

Australia: Key Industry Players – Focus on David Simpson, AXSIA

In brief

Whether it be negotiating hotel management agreements, branded residence agreements, hotel sales and purchases or other hotel and resort related transactions, we usually work in conjunction with highly qualified and experienced hotel consultants. The contribution each consultant makes to the transaction and the way the consultants interact can add significant value to the client. In this newsletter we highlight the contribution made by David Simpson, Managing Director, AXSIA and his team.

In this newsletter we devised the questions and David provided the responses.

Contents

[In more detail](#)

[Conclusion](#)

[Contact Us](#)

In more detail

Question	Answer
<p>Why should an owner use an experienced commercial adviser in hotel management agreement negotiations?</p>	<p>Owners should complete a thorough project evaluation before talking to operators and brands. This includes determining the optimal market positioning and development of plans to meet the needs of the target market customer in a way that creates competitive advantage over the competitive market.</p> <p>It is important to evaluate the feasibility of a hotel project independently and experienced commercial advisors know what is required to engage with brands and operators.</p> <p>In talking to brands/operators, there is strength by knowing that the owner has a solid team in place and that feasibility has been tested as this gets the right level of engagement.</p> <p>Operator projections are there to test whether they understand the project and market positioning. Their projections are not underpinned (unless there are guarantees at proforma level) and should not be relied upon for investment decisions. We will typically look to see alignment with our own projections and then follow up to understand differing assumptions.</p> <p>Many times, we see owners who are displeased because the first year operating budget differs greatly from the proforma.</p> <p>Owners can have valuers review the project feasibility which can provide leverage for closing out negotiations with operators and brands.</p>
<p>As a person who, in a past life, has deep experience as a senior executive for an international hotel operating company, how do you think that this impacts on your approach to deal with hotel operating companies?</p>	<p>We believe the operating and brand companies have a very real value proposition. Mainly distribution and revenue systems that contribute to achieving strong RevPAR. When we do the analysis, we believe that owners can get a solid return on a management and/or franchise agreement.</p> <p>The difference is that these groups are managing a system of hotels and the owner is only really interested in their investment. It requires a bespoke approach which we believe the operators/ brands do not always deliver.</p> <p>We have in the past, perhaps arrogantly, referred to the brand company as a Mercedes and that Axsia is the AMG kit to really enhance performance.</p>

<p>Do you have a preferred approach to such negotiations</p>	<p>We talk openly with operators and they understand our perspective. We have demonstrated how our involvement not only helps owners but improves their management fees.</p> <p>It is hard for operators to promote us given some of their owners expect them to optimise performance. However, our relationship with operators and brands is strong. They know what we try to do and why and that we have the required depth of experience to do that while respecting the brand and the management company.</p>
<p>Studies show that HMA commercial terms negotiated by owners for Australian hotel are generally more owner friendly than is the case elsewhere in the world. Do you know why?</p>	<p>In Australia, owners know they are bound by the agreements they sign and that the agreement itself has a significant impact on the valuation of a hotel and market attractiveness on sale. This may not always be the case in other countries. So our more sophisticated owners typically negotiate hard.</p> <p>Also, there is the fundamental need to be able to finance a hotel and the banks and non-bank lenders have strict requirements. Valuers understand this and the impact commercial terms have on values. Engaging the right level of help gives the owner leverage to negotiate a strong deal that is bankable.</p> <p>Where we see terrible deals, it is usually the owner acting without the benefit of good advice.</p>
<p>In your role as an asset manager what benefits are you able to bring to an owner?</p>	<p>When we do profit projections as part of a feasibility, we say to the owner that we stand behind our projections subject to two key issues:</p> <ol style="list-style-type: none"> 1. That the macro market performance is consistent with our projections. No operator can be held accountable for market shocks. 2. That the hotel is well managed; this includes asset management. <p>In asset management, our core focus is to deliver the projected profit that underpinned the investment decision to proceed.</p> <p>Our core focus is to have a solid strategic plan that drives stabilised performance and that we have (or the operator has) the right team in place to execute the strategy.</p> <p>We consider RevPAR growth in two ways:</p> <ul style="list-style-type: none"> • Natural RGI (RevPAR share) – what is the right compset and how does the hotel measure up based on physical attributes such as location, brand, facilities etc. This gives the minimum level of acceptable performance. • Strategy – by understanding your target market consumer and delivering guest experience, we believe a hotel has potential to exceed Natural RGI performance. <p>And we believe that a hotel needs a stronger team to build a business from opening than is required post stabilisation. We consider investment rather than cost.</p>
<p>What are your thoughts on how a lawyer and a commercial adviser should work together in relation to HMA negotiations and specifically in relation to</p>	<p>We typically negotiate the term sheet for owner before having the lawyer complete a review. We believe that the lawyer's review is important.</p> <ul style="list-style-type: none"> • The good hotel lawyers see deals every day and have a good feel of what operators and brands may or may not agree to. We do not mind if they pick up an opportunity to improve the deal that we may have missed.

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<p>the term sheet negotiation phase.</p>	<ul style="list-style-type: none"> • They can make sure the legalities are dealt with properly. • Most importantly, they can help to identify key issues that are typically saved for the HMA that need to be brought forward into the term sheet – items that have potential to kill the deal.
<p>Should a vendor and/or purchaser use a commercial adviser and why?</p>	<ul style="list-style-type: none"> ○ Vendor, yes: <ul style="list-style-type: none"> • Typically, the operator will not provide future projections beyond the annual plan and latest annual forecast. • It can assist the vendor to get a better price if the market understands future trading potential. • We would come in and do a review of the hotel trading and identify opportunities for profit and value growth. • If our report is not favourable, then the vendor can shelve it. ○ Purchaser, yes: <ul style="list-style-type: none"> • We believe that the buyer should have a strategy to execute post-acquisition and how that strategy can grow value, what capex is required, etc. • Renovation – this provides an opportunity to uplift a hotel from one class (e.g., upscale to upper upscale) to another. • Changing operator/brand (termination on sale). Purchasers need to understand the options and the impact of doing so. • This is harder for purchasers to engage unless they have a preferred seat at the table. We would normally come in and do some initial work which can be expanded if the buyer gets preferred.
<p>Do you see a role for a commercial adviser in branded residence negotiations acting for either the brand owner or the developer?</p>	<p>Yes. This area is a potential minefield but with potentially significant upside if you get it right.</p> <p>Most think the branded license fee is the key issue where we see other issues that get overlooked.</p> <p>For example:</p> <ul style="list-style-type: none"> • Brand’s approval rights over the residential architectural plans. • Brand’s approval rights over sales contracts. • Bankability – limitations on residential settlement if the hotel is not open. • One-time license that is not available to the purchaser on their sale. <p>The license fee can be negotiated and if the developer gets it right, the price per square meter can be higher and there is potential for improving velocity of sale.</p>

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	Axsia has been involved in negotiations on behalf of the developer for two of the three branded residential projects in Australia and many deals acting for the operator companies in previous lives.
Branded residences have not taken off in Australia at the same rate as elsewhere is Asia Pacific and other parts of the world. Why?	<p>These deals are very complex and can be expensive. Unlike other markets, the proof that this investment works for the developer is limited compared to other markets where premiums can be as high as 30-40%.</p> <p>We suggest the branded operators should be driving this with preferential terms on signature deals to help prove their own value proposition.</p>
Anything else you would like to comment on?	<p>We find many owners look at the cost of advice rather than the value. If we cost an owner \$XXk per annum in asset management but can deliver AUD 10 – AUD 20 million in value uplift over 2-3 years, then we think that is a no-brainer.</p> <p>Same logic applies if we can help an owner to improve the commercial deal on a new hotel development.</p> <p>According to our industry colleagues in North America, hotel operators are the number one referrer of asset managers. This is because the owner considers asset management as a critical component to execute strategy and the operator would rather have a good asset manager than a poor one.</p> <p>We, as an industry here in Australia, need to do more to promote the benefits of good strategic advice through asset management and then we are happy to compete for our share with other experienced consultants.</p>

Conclusion

David is a senior industry advisor who, in conjunction with his highly qualified team, usually advises owners in negotiations with operators. As David worked in numerous roles with a major international operating company before establishing AXSIA, he brings a very thoughtful perspective to the role that operators can play in maximising hotel profitability.

There is no doubting that operators generally add value to hotel performance, the true skill is to know how to fashion the relationship, as well as the incentives and drivers that underpin it to maximize such performance. We are very grateful to David for taking time out from his very busy schedule to participate in the preparation of this newsletter. There are other industry consultants we are keen to focus on in future newsletters. We trust that you find this engagement with David as interesting and thought provoking as we have.

So, there you have it the views and insights of a genuine industry insider with heaps of experience

As lawyers, we should also point out that the comments made in this newsletter are for general information purposes only and should not be relied on in any specific situation.

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