Case Study – Portuguese resort restructuring

Rio Laranja Empreendimentos Turisticos Lda

as at October 2012

Business background

- Rio Laranja Empreendimentos Turisticos Lda (“RLET”) is a Portuguese based company, established in 1987 to build and operate a resort in the Algarve

- The company was owned by a Guernsey based trust, the Directors were Guernsey based and Portuguese locals were recruited to manage the business

- The 5* resort trades under the name of Vale D’Oliveiras Quinta Resort and Spa (“VDO”) and comprises a 22 room hotel, 82 apartments, a health and leisure facility, a spa and a restaurant

- There are three parts to the business:

  - Sales of apartments in fractional units – quarter shares (time share)

  - Management and rental of the sold properties on behalf of the owners

  - Operations – hotel, spa, leisure facilities, food and beverage

- The construction of the resort was funded primarily through bank funding arranged in Portugal together with shareholder loans and the proceeds of initial sales of the apartments

- The project faced funding problems early on during construction and needed bank support to complete construction and start operating. The resort opened in Autumn 2009 against a difficult Algarve economy

The Icknield Team

- Shahin Gulamali
  - Initially cash management
  - Interim FD from early 2012
  - appointed Board member post restructuring
- Steve Smith
  - Debt/Equity swap restructuring
  - appointed Chairman of Holding Company post restructuring
- Dorothy Szulc
  - Management of the incomplete real estate sales. Completed c.75% of outstanding transactions to tidy up the resort's real estate pre restructuring

An experienced, international resort management company, Macdonald Hotels, were identified using Icknield's network and were successful in their bid to manage the resort

Key achievements

The major successes achieved since the start in August 2011 were as follows:

- In 2012, trading was ahead of budget, occupancy rates were increased, costs were reduced and cash was tightly managed resulting in significantly lower monthly outflows
- Visibility on the number of fractional sales completed, in progress and unsold. Three quarters of outstanding transactions were completed which made the financial restructuring much easier and left a much better position for the incoming operator.
- The due diligence on the Special Purpose Vehicles ("SPV") was paramount to the restructuring which included the separation of RLET and certain SPVs from the Guernsey based trust company. This was achieved by the Icknield team working efficiently and effectively alongside RLET company staff and the Trust company staff
- A consensual debt/equity swap agreement was reached with the bank and the 100% shareholder who is now a minority shareholder. A new Board of Directors was appointed and the lower level of debt in the business is now more realistic
- The management of employment contracts early in the process, avoided the need for redundancies and has left flexibility in the workforce to respond to seasonality trends
- The 2 litigation cases were settled at a fraction of the original amounts claimed
- Macdonald Hotels and Resorts were appointed to manage the resort for the next five years and sell the real estate
- A plan is in place for the company to become profitable through real estate sales and higher third party income

Key issues at the start of the project

In August 2011 Shahin Gulamali met the management team of RLET with the bank and was then appointed to help the company with cash management

At that time:

- The company had been in business support for a few years already. The shareholder director was not able to inject further funds and the bank was not willing to provide further funding without a plan
- The business was haemorrhaging cash at the rate of €150k - €200k per month, there was no visibility on cash and no cash flow forecasting
- The sales of real estate fractions dried up because of the economic climate and the delays in construction
- There were two litigation cases against the company – one with a potential claim of €4.3m
- The management of the business was by a handful of consultants. The workforce was large and inflexible – mostly on contracts. The senior management team was highly remunerated compared to market and all had long / permanent contracts

Key issues at the start of the project - continued

Vale d'Oliveiras
QUINTA RESORT & SPA

There was also a lack of visibility/problems in other areas

- there was a lack of financial information, no KPI's, no evidence of cost control against budget, management accounts did not exist, clients were not being invoiced and debts were not being chased up
- There were very poor, incomplete records of sales of apartments and payments received. The product being sold was through a complex structure of 82 SPV companies based in the UK and managed by the same Trust company that owned RLET
- There was no infrastructure for the managing and letting part of the business and holding costs for the properties resulted in significant monthly cash outflows
- Clients who had bought apartments were very unhappy due to the delays in construction and lack of information. Some clients had paid money and not received legal title of ownership. Annual maintenance cost levels were being contested and the processes for working with an Owners Committee were not satisfactory

100 Day Plan (to Dec 2011)

In the period August – December 2011, Shahin worked with the management team and bank to:

1. Reduce the cash outflow

    - Produced a rolling 13 week cash flow forecast and agree short term funding from the bank to give time for further work to be carried out
    - Stretched credit terms from suppliers
    - Implemented a purchase ordering system
    - Terminated contracts with external consultants

100 Day Plan (to Dec 2011) - contd

2. Improve the visibility

  - Produced financial information to give visibility on trading performance against budget
  - Performed a full reconciliation of apartment sales transactions which involved a line by line analysis of 3 years' bank statements
  - Gave visibility on the number of apartments sold, in progress and available for sale
  - Held fortnightly communications with staff to motivate them and to address operational matters
  - Held meetings with the owners of fractions to provide them with information and seek approval for 2012 maintenance fees

Turnaround plan - 2012

Shahin was appointed as interim Finance Director and worked with the management team and the Bank to:

1. Produce and then implement the 2012 budget for the business
2. Replace the financial controller
3. Introduce a monthly management accounts process
4. Implement a sales and marketing plan designed to increase occupancy levels
5. Close the real estate sales office to save on overheads whilst a new fractional sale product was developed
6. Introduce a weekly process of managing the staff contracts to ensure adequate staffing for the new season whilst avoiding potentially high redundancy costs through contracts becoming permanent (Portuguese employment law is complex in this area)

Trading Performance Review

At October 2012, the results were €340k better than budget and significantly improved on the previous years' results

Reduced operational losses through:

- stopping all marketing activity was and eventually closing the real estate office to reduce costs until the product for sale had been restructured
- turning each operational area into a profit centre for reporting purposes and allocating them a percentage of shared costs. Revenue targets were set for each to achieve break even / achieve profitability
- a line by line cost reduction programme
- higher targets being set for occupancy rates and sales and marketing targets being set for increasing leads and revenue

The level of losses was considerably reduced as a result

Financial & Operational Restructuring

A consensual plan for the financial and operational restructuring of the business was agreed with the Bank, shareholder and the Directors. On 8 August 2012 the cross border, debt-equity restructuring of RLET was completed. This involved the Icknield team working alongside legal and financial tax advisors from the UK, Portugal and Guernsey.

1. The Bank become a shareholder and the former 100% shareholder retained a reduced equity stake

2. The Bank debt was reduced, restructured and new facilities were put in place

3. A new board of directors was appointed (Shahin Gulamali plus a Portuguese resident director)

4. Shortly after, Macdonald Hotels and Resorts were appointed as operator of the resort for 5 years and the management team at the resort was changed