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Tips for Buying Management Rights in the COVID Era

Finance

As I contemplate an attempt to make some sense in this article there's an old English expression that springs to mind.

"May you live in interesting times" is claimed to be a translation of a traditional Chinese curse. While seemingly a blessing, the expression is normally used ironically; life is better in "uninteresting times" than in "interesting" ones, which are usually times of trouble. Talk about ironic alright.

Anyway, I digress.

Rather than write my usual meandering stream of consciousness I've decided to cut to the chase and outline some specific thoughts that might hopefully assist buyers to navigate a management rights purchase in a world of apparent uncertainty.

### **The Fundamentals Have Not Changed**

While the world has most certainly changed the basics of purchasing a management rights have not. The process of accounting verification, legal due diligence, finance and settlement remains the cornerstone of a successful acquisition.

Sure, there are some extra hoops to jump through and some days more hoops than others. However, it's important for buyers to appreciate that a proven process that has held the industry in very good stead with lenders continues to deliver positive outcomes. There is simply no reason to reinvent the wheel. Maybe put a couple of extra spokes in it and some performance tyres but it's still a wheel.

### **Get Pre-Qualified**

The first, and perhaps the most important step. Talk to us about your situation and gain some level of certainty. No point having a grand plan if you fall at the first hurdle. Our brokers will assess your personal and financial situation and offer guidance. They will be a sounding board and help you review opportunities, pointing out the potentially good and not so good aspects of the business you are looking

at. While we encourage anyone who is interested to research the industry there's simply no point in making listing enquiries or inspecting properties until you are pre-qualified.

The Covid era has delivered an incredibly volatile lending policy environment. It's imperative that buyers speak with a finance specialist who's talking to the banks on a daily basis.

### **Know What You Want and Why**

If you don't know where you're going any road will get you there. It's an old cliché but also pretty accurate. We encourage buyers to think long and hard about what's important and what boxes a listing needs to tick. Lenders are keenly interested in why you are buying a particular asset.

We love talking to clients about the opportunities they see in a particular listing and how best to make the deal happen. Part of that process is making the deal look as compelling as possible for lenders.

### **Insist On The Vendor Playing Fair**

While the fundamentals haven't changed there's no denying that Covid has had an impact on how we assess a lending opportunity. Regrettably, there are vendors out there who would prefer to pretend that Covid didn't happen. The vendor mindset of "I bought it this way, I'm selling the same way" needs to be avoided if possible. On the flip side of that coin there are management rights businesses that have actually benefitted from Covid driven demand. We think that vendors need to be realistic in respect of additional information and buyers have every right to ask. The bank simply doesn't care how the vendor bought or financed the asset, the game has changed.

You'll know you're in good hands when your agent has already asked the tough questions and has the answers ready.

### **Covid Impact – What Happened and What's Next?**

Lenders will focus on this question above all others. Regardless of what happened we need to explain why. If it's a holiday building enjoying record occupancy due to international travel restrictions that's great. But, what happens when borders reopen?

A permanent property may be enjoying strong rental demand based on inter and intra state migration. How much of this is Covid life change driven? Is it sustainable? Will government first home owner incentives and other economic policies impact letting pool numbers?

The trick in presenting a compelling case to a lender is to summarise how the business was travelling pre-Covid, what's happened since and what the likely future holds. The better we can demonstrate that our client understands these three Covid impact phases the more likely a finance approval.

### **Financial Due Diligence – A Mixed Bag**

I think it's fair to say that the bank's are treating every deal on it's merits when it comes to trading history, current performance and future prospects. Remember, in the absence of compelling data bank credit managers will default to their imagined worst possible scenario. We don't want that!

The historical benchmark in the industry has been the review of the past 12 months financial performance of the business. In this regard management rights are unique. No other going concern business is bought and sold on the strength of a single accounting period. I would argue that the Covid era has pushed the tide out and found our industry sans bathers.

So, what to do? At the risk of dodging the question.....it depends. For a permanent management rights in the 'burbs I'd be happy to go to the bank with a one year P and L review. The reality is that these businesses are easy to analyse with likely profitability being an outcome of a basic set of data. The industry has

developed a Covid impact info summary for permanent management rights which I think does the trick. My observation would be that the impact sheet has, to some degree, been rendered obsolete by the demonstrated resilience of permanent MLRs, many of which are showing improved trade, zero Covid arrears and rising rents.

For leisure based short stay properties the process is a little more “horses for courses”. If we come from the old adage that certainty = value then the more info the better is a good place to start. There won't be many leisure based MLRs that did not see some sort of negative Covid impact in 2020. The trick is to normalise the 2020 calendar year and achieve some sense of what sustainable net profit looks like. Setting a trend line or benchmark based on a couple of prior years makes sense so I think, if possible, a look at 2018 and 2019 calendar years is the place to start. Provided those years show trading stability or growth it's reasonable to review 2020 through the prism of year in, year out trade. I also think it's reasonable to reconstruct the 2020 P and L to identify Covid impacted months and compare those with the same trading months of the prior years. At the end of the day we are trying to assess sustainable net profit over time so a once in a lifetime event certainly needs commentary and adjustment. In my mind it's no different to having a unique event that drives occupancy and tariff up, it has to be netted out to get to the likely sustainable \$NP. If, by some miracle, Covid had zero impact on a leisure property we still need to explain why so best to be ready.

There is merit in preparing a projection based on the best market intel at this point. The report should be supported by commentary explaining what happened and why and justifying the projections. I don't think projections should be a “must have” as I've never seen one in any industry that didn't predict a positive result. However, as an indication of expectations driven by the business plan and broader economy a projected reconstruction of the 2020 calendar year P and L is a handy report to have and will be well regarded by the lenders.

Valuers appointed by the banks will certainly be looking for insight into the sustainability of the net profit so the more compelling and complete the data the better.

### **The Plan**

The last piece of the jigsaw puzzle. We encourage all buyers to write a business plan. Not some enormous document filled with waffle and motherhood statements. The plan should cut to the chase and demonstrate that you know what you're buying, why you're buying it and what you plan to do in order to be successful. We know what banks are looking for and we can help but.....it's important that you are able to articulate the why, what and how of your decision to buy a particular management rights. If you're stuck remove the title Business Plan and replace with Here's Why I Won't Go Broke.

In closing I think it's important to appreciate that we are dealing with an incredibly fluid situation and the banks are in this boat with the rest of us. Today's business plan can be rendered obsolete by a snap border closure or new strain of the dreaded virus. But, I believe Australia has managed the situation better than most. We have a very stable and well capitalised banking sector, a mostly competent government (at Federal level anyway) and a reasonable economic outlook. Add record low interest rates, a population in transition and all the big spenders trapped in Oz and I've gotta ask.....what are you waiting for ?

PS : We have had 6 different lenders approve finance for short stay leisure based management rights in the past week. Our advice, don't believe any stories you hear about banks not lending.