

Full house?

Leisure and hospitality
briefing

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Restructuring and Recovery
Real people, real solutions

Sink or swim for the hotels industry?

The hotels sector is definitely feeling the squeeze of the economic downturn, as depressed consumer spending and a decrease in room occupancy lead ultimately to an increase in hotel failures. In the last comparable recession of the early '90s, around 1,500 hotels went out of business and it seems it is the luxury end of the market that is struggling most this time round.

In this, the first edition of *Full house?*, Premier Cru, one of Baker Tilly Restructuring and Recovery's strategic alliances in the leisure and hospitality sector, put their heads together with our team currently working on hotel assignments, to look at what can be done to help navigate these difficult times.

What goes around, comes around

There's no good way to say this – almost every indicator, every expert and every anecdote says that it's going to be even tougher next year. The main trends for both London and the provinces are that occupancy, average room rate, the revenue

available per room, the income available before fixed charges per room, profitability and staff levels are all down.

There is no point in spreading false optimism, because burying heads in the sand is the worst way to go about things in the current climate. But if there is pragmatism in the trade, then it's only because we've seen it all before. RevPAR (revenue per available room) since 1981 has ranged by nearly 50%, from the lows of the 1981 recession through the 'things can only get better' highs of the '90s, up and down via two Gulf Wars, the SARS epidemic and the London bombings. For the hotel trade and its funders, instability is part of the deal, if not part of the fun. But there are many managers out there who know what it takes.

The June 'UK Chain Hotels Market Review' shows occupancy levels in the UK are down 3.4 percentage points for the first six months of this year. RevPAR was down 10.1% in June alone, and an average 11.5% for the first half of the year. Profit – measured as income before fixed charges – was down 16.7% in the year to June, with daylight appearing as June's profits fell by a slightly rosier 11.6%. Despite the general malaise, London hotels maintained an



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encouraging 84.1% occupancy in June, as discounts pushed the average room rate in the capital down by 8.8% to an average of £115.69. Yet, London hotels are performing better than their provincial counterparts, with occupancy rates in for the first half of 2009 for London at 77.3% versus 65.8% in the rest of the country.

In general, it is the high-end hotel market that is suffering most, as companies reduce employee travel to cut costs, affecting many of these hotels who rely on executive business. Yet leisure spending is set to fall less sharply, with Savills research showing that overall leisure spending by individuals is forecast to dip by less than 1% this year, which could explain why the budget hotels are not feeling the pinch as acutely as the luxury chains.

In fact, the expansion of the budget hotel sector can be traced to the 1990-1993 recession, when the demand for 'value for money' rooms increased. Over recent months, we have seen a similar trend – as customers who previously might have sought out well-known hotels and restaurants trade down.

Nevertheless, the insolvency statistics show there is a general rising trend of hotel failures. In Q3 2007, no hotels went into administration, yet by Q1 this year, that had risen rapidly to 31 from just two in Q3 2008. While the Q2 2009 figures show the number of administrations fell back to 12, this is to be expected due to the industry's seasonal nature. However, all eyes will be on Q4 and Q1 2010 figures after a poor summer and as

traditional holiday income tails off. While the sector's health score remains consistently modest compared to other industries, interestingly we have seen a steady fall of only four points from the high times of 2007 (see chart below).

There have been some notable hotel failures in the past six months, including Folio Hotels, Real Hotel Group, Four Pillars, The Ellington in Leeds and The Forbury in Reading (see 'Hotels in highlight'). It is predicted by four in ten European hotel executives that more than five hotel chains will go into insolvency in the coming year.

With the number of visitors to the UK falling from around 33 million to 31 million during the 12 months ending in April 2009, according to the Office of National Statistics, it is easy to see why hotels are struggling.

A question of balance

What doesn't kill you, makes you stronger, they say, and this is certainly true of businesses in a recession. Those that survive, come out stronger, leaner and more resourceful. If a hotel can increase its share of the reduced, recession market, then there's every chance that it will maintain that share of the bigger, recovery market.

Over the past months, we've been working with banks, owners and management teams to come up with new solutions. We focus on beating industry benchmarks for cost management, treat no cost as fixed, ensure that every opportunity is maximised and work with staff and management teams to

make the most of human, property and brand assets. Some of the most common areas are considered below – you may want to ask your customers if they are looking at them in their business.

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Look after the pennies

Inevitably, we have to start with costs. Whether it's pennies or pounds, you have to look after them when income is down. We have improved EBITDA (earnings before interest, tax, depreciation and amortisation) from 5% to 15% in some client properties, and we always start by getting payroll and other costs under control.

And what if the hotel provides live-in accommodation – is rent proportionate to salary? We recently implemented a review, moving rent from a flat rate to 13% of wages. Those earning above the minimum wage are now paying a fairer rate in relative terms and this produced a saving of over £20,000 per annum.

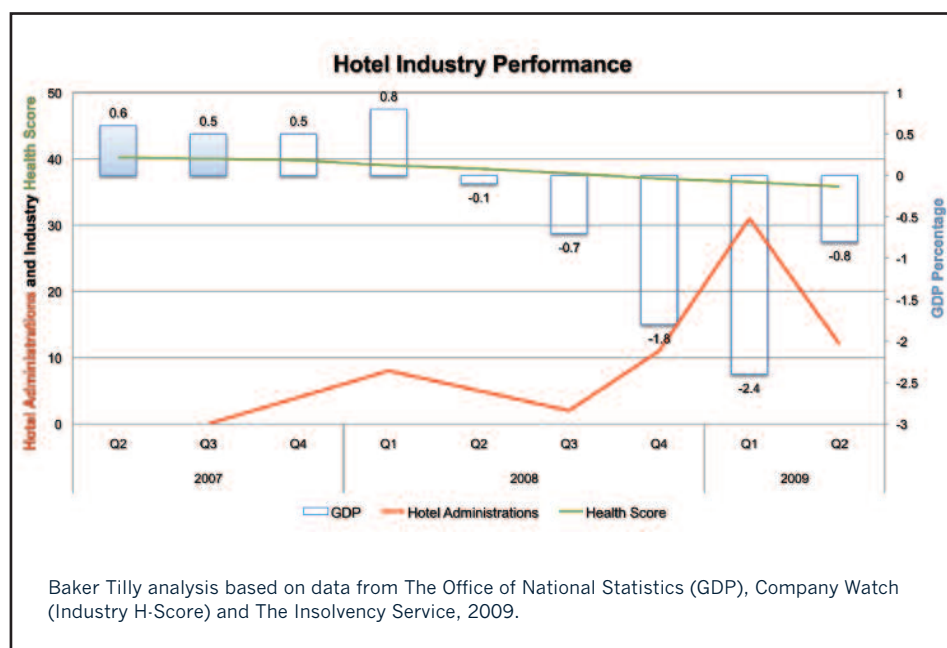
If the hotel is not part of a group or chain, it could benefit from creating a purchasing group with other local businesses, so that 'volume discounts' can be negotiated. Don't just apply this to food and beverage purchases – look at other areas – such as marketing and promotional activities.

Think short, medium and long-term

Having been slow to respond, many four and five-star hotels have now reviewed their pricing and are challenging three-star properties and budget sectors. But simply slashing room rates is a dangerous game if kept as a primary tactic.

We recommend hoteliers look to add value where they can by putting together packages. Analyse previous trends to anticipate the peaks and troughs and get promotions in place early.

They could try to work with local partners such as visitor attractions, theatres, shopping centres and sports venues so that the cost of building an attractive package



and marketing it can be shared, without tying into a lower room-rate that will subsequently have to be maintained.

Could they think about investing some money in building a flexible e-marketing capability? The initial cost of creating a really good content management system and a high quality database may be very little compared to the ease and economy with which they will then be able to advertise tactical and seasonal promotions. If there is already a good database of existing customers, they can build loyalty by making sure that they are the first to hear about good offers.

They should talk to their suppliers about joint marketing and promotion, so that loyalty can be developed in the local area. We have had a lot of success in recent months, sharing the cost of marketing and promotions.

Conferences and business meetings are down. But if these facilities are available, hotels should keep using them. Spending by public sector organisations is up, so are they targeting the local authority or companies in their area whose business is reliant on government contracts? The market for weddings is one area that is also holding up at the moment. While these tend to be long-term bookings which may not pay up immediately, it is good for confidence to know that there are high-value bookings across the year ahead.

In the hotels industry, confidence can be self-fulfilling.

Premier Cru is a professional management company offering a range of financial, operational, marketing and sales services designed to turn-around under-performing hotels.

Hotels in highlight

Baker Tilly Restructuring and Recovery LLP has traded and sold a significant number of hotels over the last two years. Recent and current engagements include:

The Forbury



Photo: Knowles Cadbury Brown, 01225 780056

The Forbury Hotel and Apartments consists of a 23 bedroom five-star hotel with two restaurants and a private cinema, together with a block of 16 serviced apartments. Following the issue of a winding-up petition by HM Revenue & Customs, two partners from Baker Tilly were appointed Joint Administrators in March 2009. Working with managing agents, Licensed Solutions, the Administrators made changes to the business to reduce the substantial monthly pre-appointment losses. This was achieved by a combination of improved room occupancy from enhanced marketing and front-of-house activities and operational efficiencies. As a consequence, the business improved to a break-even level.

The hotel and apartments were both separately and jointly marketed for sale, to ensure that best value was achieved for the combination of assets and the option of selling the apartments on a piecemeal basis was fully investigated. In excess of 100 viewings were conducted. Contracts have recently been issued for sales of the business and assets of both businesses.

Malvern Spa

A hotel, spa and health club in Worcestershire currently in administration. Our initial review concluded that forecast profits contained in the business plan were unrealistic and a number of structural flaws in the original development of the complex came to light. The business plan saw the health club as central to the proposition of the

complex and the spa, hotel and restaurant would in turn be profitable. In short, this was not a viable business. The bank was owed £6 million and within a year, the business would have lost around £1 million.

As part of our restructuring strategy, the business was sold for £300,000 to specialists Topaz Consulting who are now in day-to-day control with an agreed new business model. The company is now thriving, with the spa and hotel being the mainstay of the complex. The valuations we have had suggest the business is now worth £8-9 million, and by working with both the bank and Topaz, we are hoping to pay all the creditors what they are owed when Malvern Spa is sold.

Haleys

Two partners from Baker Tilly were appointed Joint Administrators of Haleys Hotel Ltd and LPA receivers of Haleys Hotel on 16 April 2009 and engaged Licensed Solutions, to carry out the trading of the hotel on their behalf. The hotel had suffered from a lack of investment and poor management in recent years. Since the appointment, the Joint Administrators, along with the support of Licensed Solutions have improved occupancy and margins by addressing such issues as room pricing, agreement of new terms and conditions with trade suppliers, reaching agreements with internet-based accommodation search engines and staffing issues etc.

The hotel is located in Headingley just outside Leeds city centre and benefits from the cricket and university graduation trade in the summer, so it is currently in its busiest period. We appointed Colliers Robert Barry (CRB) to market the hotel at offers over £1.25m. After an extensive and comprehensive period of marketing, including local, national and trade press advertising and profile on the CRB's website, the closing date for offers was set for 17 July 2009. We are currently progressing these offers and hope to conclude a sale of the hotel as a going concern shortly.



Even master chefs can go off the boil

Restaurateurs across the country are facing new challenges in keeping their hotplates firing as the recession takes hold – and even the biggest names are finding it hard to stay afloat.

Gordon Ramsay, famous for his four-letter outbursts and for turning around struggling restaurants in his Kitchen Nightmares TV series, is having something of a nightmare himself after his restaurant empire saw its profits tumble by 87% in the last year.

Ramsay had to put £3.5 million of his own money into the business while his father-in-law and business partner put in a further £1.5 million. Ambitious expansion plans and the closure of The Savoy Grill were to blame, as in the year to August 2008, pre-tax profits fell from just over £3 million to around £383,000 and net debt more than doubled from approximately £4 million to just short of £9.5 million.

While Ramsay had enough money to put into his restaurant empire to keep it afloat, other celebrity chefs have been forced to close their doors. Antony Worrall Thompson, for example, was forced to close his gastro pub, The Greyhound in Peppard, near Henley-on-Thames, Oxfordshire in January because of the tough economic conditions. But

in July, the turnaround was completed, when the pub re-opened. The receivers were unable to find an appropriate buyer for the pub's lease, Mr Worrall Thompson told the Reading Post, but reinvested in the business after family friends and colleagues mooted a partnership.

But there are plenty of restaurateurs who have lost the fight to save their businesses. The Bucklemaker in Birmingham is just one of the restaurants which has called in liquidators due to a drop in customers and rising debts. Just last year, the restaurant celebrated its 21st anniversary but Nick Crudgington, who is in charge, was forced to close its doors due to the recession. He is a partner in the Michelin-starred Turners restaurant in the city, but that business is still going strong.

Since Q3 2007, the number of restaurants going into administration has remained relatively constant, with between 22 and 36 failing in each quarter from Q1 2008 and Q1 2009.

No smoking, but the risk of being stubbed out

Pubs and clubs are facing a perfect storm, with the smoking ban and the recession causing an increase in the number closing their doors week by week.

Add in falling customer spending, the Wetherspoons/supermarket effect, increased rents, plus debt against two year old EBITDA lending ratios and it's all pretty gloomy across the bar.

With a loss to the Government in tax of £254 million in the last year, increasing pressure on the industry is coming from additional regulatory costs and a 'double whammy on beer tax' which will hit landlords in the coming year. VAT rises by 2.5% in January and duty will go up by more than inflation next March, as a result of the Government's beer tax escalator.

More than seven pubs a day are currently closing – a record 52 a week – resulting in the loss of 24,000 jobs in the last year. 2,377 pubs have closed in the last 12 months, according to recent figures released by the British Beer & Pub Association. It is anticipated that as many as 4,000 could fail by 2010.

Many from both within and outside the industry largely blame the smoking ban for the sector's woes. But a campaign to secure amendments to the smoking legislation when it is reviewed next year,

has received cross-party support in Westminster.

The 'Save Our Pubs and Clubs – Amend The Smoking Ban' campaign, which is being supported by politicians from each of the main political parties, pressure groups such as the smokers' group Forest, publicans and others in the hospitality industry, is designed to raise awareness of the issue and to help prevent more pub and club closures.

Conservative MP for East Yorkshire, Greg Knight, Liberal Democrat MP for Birmingham Yardley, John Hemming and Labour MP for Tyne Bridge, David Clelland, are all standing up to support the moves for changes to the current laws in a bid to bring back customers.

Mr Knight said: "Britain's pubs and clubs are at the heart of every local community and the UK approach of banning indoor smoking everywhere is damaging the viability of many licensed premises where people wish to smoke. Pub landlords and club committees know best what their customers want and they should be allowed to provide smoking rooms if there is a demand."



About the Restructuring and Recovery Leisure and Hospitality Group

Baker Tilly's Restructuring and Recovery Leisure and Hospitality Group brings together a multi-disciplinary team of partners and senior staff, all with significant experience of working for lenders to the sector. As an integral part of Baker Tilly's Retail and Leisure Group, the combined skills of our national team provide a one-stop shop, offering practical and commercial solutions.

Restructuring and Recovery experts in:

Birmingham, Bristol, Bury St Edmunds, Crawley, Edinburgh, Glasgow, Guildford, Hereford, Hull, Leeds, London, Manchester, Milton Keynes, Newcastle and Watford.

Baker Tilly offices also in:

Basingstoke, Bromley, Chelmsford, Chester, Ipswich, Lerwick, Liverpool, Saltair, Stoke on Trent, Tunbridge Wells and Warrington.

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