



**HOSPITALITY  
INSIGHTS  
2017**

Key developments  
in the sector







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Ferrier Hodgson has deep experience within the hospitality sector advising companies, financiers and other stakeholders on business strategy and financial performance for over 40 years.



# WELCOME

## Hospitality Insights 2017

Welcome to Ferrier Hodgson's 2017 Hospitality Insight Report, featuring our analysis of the key developments over the last 12 months and the outlook for the year ahead and beyond.

2016 was a very active year, and the hospitality sector was no exception. Sales pricing in 2016 remained very firm while demand continued to greatly exceed supply, driving many buyers into previously less active regional areas. The sector has seen some consolidation, and the expansion of groups such as Dixon Hospitality and Casual Dining Group have been high profile examples of the level of capital being attracted to the sector.

Very few headwinds have presented during the year, with the exception of the spectre of a rise in interest rates. Potential gaming reform and ongoing debates on extension of lockout laws create uncertainty, but have not dampened confidence in the sector, and the industry remains a strong and vibrant contributor to the Australian economy.

During 2016, Ferrier Hodgson's hospitality team managed a number of matters, including the Keystone Group (17 venues nationally), the Lucky Australian Hotel (NSW), the Orana Hotel (NSW) and the Maylands Hotel (SA). We successfully concluded sales on all venues.

Our report this year looks at sector developments and transactions that occurred in 2016 and our views on the outlook for the remainder of 2017 and beyond.



**Morgan Kelly**  
Partner  
National Hospitality Practice Leader





## 01 KEY DEVELOPMENTS

The outlook for 2017 is strong, however lender sentiment, ease of access to finance and any adverse regulatory changes may rapidly impact the market.





The industry is more competitive than ever before

- Current explosion of food and beverage focused venues
- Increasing trend towards premium beverages
- Successful operators leverage their full service offering
- Food revenue should enhance and not replace existing high margin revenue

Technology increasingly yields competitive advantage

- A well planned social media strategy is essential
- Accommodation is the next profit growth horizon – using hotel booking websites for underutilised space
- Point of sale technology and payment apps reducing customer friction
- UberEats is a game changer - potential to capitalise on new customers & increase sales

Gaming has underpinned growth in profitability and asset values

- Four years of sustained gaming growth
- Successful operators continue to recognise the importance of gaming to their bottom line
- The industry remaining very sensitive to legislative changes
- Currently few political threats to gaming reform

The outlook for the regulatory environment in New South Wales is stable

- Sydney CBD lockouts are here to stay
- Active self-regulation is critical to avoid any extension of lockout areas
- Extension of smoke free areas to cover all of a licensed premise is a possibility in the medium term (next two years)

The market is incredibly buoyant in East Coast metro areas

- Transactions were booming in 2016
- Large non-gaming groups have been active across the East Coast
- Low interest rates, a booming real estate market and strong gaming are the key drivers
- Uncertainty whether the boom will continue in 2017



## 02 ISSUES FACING THE SECTOR

Savvy operators are using technology to yield an advantage in an increasingly crowded and competitive market.

The hospitality sector is fiercely competitive. The rise of quality food, craft beer, unique customer experiences and convenience have created an arms race in the sector. This arms race is turbo-charged by competition from small bars.

This is great news for consumers but tough on operators. As standards have risen, competition has spread to other areas and offerings, accompanying revenue enhancement, social media and in-venue technology.

Whatever the offering is, the key to success is the ability to understand and focus on the target customer base.

Customers like to socialise, drink and eat, be entertained and do it safely. Depending on the demographic of the customer base, the mix and focus of any offering is refined to meet the specific requirements of that base. Engagement with customers has however changed mainly due to increasing customer empowerment.

Social media has given consumers access to information on more venues and menus than ever before, and more forums to express their views on service and quality. If someone has a bad experience, they can share that with a huge audience, immediately.

Alcohol consumption is at its lowest in 55 years according to IBISWorld. This has put pressure on revenue growth, particularly for operators who haven't embraced changes in consumer behaviour.

Australians are consuming more alcohol at home than at licensed establishments.

IBISWorld reports that liquor retailers are receiving a larger share of total alcohol spend than pubs, bars and clubs.

### 2.1 Food and Beverage

Over the last few years, there has been an increasing drive by operators to lift their game in relation to their food offering, whether by quality, provenance or "the story" behind the food. This has been driven by various factors, but largely the quality "arms race".

Food and beverage quality and venue presentation have always been the foundation of a good offering.

Specialist competitors can often provide a superior offering, by focussing on one or two items that suit their demographic customer base to create a competitive advantage and do that exceptionally well. Everything else supports the core competency and helps to differentiate from competitors.

The trend towards premium beverages means consumers are much more discerning about what they purchase. When setting the right price model, the demands of consumers need to be balanced against the need to make it pay.

There are two very important factors operators need to bear in mind when investing further in a food offering:

- Food is lower margin than beverage and gaming and has high labour costs. Getting the revenue mix wrong for a particular venue could lower margins overall.
- Focus on the target audience and avoid being everything to everyone.

An attractive food offering is a way to attract patrons and should enhance revenue, not replace other higher margin revenue. Selecting the right food service for a specific venue is critical due to its high cost and lower margin, and choice is already abundant.

Businesses are absorbing CPI increases in their cost base as consumers are sensitive to price increases. This is further compounded by a rationalisation of corporate entertaining spend, which has traditionally been a significant revenue stream for restaurants.





Watch out for the craft beer industry looking to export their products - particularly to Asia.

Per capita beer consumption in Australia has declined by just over 7.5 percent in the past five years. Although in many cases consumers are still spending the same amount through switching to a “premium product”. The craft beer and craft spirit movements are the current growth areas of the market.

We are seeing exponential growth of craft beer with young Australians who, in particular, are more knowledgeable and discerning about their choice of beer. Consumers are also showing a preference for locally-produced craft beer.

The Brewers Association of Australia and New Zealand indicates that 93 percent of beer consumed in Australia is locally-produced. Victoria is estimated to account for the largest number of craft beer producers in 2016-17, comprising 30.1 percent of the industry.

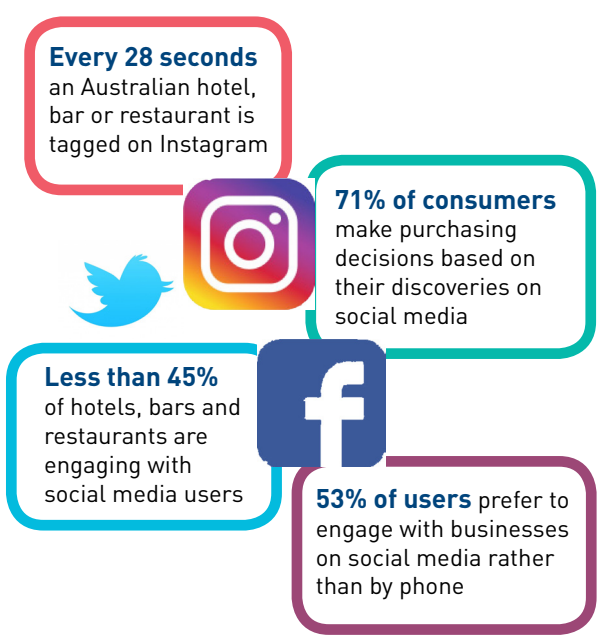
The craft beer industry currently has relatively low exports, so watch this space as more breweries look to export their product, particularly into Asia.

ABS statistics show that food entertainment spending is outpacing general retail spending.

## 2.2 Social media

From our perspective social media presents an important channel for operators to listen to their clients. A social media profile does need to be actively managed to control the story if there are any complaints or negative comments. Customer loyalty can erode quickly.

A well thought out and effective social media strategy is really important. Many banks have a dedicated resource centre for assisting their customers in social media monitoring and education.



*Hootsuite, The Connected Consumer – Rethinking the Social Customer Journey in Australia’s Hospitality and Tourism industry.*

### 2.3 Innovation and disruption in the sector

As the sector becomes even more competitive, operators need to find new ways to grow revenue and enhance their point of difference.

[Airbnb](#), [Hotels.com](#), [Wotif](#) and [Pubrooms](#) are all providing new sales channels for accommodation. Presently, some of the sector has surplus accommodation capacity that can be accessed and sold. As food, beverage and gaming revenues are maximised, accommodation becomes the next profit growth horizon.

Rooms are becoming like Uber cars – increasingly accessible to individuals on demand. Where once the pub room may have been used for storage, it can be a revenue enhancer, and customers can be effectively reached through social media, mobile apps and good venue websites with online booking software.

The rise of “Uberisation” is more than releasing unused capacity. A big part of the Uber phenomenon is the rating system, of both drivers and passengers. Diving into accommodation opens up all these issues for operators. Even without ratings, one bad experience shared quickly can have a disproportionate impact on revenue.

Everything a venue does - good and bad - is immediately reported on Facebook and becomes public knowledge.

**UberEats appears set to revolutionise the restaurant business:**

- For consumers (particularly millennials) it is bringing restaurants to their door at the touch of a button.
- Connects restaurants and pubs with a larger audience enabling them to expand their customer base.
- Launched an alcohol delivery service in Melbourne on 24 March 2017 – competitive advantage for venues with an “off premise” licence.





## 2.4 Point of sale technology

Point of sale technology represents another area of innovation by reducing customer friction. Customer friction is a term used in retail to measure the degree of difficulty a customer has in trying to give you their money.

There is a direct correlation between customer frustration and in-venue atmosphere which affects customer experience. Less friction means happier customers, which reduces the likelihood of violence or anti-social behaviour.

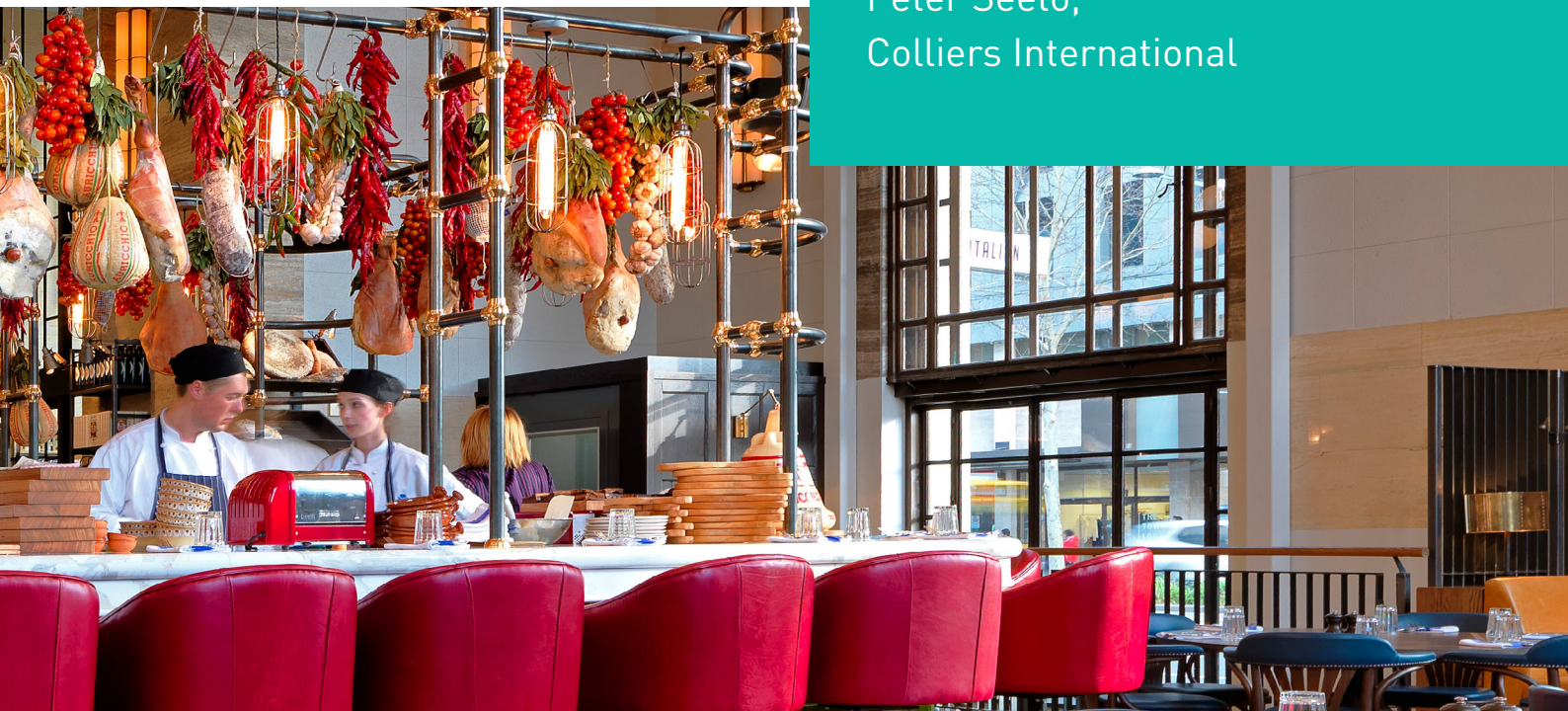
Point of sale technology and fast service reduces friction. Using apps is even more customer friendly. Free wifi is expected by customers, and paying with a smartphone is a delight.

Being a “member” by downloading an app for the venue and customer facial recognition are smart ways to make customers feel welcome, and reduce the degree of friction between the customer and the cash payment. Technology makes it easier to pay, and reduces stress at the point of sale for everyone.

Innovative use of technology must be embraced. For example, a website called “Grub Hound” allows users to enter their location and their desired cuisine, and they will locate pub specials and the cheapest food offered by nearby pubs. This gives the users secret knowledge of what is going on in the pubs locally and finds pub food venues customers want.

*“From Bondi to Bourke, we are all eating out more. As a direct result, hospitality venues are now forced, not just to have “good food” they are forced to have “great food, exceptional family facilities and quality entertainment”.*

Peter Seeto,  
Colliers International

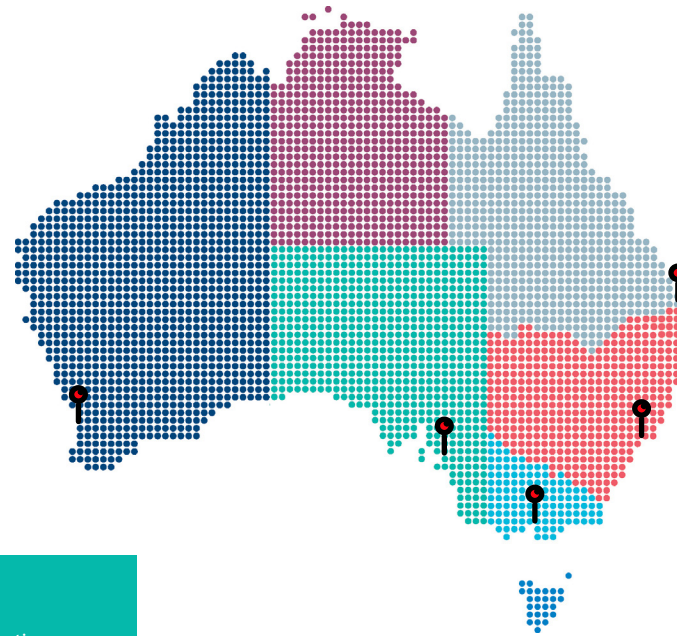


# 03 NATIONAL ROUNDUP

## Key Developments across Australia

### Western Australia

- The mining downturn has impacted hospitality operators state-wide. Businesses in regional areas have suffered substantially, particularly the accommodation sector in 'Fly In Fly Out' areas.
- Small bars and specialist cuisine restaurants are continuing to take market share away from established and traditional dining venues in Perth.
- Age and quality of the Perth hotel accommodation market is improving with many renovation and construction projects underway or recently completed: Crown Towers at Burswood, 'Como The Treasury Hotel', The Ritz Carlton at Elizabeth Quay, the Westin and Intercontinental hotels in the CBD.



### South Australia

- Introduction of small bars to the Adelaide CBD in 2013 continues to impact traditional venues. The Government has deferred a decision on extending Small Bars to the inner suburbs to 2019.
- State-wide gaming revenue has fallen to pre-2003 levels and has been further affected by the introduction of maximum bets being reduced from \$10 to \$5 from January 2017. Gaming machine entitlements are now trading at less than half (approximately \$23k to the vendor) than what was achieved in the first trading round in 2012.
- Increasing number of country hotel closures, with rising energy costs, excessive rents and declining populations being contributing factors.
- 3am lockout laws to remain whilst the first major amendments to the liquor legislation in 20 years are currently before parliament aimed at modernising the licensing system.

### Victoria

- Ban on smoking in all outdoor dining areas at restaurants, cafes, take-away shops and licence premises from 1 August 2017.
  - Estimated 22,000 business to be impacted by the new laws.
  - Potential to cause confusion around what is classified as an "outdoor dining area".
- Victoria is unlikely, in the short term, to adopt the strict lock-out laws and regulation currently seen in other states.
- Current freeze on inner city late night liquor licences to be extended until 2019 – small boutique bars with capacity under 200 are now able apply for exemptions.
- In the lead up to 2022, the Gaming Machine Arrangements Review has the potential to significantly affect the industry.

### Queensland

- Lockout laws introduced state-wide in July 2016 with 2am last drinks (3am last drinks in Safe Night Precincts).
- Amendments to bring forward the lockout to 1am for Safe Night Precincts have now been scrapped. The following measures will now be implemented:
  - ID scanners required for hotels trading past midnight in Safe Night Precincts from July 2017.
  - 2am cessation of alcohol (3am for venues in Safe Night Precincts).
  - Midnight ban on rapid intoxication, high alcohol drinks.

### New South Wales

- Renewed commitment to Sydney CBD's precinct wide lockout (1.30am lockout and 3.00am last drinks) with some minor variations:
  - Temporary 30-minute extension to lockout for live entertainment venues.
  - Bottle shops permitted to trade to 11pm, instead of 10pm as previously legislated.
- Small bar patron capacity increased from 60 to 100, and extended trading hours to 2am.
- Surge in demand for poker machine entitlements as some venue's unused gaming machine thresholds expire in the next 6 – 12 months.



## 04 REGULATORY REVIEW

Operators should continually consider the possible impacts of regulatory changes on their businesses.

The hospitality industry is heavily regulated including service of alcohol, food services preparation, provision of gaming and extensive labour laws.

This regulation ensures that the industry is well governed and provides exceptionally high standards of service and offering. In addition, it creates high barriers to entry for competitors.

The downside of such a regulated environment is the impact of any regulatory changes are twofold: (a) additional costs to ensure compliance and (b) impact on revenues.

For example, one of the biggest structural shifts in the industry was the introduction of the smoking ban (in 2007 for Victoria, New South Wales and South Australia). This had an immediate overnight impact on gaming machine revenues. Those operators who responded quickly to construct outdoor gaming areas certainly yielded a competitive advantage.

Operators should continually consider the “what if” impact of certain regulatory changes on their businesses, and formulate strategies to respond.

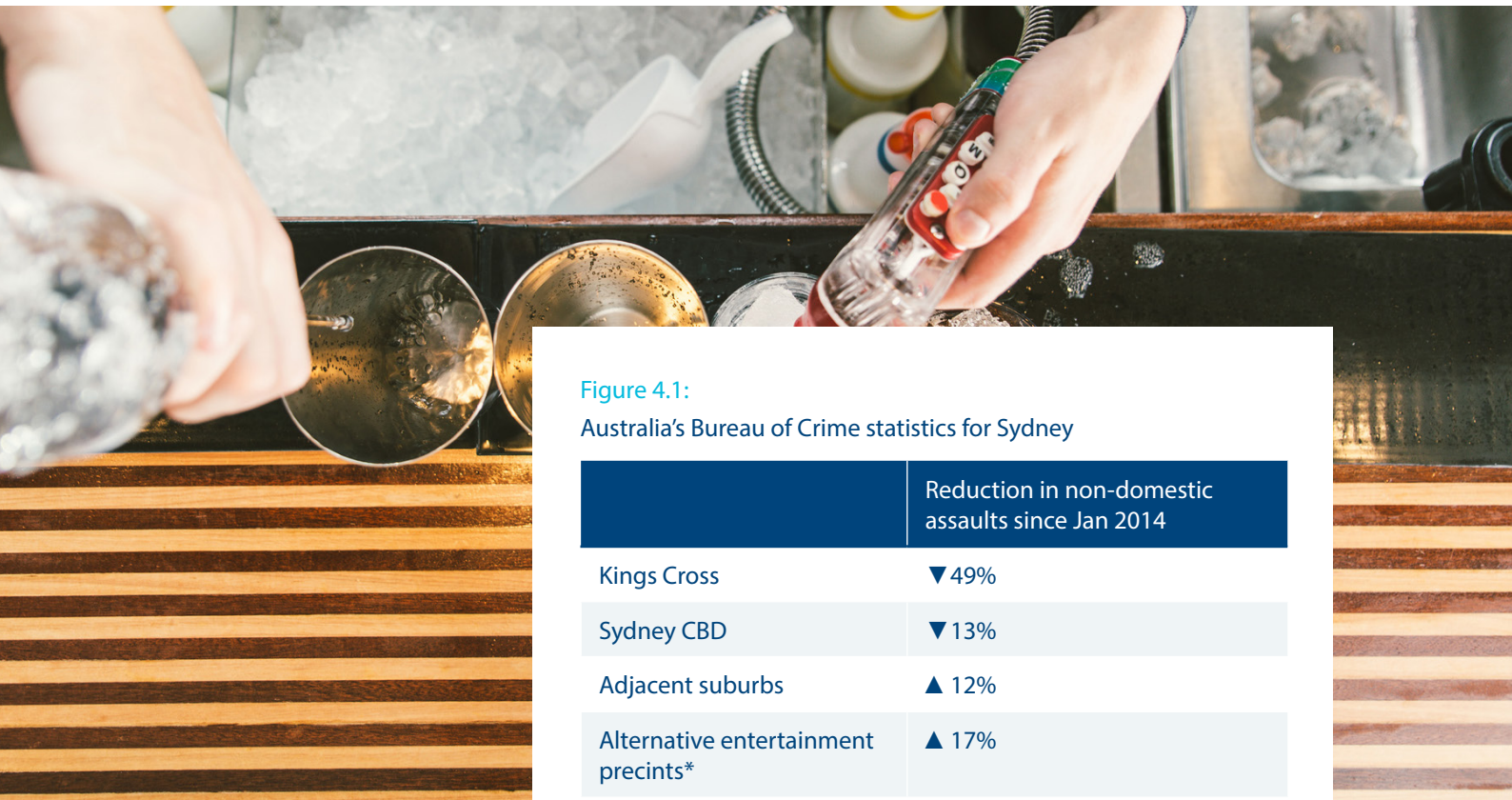


Figure 4.1:  
Australia's Bureau of Crime statistics for Sydney

	Reduction in non-domestic assaults since Jan 2014
Kings Cross	▼ 49%
Sydney CBD	▼ 13%
Adjacent suburbs	▲ 12%
Alternative entertainment precincts*	▲ 17%

Source: BOCSAR research findings

\*Bondi Beach, Coogee, Double Bay and Newtown

## 4.1 Alcohol related violence

Regulators are implementing precinct wide lockouts as a way to quickly reduce alcohol related violence in high density entertainment precincts. The intense media attention given to alcohol-related violence has spurred regulators to take wide ranging action.

One of the most contentious reforms was the Sydney CBD lockout introduced in April 2014. This restricts patron access to hotels from 1.30am, with last drinks to be served by 3.00am across the entire CBD area.

Brisbane subsequently followed suit, implementing similar lockouts albeit over a smaller precinct area. Melbourne by contrast, executed an unsuccessful three-month trial in 2008, and is unlikely to adopt any lockout conditions.

Whilst the success of a precinct wide lockout is often debated, particularly the impact on nightlife, recent Bureau of Crime statistics for Sydney support a sustained reduction in violent incidents (Figure 4.1).

This data indicates displacement of violent incidents to entertainment areas outside of the lockout zone.

The challenge for the industry is to develop self-regulating policies that not only minimise violent incidents but are also workable for patrons and operators. Full engagement with the Police and regulators is critical.

### Ferrier Hodgson's views

- *Lockouts are here to stay, particularly in New South Wales where statistics support a sustained reduction in violent assaults.*
- *More efficient use of data sharing between venues, to identify and track problem patrons, may assist in a further relaxation of the laws. For example, the ability to ban a patron from all venues within a precinct.*
- *Proactive self-regulation aimed at containing the displacement of incidents should remove the impetus to widen the precinct areas.*

## 4.2 Small bars

Small bar licences introduced in 2013 has been a game changer in the hospitality industry in New South Wales. It has permitted low cost entry into the market, and significantly lessened the barriers to entry. Many other states have similar legislation.

As a result, competition for the traditional full service hotel has flourished. In the Sydney CBD alone, over 50 small bars have been opened over the last four years.

Small bars are not without their operational challenges: difficulties in securing finance, high labour costs and often space constraints (maximum 60 patrons), resulting in poor economies of scale. In addition, there are limited options for an operator to sell their investment and trade up in the market.

### Ferrier Hodgson's views

- *The operational challenges mean venues have a two to three year life span.*
- *Small bars initially took market share from traditional hotels, however these venues have responded to the increased competition—by improving their premium alcohol range and food offering, and investing to regularly refresh venues.*
- *The full service hotel will always have exceptionally high barriers to entry and be better equipped to respond to competitive changes.*



### 4.3 Smoking

Smoking in hotels was banned by all states and territories progressively, and by 1 July 2007, smoking was outlawed in all venues nationally.

The impact of this regulatory change took most of the industry by surprise. Revenues in some venues dropped by up to 20% almost immediately. Gaming focused venues were particularly impacted, as patrons broke their gaming to take cigarette breaks.

In Victoria, a high number of non-gaming venues saw an immediate increase in revenue following the introduction of these smoking laws and it was likely the start of the gastro pub food revolution.

Whilst there are no current intentions to extend the existing ban, there is likely to be pressure from a public health perspective to take further action. For example, smoking was outlawed in outdoor dining areas in New South Wales and South Australia with effect from July 2015 and July 2016 respectively, and due to come into effect in Victoria on 1 August 2017.

Such further action may involve the total ban on smoking anywhere within the boundaries of licensed premises.

### Ferrier Hodgson's views

- *Whilst industry lobbying is strong, we see no smoking within the boundaries as an inevitable next step in the extension of smoke free areas.*
- *Any revised legislation would likely be introduced over a long lead time, possibly over 2 years to allow operators to plan for any changes.*
- *Gaming reliant hotels will be most heavily impacted by the reforms, particularly those that have heavily invested in outdoor gaming areas and not yet recouped their return on investment.*



## 05 GAMING ROUND UP

Gaming is central to the industry's growth and profitability.

The introduction of gaming to hotels in the late 1990s in New South Wales was a key turning point for the hospitality industry. This generated reliable revenues, sustainable and quality profits and created significant barriers to entry, in turn driving up asset values and investment in the sector.

Gaming is central to the hospitality industry's growth and profitability and has benefited from four years of consecutive year-on-year growth. Drivers behind this growth include:

- Rising household discretionary income, as a result of low interest rates.
- High levels of inbound tourism, particularly from the Asian middle classes who are increasing self touring as opposed to travelling on group tours.
- Most importantly, improvements in technology creating an enhanced customer experience. Examples include:
  - Greater use of Ticket In Ticket Out (TITO) machines – allowing players to transfer their winnings between poker machines or withdraw their winnings without requiring interaction with a cashier.
  - More enhanced games such as Aristocrat's Lightning Cash, which is proving exceptionally popular and is the highest performing game for many hotels.
  - More linked machines, meaning a number of different players can contribute to the same progressive jackpots as they play.





Successful operators continue to recognise the importance of gaming to their bottom line, and continually invest in gaming upgrades and hardware. Key themes for success are:

- High levels of customer service
- Up-to-date hardware and in-demand games
- Well designed and constructed smoking solutions
- A discreet gaming environment

Growing other revenue streams (particularly food) can have an impact on operator's gaming revenues. A reasonable balance should be struck between revenue streams to maximise overall profitability.

Whilst gaming will always be a very desirable revenue stream for hoteliers, it is exposed to a variety of legislative and digital threats:

- Poker machine reform (such as pre-commitment technology or implementing a maximum bet) - \$1 maximum bet is the biggest threat to profitability, limiting player losses from \$1,200 per hour to \$120 per hour. There does, however, appear to be limited political pressure to reform gaming in the short to medium term.
- Extensions to the smoking ban to include outdoor gaming rooms have the potential to negatively impact profits, particularly for those venues that have yet to recoup investment in these areas.



- Digital disruption from apps, mobile devices and online sites that offer a similar gaming experience:
  - From anecdotal evidence, online gaming does not appear to have impacted traditional poker machine gaming.
  - The player environment is the most critical element of poker gaming, and this is very difficult to replicate with mobile devices.
  - The ability for a venue such as a small bar to provide the player environment with a Bring Your Own Device (BYOD) offering remains a risk, as evidenced by a downsizing on TAB in pubs due to the rise in mobile betting.
- Gaming machine tax thresholds provide an opportunity for State Governments to increase their revenue. While not currently contemplated, an increase to the top tax threshold cannot be ruled out in the medium to longer term.

Overall, the industry perception is that there will be very few headwinds to gaming in the short to medium term and the outlook is positive, stimulating significant demand for gaming hotel assets.

We caution that the hospitality industry as a whole is very sensitive to any proposed or introduced legislative changes to gaming and any uncertain political environment can quickly change sentiment in the sector.

## New South Wales Market – in depth view

From our analysis of the quarterly ranking of the state's gaming hotels:

- Sydney CBD venues have experienced a sharp decline in gaming profitability over the last 2 years largely due to declining late night trade from the lockout laws:
  - A review of approximately 180 existing venues in the CBD show an average decline in gaming profitability ranking of seven points.
  - Up to 24 gaming premises in the Sydney CBD area have ceased to trade since December 2014.
- Gaming venues in Western Sydney have demonstrated a steady rise in rankings in the last two years. This region continues to be the most profitable area for gaming venues across New South Wales.
- Coastal gaming venues, in turn, have experienced a healthy growth in profitability. A review of venues in this region (total of approx. 320) indicate an average improvement in ranking of seven points by each venue.

The table overleaf (Figure 5.1) shows the top 20 ranking venues across New South Wales as at December 2016 are clustered around outer-ring lower socioeconomic areas.

***“Over the past 18 months we’ve enjoyed the good fortune to manage the sale of in excess of 20 landmark hotels in Sydney and Brisbane, and the quality of purchaser profile for each has been a consistent theme. Fundamentally, purchasers in this market are better funded, better informed and better served by operational experience and competency; and these key factors underwrite our considered view that the prevailing market strength, and depth, will continue well beyond 2017.”***

Andrew Jolliffe,  
Ray White Hotels



Figure 5.1:

Top 20 ranking venues across New South Wales

Name	Suburb	Postcode	Local Government Area	State Profit Ranking Dec 2016	State Profit Ranking Dec 2014	State Profit Ranking Dec 2012
El Cortez	Canley Heights	2166	Fairfield City Council	1	1	1
Railway Hotel	Lidcombe	2141	Auburn City Council	2	2	11
Eastwood Hotel	Eastwood	2122	Ryde City Council	3	5	3
Twin Willows Hotel	Bass Hill	2197	Bankstown City Council	4	9	2
Crossroads Hotel	Casula	2170	Liverpool City Council	5	10	7
Campsie Hotel	Campsie	2194	Canterbury City Council	6	7	8
Markets Hotel	Flemington	2140	Strathfield Municipal Council	7	18	19
Meridian Hotel	Hurstville	2220	Hurstville City Council	8	6	10
Berala Hotel	Berala	2141	Auburn City Council	9	15	34
Sefton Hotel	Sefton	2162	Bankstown City Council	10	11	9
Keighery Hotel	Auburn	2144	Auburn City Council	11	21	24
Pitchards Hotel	Mount Pritchard	2170	Fairfield City Council	12	4	4
Oasis on Beamish	Campsie	2194	Canterbury City Council	13	13	6
Greenfield Tavern Hotel	Greenfield Park	2176	Fairfield City Council	12	4	4
Ermington Club Hotel	Ermington	2115	Parramatta City Council	15	8	22
The Crown Hotel	Revesby	2212	Bankstown City Council	16	25	38
Cabramatta Club	Cabramatta	2166	Fairfield City Council	17	19	16
Belmore Hotel	Belmore	2192	Canterbury City Council	18	44	26
Gladesville Hotel	Gladesville	2111	Ryde City Council	19	26	248
Burwood Hotel	Burwood	2134	Burwood City Council	20	12	25

## Victorian Review of Gaming Machine entitlements in the lead up to 2022

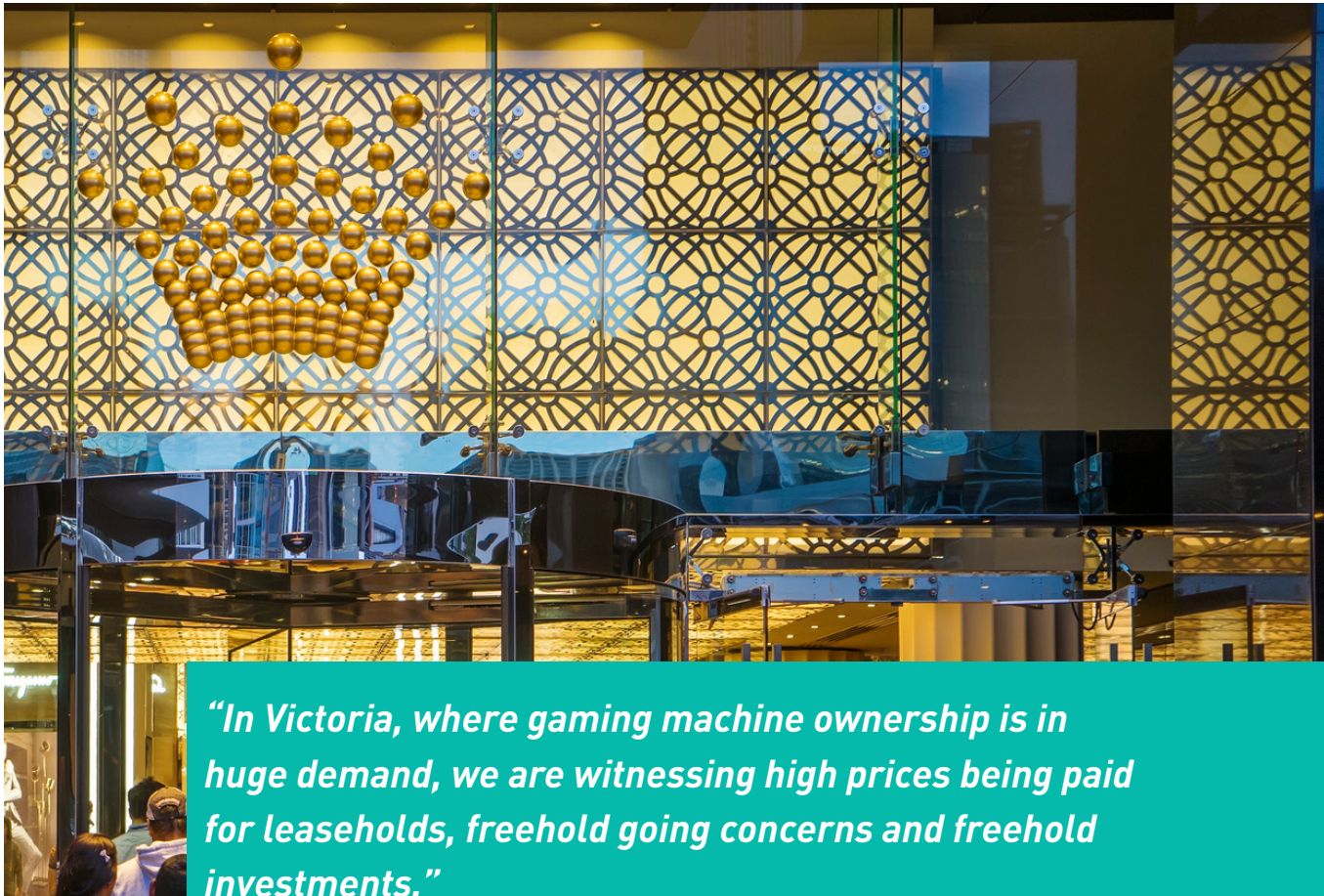
Victorian gaming entitlements are due to expire on 15 August 2022. In preparation, the Victorian Department of Justice and Regulation announced in 2015 the Gaming Machine Arrangements Review to look at:

- Whether the current entitlement model met its objectives
- How venues, own and operate gaming machines
- The distribution of machines between hotels and clubs
- The length of entitlements

The review is being conducted in two stages:

- Stage 1 – To broadly assess the venue operator model and review the regulatory settings and changes required.
- Stage 2 – Timelines for this stage are yet to be determined. This stage will implement reforms from Stage 1.

Proposed changes are expected to be announced shortly and are likely to extend the current entitlements by 20 years, with the price to be set based on machine expenditure and potentially payable over four years.



***“In Victoria, where gaming machine ownership is in huge demand, we are witnessing high prices being paid for leaseholds, freehold going concerns and freehold investments.”***

Mathew George,  
JLL



# 06 SUCCESS FACTORS

Businesses that underperform lack real-time and accurate data to make decisions.

In our experience, well run hospitality businesses routinely benchmark their performance to industry average to ensure their performance is optimal. Point of Sale technology is used by operators to provide real time data to assist in decision making.

Benchmarking is especially important in pubs and hotels, as these venues comprise several businesses under one umbrella – for example gaming, accommodation, bistro and bottle shop. It is important to assess each business unit to ensure it is operating effectively.

Businesses that underperform almost always lack real time and accurate data to make decisions. Some key fundamentals are:

- Labour – effective rostering and real time management of wages. This is particularly relevant for labour intensive service lines such as bistro operations.
- Stock margins and pricing – monitoring of wastage and being prudent to pass on any supplier price increases.
- Cash management – identifying and managing any variances as soon as they arise.
- Capital expenditure – providing for an appropriate amount of capital to be reinvested in the venue. Investment in technology should be a key component of any capex plan.



**Figure 6.1:**  
Provision for refurbishment cycles

	Paint / maintain	Capital refurbishment
CBD - Contemporary	2 - 4 years	4 - 6 years
CBD - Traditional	3 - 6 years	7+ years
Suburban	7 - 10 years	7+ years
Country	7 - 10 years	10+ years

For many operators, bistro operations are their achilles heel. Food operations present challenges in controlling food costs and labour margins, plus many operators have difficulties in attracting and retaining qualified chefs. Due to the wage competition in the industry, turnover of qualified kitchen staff is often very high, again adding to the challenges of food operations.

One of the common denominators we see in distressed venues is the failure to reinvest. Very quickly market share is lost, and the ensuing spiral of declining revenue, declining profits and declining capex results in lower asset values. Quality operators are those who read the market and constantly improve the quality of their offering.

From our experience, operators should be making adequate provision for the following refurbishment cycles (Figure 6.1).

Each venue will differ according to factors such as the intensity of local competition, the intensity of venue usage, whether the venue is contemporary or traditional and any overhang of repairs and maintenance.

## Ferrier Hodgson's views

- *Real time information is key to running an efficient business and successful operators use technology to help control their business and take informed decisions.*
- *Benchmarking of each business unit enables sub-optimal business units to be identified.*
- *Capital expenditure is critical and failure to provision, or being capially constrained leads to a venue becoming less attractive to its patrons and a downward spiral in performance.*





# 07 2016 DEAL REVIEW: MARKET SENTIMENT, VALUES AND PRICING

Market demand greatly outstripped supply for quality metropolitan assets.

2016 was a watershed year for the hotel industry and its busiest since 2006. Over \$800 million of hotels were transacted nationally and of which over \$500 million were in the New South Wales.

Broadly the boom in transactions is being driven by:

- A resilient Australian economy underpinned by low interest rates, encouraging investors to seek better returns outside of deposits.
- Availability and flexibility of credit to the sector, giving operators the ability to use equity gains in existing assets to part fund new acquisitions.
- Good revenue growth as a result of strong consumer confidence and spending, and increased levels of inbound tourism.
- A booming residential property market, underpinning the market value of pub landholdings.

The strength in the hotel market over the course of 2016 has primarily been focussed on the East Coast, where pub operators are benefitting from strong year-on-year growth in gaming revenue, as well as an exceptionally strong property market.

By contrast Western Australia, South Australia and country areas of Victoria, New South Wales and Queensland have experienced a relatively flat year.

For metropolitan areas of Victoria, New South Wales and Queensland, the simple economic force is demand greatly outstripping supply – resulting in a fiercely competitive market with sharp pricing for the right assets. An entry level metropolitan hotel is now well beyond the reach of a new entrant to the market, causing demand to push into regional areas.

Leaseholds were the traditional low cost entry to the market for new operators. Access to finance to fund leaseholds has become increasingly difficult, marked by relatively few leasehold sales in 2016. Lenders are still mindful of the enforcement issues they experienced with leaseholds in the years since the GFC.

The low interest rate environment has also stimulated the return of investors to the hotel sector. Sale of lessor's interests, even in country areas, are in high demand. Whilst these investments provide better returns than other options in the market, risks for investors are significantly higher – securing a strong tenant with sound operational experience will help mitigate these risks.



## Ferrier Hodgson's views

- *Market sentiment is exceptionally strong for well-located assets with good revenue growth potential (linked to population growth and employment opportunities). Hotels underpinned by strong gaming have been particularly in demand:*
  - *Uncle Bucks Tavern, Mount Druitt (NSW) – \$25m\**
  - *Ambarvale Tavern, Ambarvale (NSW) – \$21m\**
  - *Five Dock Hotel, Five Dock (NSW) – \$29m\**
- *Large, once in a generation landmark assets were bought to the market in 2016 as skilled operators took advantage of sharp pricing:*
  - *Commodore Hotel, North Sydney (NSW) – \$15m\**
  - *Colombian Hotel, Darlinghurst (NSW) – \$15m\**
- *A ripple effect is becoming evident, as priced out buyers are increasingly competing for opportunities outside of capital cities.*
- *Hotels in strong regional centres, with balanced employment, population growth and excellent transport links to a capital city are now in higher demand:*
  - *Bradford Hotel, Rutherford (NSW) – \$11m\**
  - *Swansea Hotel, Swansea (NSW) – \$13m\**
  - *Nags Head Hotel, Adamstown (NSW) – \$10m\**
- *Areas with struggling economic growth have seen flat demand for assets – for example South Australia and regional areas in most states, and mining exposed areas in Western Australia:*
  - *Central Hotel, Singleton (NSW) – price undisclosed*
  - *Hotel Cessnock, Cessnock (NSW) – price undisclosed*
  - *Maylands Hotel, Maylands (SA) – \$6m\**
  - *Earl of Leicester Hotel, Adelaide (SA) – \$5.7m\**

*\* Estimated sales price*

## Keystone case study

*In July 2016, Ferrier Hodgson conducted a comprehensive marketing campaign in conjunction with CBRE to sell the Keystone portfolio of 17 hotels, bars and restaurant assets.*

*We conducted a multi-faceted campaign to target all streams of potential interest, ranging from private equity participants and large scale hospitality operators to individual owner operators.*

*We were able to leverage competitive tension from a range of portfolio, segment and individual buyers to maximise the eventual sales price.*

*The significant interest from the campaign reinforced that well established and well located food and beverage brands are highly desirable, as well as the unique opportunity to acquire immediate size and scale in the industry.*



## 08 OUTLOOK FOR 2017 AND BEYOND

Lender sentiment, access to finance and adverse regulatory changes may impact the market.

### Impact of proposed changes to 457 visas

The decision to scrap the 457 visa program could create challenges for the hospitality industry, which is heavily dependent on skilled workers to fill gaps in the local labour market due to:

- Growth in the hospitality industry as a result of the restaurant boom, expansion of bars and catering services along with growth in hotels and convention centre developments.
- Australian culture around the hospitality industry being a platform for in between jobs, e.g. limited “career waiters”.
- Seasonality issues in peak tourist locations.

Cooks are the largest occupation class in the 457 visa program. Skills shortages may result in increased wage competition for kitchen staff.

### Our predictions

Some industry experts believe that the hotel market is starting to exhibit signs of overheating, as a result of the incredibly firm pricing experienced in 2016.

The start of 2017 has not experienced the same level and intensity of sales witnessed in 2016, and it is too early to tell whether the market is continuing to run hot.

Whilst the market is demonstrating some similar characteristics to the pre GFC era – sharp pricing and yields, high demand from investors – the circumstances are very different.

The main drivers of the significant correction in mid-2007 was the perfect storm of:

- Scarce availability of credit due to the GFC
- Smoking laws impacting revenues and profitability

Both lender appetite and the current regulatory framework appear stable and there are no significant headwinds that are currently present. A correction would only be likely if there was a significant change in either of these areas.

One area warranting caution is food and beverage venues. Many operators are making a strategic decision to focus on these revenue streams to the exclusion of gaming and other full service hotel offerings. Competition in food and beverage is intense, and the market as a whole has been fortunate to experience year-on-year growth in consumer spending for some years.

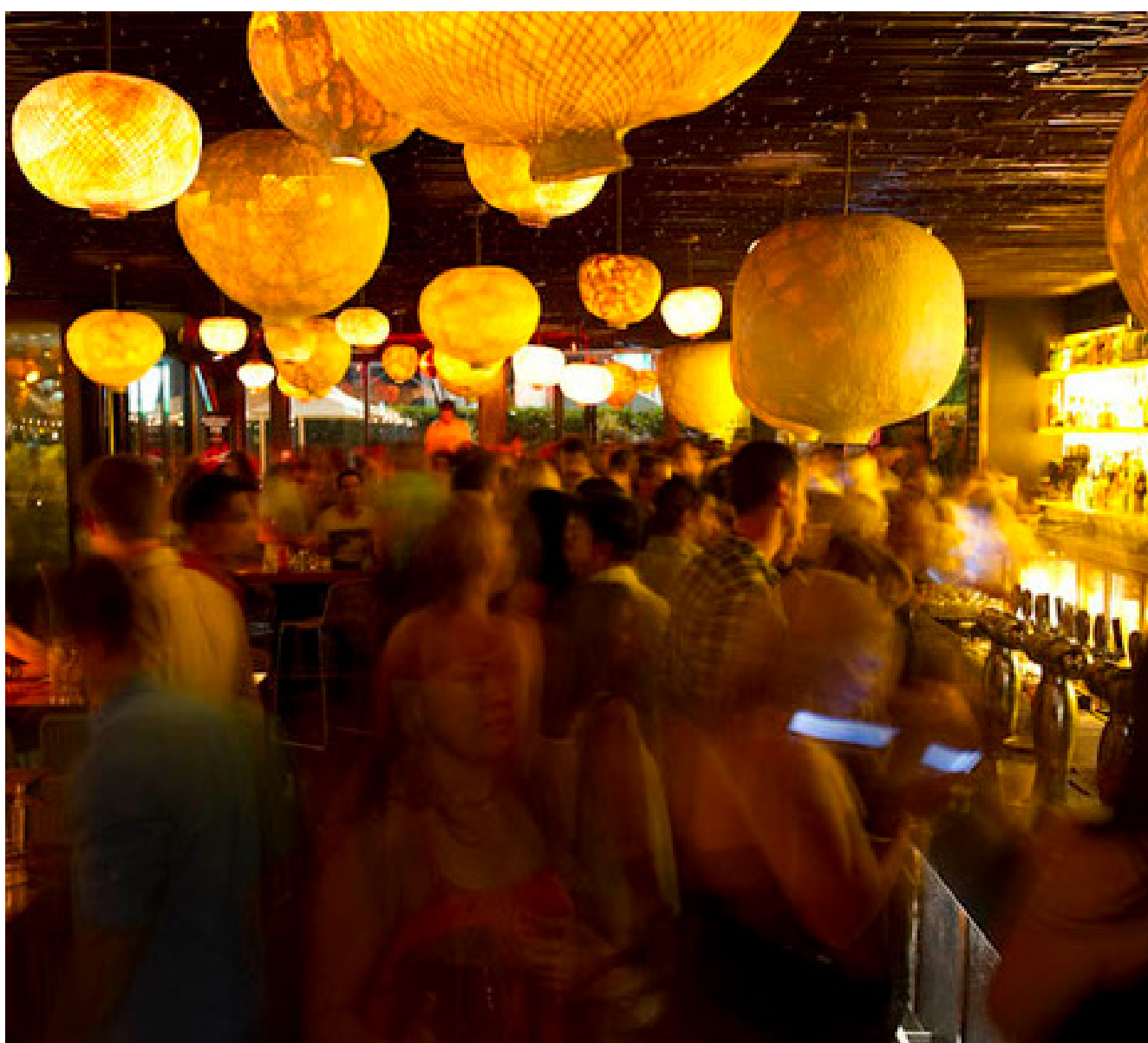
If household budgets become strained, and consumer spending stagnates or contracts, there will likely be a level of distress for some of these venues. Hotels with gaming have a significant advantage in that gaming revenues are usually constant, regardless of disposable income levels.

***“The same opportunities exist as they always have - developing good ideas and talent will continue to thrive in the hospitality sector. Biggest threats would have to be the reluctant banking sector and access to capital.”***

Fraser Short,  
The Sydney Collective

## Ferrier Hodgson's predictions

- *There will be a lack of quality stock to the market in 2017. Gaming assets are in high demand and short supply to the market, following a high volume of sales in 2016. We could continue to see sharper pricing for the right assets.*
- *The ripple effect will continue for some coastal and regional areas, with priced out operators continuing to explore opportunities in strong regional centres.*
- *Food and beverage style assets will be sensitive to any upwards movement in interest rates. The increased competition for the available spend may see more of these assets come to the market. Appetite and pricing for food and beverage style assets is relatively untested.*
- *There will continue to be little activity for leaseholds, with funding options for these types of assets remaining limited.*
- *As has always been the case for the sector, lender sentiment, ease of access to finance and any adverse regulatory changes may rapidly impact the market.*





# ABOUT FERRIER HODGSON

Ferrier Hodgson is a market leader in advisory and restructuring services to the hospitality industry, having successfully partnered with financiers and operators in the industry for over 40 years.

We understand the key drivers to the industry – regulation, access to finance and consumer trends and behaviour – and are adept at recognising problems with financial performance or operations, and identifying and implementing practical solutions.

Our hospitality team have assisted businesses transition throughout their whole life cycle, from obtaining finance, implementing new strategies and expansion to navigating more challenging times. Our extensive experience means we can quickly formulate innovative, practically focused solutions and strategies for complex situations.

Our services include:

- Due diligence services: acquisitions, divestments and portfolio reviews
- Strategic business reviews: pre-lending, performance improvement and strategic planning
- Assistance in obtaining debt or equity funding
- Business restructuring and change management

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