## Our regional views

Three partners from Baker Tilly Restructuring and Recovery LLP outline their recent experience and future expectations for the leisure and hospitality sector in their respective regions.



Lindsey Cooper
The North

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Number of years experience working on assignments in the sector – 15 years.

**Most recent sector assignment** – The sale of Blenheim Lakeside Hotel, Liverpool. The hotel sold as a going concern.

### Most challenging/complex assignment

– Small country house boutique hotel in the 'wrong' location where owners had lost all grasp of the reality of the situation and let their passion for the business rule their head. They remained completely convinced that the business would turn round if only the bank would lend them more money! Everything compounded by the fact that deposits had been taken for several months worth of weddings.

Worst performing segment (i.e. hotels, bars, restaurants, leisure/sports centres etc) regionally and why – Mid-market small hotels, often in out-of-town locations, occupying the market between budget and four-star operators.

Biggest challenge/threat to the wider L&H sector in the region – The reduction in household incomes impacting on everything from sports club memberships to eating out. Corporate organisations are also tightening their belts and choosing to cut back on conferences and overnight stays or moving down market in terms of venues.

Unique insolvency skills/experience required for the sector – Strong sector knowledge combined with common sense and good people skills.



complications.

## The Midlands

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Number of years experience working on assignments in the sector – Approx 15 years.

Most recent sector assignment – Supersun health and leisure club. Administration of a club with 2,500 members. Sold to a new operator who is now successfully running the club.

Most challenging/complex assignment — Broad House hotel. Boutique hotel which, on our appointment, had many weddings and special functions booked. Deposits previously taken had already been spent making it difficult to hold or cancel functions whilst trading in Administration. Most functions went ahead but ultimately several were cancelled as the facility was eventually sold as a private residence. In addition, husband and wife owners had a fraught relationship and the property was tied up with several titles and

Worst performing segment (i.e. hotels, bars, restaurants, leisure/sports centres etc) regionally and why – Small hotels in unattractive areas and working mens clubs. Small hotels are struggling to compete with the large chains and often have few unique selling points to attract visitors. Businesses and private individuals are also seemingly cutting back on short stays. Working mens clubs appear to be struggling as memberships get older and new younger members are difficult to attract, particularly in areas where dependent industries have re-located or decreased.

Biggest challenge/threat to the wider L&H sector in the region – Falling demand from both businesses and consumers as public sector cuts bite and economic uncertainty continues. Discretionary spend is being held back or saved, often at the industry's expense.

Unique insolvency skills/experience required for the sector – Knowledge of the practicalities of operating in the service sector, including licensing law, friendly societies etc.



# The South

Number of years experience working on assignments in the sector – More than 20 years.

**Most recent sector assignment** – The Administration of Pash Inns, a small Sussexbased hotel. We are currently trading the business with a view to a going concern sale.

Most challenging/complex
assignment – The trading of a nightclub,

amusement – The trading of a nightclub, amusement centre and timeshare group. The issues included the removal of all incumbent management due to a lack of trust and credibility. The involvement of local 'mafia' added to the internal conflicts, together with the out-of-centre location of the nightclub.

Worst performing segment (i.e. hotels, bars, restaurants, leisure/sports centres etc) regionally and why – Regional hotels and pubs – demand outside of London is significantly depressed,

of London is significantly depressed, particularly at the lower end of the quality spectrum. The squeeze on disposable incomes is likely to be one of the major root causes.

Biggest challenge/threat to the wider L&H sector in the region – Continued squeeze on discretionary spending impacting pubs and bars and the rapid increase in the trend towards home drinking via slashed prices of alcohol in the major supermarkets.

Unique insolvency skills/experience required for the sector – Experience of dealing with licensing, trading of cash-based businesses and management who typically sale a little close to the wind!



# Full house?

Leisure and hospitality briefing

Nov/Dec 2011



Restructuring and Recovery Real people, real solutions

## Can the resilience last?

Despite the media's focus on high-profile casualties in the hospitality and leisure sector, overall sector performance has arguably been better than predicted during the economic crisis, with some segments of the market even showing modest growth.

Ignoring wet-led pubs, for whom the last few years have proved particularly challenging, sales across the hotel, restaurant and food-led pub sectors have remained relatively consistent since 2008. Profitability has held up surprisingly well, reflecting the implementation of operational and financial efficiencies as businesses battened down the hatches.

We do, however, question whether this is sustainable in the long term, particularly in the face of declining consumer confidence and rising operating costs. Snow, volcanic ash clouds and inner city riots did little to help the sector over the last 12 months and businesses will inevitably face similar 'one-off event' challenges in 2012.



Looking at the domestic economy, the UK's Retail Price Index reached 5.6% in September, putting further pressure on discretionary spending as household earnings suffered another unwelcomed squeeze – bad news for those looking for top-line growth and equally worrying for management teams looking to increase margin by cutting cost. So if sales growth isn't an option, and further cost reductions are unlikely, will the sector now stagnate and suffer a raft of failures?

As the festive seasons leads us into the new year, one thing is certain – there will be casualties along the way. Following the 33% increase in administrations across the sector in Q3 2011, we expect formal insolvency statistics for Q1 2012 to show a further rise.

Assessing how businesses deal with issues such as inflation – or indeed whether they address them at all – may serve as a barometer for the fortunes of a business as a whole. Those that embrace the changing economic environment will do their best to turn a problem to their advantage, for instance, by adapting menus or developing promotions to suit the shifting market. Others will simply ignore the problem and allow inertia to carry their business towards a terminal decline.

## Welcome

In the previous edition of *Full House?*, we noted signs of a modest UK recovery in the context of a possible interest rate rise and the broader effect of the 2010 Comprehensive Spending Review. Since then, the outlook has, if anything, become more complex, as unexpected domestic and world events continue to put UK plc under pressure.

Despite the volatile economic backdrop, the distinction between winners and losers in the hospitality and leisure sector will arguably still boil down to the key fundamentals – location, appearance and quality of the facilities on offer, strong financial and operational management, the ability to adapt and evolve, and a focus on customer satisfaction.

In this issue, we explore the key challenges for the hotel and pub sectors with the help of two of our strategic industry alliances.

Inside, we join forces with Leo Murphy of The Arizona Group to share our collective thoughts on the future of the pub market, arguing that the industry will survive and thrive – as long as it adapts to suit the prevailing conditions. Turning to hotels, we team up with BDL Management to look at the challenges ahead for operators in 2012.

We hope you find this edition of *Full House?* an insightful read and look forward to working with you on future assignments in the sector.



Peter Cooper is a Restructuring and Recovery partner at Baker Tilly in London. He has broad experience of working on assignments in the leisure and hospitality sector.

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#### 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, Hull, Leeds, London, Manchester, Milton Keynes, Newcastle, Stoke On Trent and Watford.

Baker Tilly offices also in:

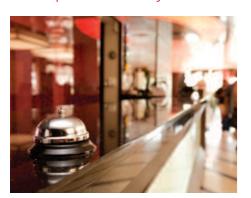
Basingstoke, Bath, Bromley, Chelmsford, Chester, Ipswich, Lerwick, Liverpool, Peterborough, Saltaire, Tunbridge Wells and Warrington

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## Hotels look set to dig even deeper in 2012

Baker Tilly Restructuring and Recovery and BDL Management are currently working on a number of assignments in the sector. Paul Zalkin and Ross Morrow put heads together on the challenges faced by hotel operators in the year ahead.



The economic landscape has once again become chaotic, particularly in the eurozone where government debt crises and turmoil in the bond markets threaten to plunge parts of the world economy back into recession. As relative market optimism turns into a very real sense of caution, the hotel sector is likely to feel the effects in the months and years ahead.

Whilst some commentators predict London hotels will perform well on the back of major events such as the Olympics and Diamond Jubilee, others argue tourists may actually stay away from the capital to avoid the disruption and over-inflated room rates. Meanwhile, forecasts for the provinces appear uninspiring.

If trading conditions remain tough as a result of leaner pricing opportunities, suppressed occupancy levels, working capital and other funding pressures, the number of hotel businesses showing signs of financial distress will inevitably increase in the year ahead. Formal insolvencies will also increase.

In response, some lenders are looking to reduce their exposure to the sector or to re-price existing facilities, leaving underperforming hotels in a precarious position. Those suffering the combined effects of a highly-geared balance sheet and bad operational practices will find it particularly difficult as they struggle to invest in essential operational improvements.

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#### Proven track record

Having recently managed a significant number of hotel assignments with impressive results, BDL Management and Baker Tilly are well placed to assist both lenders and management teams. In addition to undertaking detailed financial and operational reviews, we have extensive experience implementing the Administrator/management agent model increasingly favoured by banks when enforcing their security. Indeed, in most instances, we consider this to be the most effective method of adding value to a hotel insolvency process.

### Case study – Food for thought

A five-star retreat hotel with an excellent reputation for food quality was placed into Administration on a Thursday, immediately prior to a busy weekend's trade. BDL was contacted upon appointment as all kitchen staff, the general manager, assistant manager and financial controller had resigned leaving only waiting staff, housekeepers and the bedroom manager to keep the hotel in operation. BDL took control of the hotel the next morning, bringing in operations, finance and property experts to manage the business.

BDL subsequently staffed the hotel by pulling in personnel from other operations under its control. Quality was maintained by sourcing appropriate chefs through BDL's contact base and food was sourced through its existing suppliers. Guests felt no impact and BDL provided the Administrator with a detailed financial appraisal of the hotel's viability, which then determined the overall strategy.

When a hotel group enters Administration, effective crisis management and business stabilisation are key to ensuring the assets can be marketed for sale – ideally on a going concern basis. To achieve this, we focus on effective planning and a project management approach, with duties divided based upon legal and operational requirements, core strengths and financial efficiencies. The key features of this approach are summarised in the table below:

- Review the business model, establish the current position & set strategy Agree a division of duties & fee structure Model trading cash flows & funding requirements
- Contact staff, critical suppliers & function guests. Issue a positive press release
- - Conduct a detailed review of all operations
- Reset cash flow/funding requirements
  Implement additional financial controls
- Optimise supply chain relationships, pricing,
- internal systems and marketing · Consider headcount efficiencies
- Continually monitor performance against forecast Consider CAPEX spend to optimise sale
- Liaise with agents & interested parties Collate information for the data room Negotiate & complete sale agreement

We understand the key issues and work hard with lenders, management, suppliers and staff to ensure minimal disruption during the handover phase. BDL also has a large central administration team capable of taking on additional properties and using its buying power to achieve cost savings. This, in turn, allows the Administrator to significantly reduce central costs.



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## Few cheers in the new year?

Going into the traditional trading peak of the Christmas and new year festivities season, Peter Cooper and Leo Murphy reflect on the challenges likely to impact pub operators thereafter.



As pubs continue to operate against a backdrop of shifting competitive forces, an evolving regulatory environment and material uncertainty over the strength of consumer spending, many commentators appear fixated on the decline of this hugely important industry. However, to paraphrase a famous quotation, reports of the death of the pub are greatly exaggerated.

Although pubs represent many things to many people, there is consensus around the need for the industry to adapt and evolve. Sadly, the idea of the 'backstreet boozer' – a nostalgic view of the pub as an essential element in our social fabric – is outmoded and describes an ever-diminishing number of pubs in the UK.

That is not to say the traditional pub should be consigned to the nation's history books far from it. However, recent formal insolvency statistics appear to bear out the argument that wet-led community pubs are still facing real challenges, not least from their commoditised high street and food-led counterparts.

According to recent analysis published by the British Beer and Pub Association, the UK's tax regime is largely to blame for recent declines in beer sales, stifling growth prospects for an industry that could actually help the UK economy overall to recover. To

put this point in context, over 600,000 staff serve over 15 million customers who drink in one of the nation's 54,000 pubs at least once a week. Clearly, the industry is a major contributor to the nation's coffers.

Better to be in a busy high street frequented by ABC1s than a tertiary back street in a depressed semi-rural location, particularly when margins are slim.

However, many economists (and treasury tax advisers to the Chancellor of the Exchequer) would argue that demand for alcohol is price inelastic. In other words, a duty-led price increase has a proportionally smaller impact on demand, thereby guaranteeing that consumers will continue to buy beer and wine despite the odd 10p price increase here

Anecdotal evidence proving this point is easy to find in any major city centre, where relatively well-off workers can easily spend £4 or £5 on a pint of lager. So the question is, why can some operators charge eye watering prices and survive whilst others struggle?

One obvious answer is location, arguably the key factor in ensuring sufficient footfall of the right type of customer. Better to be in a busy high street frequented by ABC1s than a tertiary back street in a depressed semirural location, particularly when industry margins are already slim. Pubs in less busy locations need to focus on driving customers through the door and keeping them there, for instance by arranging quiz nights, live music or other community entertainment.

Equally, a food offering can be another hugely important factor, providing a higher margin income stream whilst extending the most revenue generative hours. That is not to say menus have to provide sophisticated gastro-pub fayre. The trick is to consider and understand the customer base and to provide a suitably priced offering – be it pie and mash or Michelin starred food. It sounds simple yet so many get it wrong.

Ultimately, the pub as we know will survive - as a community site, a high street bar or destination food outlet - provided it adapts to whatever the customer demands.



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