

Restructuring in the leisure sector:

What does the future hold?

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Publication

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Synopsis

The UK's leisure sector – encompassing everything from gyms to cinemas and leisure complexes – has faced a year of challenging conditions, with successive lockdowns cutting revenue and forcing many management teams to mothball their operations. Earlier this year, leisure and fitness industry association ukactive estimated that gyms, swimming pools and leisure facilities would lose a combined £90 million in revenue for every week under lockdown restrictions.

As the UK progresses on its path out of lockdown, leisure businesses will now be focused on successfully navigating the restart against a backdrop of uncertain demand, consumer spending power and changing consumer attitudes. While there will undoubtedly be an initial rebound in demand for leisure services, directors will need to ensure their businesses are financially and operationally fit to return to trading, and carefully consider how they might need to adapt their business to recover and thrive in a new, post-lockdown environment.

Here, we explore the headwinds the sector is facing, and the key factors that leisure businesses will need to keep in mind as they reopen their doors.



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What is the current state of play?

With the UK now on a path out of lockdown, businesses in the leisure sector – from gyms, to pools, bingo halls and bowling alleys – are focused on the opportunities of the restart.

After being denied access to leisure throughout periods of lockdown, there is an increased demand for leisure services, which could lead to an initial surge in activity as restrictions continue to ease. This demand could be further amplified with consumers likely to spend significantly more on leisure activities, with the additional savings gained as a result of lockdown.

Businesses are wary, however, that this initial surge might not last as consumers reduce spending over the long-term in the face of what could be ongoing economic uncertainty. And, as they look to the months ahead, firms are also carefully considering how they can fund a restart and manage ongoing liabilities.

When this working capital requirement is added to the financial challenges generated by the Government funding support schemes, HMRC Time to Pay (TTP) agreements and legacy arrears of liabilities, the scale of these funding challenges could be intensified.

How has COVID-19 impacted the sector?

COVID-19 has unsurprisingly brought significant challenges for the UK's leisure industry. With the stop-start nature of the lockdown restrictions, many businesses have been forced to close their doors entirely, while those that have been able to re-open during temporary lifts have often had to operate below normal capacity, often without an ability to reduce running costs commensurately.

The nature of some leisure facilities – particularly gyms or fitness centres, where many individuals may be concentrated in enclosed spaces and sharing equipment – means they have faced a challenge of public perception as areas of risk when it comes to viral transmission.

Meanwhile, the shift to homeworking has significantly reduced footfall, and consequently customer flow in town and city centres, even during short periods of re-opening between full lockdowns. This is an issue that has been particularly felt by businesses in major urban areas, where a buoyant after-work market that traditionally helped to fuel the industry disappeared almost overnight.

It is estimated that UK gyms alone have lost more than £3.1 billion since the onset of the pandemic, according to a study by Pharma Nord, after their doors remained largely closed. For British cinemas, revenue fell by 76 per cent in 2020, from £1.25 billion to £297 million.

Both perception and location are challenges that businesses will need to contend with in the months to come and factors that could affect different businesses differently during the next phase of recovery. It remains to be seen how quickly individuals will feel comfortable returning to certain leisure activities that feature elements of mass participation or close contact, even as the vaccination programme continues at pace.

We are yet to see the degree to which current work from home patterns continue post-lockdown. A long-term shift away from city-centre, office-based work could mean that some facilities will need to rethink their operating models. The persistence of a more localised existence with individuals concentrating their work and play in the immediate vicinity of their homes could be a benefit to leisure businesses located in more residential areas.

Another area where businesses will have seen change is with regards to subscriptions. For firms in the leisure sector – particularly the likes of gyms or golf clubs, but also cinemas, with monthly 'film passes' – subscriptions offer real benefits by providing a regular income that management teams can plan around with confidence, and providing an attractive degree of income certainty for investors. Operators have proactively sought out new revenue streams to capitalise on this trend.

However, with customers unable to access facilities and spending towards more home-based leisure activities, some will be more likely to cancel existing subscriptions and not re-subscribe. Additionally, with subscriptions being a more fixed model, consumers may be keen to vary their leisure activities more regularly and therefore move away from this model.

While this will undoubtedly serve as a setback to revenue streams, it will give firms the opportunity to reset their subscription baselines building a new membership base of active customers that could, in turn, support efforts to attract new investment or secure new lending.

What hurdles will leisure businesses need to face in the coming six months?

The immediate challenges for businesses will be funding the working capital they need to re-open while managing ongoing liabilities. While some businesses in this sector will see a spike in demand, it will likely take some time for customer, membership and subscription levels to return to pre-pandemic levels.

Leisure firms will face the disadvantage of not being able to easily scale their operations to closely match demand. The nature of businesses, such as swimming pools, means they have certain fixed costs that are essential to them being open and that they will need to meet, regardless of customer volume.

Over the coming months, companies that have taken on government support such as the Coronavirus Business Interruption Loan Scheme (CBILS) may need to start making repayments, and securing Recovery Loan Scheme (RLS) finance could be challenging without a track record or a revenue profile that can be easily underwritten.

While measures protecting commercial tenants from being evicted for non-payment of rent were recently extended by the government, some businesses have already agreed payment plans for outstanding rent on commercial properties. There remains widespread uncertainty over when support measures will be fully lifted, and how much businesses will eventually pay. This has posed a significant challenge for landlords and key suppliers with arrears have been stretched. In the absence of a clear path to unwind liabilities, we could see stakeholders begin to look at alternative recovery options.

This uncertainty will make it difficult for businesses to plan their working capital needs with clarity, and could be a factor that inform lenders' decision-making when considering new or additional backing.

90

Million pounds
estimated revenue loss
for leisure facilities
per week in lockdown

3.1

Billion pounds
estimated total
revenue loss for gyms
since March 2020

76

Per cent drop in UK
box office revenue
during 2020

What steps can they take to manage risk?

For a long period during lockdown, many businesses in the leisure sector will have effectively been mothballed and directors understandably have been focused on survival. With the roadmap out of lockdown now in place, and a successful vaccination programme, management teams must ensure they have their own roadmap for managing their re-opening and navigating the inevitable challenges along the way.

Throughout the process of re-opening, clear and honest communication with stakeholders will be key, including management teams, operators and equity or debt providers. Having well-informed stakeholders will improve the chances of reaching successful additional support or concessions, should a recovery journey hit bumps in the road. An aligned group of stakeholders in support of a recovery strategy will also reduce the likelihood of needing to switch to focus to value preservation or realisation, which may not optimise the outcome for all parties.

Securing stakeholder support will require a clearly articulated strategy and a supportable recovery plan that can be stress tested, starting with an assessment of demand, valuation and consumer trends within a stabilised market in the medium to long-term. To undertake this assessment:

- Businesses and financial advisers should collaborate with independent real estate consultants with sector specific experience to provide appropriate legal, environmental and political analysis. Key conclusions from this will identify repositioning or capital expenditure requirements.
- A thorough analysis of key suppliers, licenses and employee resource should be undertaken to ensure that leisure assets can be safely and sustainably returned to operation. Failure of operational matters or a key supplier could irretrievably damage the recovery plan, a business and its reputation.
- A strong forecasting in the short and longer term with emphasis on underwriting consumer demand or trends, and cash requirements from trading, working capital absorption and capital expenditure. This includes unwinding of deferred liabilities, such as rent or Time to Pay (TTP) arrangements.
- Once the funding requirements of the recovery phase are understood, they can be compared to existing capital headroom availability, however, additional capacity could be constrained as a result of Government funding schemes. A robust plan to healthy business with a normalised debt capacity may also attract additional leverage, such as the Recovery Loan Scheme (RLS) or equity.

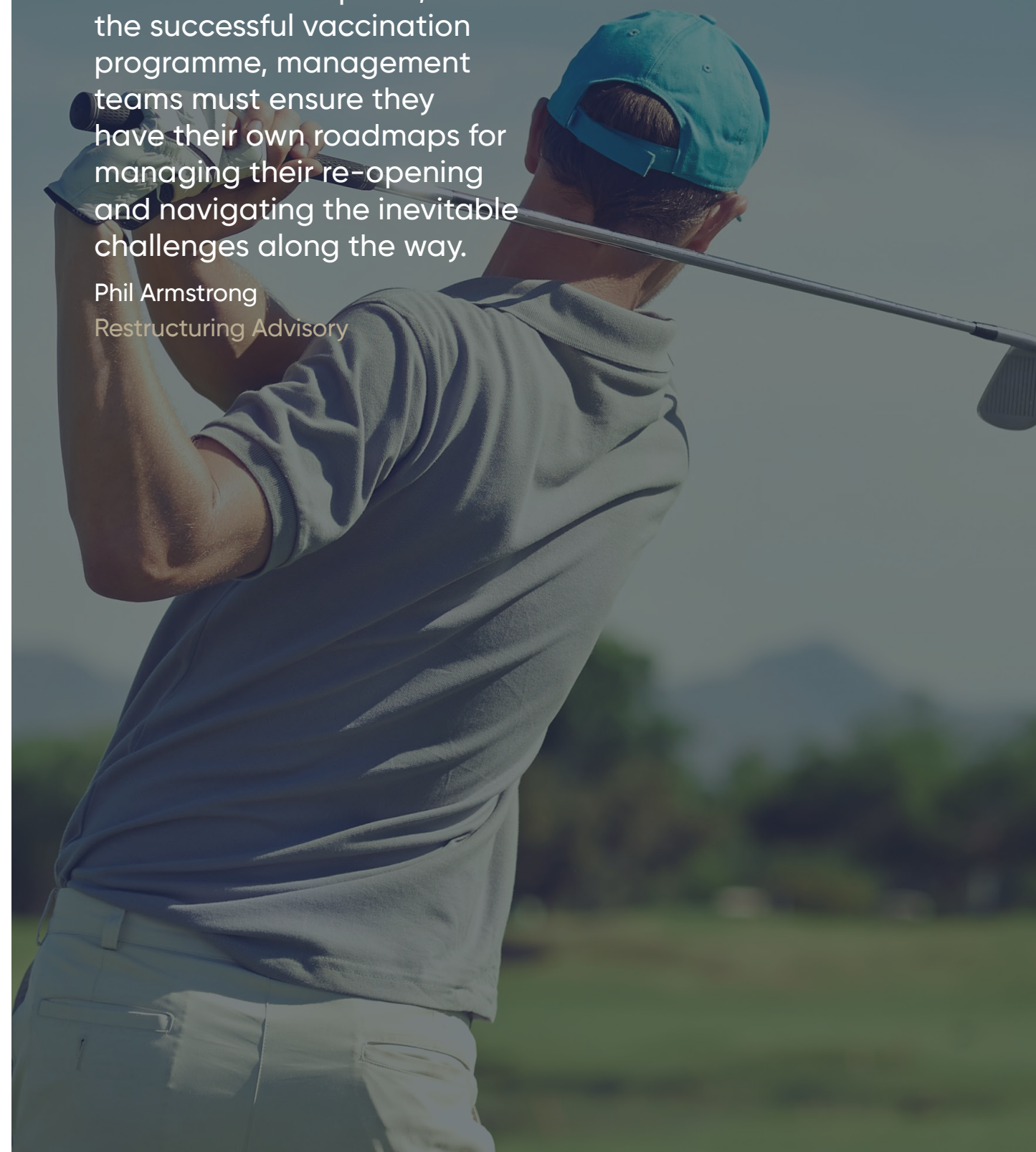
There is substantial capital in the marketplace, both debt and equity, available for deployment into businesses that can demonstrate value but are unable to secure support from existing stakeholders. Whether new capital partners remain with the existing stakeholders, or replace them, will be dependent upon on the situation, the business and the stakeholders.

When management teams identify pressure points within their businesses, or challenges in their re-opening plans, it is important that they seek support as early as possible. This will lengthen their recovery runway – giving them, their advisers and their stakeholders the maximum amount of time to find effective, sustainable solutions.



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What does the future hold?

Conclusion

It has been a sobering year for leisure businesses – it is one of the sectors that has almost entirely ground to a halt during the pandemic when its routine activities underwent radical changes.

We expect to see the sector benefit from a surge in demand as lockdown restrictions continue to be lifted. However, how this will settle into long-term patterns is still uncertain. Businesses will ultimately be emerging into a changed operating landscape, and will need to contend with what could be long-term shifts in consumer preferences, attitudes and behaviour, including a degree of cautiousness around mass socialisation, and changes in where people work and play.

Now is the time for management teams to review, adapt and evolve to be best placed to recover post lockdown and capitalise on any new opportunities.

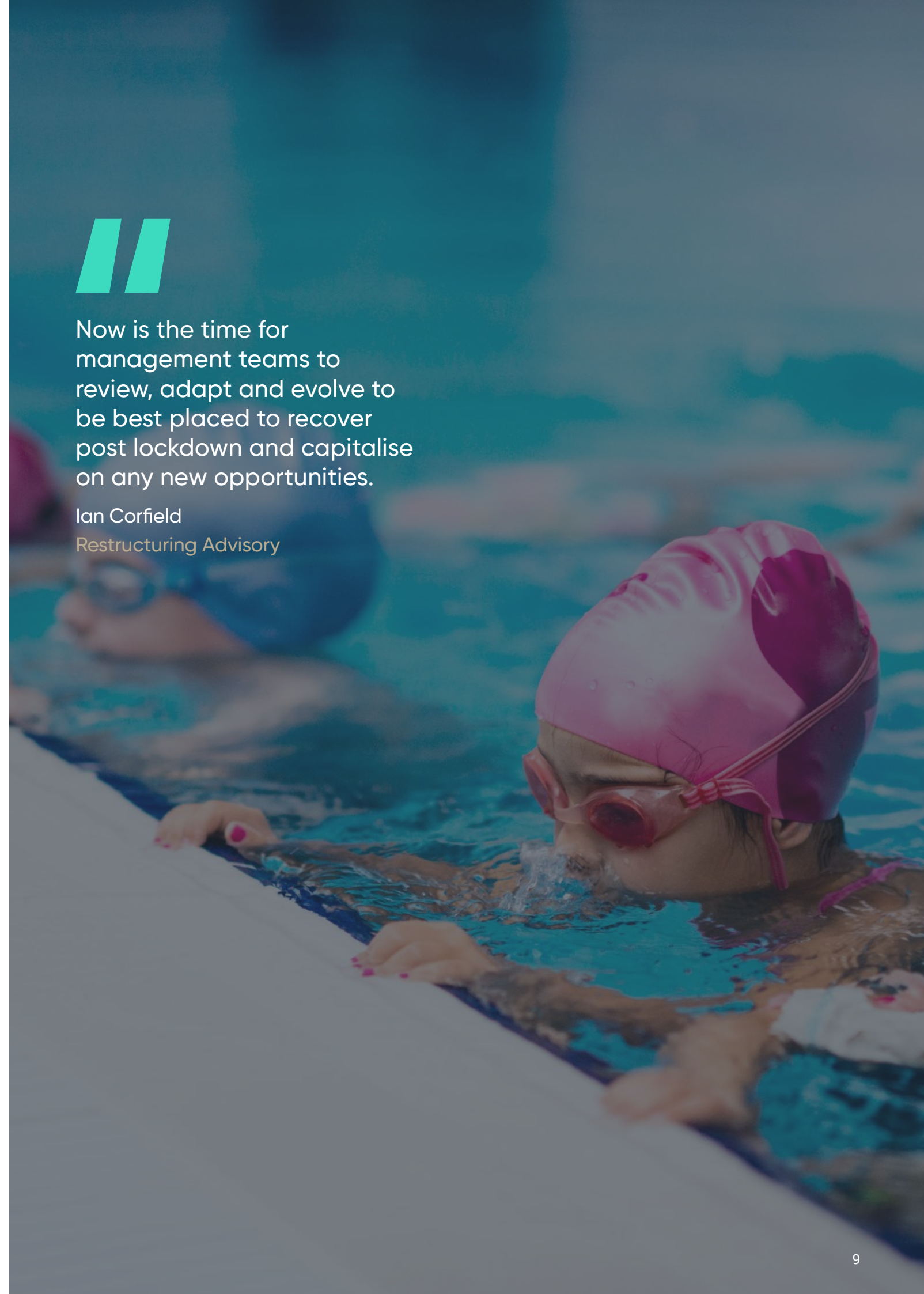
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