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MIKE PHIPPS FINANCE ACL (364 314)

fresh ideas...



Deal Killers: Have We Beaten The Fatal 5?

Back in 2011 I wrote about experiences we were having that resulted in transactions not proceeding. We identified what we referred to as the Fatal 5 and introduced the article at the time with the following quote and comment:

The contemporary form of Murphy's Law goes back as far as 1952, as an epigraph to a mountaineering book by Jack Sack, who described it as an "ancient mountaineering adage":

"Anything that can possibly go wrong, does"

May I suggest that in terms of some management rights and motel transactions: Murphy was an optimist!

So how are things looking in these enlightened times? Let me tell you, nothing much has changed and in fact I reckon the challenges that present themselves in the course of a deal are actually getting more complicated.

Let's look at the key issues we encounter at the moment:

Pre-Qualification

We still run into potential accommodation industry purchasers who have only a limited idea of how much they can afford to spend. Prudent industry professionals know that the first step in the purchase process is to ensure that the intending purchaser can afford to undertake the planned venture. This pre-qualification process should not take the form of a simple equity calculation but should be a reasonably detailed analysis of the purchaser's financial position combined with a critical look at the likely avenues for raising debt finance via the various lenders. Anything less is a step on the path to that first speed bump.

What Is Being Sold?

Sales agents are a source of many of our best referrals so far be it for me to bite the hand that feeds, but perhaps just a little nibble! I've raised this in the past and it's still a bit of a problem. While a number of sales agencies have really stepped up in terms of listing information and supporting research I simply don't believe some accommodation businesses are marketed with sufficient detailed information about the asset.

Experience suggests that in some cases purchasers have been presented with a summary of the asset being marketed, have made an offer in good faith only to discover that all is not as it seems. In some cases the sales agent could not have known and in others I suspect that the vendor may have overlooked certain matters. In a minority of cases I believe the agent simply didn't dig deep enough when taking on the listing. The result is generally the same.

The purchaser, already doing what purchasers do and wondering if they've made the right decision, is completely spooked by the revelation that things are not as originally presented. In many cases this triggers a renegotiation at best and a failed contract at worst. My advice when listing, get as much data as possible up front including copies of agreements, detailed letting pool and unit ownership data, BC minutes, independent accountant's report and, if possible, a valuation of the manager's unit.

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I am not suggesting that all these documents be given to a buyer, just that they be available to ensure the accuracy of the listing.

Let's face it, we are not selling and financing fish and chip shops, these are often seriously big businesses deserving of sophisticated and in depth listing information.

Educated Buyers and The Process

I know that buyers are now more educated than ever and for the most part that's a good thing. With every man and his or her dog running seminars and education options available via ARAMA and the private training companies there's plenty of information out there for the new industry entrant. Trouble is, in some cases a little bit of knowledge can be a dangerous thing. We are seeing a trend where some buyers attempt to almost conduct their own mini due diligence when looking at a property and in some cases simply confusing themselves or coming to incorrect conclusions.

There is a tried and true process for acquiring management rights, motels and other accommodation businesses. The process has been around for a long time and it works. While we encourage our clients to do as much research as they like the fact is that they need to stick to the process and we as industry professionals need to ensure that this happens. Sadly, in some cases you can lead a horse to water.....

Inexperienced Advisors

These fall into two categories. The first is well known to all of us. It's the lawyer, accountant, lender or financial advisor with no clue who thinks that management rights or motel leasehold is no different to any other type of commercial transaction.

Thankfully the instance of potential purchasers ignoring advice in terms of using industry expert professionals is minimal. The more concerning situation is that of accommodation industry professionals straying outside their areas of expertise. I'm surprised at the number of purchasers we have worked with who've indicated a desire for a particular loan structure and debt product based on flawed banking and finance advice from their agent, accountant or lawyer. I am also surprised by the misinformation and confusion sometimes created when buyers receive banking and credit policy advice from people outside the finance process.

When industry professionals stray from areas of specific expertise it just confuses the purchaser and creates doubt. I'm a great believer in sticking to the knitting, so to speak.

Buyer's Remorse

According to Wikipedia, buyer's remorse is the sense of regret after having made a purchase. It is frequently associated with the purchase of big-ticket items such as a car or house. It may stem from a sense of not wishing to be wrong, of guilt over extravagance, or of suspecting having been "snowed" by a sales associate. The anxiety may be rooted in various factors, such as: the person's concern they purchased the wrong product, purchased for a bad price, purchased instead of waiting for a newer model, purchased in an ethically unsound way, purchased on credit, or purchased something that would not be acceptable to others.



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In the phase before purchasing, a prospective buyer often feels positive emotions associated with a purchase (desire, a sense of heightened possibilities, and an anticipation of the enjoyment that will accompany using the product, for example); afterwards, having made the purchase, they are more fully able to experience the negative aspects: all the opportunity costs of the purchase, and a reduction in purchasing power.

If we consider this outline of buyer's remorse in the context of the first 4 Deal Killers in the Fatal 5 it's pretty obvious how to minimize the risk of a purchaser getting cold feet. Simply ensure that the process is well managed and professional with no nasty surprises along the way. Of course, if a purchaser simply has a change of heart it should always be OK for that party to walk away with no regrets or recriminations. Life's too short for regrets.

In closing I would like to make a few observations in respect of the purchase process and a number of key things I have noticed since the original Deal Killer article 6 years ago. The first is that the key industry professionals in law and accounting have never been better to deal with or more well organized in terms of supporting new entrants, explaining the process, providing information and acting in a co-operative manner. I see many giving their time to new entrants and they are to be commended for doing so.

The level of support we see clients receiving, particularly when preparing for assignment meetings, is really encouraging. Secondly, the level of professionalism within the sales process has certainly stepped up over the last few years with many agencies now presenting listings in an extremely professional and well researched manner. Recently I saw an agency list a management rights which had NRAS units. They provided potential buyers with a complete history, explanation and analysis of the NRA Scheme in a really transparent manner. Needless to say buyer concerns were put to rest and I believe that property is under contract.

Lastly, and to no great surprise, the banks continue to range from great to truly terrible in terms of reliability, timeliness and service delivery. We have just put on another experienced banker whose job is almost solely to monitor transactions and keep the banks on task. Talk about the hospital pass!

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no surprises...