IN CONVERSATION WITH ...
... ROMAIN SEMMEL

Romain Semmel is Investment Director at Pygmalion Capital. He built the foundation of his career with globally recognised property advisory firm Jones Lang LaSalle, where Romain has been involved in over EUR €2.5billion in hotel acquisition and financing deals across Europe. He joined Pygmalion in 2018, a dedicated European investment firm deploying institutional capital to acquire hospitality assets and operating platforms. The company has had its first foray into the hotel sector by acquiring a portfolio of Spanish upscale hotels and is now looking to continue its acquisitions despite the current environment.

Closing the Deal - A Conversation About Investor Sentiment and the Role of Human Capital in Acquisition Due Diligence

With local and regional lockdowns still in place, Romain and I caught up over a cup of coffee, using one of the now omnipresent video chat platforms which have, throughout the past 12 months, proven so helpful in maintaining 'face-to-face' contact and a sense of normality. They have, however, also been very useful in continuing a positive momentum as it relates to facilitating key business decisions – but often, to 'close the deal', the parties involved are still required to meet in person.

"AETHOS has had an influx of inquiries from newly launched investment platforms looking for help to beef-up their acquisition and asset management teams," I commented, however, "social distancing requirements and travel restrictions have often delayed the recruitment process and hiring decisions – despite the options to conduct video calls and meetings". Drawing similarities to his world, Romain concurred, citing that similar factors are currently holding back, or delaying, decision-making processes on property deals. We both agreed, though, that with plenty of firms having recently announced fresh capital raising initiatives and, with deal volumes having hit historic lows, market activity is bound to tick up – significantly. We thus started talking about sentiment amongst the hotel investment community, about the role of human capital and talent in the acquisition due diligence process and about prospects for 2021 and beyond.

“Albeit operational pressure remains high whilst lockdowns prevail, consumer confidence appears to be growing. Is this more positive sentiment echoed within the European investment community?

RS: Generally speaking, investment sentiment is positive, but I would argue that we might still be facing a quiet market for a few months yet. One might say life is a rollercoaster right now... At the end of March, it was the great depression. In June, we were all going on with our lives like nothing happened. Come November, the risk of the second wave became reality. And just before Christmas, with vaccine approvals, we thought we were on the right track but are now facing the realities of a new virus strain and further lockdowns.

Everything is changing very fast and it is difficult to make mid-term projections; however, some things remain constant:

- Appetite for travelling remains fairly intact. As soon as travel ban eases there is a surge in bookings, and
- Investor appetite remains strong and even growing for the hotel asset class

However, despite strong investor sentiment, we are really not just yet seeing a huge number of transactions in the market – this is mainly because everyone is trying to time the bottom of the market. We also need to remember that traditional lenders remain 'out of the game' as they are still focused on (predominantly) 'troubleshooting' the assets which are on their books rather than underwriting new deals. Another key factor for the lack of activity, at least for the moment, is that vendors' expectations have not moved significantly enough to match the inherent risk estimated by investors.

“ The likes of Blackstone, KKR and KSL, to name just a few, have been quite bullish about hotel investment opportunities and some have recently raised fresh capital. At the same time, AETHOS has also been more frequently approached by family offices to build investment teams and operating platforms. With so much capital waiting to be deployed, will we see real distressed opportunities coming to the market or will investor demand outstrip supply?

RS: This crisis, unfortunately, will create an unprecedented level of opportunities for both traditional players and new entrants. The longer the pandemic lasts, the larger the opportunity will be. And yes, there is a significant amount of capital available in the market right now with a lot of funds having accumulated 'dry powder' over the last twelve months. We have ourselves announced last week the first close of our new fund dedicated to special situations in the hospitality sector in Europe. Compared to the last global financial crisis, where appetite for hospitality investments was particularly low up until the end of 2011, there is nowadays really no shortage of investors wanting to 'get in'.

Does this mean the distressed will not be as pronounced as anticipated, or feared? There will certainly be pockets which will be much more affected than others (e.g., business vs leisure). But quality assets or prime locations will continue to, to some extent, hold their value. Also, one should not forget that there has been a significant spread as it relates to investor activity – and the sectors and segments sought by them. Investors have different investment horizons, cost of capital and appetite for risk. This will soften the distress.

Overall, the impact on pricing will depend on the type of asset (e.g., hotels having been much more affected than student accommodation or serviced apartments), location as well as the type of investors attracted to the investment opportunity. A 5-star hotel in Paris city centre, appealing to institutional investors, family offices or HNWI might only be impacted by 5-10% while a hotel in the suburb of Rome might see 30% discount, or more, compared to its pre-Covid valuation. We anticipate that a portion of the demand pre-Covid will forever disappear (i.e., some portion of business travel) but new forms of demand might arise in the meantime, like staycation or co-working. More than ever, hotels will need to find new ways to also cater to the local demand which will be a source of growth in the coming years.

“ AETHOS has increasingly worked with 'hands-on' investors. Pygmalion itself can be classified as such. Yet, you sit alongside many other big equity players all willing to seize this unprecedented opportunity to strengthen, or gain, a foothold in hospitality real estate. Is there enough room for 'boutique investors'?

RS: Specialised investors – like Pygmalion – represent a very attractive proposal as they have the opportunity to invest alongside a manager with a track record and a proper institutionalised structure while also benefiting from a very specific 'know how' that larger generalists cannot provide. Therefore, with smaller but experienced managers like us they see an opportunity to diversify their portfolio in increasing their exposure to the hospitality market with very limited execution risks.

However, as we are looking at single assets and/or portfolios of hotels where we own also the going concern, we have more 'skin in the game' than institutional investors who might only look at hotel real estate with lease contracts attached to them. This means that we are going through a much more thorough analysis and due diligence process when investing our funds. In particular, we are interested in understanding the management and leadership capabilities of the executives who form part of the hotel business prior to executing the deal. Do we have the right people on board? Will there need to be some hiring or coaching taking place to be able to execute against our business plans? Knowing whether we must replace key personnel early in the process further helps us develop and execute our value-add strategy.

And, suffice to say, this closeness to the management team continues all throughout the investment lifecycle – and it is certainly also to the benefit of the operator. We bought our first portfolio back in 2018, and since then, we have helped our operator to reshape its business and to improve its financial success. This special relationship which we have had from day one, being approachable and open to dialogue, has proven useful in the last few months as we worked jointly to make the best out of the situation. In that respect, the crisis demonstrated that our approach was the right one. We want to work with operators and managers with whom we share the same objectives, values, and ambitions, where each parties' strategy is clearly defined, and the relationship balanced and fair from the moment we sign the contract.

“ On the subject of human capital, what role do you believe HR-related question will play during board room discussions in the next 12-24 months?

RS: Human capital has a significant impact on the value of our investment. Of course, managing payroll is always a top priority for us – however, not having the right people on board is a considerably worse problem to have. I believe it will be easier to secure 'top talent' in a post pandemic environment as redundancies will ensure that the available talent pool is considerably larger than before. The hospitality industry has always had its 'war for talent' but I believe the situation to become less competitive in the coming months. However, as soon as the momentum picks up, savvy investors and business leaders will continue to want to make sure that they have the best of the best to either restructure, reposition or build their platforms and the situation might return to pre-pandemic level. With considerable distress and operational pressure likely to prevail for some time, I anticipate a larger than usual number of investors re-assessing and re-evaluating the capabilities of their leadership teams at the platform or property level.

I also believe that investors, as management companies, will continue to take a closer look at costs – and as mentioned, payroll is a significant factor in the hospitality industry. The pandemic may thus give the necessary push to the involved players to start re-evaluating more critically the compensation best practices in the industry. Compared to other sectors, it is still surprising how only a relatively small portion of an executive's total compensation is driven by KPIs, and thus performance. And, let's face it, turning around a distressed portfolio may require 'big hitters' who usually come with hefty financial expectations. A good way to secure those leaders would be to develop short and long-term incentive schemes which really tie their performance to that of the business. I thus expect HR-topics, and alignment of the business strategies with the people practices, to be frequently referenced during board meetings.

“You seem to have an optimistic outlook on the sector. What will be your main objective in the next 12 to 24 months?

RS: I see tremendous opportunity for the Continent as one of the most attractive hotel markets to invest into in the near future. This stems from the fact that here, many destinations do not just purely rely on international travellers, but actually also benefit from strong local demand – and Europe has a fairly wealthy population of 450 million inhabitants craving for travel, as we have seen during summer 2020. For us, the objective will be about securing the right deals in Europe and we anticipate a very busy 2021 in that respect.

About the Author

Thomas Mielke is Co-Founder and Managing Director of AETHOS Consulting Group – an established human capital advisory and executive search firm focused on hospitality, travel and real estate. He is a fully certified executive search consultant by the AESC, and has grown leadership teams on behalf of operators, private equity investors, institutional funds and family offices across Europe, Middle East and Africa.

Acting as a trusted advisor, Thomas equally supports organisations in identifying and developing values and best practices that define and foster a corporate culture and consults his clients on talent management programs.

He holds a BSc in International Hospitality Management from Ecole Hôtelière de Lausanne, has authored a broad variety of articles on leadership, recruitment and talent management, and has participated in and chaired numerous industry panel discussions. Thomas can be contacted on tmielke@aethoscg.com