The failure of MEL Topco Limited

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1. Background

MEL Topco Limited ('MEL') is the parent company of the chain of stores trading under the Maplin name. The company went into administration on 28 February 2018. https://www.theguardian.com/business/live/2018/feb/28/markets-fall-interest-rate-fears-brexit-pound-growth-gdp-business-live The timing would suggest that a VAT liability was due and could not be settled.

MEL was incorporated on 1 May 2014.

It was reported that the company was used to acquire the Maplin stores in June 2014. https://www.theregister.co.uk/2014/06/27/maplin_rutland/ The price paid was reported to be £85 million. The beneficial owner was reported to be as follows in the 2017 accounts:

MEL Topco Limited
Annual report and consolidated financial statements
52 weeks ended 18 March 2017

Notes *(continued)*

24 Related party disclosures

The ultimate controlling party is Rutland Partners LLP as a result of the size of their shareholding in the Group.

The 2016 annual return suggests that there were 810,000 A ordinary shares in the company, 154,900 B ordinary shares, and 22,600 C ordinary shares in 2016 when the last shareholder list seems to have been filed. Rutland and its associates appeared to own 754,952 A ordinary shares, or 93.2% of those shares, giving it control of the company. Rutland also had 15,000 B shares.

2. The Rutland relationship

It would seem that the acquisition of MEL was a cost incurred for the benefit of Rutland but for which MEL paid a heavy price.

MEL said in its 2015 accounts:

Principal activities

The Company was incorporated on 1 May 2014. These financial statements cover the 46 weeks ended 21 March 2015. MEL Bidco Limited, a subsidiary of MEL Topco Limited, acquired the entire share capital of Maplin Electronics Group (Holdings) Limited on 27 June 2014. Therefore these financial statements cover the period of trade of the underlying group for the 40 weeks ended 21 March 2015.

During the period MEL Topco Limited has operated as a holding company of the Maplin retail group ("Maplin"), a retailer of electronic and electrical products and technology solutions. Maplin operates as an omni-channel retailer with numerous routes to market directed via retail outlets, ecommerce and mail order and servicing both the consumer and business markets. The business produces the Maplin Electronics Catalogue which remains the market leading publication of its kind.

The balance sheet shows that it MEL did seem to be the whole purchase price using borrowed funds:

MEL Topco Limited
Directors' report and consolidated financial statements
46 weeks ended 21 March 2015

Consolidated balance sheet
at 21 March 2015

	Note	21 March 2015 £'000	£'000
Fixed assets			
Intangible assets	*9*		**41,711**
Tangible assets	*10*		**30,105**
			71,816
Current assets			
Stocks	*13*	**51,443**	
Debtors	*14*	**3,128**	
Cash at bank and in hand		**13,078**	
		67,649	
Creditors: amounts falling due within one year	*15*	**(50,369)**	
Net current assets			**17,280**
Total assets less current liabilities			**89,096**
Creditors: amounts falling due after more than one year	*16*		**(87,294)**
Provisions for liabilities and charges	*18*		**(3,948)**
Net liabilities			**(2,146)**
Capital and reserves			
Called up share capital	*19*		**50**
Share premium account	*20*		**925**
Profit and loss account	*20*		**(3,121)**
Shareholders' deficit			**(2,146)**

Notes on pages 15 to 35 form part of the financial statements.

The income statement showed the following result:

Consolidated profit and loss account
for the 46 week period ended 21 March 2015

	Notes	46 weeks ended 21 March 2015 £'000
Turnover	*2*	186,914
Cost of sales		(95,993)
Gross profit		90,921
Distribution costs		(30,784)
Administrative expenses		(50,713)
Other operating income		428
Operating profit before goodwill amortisation, impairment and costs of acquisition of subsidiary companies		9,852
Costs relating to acquisition of subsidiary companies	*3*	(1,994)
Amortisation of goodwill	*3*	(1,668)
Operating profit	*3-5*	6,190
Other interest receivable and similar income	*6*	199
Interest payable and similar charges	*7*	(9,349)
Loss on ordinary activities before taxation		(2,960)
Tax on loss on ordinary activities	*8*	(1,006)
Loss for the financial period	*20*	(3,966)

The loss for the financial period is derived entirely from continuing operations.

It will be noted that:

- The company made an operating profit of £9.8 million;
- This was reduced by costs of acquiring the trade of £3.7 million;
- And interest of £9.3 million was paid.

As a result the operating profit turned into a loss.

The interest is explained as follows:

7 Interest payable and similar charges

	46 weeks ended 21 March 2015 £'000
Interest payable on bank loans and overdrafts	1,524
Interest accrued on shareholder loan notes	7,797
Other interest/fees payable	28
	9,349

The loans on which that interest was paid were as follows:

16 Creditors: amounts falling due after more than one year (continued)

The group's borrowings, excluding share capital, at the balance sheet date together with their principal terms were as follows:

	Initial capital advance £'000	Invested capital outstanding at period end £'000	Repayment terms	Interest
Loan stock	72,153	79,951	Redeemable in full on 30 June 2019	15%
Bank loans	15,000	12,721	Repaid over 3 years to 26 June 2017	LIBOR + 7.5%
Less: unamortised loan issue costs	-	(453)		
	87,153	91,219		

In effect MEL paid the entire cost of acquiring Maplin, and agreed to pay 15% interest on doing so to Rutland, from whom it had borrowed £72 million. This rate was higher than that paid to its bankers, by some way.

It should be noted that HM Revenue & Customs did not seem to take the view that all this interest payable was tax deductible. The tax note for 2015 said:

8 Taxation (continued)

Factors affecting the tax charge for the current period

The current tax charge for the period is higher than the standard rate of corporation tax in the UK 21%. The differences are explained below:

	46 weeks ended 21 March 2015 £'000
Current tax reconciliation	
Loss on ordinary activities before tax	**(2,960)**
Current tax credit at 21%	**(621)**
Effects of:	
Expenses not deductible for tax purposes (primarily non qualifying goodwill and disallowed interest)	**1,177**
Goodwill amortisation	**350**
Depreciation of ineligible assets	**399**
Utilisation of tax losses	**(264)**
Fixed asset timing differences	**62**
Short term timing differences	**(25)**
Adjustments to tax charge in respect of prior periods	**(11)**
Differences in overseas tax rates	**33**
Total current tax charge (see above)	**1,100**

Given that goodwill amortisation is separately categorised and at £350,000 is exactly 21% of the goodwill charge in the accounts it would seem that most of the disallowable £1,177,000 must relate to interest , implying some £5.6million of the interest paid was not considered tax allowable by HM Revenue & Customs.

3. The view from the 2017 accounts

The 2017 accounts were the last to be filed by the company before insolvency. The income statement was as follows:

Consolidated profit and loss account and other comprehensive income

for the 52 weeks ended 18 March 2017

	Notes	52 weeks ended 18 March 2017 £'000	52 weeks ended 19 March 2016 £'000
Turnover	2	**235,818**	234,550
Cost of sales		**(123,253)**	(122,013)
Gross profit		**112,565**	112,537
Distribution costs		**(39,483)**	(38,625)
Administrative expenses		**(71,157)**	(67,387)
Other operating income		**463**	340
Operating profit before goodwill amortisation		**2,388**	6,865
Amortisation of goodwill	3	**(5,038)**	(5,037)
Operating (loss)/profit	3-5	**(2,650)**	1,828
Other interest receivable and similar income	6	**14**	128
Interest payable and similar charges	7	**(13,696)**	(12,729)
Other finance (costs)/income	8	**183**	(250)
Loss on ordinary activities before taxation		**(16,149)**	(11,023)
Tax on loss on ordinary activities	9	**391**	(666)
Loss for the financial period		**(15,758)**	(11,689)
Other comprehensive income			
Gross exchange differences on the retranslation of net investments		**257**	41
Total comprehensive income for the financial period		**(15,501)**	(11,648)

Losses were incurred in both years and there was no growth in 2017.

It remains the case that there were operating profits.

Interest charges were as follows:

7 Interest payable and similar charges

	52 weeks ended 18 March 2017	52 weeks ended 19 March 2016
Interest payable on bank loans and overdrafts	1,523	1,880
Interest accrued on shareholder loan notes	12,146	10,828
Other interest/fees payable	27	21
	13,696	12,729

Including the 2015 charge a total of £30.8 million in interest had become due to Rutland over this period.

Extrapolating this to February 2018 it is likely this sum would have reached £42 million, or almost exactly half of the original acquisition cost of the company.

The tax note reveals the same trend of disallowed interest for tax purposes:

9 Taxation *(continued)*

Reconciliation of effective tax rate

	52 weeks ended 18 March 2017 £'000	52 weeks ended 19 March 2016 £'000
Loss for the year	(15,758)	(11,689)
Total tax (credit)/expense	(391)	666
Loss before tax	(16,149)	(11,023)
Tax using the UK corporation tax rate of 20% (2016: 20%)	(3,230)	(2,205)
Expenses not deductible for tax purposes (primarily disallowed interest)	2,415	1,557
Goodwill amortisation	1,008	1,008
Depreciation of ineligible assets	296	367
Utilisation of tax losses	(952)	(128)
Fixed asset timing differences	-	(2)
Short term timing differences	-	(38)
Adjustments to tax charge in respect of prior periods	(172)	(49)
Differences in overseas tax rates	131	137
Restatement of prior year comparatives on first time application of FRS 102	-	-
Impact of rate change on deferred tax balances	(24)	117
Adjustments to deferred tax in respect of prior periods	68	(98)
Difference between current tax and deferred tax rates	69	-
Total tax (credit)/expense included in profit or loss	(391)	666

It is likely that in the two years £19.9 million of interest was disallowed for tax, meaning that by March 2017 some £25.5 million had been treated in this way, or at least 80% of the interest paid. Extrapolating to February 2018 this might have reached almost £34 million of disallowed interest.

The balance sheet in 2017 was as follows:

Consolidated balance sheet
as at 18 March 2017

	Note	18 March 2017	19 March 2016
Assets employed:		**£'000**	£'000
Fixed assets			
Intangible assets	*10*	**45,871**	45,207
Tangible assets	*11*	**21,930**	24,146
		67,801	69,353
Current assets			
Stocks	*13*	**49,436**	44,087
Debtors	*14*	**11,356**	11,755
Financial assets		**145**	-
Cash at bank and in hand		**7,198**	8,551
		68,135	64,393
Total assets		**135,936**	133,746
Creditors: amounts falling due within one year	*15*	**(60,124)**	(51,674)
Net current assets		**8,011**	12,719
Total assets less current liabilities		**75,812**	82,072
Financed by:			
Creditors: amounts falling due after more than one year	*16*	**103,380**	93,893
Provisions for liabilities and charges			
Deferred tax liability	*19*	**-**	350
Other provisions	*20*	**3,983**	3,879
Shareholders' deficit			
Called up share capital	*21*	**55**	55
Share premium account		**933**	933
Profit and loss account		**(32,539)**	(17,038)
Total shareholders' deficit		**(31,551)**	(16,050)
		75,812	82,072

The company was insolvent by £31.5 million with regard to shareholder funds in March 2017, which so happened to be almost exactly the interest due to Rutland by then.

The loans due were as follows:

16 Creditors: amounts falling due after more than one year

	Group 18 March 2017 £'000	Company 18 March 2017 £'000	Group 19 March 2016 £'000	Company 19 March 2016 £'000
Deferred income (lease incentives not yet recognised)	8,872	-	10,266	-
Amounts payable under finance leases	64	-	28	-
Bank loans (see note 17)	1,020	-	2,321	-
Loan notes	63,825	-	63,825	-
Accrued interest on shareholder loan notes	29,599	-	17,453	-
	103,380	-	93,893	-

Included within the Creditors due over 1 year balance is £93.4m relating to loan notes held by our investor and management, with a redemption date of June 2022. The redemption date was extended from June 2019 to June 2022 on 21st August 2017 (post the balance sheet date), reflecting the fact that this represents a longer term investment in the business, albeit the amounts form part of the creditor balance.

17 Interest bearing loans and borrowings

Analysis of debt:	Group 18 March 2017 £'000	Company 18 March 2017 £'000	Group 19 March 2016 £'000	Company 19 March 2016 £'000
Debt can be analysed as falling due:				
In one year or less, or on demand	4,509	-	4,734	-
Between one and two years	1,047	-	2,349	-
Between two and five years	93,461	-	81,278	-
In five years or more	-	-	-	-
	99,017	-	88,361	-

The Group's borrowings, excluding share capital, at the balance sheet date together with their principal terms were as follows:

	Initial capital advance £'000	Invested capital outstanding at period end £'000	Repayment terms	Interest
Drawn down under Revolving Credit Facility	2,890	2,890	At end of drawdown period (26 October 2021)	2.01%
Less: unamortised Revolving Credit Facility issue costs	-	(193)	At end of drawdown period (26 October 2021)	
Loan stock	63,825	93,424	Redeemable in full on 30 June 2019	15%
Bank loans	3,500	2,775	Repaid over 2 years to 1 October 2018	3.51%
	70,215	98,896		

It would seem that most of the interest due had not been paid, but the resulting cumulative sum owing was being charged interest at 15% when the bankers to the company were charging 3.51%.

4. Suggestions

It cannot be said that Maplin's insolvency was entirely down to its structuring. That cannot be the case, partly because not all the interest due was paid.

That said the structure used did reveal a weak company that must have prejudiced its trading situation.

In addition, that structure was one that did give rise to HM Revenue & Customs considering that not all the interest charge could be considered a cost6 of the business for tax purposes.

If less had been paid for the business (reducing the goodwill charge) and if interest charges had not been applied it would have been clear that Maplin was about covering its costs for the period of time it was owned by Rutland.

This may not have prevented failure due to changes in exchange rates and buying patterns but the view of the company would have been very different: instead of appearing a business burdened by debt due to an owner appearing intent on extracting a considerable reward from that relationship the business might have instead presented a view of one struggling to make ends meet, but at least having a chance of doing so.

There remains questions to ask on structures such as this, including:

1. Why is it permitted in the UK for the acquisition costs for a trade to be piled onto the balance sheet of the company that has been acquired? Doesn't this just encourage:

    a. Asset stripping?
    b. Financial stress?
    c. The impression of a business focused solely on the need to generate a return to shareholders seeking excessive interest payments (as 15% might reasonably be interpreted to be)?
    d. An attitude that discourages further investment in the trade when that is sorely needed?

2. Should there be unlimited liability for companies that trade when showing a deficit of funds on their balance sheets, and why?

3. Should there be clearer indication of interest payments that are not considered tax allowable with better explanation given?

Maplin had almost no chance of meeting the expectations of its new owners. The chance that it could ever pay a 15% return was remote in the extreme. The chance that it was over-stressed in an attempt to make such payments is highly likely. The result is its employees losing their jobs and a valuable resource for many being lost to the High Street. The time has come to question whether the venture capital business model adds value in the UK. The evidence is it may not because it places real business under too much financial stress to survive, let alone prosper.

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