EVALUATING BeU LTD PURCHASE

Detailed Internal Analysis Upon MT-BeU Venture Acquisition

A necessary basis for evaluation is a profit forecast applying MT management's suggestions using the following assumptions:

- Given hotels involve highly geared operations (Jeffrey et al., 2002) and BeU's gearing position, to accommodate the occupancy threshold, fixed-costs are stepped at 75% by increasing staff costs (5%).
- BeU's forecast is reliable; change in occupancy is expected to be 68%: 2022 and 75%: 2023 at £150.
- If/when implemented, MT expertise can reduce fixed costs by at least 10%.

Key calculations in Appendix

STRENGTHS	WEAKNESSES
• Well established with 14 hotels operating in large European cities, the most popular touristic continent (United Nations World Tourism Organisation [UNWTO], 2021). • Perceived as premium product whereby many customers are not too price sensitive allowing to capitalise on differential pricing. • Core operations are already effective as BeU's pre-pandemic performance was quite successful achieving high revenues (2019: £21,681,000) with plenty of free cashflow (EBITDA 2019: £489,802,000; margin: 23%) with lower debt and interest payments compared to pandemic levels. • Having free and healthy cashflow (proxied by EBITDA) allows for readily available cash for investments/expansion plans or for any emergencies needed for starting working capital. • Easier and cheaper access to loans given MT's reputation and level of risk with WACC at 6%. • Increasing occupancy to 75% upon price change allows for better profitability (fully in appendix) highlighted by EBITDA and positive residual income using required rate of return (6%) starting from 2023 (forecasted £140,783,000) allowing for greater investment for future operations. • MT capabilities in focusing internal operations to maximise output is key given operations are highly geared (BeU C/S ratios between 77.49% and 78.87%), so maximising occupancy leads to contribution better covering high fixed costs. • MT's variety of unique resources and core competencies accompanied by experience in the tourism industry, powered by organisational support, gives a competitive advantage thus will make it difficult for competitors to imitate.	• Weak financial and cost management systems in place from Daisy's management requires costs and time to replace with new systems disrupting operations. • Implementation of MT unique resources and core competencies is not instantaneous and takes time thus any effects will take a while to reflect on financial performance. • Lacking focus on marketing; decreasing investment in marketing (marketing costs -to-revenue; 2018: 1.46%, 2021: 0.63%) where it is a key factor to boost sales. • Upon venture acquisition there will be significant short-term and long-term debt to cover with current ratios (2019:0.31, 2021/2022: 0.17) worsening and absolute numbers of non-current liabilities increasing and forecasted to increase (BeU balance sheets) stemming from struggling operations from the pandemic. • Cost-cutting attempts in place are unsuccessful, depicted by absolute numbers of fixed costs, new hotel in 2019 led to building costs increasing but operating profit margin did not reflect substantially greater contribution of £1,806,290 (OPM 2018: 6.65%, 2019: 8.52%). This indicates costs are being cut in the wrong areas with unreliable supplies possibly compromising quality given complaints of sometimes average service. • Profitability indicators (fully in appendix) shows operational inefficiency/low profitability from investment perspective with return on profit [ROCE] always being low since 2018 (1.90%) and forecasted to increase slightly in both 2022 forecasts (3.34%), furthermore residual income using MT's required rate of return shows negative residual income in first year (2022 new forecast: -£5,575,000).

Detailed External Analysis Upon MT-BeU Venture Acquisition

OPPORTUNITIES	THREATS
• Investing in bringing MT's robust operating systems and strong controls to Europe and embedding such systems brings significant utility in effective cost management encompassing singularity between the hotels across Europe. • Setting up a focused marketing team is the perfect opportunity to cost-effectively boost sales and add value as the target market is a mix of young and older millennials who primarily use social media, so specifically social media marketing costs should not be substantial. • Benefit from economies of scale by using MT's experience and resources to re-engineer the supply chain to maximise value, for both labour and materials. • Gain customer loyalty by providing exclusive deals across all locations and uniquely target customers for offers on MT cruise lines. • Capitalise on seasonal special events taking place in Europe (World Cup, Olympics). • Arrange exclusive hotel catering for events through contracts.	• Seasonal demand leads to uncertainty in expected revenue streams and operations management especially knowing when and how much part-time staff are required to meet such demand. • BREXIT's impact on supply chains and operations makes it more challenging to operate with new legalities and higher import costs across BeU hotels given the head office is in London. • Possible lockdowns disrupting operations and revenue streams given COVID cases are heavily increasing in Europe. • Threat of substitutes, especially air b-n-b services where some customers might find more suitable. • Negative economic impacts on people's disposable income lowers footfall/occupancy and makes tourism predictions more challenging.

Brief financial overview based on MT management suggestions following stepped costs:

	Sep-22	Sep-22	Sep-23
	Forecast £'000	New Forecast £'000	New Forecast £'000
Hotel Revenue	17,903	18,243	20,121
Ancillary Revenue	2,769	3,466	3,823
Hotel Contribution	14,559	14,109	15,561
Ancillary Contribution	1,708	2,155	2,376
Fixed Costs			
Admin & Management Costs	4,191	4,191	4,400
Building Costs	8,480	8,480	8,480
Marketing Costs	107	107	107
Other Fixed Costs	1,132	1,132	1,132
	13,910	13,910	14,120
Operating Profit	2,357	2,353	3,817
Interest charges	3,091	3,091	3,091
Profit Before Taxation	-735	-738	726

BeU venture profitability indicators

EBITDA	5138.69	5135.51	6641.00
EBITDA margin	24.86%	23.66%	27.74%
Operating Profit Margin	11.40%	10.84%	15.94%
ROCE	3.34%	3.34%	5.42%
Residual Income	-52.57	-55.75	1407.83

Key calculations in Appendix

TAKING ACTION ON SWOT ANALYSIS

Necessary direct actions:

- Purchasing BeU would mean research on restructuring of costs is essential in finding and reducing/eliminating high cost/low value activities; with working culture clashes when improvements are carried out. However, organising meetings and announcements informing staff on the new approach and mission to improve the hotel should prove useful.
- Research required for legal side of costs of entering a new continent as well as an understanding of the tourism in Europe.
- BeU holds significantly high interest charges stemming from COVID-19; less interest charges if paid sooner given MT's lower WACC indicating lower risk to lenders.

Enhancing actions:

- As BeU is currently struggling and are advised to be sold or face closure, MT could get a bargain given BeU's circumstances.
- Purchasing BeU allows for diversification into a new market with different target customers in another geographical region.
- Capitalising on BeU would allow for improved interest rates for future expansion plans in the most popular touristic content, given the successful reputation of MT.
- Improving product quality and staff hospitality should attract customers and gain their loyalty.

DECISION

Investing in BeU is the perfect way to diversify given its established reputation and geographical location while benefitting from a high chance of getting a bargain price. Taking necessary and enhancing actions does not require excessive activities along with MT's unique resources and core competencies in operations management, marketing and experience should improve financial performance highlighted by MT's cost management capabilities to reduce costs by at least 10% (forecast in slide 5); based on both forecasts, reducing the average price to £150 is slightly less profitable in 2022 but pays off in 2023.

As, BeU is perceived as a premium product with its customer base not too sensitive on price changes, rather than only reducing average price to £150 attempt differential pricing or seasonal deals to capitalise on individual customers' price range; this must be supported by a strong marketing team.

Key calculations in Appendix

ACTIVITY BASED MANAGEMENT [ABM]

Concept

Activity Based Management [ABM] is a management concept derived from Activity Based Costing [ABC]. ABC is on the basis that products/services consume activities, in-turn consuming resources and costs; such systems allocate relevant costs to identified activities [cost drivers] based on resource consumption with activity costs ultimately being allocated to products/services proportionately following their individual workloads (Gupta and Galloway, 2003).

By understanding cost creating activities, ABM can assist by:

- ✓ All management levels being responsible; especially in identifying and managing value adding/non-value adding activities at respective stages then taking action (Gunasekaran, 1999).
- ✓ Allowing for better price-setting accounting for costs while reflecting quality and product image to customers.
- ✓ Identifies areas of improvement of operations in respect to quality of resources, work efficiency and speed.

Limitations of ABM:

- ❖ Indirect costs can often be stepped, so identifying a causal link between activity-cost does not guarantee reducing such activity diminishes the cost, except upon a threshold.
- ❖ Cost drivers are somewhat difficult to identify.
- ❖ Given ABM derives from ABC, data required for ABC is often expensive and difficult to find.

As ABC is very costly to fully implement, using its insights to develop a management mindset [ABM] helps improve performance.

In order to be successful ABC/ABM is to be integrated with the likes of TQM and JIT whereby adequate training is carried out for implementation (Innes et al., 2000).

Implementing ABM to Improve Financial Performance

By understanding cost creating activities using the ABM mindset/management techniques to improve financial performance we can signal various areas of improvement.
Using the ABM mindset, MT can use their expertise and apply their systems and operations to minimise non-value adding activities, maximise value adding activities, and solve weak cost management thus reducing fixed costs by at least 10%.

Financial overview based on MT management suggestions following stepped costs, using MT cost-reduction capabilities (10%):

	Sep-22 Forecast £'000	Sep-22 New Forecast £'000	Sep-23 New Forecast £'000
Hotel Revenue	17,903	18,243	20,121
Ancillary Revenue	2,769	3,466	3,823
Hotel Contribution	14,559	14,109	15,561
Ancillary Contribution	1,708	2,155	2,376
Fixed Costs			
Admin & Management Costs	3,771	3,771	3,960
Building Costs	7,632	7,632	7,632
Marketing Costs	97	97	97
Other Fixed Costs	1,019	1,019	1,019
	12,519	12,519	12,708
Operating Profit	3,748	3,744	5,229
Interest charges	3,091	3,091	3,091
Profit Before Taxation	656	653	2,138

Competitor Comparison: Hilton Hotels Profitability indicators (Capital IQ, n.d.)

	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Sep-30-2021
Operating Profit Margin	11.38%	31.84%	20.83%	23.39%	-44.69%	1.90%
EBITDA Margin	37.89%	42.83%	47.60%	50.74%	23.56%	47.91%
ROCE	4.42%	6.76%	11.01%	11.81%	0.30%	5.13%

BeU venture profitability indicators

	Sep-22	Sep-22	Sep-23
Operating Profit Margin	11.40%	10.84%	15.94%
OPM after cost reduction	18.13%	17.25%	21.84%
EBITDA	5138.69	5135.51	6641.00
EBITDA after cost reduction	6251.52	6248.34	7770.59
EBITDA margin	24.86%	23.66%	27.74%
EBITDA margin after cost reduction	30.24%	28.78%	32.45%
Residual income	-52.57	-55.75	1407.83
Residual income after cost reduction	1338.47	1335.29	2819.82
ROCE	3.34%	3.34%	5.42%
ROCE after cost reduction	5.32%	5.31%	7.42%

Starting with eliminating/minimising waste at early stages before burdening the consumer with activities' non-value adding waste flowing through operations; thereafter ensure each operational manager is responsible for identifying and managing activities for cost minimisation and value maximisation ensuring quality is not compromised.

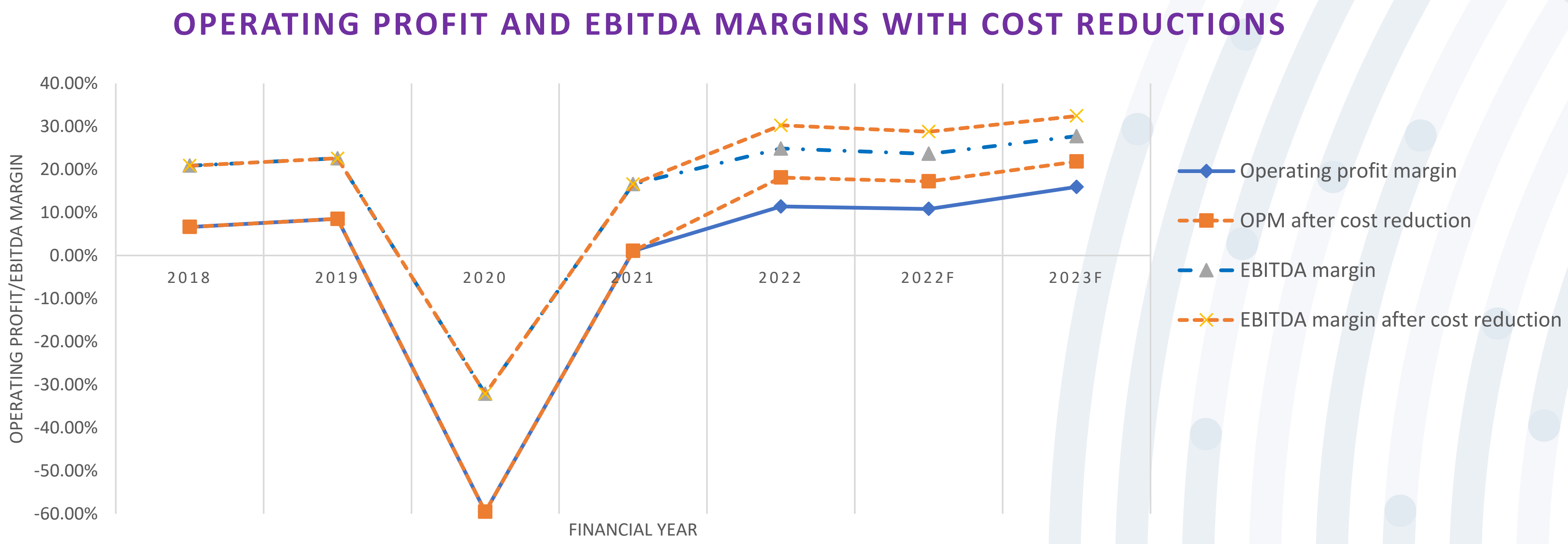
Furthermore, whereby necessary improvements are identified activity based management can substantially reduce cost within operational activities through minimising waste in respect to quality of products/services, efficiency of operations and speed of services and their delivery; re-engineering both the supply chain and day-to-day operations while having a mindset of continuous improvements in place is even more effective.

Implementing ABM to Improve Financial Performance

A better understanding helps in price setting of different types of rooms and suites. Managing cost using ABM also effectively allocates overheads to their cost drivers following individual workload linked to different ‘levels’ of rooms and suites. This enables management to better negotiate with customers about ranging prices (differential pricing), included amenities, quality of products, and delivery of services.

Implementing ABM can be used to enhance decision making relative to products/services, price mix and investment. Investment decisions are improved by understanding cost driven activities required for the desired investment, possibly evaluating if investment in automation of kiosk services reduces costs enough to become worthwhile.

Using ABM ultimately leads to better cost management with its importance reflected in profit and cashflow using the chart below.



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APPENDIX

Profitability indicators

	Sep-18	Sep-19	Sep-20	Sep-21	Sep-22	Sep-22	Sep-23
Operating profit margin	6.65%	8.52%	-59.55%	1.08%	11.40%	10.84%	15.94%
EBITDA	4104.70	4898.02	-3276.89	2968.85	5138.69	5135.51	6641.00
EBITDA margin	20.88%	22.59%	-32.14%	16.60%	24.86%	23.66%	27.74%
ROCE	1.90%	2.48%	-8.39%	0.27%	3.34%	3.34%	5.42%

	Sep-22	Sep-22	Sep-23
EBITDA	5138.69	5135.51	6641.00
EBITDA margin	24.86%	23.66%	27.74%
Operating Profit Margin	11.40%	10.84%	15.94%
ROCE	3.34%	3.34%	5.42%
Residual Income	-52.57	-55.75	1407.83

Detailed EBITDA information

	Sep-18	Sep-19	Sep-20	Sep-21	Sep-22	Sep-22	Sep-23
EBITDA	4104.70	4898.02	-3276.89	2968.85	5138.69	5135.51	6641.00
EBITDA margin	21%	23%	-32%	17%	25%	24%	28%
EBITDA after cost reduction					6251.52	6248.34	7770.59
EBITDA margin after cost reduction					30%	29%	32%

Leverage ratios

	Sep-18	Sep-19	Sep-20	Sep-21	Sep-22
Gearing ratio	18.21%	24.21%	35.36%	40.87%	43.01%
Debt to asset ratio	0.23	0.28	0.40	0.46	0.48
Interest Cover ratio	1.51	1.45	-1.93	0.06	0.76

Liquidity ratio

	Sep-18	Sep-19	Sep-20	Sep-21	Sep-22
Current ratio	0.32	0.31	0.21	0.17	0.17

Marketing cost

	Sep-18	Sep-19	Sep-20	Sep-21	Sep-22
Marketing cost to total revenue	1.46%	1.31%	1.06%	0.63%	0.52%

Limitations of assumptions and forecasts:

- Assumes all costs are carried over in the same proportion, that is not the case as investment in marketing is necessary so more costs involved.
- Although new occupancy rates are expected they may not be achieved thus reflecting on total revenue.
- Forecasts use the same forecasted interest charge, interest charges will definitely decrease upon MT's acquisition, however unknown by how much.
- Forecasted assets and liabilities are the same throughout, however they are likely to change overtime.

Contribution ratio

	Sep-18	Sep-19	Sep-20	Sep-21	Sep-22
C/S ratio total revenue	77.80%	78.87%	77.49%	78.67%	78.69%