off applies. The IP will therefore seek to realise assets and satisfy liabilities owed to the bondholders and the securitisation creditors in the first instance.

Preferential creditors

Preferential creditors

- Ordinarily in an insolvency, ALL's employees would have a preferential claim in the insolvency for various items including limited unpaid wages, pension scheme contributions and holiday pay. ALL does not have direct employees. This function is provided by the staff of a service company and there is therefore no employee preferential claim.
- However, the other aspect to preferential creditors comprises certain HMRC liabilities. As with employee liabilities referenced above, any PAYE and NIC claim would be against the service company as the employer entity. However, HMRC would have a preferential VAT claim in ALL's insolvency. The value of this claim is expected to be immaterial to the EOS output.

Unsecured creditors

Unsecured creditors

- As can be seen on the following slide, in an insolvency realisations will not to be sufficient to fully repay the creditors payable in priority to unsecured creditors.
- In terms of unsecured creditors, in addition to unpaid trade creditor liabilities at the date of insolvency, there would be redress claims submitted to the insolvency from customers. For customers with a valid claim, this redress could only be met through set-off against current outstanding loan balances. The IP would not incur any costs dealing purely with claims as no dividend is expected.
- No further work has been performed to try to estimate the value of the aggregated unsecured creditor claims as it has no impact on the EOS output.

Prescribed part

- A prescribed part (“PP”) may sometimes apply in an insolvency. This sets aside a small fund from total realisations for distribution to unsecured creditors. However, it is expected that the costs of administering this distribution would exceed the value of the PP. It is therefore likely that the IP would seek to disapply the PP as it would not result in a recovery for unsecured creditors.

Summarised insolvency EOS output

Two scenarios have been modelled to estimate the outcome of the insolvency for the creditor groups. These scenarios vary the combination of insolvency stress risk that the IP will face in realising assets, and the choice of strategy that the IP may pursue. Both scenarios factor in the reduction in asset value as a result of valid claims being received from customers with outstanding loan balances. In both scenarios, there will be a shortfall of realised assets to pay both the bondholder and securitisation facility creditors in full.

	Scenario 1	Scenario 2
Length of insolvency	24 months	24 months
Book net asset value at insolvency	£443m	£443m
Collections strategy within insolvency	Speed	Value
Realised asset total	£312m	£325m
Collections and insolvency costs	(£37m)	(£37m)
Bondholder and securitisation facility creditor liabilities (incl. interest)	(£324m)	(£324m)
Shortfall for creditors payable in priority to unsecured creditors	**(£49m)**	**(£36m)**
Recovery for unsecured creditors	**0%**	**0%**

Conclusions

- In an insolvency it is expected that the IP would not realise sufficient asset value to pay both the bondholder and securitisation facility liabilities in full.
- On the basis of these estimates there will therefore be a shortfall of 15-20% to creditors payable in priority to unsecured creditors, after the payment of insolvency costs. Current pricing indicates that this may already be factored in by the market with our bonds currently trading at a 25-30% discount to par value.
- Because of the expected volume of unsecured redress creditors, our advisers have explained that it is likely that the costs of distributing the PP would outweigh its value and therefore this would be disapplied.
- Customers with valid redress claims and outstanding loan balances would receive set-off in an insolvency.
- Otherwise, based on these estimates, unsecured creditors, including customers with redress claims, would receive no cash dividend from an insolvency.

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