

GET YOUR HOUSE IN ORDER

CON QUIGLEY offers advice for businesses considering restructuring in 2010.

The hospitality sector is at the coalface of the current economic downturn, with the fourth highest level of insolvencies in the January to November 2009 period (insolvencyjournal.ie).

The industry is suffering with a number of major challenges including overcapacity and an increased cost base; this coupled with falling demand has seriously impacted on the profitability of a number of operations. Horwath's *2009 Hotel Industry Survey* showed that the Republic has 58,467 hotel rooms forming part of 905 hotels. With occupancy rates down 6.2% in 2008, hotels were on average selling rooms 10% cheaper than in 2007 in an effort to increase volume and attract business. This is having a huge impact on cash flow for hotel operations and high profile examinership cases such as the Lynch Group are but the tip of the iceberg.

Most hospitality restructuring work goes to insolvency practitioners and, in my opinion, most of them are wholly unsuited to this role. Not only are most insolvency practitioners primarily interested in generating insolvency appointments, but most are generalists and not specialised in any sector.

At present, a number of hotel projects are managing to avoid insolvency – for the time being. Some have been the subject of standstill agreements whereby the debt is frozen (temporarily) – sometimes through a formal examinership and sometimes informally.

In such cases, the underlying problem of over-gearing is merely being 'parked' and the problem has not gone away. The business may get a reprieve – and possibly some cash flow assistance – but ultimately a restructuring will be required. In the current economic environment, banks often prefer standstill agreements because of the belief that this is not a good time to agree to a restructuring – usually for a combination of two reasons: (i) to avoid crystallising a loss at a low point in the valuation trend and (ii) to avoid basing a restructuring on cash flows which are also at or near the bottom. Every proper restructuring starts with an estimation of the maintainable cash flow and, if this is at a low point, the ability of the business to carry debt may be underestimated.

Even in these exceptional times, the old rules apply and before agreeing to any restructuring or standstill

arrangements, a bank will want to know two things: First that the business is paying as much as it can ie:

- That the borrowers are not understating or hiding cash flows
- That the financial performance (be it a profit or loss) is as good as it can be for this business at this time
- That no other creditor is getting off easy at the bank's expense.

Secondly, that the bank is better off by supporting the proposal. If it is not better off in the short term, then it will have to be convinced that it is better off in the medium term.

Do bear in mind that banks are not always looking for the final solution every time. There is and will continue to be an absolute desire to avoid writing off

principal. Banks will tolerate arrangements that they know to be temporary, in the knowledge that they will most likely have to negotiate another agreement at some future date. The bank hopes that trade, the economy, liquidity and valuations will increase by this time – and meanwhile they minimise the principal write-off and ideally they have a performing (restructured) loan.

Banks will not rush to any conclusion at present and are deeply suspicious of heightened urgency. The analysis is much more probing at present than ever before. In many cases, historical relationships and events make it hard to get banker and borrower to reach agreement.

In difficult cases, banks are slow to listen to a hotel's traditional advisor. There is a tendency to see them as part of the problem. The only way to get an arrangement agreed is to get beyond the uncertainty (and possibly mistrust). In some cases, it has been necessary to encourage the bank to retain their own independent advice. Of course the fees are usually added to the cost of the loan and therefore potentially at the hotel's expense in the long term. If going this route, it is critical to ensure that the bank retains

someone who has the right profile. They should be:

1. Genuinely independent – and not conflicted or pursuing any alternative agenda
2. Genuinely specialised/expert in the hospitality sector
3. Sufficiently credible and influential to make one or both parties recognise the reality of the situation
4. A financial advisor, not a management consultant. If the person is not able to use their industry insight to creatively drive banking/financial solutions, then their input may only create further confusion/frustration rather than agreement.

A lot of this kind of work goes to insolvency practitioners and, in my opinion, most of them are wholly unsuited to this role. Not only are most insolvency practitioners primarily interested in generating insolvency appointments, but most are generalists and not specialised in any sector.

Finally, remember the power of fresh equity in any restructuring. If the hotelier or restaurateur can bring fresh equity into a business, their credibility and ability to negotiate is immeasurably increased. Many hospitality operators feel under pressure to shore up their businesses by ongoing cash injections when the pressure comes on. Unfortunately, in so many of these cases, the money runs out eventually because it is being pumped into an unstructured business... And then it is too late.

Depending on the circumstances, it is often one of an advisor's most important challenges to embolden the hotelier to ensure that the bank(s) and/or other major creditor(s) agree to some form of restructuring before they commit any more equity to a fundamentally insolvent project. ♦



Introducing Con Quigley

Con Quigley joins *Hotel & Catering Review's* team of monthly columnists this issue.

Con is a chairman in the London office of Horwath HTL, the world's largest consulting organisation specialising in the hospitality industry, with 50 offices

in 30 countries. As the partner responsible for the corporate finance activities in the London office, Con works with hotel and hospitality clients all over Europe, the Middle East and Africa on valuations, market and financial feasibility studies, business plans and strategy, project management and due diligence.

He is also a corporate finance partner and currently the managing partner in Horwath Bastow Charleton in Limerick. Con has a long and distinguished career as a specialist advisor to private and multinational clients in a variety of sectors. He is regularly engaged by banks, state bodies, legal advisers and investors to provide an independent view on financial and strategic business issues, drawing on his theoretical background, wide experience and consulting skills. cquigley@horwathhtl.com