C&D Restructure and Taxation Advisory

Hospitality Observation Guide 2019

By Kevin Carmody

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Restructure and Taxation Advisory

Foreword

Working within the hospitality sector for over 50 years, the team at C&D have seen the good and the bad, changing conditions, the influence of technology and now the expansion of product offerings which are impacting traditional operators.
Our 2018/19 guide is influenced by the sites that we have operated as well as external research. We have assisted in the operation of 24 locations, with a wide geographic spread and across accommodation, liquor and gaming and food retail.
With the capacity for the rapid deployment of onsite managers, we are able to assist any owner or operator in need of help.

Starting with C&D in early 2019 it was the first time that I had stepped away from hands on active management since I was in my 20s. The year that passed was one of the hardest I have seen in hospitality and things are still looking tough.
Stepping out of a recent management role, the comments in this report resonated with me. Capital expenditure was limited and there was a need to refresh older venues, as customers are demanding more.
What worked over the course of my career has been tipped on its head as business conditions are influenced from all sides. The continual rise in technology has been significant. Those who are using it in their outlets are looking a lot stronger than those who have not been adopting it.

***Senior Advisor**, Kevin Carmody*

Having been both a landlord and tenant, I have always strived for commercial outcomes and ensuring mutual profitability, but there appears to be a shift in thinking that it is us and them. It can only be hoped that there is a reckoning and that pricing reaches a semblance of affordability.
I see the year ahead as being a continuation of the difficulties of the current year. Businesses will continue to struggle, and rationalisation within the industry is more likely to continue.

Restructure and Taxation Advisory

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Executive Summary

The past year has been tough for smaller operators as the impact of technology continues to increase and businesses struggle with significant fixed costs that may not be achieving a realistic return on investment. Our involvement in outlets has increased, with tenants being under pressure, costs rising rapidly and rents not necessarily reflecting commercial reality and the conditions on the ground where businesses are struggling to keep the doors open.

The year has been one of a more robust regulatory environment, with Fair Work starting to emphasise non-compliance of large organisations, not just small. The changing of the franchisor obligations to protect franchisee employees has placed some business under a long-overdue microscope. Further emphasis on the contractor/employee divide has made businesses focus even more on the cost of labour.

Outlets and operators that are willing to adapt are seeing improving returns, while reinvestment and regeneration is bringing better overall results. Different ways of thinking are bringing results for businesses as they are no longer simply reliant upon what has worked in the past. Our overall observation is that there is a desire for something unique, different and an experience and it is this differentiation that will assist most businesses.

A general concern has been the detachment between occupancy cost and profitability. There is an expectation that rents will continue to rise, regardless of the underlying performance of the location vis a vis previous years. When landlords have met the market and worked actively with tenants, we have seen an improvement that will be sustainable into the long term. Where the reaction from landlords has been rigidity, we have seen tenants stepping away.

Single touch payroll is an unknown, but we expect that this will be problematic for marginal businesses. Coupled with an emphasis from the regulators to check employee entitlements, those failing to make payments on time are going to be immediately under pressure and arguably will not survive the first round of ATO generated audits of employee entitlements. It is our view that this will be a significant impost for businesses and will ultimately result in operators that were just holding on to jump off rather than risk further non-compliance.

Part 1

Accommodation

By Kevin Carmody

Airbnb is here to stay and traditional accommodation providers (motels and serviced apartments) are under pressure. There has been an increase in the number of motel leases handed back, or tenants who have walked away from properties, often after a period of requesting rent relief or threatening to depart.

On the Ground

It has been a difficult year for premises where we have needed to assist the owners in taking over or finding new managers. Aged, tired and under-invested has been a common thread across the properties that we have been involved in over the last year. Properties that had a facelift in the 1980s, furnishings that were last cleaned years ago, threadbare manchester and absent facilities were common and reflective of the position of the industry.

Food offerings in these venues have been sad or underutilised and even in small locations, without significant competition, the food offering is a loss leader or a straight loss. We noticed that the function spaces were usually turned into storage areas as it had been years since the function aspect of the business was viable or even advertised. Bar areas and liquor sales were stale, non-existent or dust collectors, with our “favourite” example being a site with “antique” half-filled dusty Vok bottles on the shelf.

In each of the premises an immediate capital expenditure was necessary, the cheapest being $100,000, while the most expensive required bulldozing the location and repurposing the site. A common concern was that the sites looked tired, and when compared with AirBnb and newly built locations, it was noticeable.

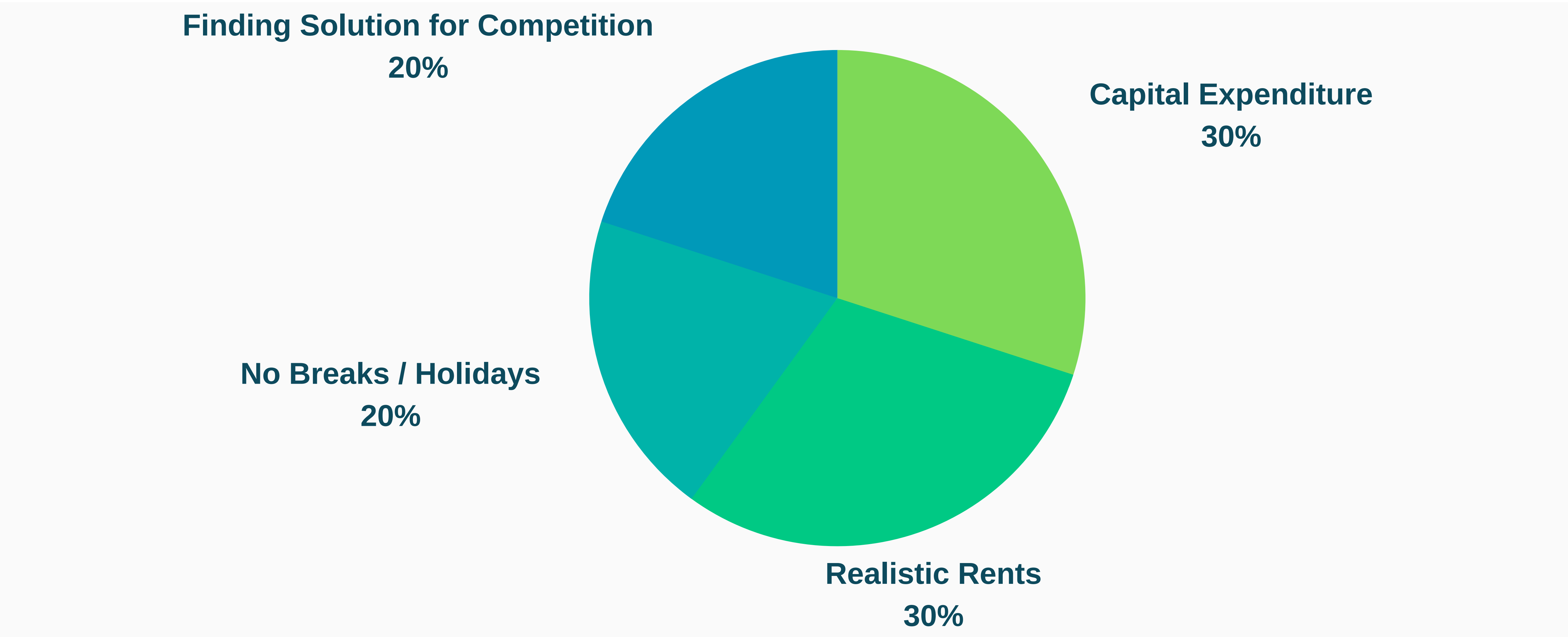

Figure 1. Business requirements as observed by C&D Restructure and Taxation Advisory clients, 2018-19 financial year.

Strategic Concerns

Each of the locations had a period of poor performance, underinvestment and a lack of development of the business. Regular customers had been turned away or had found an alternative. Contracts were under pressure or not being renewed and there was minimal tourism travellers, these traditional customers finding different locations.

Comments online were consistently focused on the past and how the property used to be, which was common between each of the properties. Complaints mentioned cracked tiles in bathrooms, unworking technology and slow internet. There was limited or no engagement with customers online, and there were no active attempts to engage with customers about their observations, concerns or complaints.

Example

A comment on Facebook or Tripadvisor that showed the condition of the property stated...

"stayed here xx years ago and it was great, so disappointed at how the place is now"

AirBnB has pervaded the smallest locations and dramatically opened up the field of accommodation options. When taking over a property, we would firstly find and stay at a local AirBnb of a similar price to the motel being secured, then have a night at a local motel. The difference was stark in each situation and told us a horror story, where the recovered premises was no longer able to compete.

C&D Restructure and Taxation Advisory Senior Advisor, Kevin Carmody on a recent trip across regional Victoria, visiting clients.

Finding Tenants

We were trained on a Rent to Turnover ratio of 22 – 28% with a lease cost of 3 to 4 times profit being viable in the long term. Practically, we were finding that this would not provide long-term viability in the tenant pool. In each of the takeovers this year, the average tenant tenure was eight years and they had been unviable for at least two. We calculated that the loss on the termination of a tenant averaged $350,000.

Owners that took significant steps in ensuring viability appeared to be able to achieve the best results. This included a consolidated approach to the underlying business and working with one of the more significant landlords to turn the overall businesses around. Rent being reduced to market conditions as well as a capital investment achieved a level of stability where some tenants were about to walk or depart. Understanding the motel business was important, there needed to be a profitable underlying business, but also something that would be able to be sold to an incoming tenant. Expecting to be able to simply replace a tenant became a busted myth this year, the average time to replace a tenant expanded to three years.

Leases that forced the opening or retention of the food and beverage offering failed to attract buyers. Equally, those that lobbed the problems back to the tenants made it a hard sell, and some of these are still under management (in some cases for more than five years).

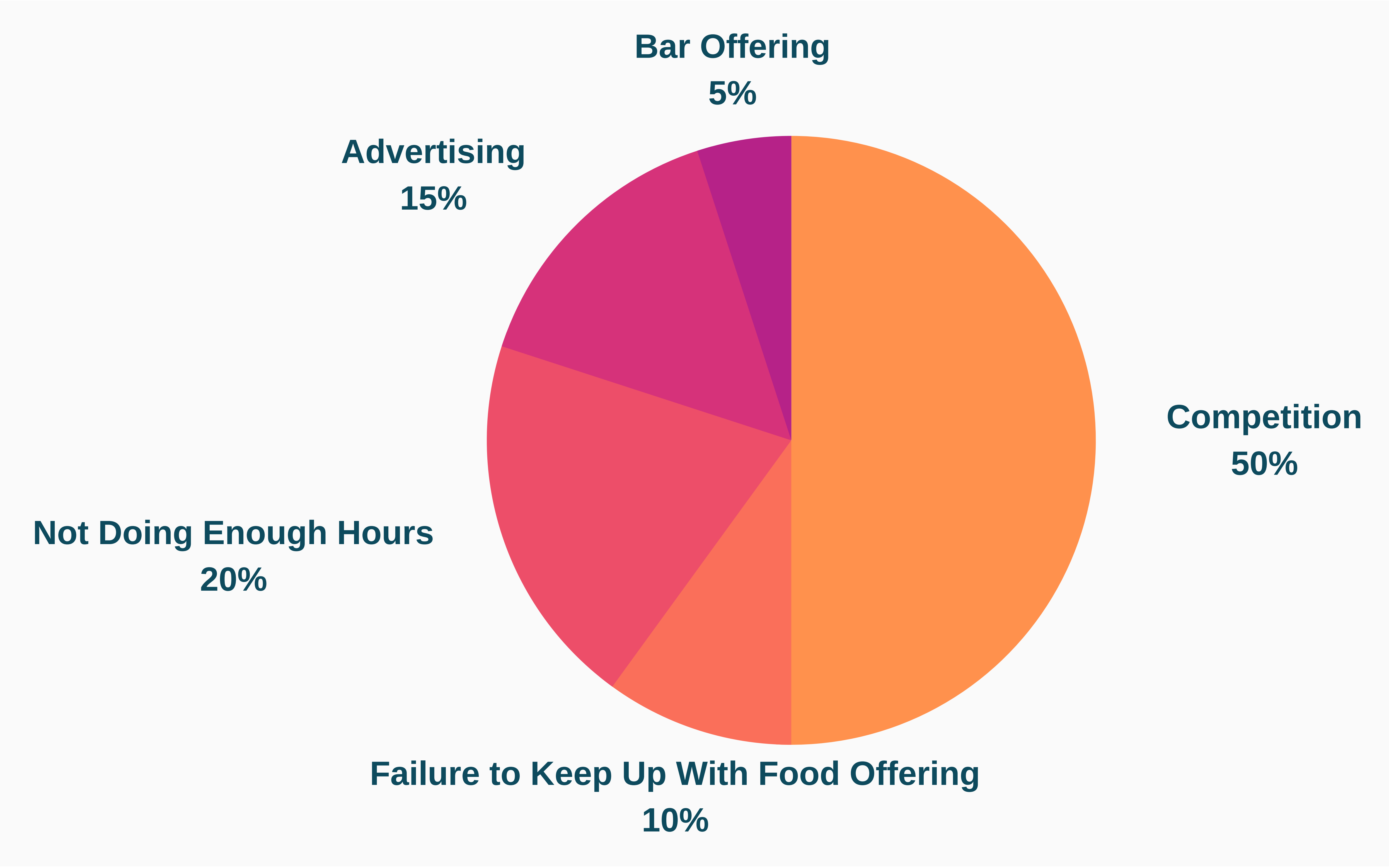

Figure 2. What property owners see as issues with their tenants, C&D Restructure and Taxation Advisory observations, 2018-19 financial year

Food Offerings

This is a vexed issue, generally outlets have invested significantly in a commercial kitchen, but sadly this has often merely been a holdover from better times. When each outlet was taken over, the initial stage was to analyse the food sales and it was not uncommon for this part of the business to be losing significant money.

Example

Analysing a property in a semi-rural location, the business had been owned by the same tenants for 15 years, finally deciding to shut the restaurant before selling the lease. Over that 15 years the performance of the motel has been solid, but the restaurant had been declining year on year. During the lifespan of the motel the number of competing food offerings had increased from 25 to 120. The 'bundling' of food and room had ended several years before, and for the final year of operation a deal with local restaurants and a chargeback resulted in a small profit from food. On arrangement review, the restaurant had not made a profit in ten years.

Opportunities

A good, solid accommodation option, if convenient and priced well, continues to be strong when well-managed, especially in rural locations. However, price pressures and competition are still a problem and there is an argument of continued oversupply.

Example

During the year we assisted a property owner that was faced with 20 competing motels and a population of 18,000. It was determined that with the required capital expenditure to bring the property to market standard, that it would be better to simply bulldoze the property and convert the site to a commercial premises.

Analysis of the location noted that there were another 100 B&B competitors with AirBnB, and to survive the business would need occupancy at 135% in the long term. Selling a new lease was unlikely and the better outlook was to re-focus the location.

Example

One owner we assisted held 40 locations of which one had a viable food and beverage option. The rest hadn't seen profits in years.

What Worked Well

The most successful transitions have been in the locations that have adapted to the changing markets and made their business accommodation plus something, something different, something customers could not get elsewhere. This did not mean having a food and beverage option, but in most cases offering something simple and more than their competition.

Offering real coffee was a major benefit and a barista course for the front reception was a significant improvement and offering a takeaway coffee to departing customers was well-received (and a croissant if there was no longer breakfast provided).

Opening the kitchen to patrons was beneficial, most rural motels had an outdoor BBQ area but an unused kitchen and if the weather was bad, the BBQ went unused. One of the most successful transitions, was to simplify the kitchen and allow it for patron use. A benefit that was articulated about alternate options was that there was an ability to cook in a normal kitchen. When this was offered (and highlighted) it became a strong marketing opportunity and increased the number of travelling families, where the cost of meals can be prohibitive.

In rural Queensland, the operator found that their location became a travel hub once the kitchen opened to patrons, with stays increasing from overnight to doubling as families used the location as a base once they knew they could use the kitchen.

Installing solar in most locations was a logical step, and as a core business decision, reduced a substantial variable cost for the businesses. In each case, this reduced costs by a significant margin, so as to make the payback period less than 5 years (or a 20% return).

Little things made the businesses improve, whether giving car windows a wash at night, a courtesy lift into town for satellite motels (especially where the food was discontinued), fresh baked items (as opposed to a two biscuit plastic wrap), real coffee and a reception that was not something out of the 70s all worked.

Summary

There is no doubt that accommodation is a tough field and the surviving businesses will be those that recognise and adapt to this challenge. There is the opportunity for a well-run location to be able to thrive, but the old method will struggle as competitors abound. For owners that assume things will just run as normal, we are finding that it is a tough wake-up call; rents need to be brought to market and to allow profitability for tenants or they will depart.

Part 2

Liquor and Gaming

By Kevin Carmody

Our team took over five venues during the year, all rural and under significant pressure. Each location had a quirk and potential but management had run them into the ground. Understanding the underlying economic conditions was important, as there was a common thread of local economic problems.

On the Ground

When taking over the premises we noticed that there was a lack of entertainment. Not necessarily live events, but there was simply nothing that made the places enjoyable, they were sad to be in and the clientele reflected this. Each had substantial underinvestment and the offering was not reflective of what was expected in the town.

Prior to entry, we would visit the competition and find that there was buzz, activity or simply something on that would encourage patronage. Social engagement for each of these outlets was significant and there was a real connection with the customer base (even if it was a weekly update); our locations had none of this.

Food offerings were inconsistent, and pricing made no sense. The supply chain was sub-par, reflecting the late payments to suppliers and the unwillingness of suppliers to work with the venue. Frozen seemed to be the preferred meal offering. Staff were unhappy and it showed in the service quality. Communication from management had been poor and the staff were dealing with unpaid suppliers.

Strategic Concerns

In one location we found there were over 20 licenced venues for a population of 22,000. It was a similar story for each outlet and each location; each of the locations was one of the herd and needed to be differentiated in order to be able to succeed. At the end of the year there were four shuttered locations and we expect that there will be more to follow over the coming year as our location continues to improve.

Staffing is dynamic and there were too many hours that the venues were overstaffed. Rostering in each location became important and once properly installed made a significant change, but overall this was an afterthought by management. Bigger sites were not able to shut off which meant that there was a need for additional or over-staffing.

Gaming is important, but to rely on it is tough in country areas. We found that the performance of the outlets was reliant upon the gaming revenue which was up and down. There was a lack of investment into the gaming rooms in each location, and without substantial investment it would continue to suffer.

Competition is heavy and there is substantial over-investment in the sector, especially in rural locations, where the recovery of investment will take lifetimes. We worked with two operators in the same town, and at present trends they were both facing a 30 year return on investment for a major re-development of existing facilities.

Example

A location in rural NSW invested $8,000,000 on a refurbishment of an old hotel, the improvements were amazing, but completely overblown for a small country town. Short of the population increasing by 100% there would never be a sufficient population to recover the expenditure.

What is Working

Food offering to the expectations of the location. Early in the year we worked with a venue in a town of less than 3,000 that had a restaurant with an average main of $38. It was painful to watch customers look at the menu and walk out. The premises had become reliant upon passing trade and failed to attract locals, it was easy to see why. A food offering that was closer to the local expectations meant that there was an instant increase in the traffic in the venue, passing trade also picked up as there was a more realistically priced offering. Without needing to destroy the food offering, bringing it to a realistic spend per head was immediately successful.

Event and expenditure on the activities in the premises was valuable and important for operators where competition is high. Our most successful operator changed the emphasis of the location to being strong mid-week and then leveraged this to being a weekend focused pub as staff could be acquired from competitors (given the ability to offer mid-week work). Making sure that there is something on, makes it a substantially better entertainment option than hoping a television with the sport on in the background will bring in patrons.

Staff management and rostering has become more important. There is no excuse now as the technology options are significant and cover all aspects of operation down to integrating with POS. Each location had an immediate headcount control and analysis of the staff levelling and its efficient rollout made significant improvements.

Gaming continues to be important but needs to be balanced with an overarching plan for the venue to ensure that it is not the sole focus of the business. Our best results have been achieved where the gaming is supported by the balance of the business. Room regeneration was important, as was making sure that there was machine change over, reflective of more recent trends.

Engagement with customers on social media is a continuing need for outlets and ignoring this is dangerous for any operator. We have observed this transition to social media being the primary advertising medium, and our better locations have invested significant resources. Promotions appear to be more expected by consumers, with resultant engagement leading to a better return than other options.

Part 3

Food Retail

By Kevin Carmody

Our year in food has seen the widespread closure of outlets rather than regeneration, it has been a tough year with the dual influence of rising costs and external pressures. There has been an escalation in shutdowns as marginal operators have started shutting the doors earlier and walking away from unrealistic leases.

Press in this area has been increasing and there has been a slew of prominent restaurants closing their doors.

"Really, don't do it." says Mitch Orr, chef and co-owner of recently closed ACME in Sydney's Rushcutters Bay. ***"If you have $400,000 to $600,000 burning a hole in your pocket, give it to me. It's a lot quicker way of saying goodbye to it."***

In the wider market this has been a common trend, we have noticed that food courts and centralised food locations are starting to show more closures with no replacement for the departing outlet. This generally drags down a location, and once one goes it can be difficult to recover.

The influence of delivery services has increased revenue, but not necessarily with an increase in profit, as margins are being squeezed. We have noticed an increase in dark (offsite) kitchens and a preference for shutting staffed locations.

On the Ground

Sadly, this has been a year where closure has been the norm and it has involved attempting to extract the best result with the shortest amount of time. Where outlets would normally be salvageable, unrealistic landlords have meant that options are limited or non-existent.

Best results have come from multi-use locations, where we are able to supplement or reduce the rent imposition. For businesses that may only have a lunch or dinner offering, a sub tenancy arrangement with a coffee / breakfast operator has been successful. Equally there has been good traction in using a breakfast / lunch venue as a small bar with limited food options. Each business running in isolation but being able to share the occupancy cost.

Staffing continues to be difficult and poorly laid out venues are one of the biggest issues we have seen, in terms of inefficient utilisation of staffing. Where there has been conversion of existing premises, we are yet to see a functional layout that won't end up increasing the overall staff cost.

Observation

Conversations with owners have shown a similar trend: rents, staff and customers each causing problems. Competition is increasing and there appears to not be a simple solution.

There has been a trend of absent owners, which has continued into the year and been a constant source of new engagement. We are finding that traditional operators seem to be doing better as they are able to control costs and manage the issues as they arise, while absent owners continue to be problematic.

The influence of Retail Food Group has been significant and made things more difficult for businesses near their locations. This has especially been the case in smaller venues where they are a dominant tenant. Equally, Max Brenner also had an adverse influence as they also had significant real estate.

Working with our clients this year, we are noticing that things are getting tougher earlier. Early engagement with stakeholders such as landlords appears to be more successful than waiting until later, but there is still a lack of realism.

Strategic Concerns

Structural factors such as increasing costs and reduction in patron spending herald wider concerns in the industry. The influence of food delivery services and expectations of patrons are becoming tougher. Staffing and continual pricing pressures make it harder to run premises in quiet times, which means that rostering is key.

As input costs continue to rise there is a balance between increasing prices and risking the loss of customers as a result. The strong operators are already adapting to this change and are able to balance the requirements.

Wider economic concerns are impacting business and need to be addressed. For businesses that are struggling now, the prognosis is not great, and without significant change there is unlikely a panacea to the improvement of the business. We are watching these marginal operators start to stumble and it is becoming more of a reality over the next year.

Unrealistic landlords continue to be a strategic concern for operators, and we are noting that those with a rigid approach to tenancy are finding higher levels of delinquent tenancies or struggling to find tenants. Where landlords are not willing to meet the market or to work with tenants, we are seeing that tenants are choosing to leave, often to the detriment of complimentary businesses surrounding the location.

In analysing businesses this year, there has been a common thread of relying upon the finalisation of the election to give a shot in the arm and improve trading. In a short period of time we are already seeing that the expected jump has been more of a sugar hit than significant upward improvement. Without overall economic improvement, we feel that the marginal businesses will struggle to continue in the upcoming year.

What is Working

Throughout the year we have noticed the success of smaller venues, where the staffing costs have been controlled and occupancy costs have been well managed (either through split tenancy or renegotiation).

In working with smaller operators, especially in smaller geographic areas, a rationalisation of the busy times and heavy data focusing on core opening hours has proven valuable, especially in mitigating staffing costs and managing quiet times in the business. With locations that have been poorly laid out, there has been an improvement of layout of the site, to effectively manage staff better. An increase in offerings (in terms of licencing or low-cost options) has improved these outlets as well. Active management seems to be the key, and where management are on the ground there appears to be a better approach than where they are absent and operating remotely.

Where operators are aligning with delivery services we are finding that alternative menus have worked more efficiently than the standard menu, where the margins are too thin to make profit. Furthermore, running venues as a “dark kitchens” on off-nights (when staff costs and input costs can be controlled) have been equally successful.
A key factor has been the affordability aspect. Our most successful outlets have offered low cost or realistically priced off-hours liquor retail. For venues that have been struggling with traction, we have found that a smaller bar style approach has been significantly more successful than alternatives.

Part 4

Where to from Here?

By Kevin Carmody

Being on the ground in 2018/19 has given us an insight into what is happening in the year ahead, and we expect that things will continue to be challenging. Taking active steps for the continuation of business now will mean that there is a better chance of survival for the tough times ahead.
It's not all doom and gloom, but things are getting harder and businesses are going to need to be smarter in order to survive. Businesses that are struggling now are unlikely to be able to pull things around without significant change.

This report

We prepared this report for our partners as our insight into how the year that passed has progressed. Introducing Kevin Carmody, who has owned and operated over fifty venues during his career, has brought a commercial edge to the business. We welcome any thoughts and are always happy to work with organisations needing guidance.

Restructure and Taxation Advisory

Resources and Help

Presentations
We have a library of presentations available for our partners, covering a range of areas that influence restructure. During the year we present these in multiple geographic locations for both accountants and their clients.

Staff Training
We understand that there is a gap in the market for specialist training in these areas. We are happy, especially when we are in rural locations, to run a training session on the issues involved within restructure. This can be either formal or informal depending upon what is required to bring your staff up to date or increase their existing learning. This a complimentary service to our partners.

Online resources
We have developed a comprehensive reservoir of informational blogs and industry news for our partners, updated daily with additional resources.

Written Guides
Free downloadable guides covering what is happening on the ground and what influential forces we are seeing on the marketplace.

Instructional Videos
Our library of instructional and informative videos covering all aspects of the restructure process and what to look out for.

Face to face or phone conferencing
If you are wondering about options or feel that a client may be in need of assistance, we are only a phone call or a drive away. Our preference is always having a whiteboard handy to be able to run through scenarios, but we are always happy to jump on skype.

Schedule Conference

Shop 3,
156 Park
Road,
Yeronga
4104

We work with you
The area of restructure is complicated, and we encourage the involvement of our partners in each stage of the process. There are many moving parts and the more heads involved, the better the results can be. Working with our partners, we pride ourselves on a solutions-driven approach to restructure and turnaround.

Restructure and
Taxation Advisory

About C&D

A bit of background

The C&D team has worked in restructuring for several years and more closely in taxation for the last 20 years. They have seen things good and bad during this time and have been at the forefront of significant change. We have personal experience in restructures and have seen what can go wrong, where advice is lacking or where the interests of the advisors are not the same as the business owner. We pride ourselves on not being aligned with any insolvency firm and will only make a recommendation for insolvency where they are the best fit for a situation.

We have worked closely with business owners in all stages of restructure, had tough conversations and sadly destroyed a lot of dreams to get to practical outcomes. We pride ourselves on under-promising and over-delivering solutions.

We are often described as blunt and direct, this comes from an understanding that the more practical the solution and the more realistic the outcome, the better chance we have of getting to the other side.

The C&D Team

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