

Hotels - does your business need a health check?

Tara Marlow - Partner, Head of Real Estate, Hotels & Leisure - Real Estate / Family Business
- Dubai International Financial Centre

Hospitality in the Middle East - the journey

Looking back over the last 5 – 10 years, the hospitality industry throughout the Middle East region has undergone an exciting and eventful journey.

Investment has poured into the region, attracted by the ever-increasing number of tourists, creation of the many free-zones attracting international business, relaxation of property ownership restrictions and a general opening up of the region. The boom which started at the beginning of the last decade saw new hotel and resort developments being announced so fast, that it was hard to keep count. For many countries, room rates and occupancy were at an all time high and visitors had money to burn.

The end of the last decade brought an abrupt slow down, reduction of revenue and profit, cancelled developments, litigation between investors and developers, an oversupplied and stagnated property market, redundancy, and bankruptcy/corporate restructuring. If that wasn't enough, the turbulence emanating from the 'Arab Spring' protests added fuel to the fire. For the hotel business, this has benefitted some and caused suffering to others.

Now, as we draw towards the end of 2011, things appear to be more stable and with the experience of the past 10 years, we are able to look to the future.

As a hotel owner or a lender with exposure to the hospitality industry, what does the future hold for you? What should you be doing to ensure that your business is in good health and well-placed to grow over the next decade?

A healthy business? Book a check-up

A successful business is about financial performance and growth. To achieve this, the business must have the right foundations underpinning its day to day activities. These extend from the corporate structure that 'owns' the business, its risk exposure (financial and operational), its management, its product, its performance, its position amongst competition and its ability to adapt to a changing economic environment.

As the business matures, it would be wise to make sure that you understand what has brought it to its current position, what is needed to keep it fit, healthy and growing, and how to plan ahead. For some, it might be a case of learning how to revive a sick business to good health, for others, how to make healthy performance even better.

In this article, I have set out some important areas to focus on:

Performance

The hospitality industry for most of the Middle East region is now mature and well-established. For many hotels, stabilization has been reached and long-term overall performance can be analysed in detail, and effectively measured against competitors. As an owner or lender, you should always have a right of access to the financial records of the hotel, together with a right of audit.

Don't just pay this lip service to these rights, now is a good time to really dig into the business, with the help of industry experts, to understand how best to move forwards.

Undergoing such analysis will assist in understanding the business' performance, including not just the performance of the hotel, but also of the operator and the brand. Looking forwards at future growth, you should be able to consider whether the business is positioned appropriately, all in terms of its structure, market position, competition, customers and cost.

Strategy

Measures to be taken to improve performance can be considered, both short and long term. Additionally, a longer view might be appropriate in terms of focusing on the business strategy going forwards. This might include consideration of future hotel renovation, repositioning, asset/brand conversion, or liquidation of some parts of the business or its assets.

Corporate Structure

Equally important to business performance is its structure. Does the structure remain appropriate to the business? It may have been sensible at the outset for a hotel to be held in a personal name when the portfolio only consisted of 1 property, however, that is unlikely to remain the case for a growing business.

A health check will give business owners and lenders, an opportunity to examine the underlying corporate structure and either change or reinforce it. Consider whether new corporate vehicles should be introduced to ring-fence a business and its assets from potential risks and liabilities of other parts of the business. Consider personal liability, or succession and inheritance issues where assets are personally owned.

What are the tax implications for the existing and proposed structures – can savings be made?

Ownership, consolidation and appropriate vehicles

In tandem with ensuring the correct corporate structure is in place, portfolio ownership should also be analysed, with thought given to the various 'investment' options that may be available to the business, and consideration of whether these align with the business requirements.

In the Middle East, it is common for the hotel and the land upon which it is situated to be owned. The owner then enters into a management agreement with a third party operator to manage the hotel on the owner's behalf.

Is a different option available and if so, is it more attractive? Perhaps sale of an asset(s), or sale with a leaseback of the asset from the new owner might be worth considering? This would enable capital to be released for the owner to improve its debt position, or to take advantage of the current economic environment and purchase distressed assets, thereby providing a way for the company to reduce its risk/financial exposure, or to continue to expand.

Contractual obligations and risk analysis

For many, negotiation of a contract culminates in its signature by the parties involved, and the contract is then filed safely away never to be looked at again unless things go wrong.

No business can properly operate unless it knows what it can and cannot do, how it should operate, and how its future might be impacted by existing rights and obligations. No analysis can be complete, nor should plans be made, without understanding the contractual framework within which a business operates.

This extends not just to the hotel management and ancillary agreements, but also to the business' financial arrangements, its principal operational contracts, its staff, and the local licensing framework,

regulations and restrictions that may impact any future action. An understanding of these is therefore vital.

Does the business have any potential claims against it, or should it consider taking any claims against third parties? What is its conflict exposure and what steps can be taken, if any, to remove or mitigate these.

Conclusion

I have outlined above why, in a changing environment, it is prudent to take stock and analyse the health of your business and asset portfolio, and have given examples of what I consider to be the main areas for consideration.

The time and cost spent on undergoing such an exercise need not be huge – many of these can be looked at from a high level and where issues are identified for further examination, the exercise can then be drilled down specifically where required.

Prevention is always better than cure and a healthy business will be in a position to expand and prosper where an unhealthy one cannot.

Owners and lenders alike can benefit from such an exercise, and Al Tamimi is well-placed to assist and advise you. Our Hospitality team incorporates experienced lawyers across all legal practice areas, who have excellent relationships with experts throughout the hospitality industry.

If you would like more information, please contact Tara Marlow, Head of Hospitality on t.marlow@tamimi.com.