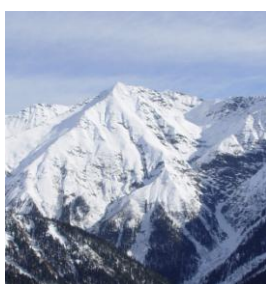




OVERVIEW OF HEALTH & WELLNESS RESORTS MARKET, SOCHI, RUSSIA.

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Introduction

A lot of attention by government officials, developers and the business community has been drawn lately to Sochi. The main focus is on Imeretinskaya Lowland and the mountain cluster where most development for Olympics 2014 is happening. Meanwhile, the medical, rehab and wellness markets, that used to blossom during Soviet times in the area (mainly concentrated in Central and Khosta districts of Sochi) has been ignored and even suffered in terms of numbers of tourist arrival due to reputation of the whole region as an “Olympics construction site”.

Publication focuses on the medical & wellness resorts of Sochi that are currently undergoing a transition, caused by the socio-economical changes of the past 20 years.

Historical Background

The collapse of the Soviet Union and the subsequent economic changes significantly affected visitation trends of Sochi. Number of tourist arrivals has significantly dropped down to 1 million visitors per year from the 1980's when it used to reach 5 million people. Such a drastic decrease caused a transition for Sochi as an all-year destination to a seasonal one.

The financial crisis of 1998 that severely hit Russia actually benefited Sochi, as people started to reconsider their travel plans due to the lower budgets; hence domestic tourism figures have significantly picked up starting from 1999. However, despite the positive arrivals health & wellness resorts are still operating during the peak season.

Political and economic conditions under which Russia has been evolving from 1990's has defined the transition of the health & wellness resorts market from being fully based on the government's entities controlled demand to competitive market conditions. Considering that mostly, management of the wellness & health resorts have never previously worked in the market environment, this segment has been developing uncontrollably and impulsively. Country-wide reforms of the health and wellness resorts complex have caused restructuring of the feeder markets and distribution channels. New market conditions and rules have been formed due to the drastic negative changes in the scale of governmental support and guaranteed demand for the services of the sector, decrease of financing of employee health benefits programs at major state-owned enterprises, along with the reform of social security system.

Current state

Sochi benefits from natural, geological and climatic resources that allow the destination to evolve into a modern resort competitive not only on federal level, but drawing interest from international markets as well. Such factors as presence of mineral springs and therapeutic muds, proximity to the mountains and opportunity to combine various kinds of leisure activities, and the image of Sochi as a destination for the Russian elite, positively impact the attractiveness of Sochi for tourists.

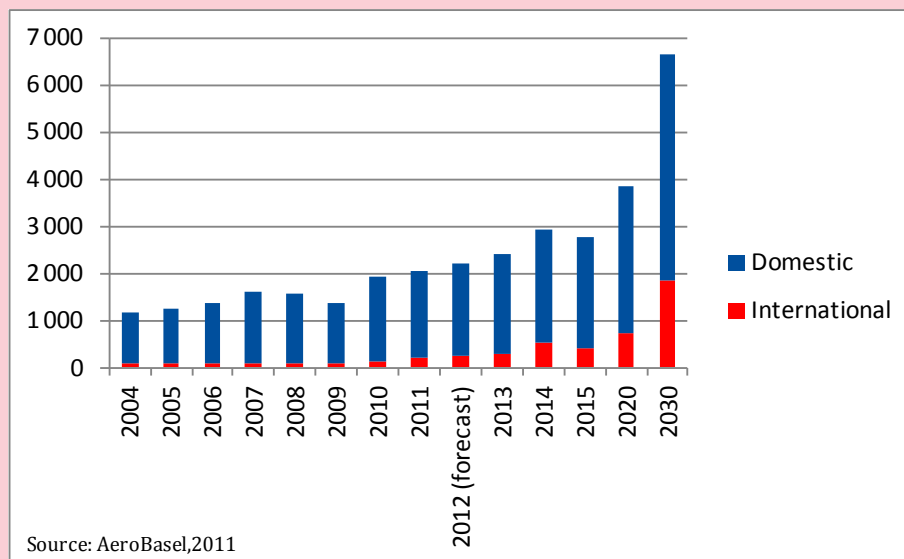
On the other hand, there are still many obstacles that slow down growth of the destination. Sochi is lacking a structured marketing strategy to promote it as an appealing tourist-friendly resort on the federal and international level. In order to improve the image of the destination; quality of services provided should be brought onto a different level, competitive with other destinations are popular among the target market. In addition, both the line staff and management have to be trained and re-trained to be customer-oriented, competitive and adaptable to the current market conditions. Such factors as a deficit of competition in passenger air travel, hence overpriced tariffs and lack of direct flights to international destinations, along with undeveloped road infrastructure that is not coping with steadily increasing transportation volumes, are slowing down the progress of Sochi as a travel destination to its full potential.

Current promotional opportunities that exist in Sochi due thanks to the Olympics, Paralympics 2014 and other large scale international events should not be overlooked. Increased recognition of the destination and improved image of the resorts are expected to cause an increase of the tourist arrivals in the next few years. Growth of this indicator is also possible due to existing and growing demand for quality leisure destinations by the domestic market. In addition, Sochi should take advantage of the growing interest of the international and domestic tourists to the wellness programs, mineral springs, thalassotherapy, spas etc.

Tourist Arrivals and Accommodation Demand trends

Adler airport statistics can be considered as an indicator that reflects existing travel trends of the greater Sochi area. From the table below, one may notice that share of the international arrivals does not exceed 10%. Such data only confirms the fact that Sochi is a stable and well recognized destination for domestic tourism; however, it is still unknown in the international markets; however an increase in the international arrivals is expected in 2014, which will reflect the interest of the international community in Olympics and Paralympics.

A new airport terminal has been partly completed in 2010 and upon completion of construction works the airport will be able to serve 3, 800 passengers per hour. The airport is considered to be one of the key infrastructure projects for the Olympic Games 2014.

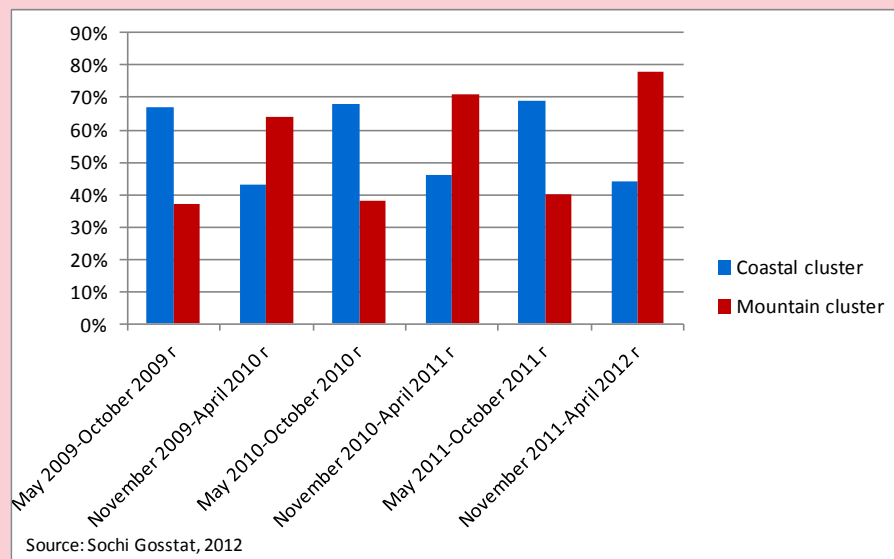
TABLE 1. PASSENGERS – ADLER AIRPORT (000)

Due to the large scale pre-Olympics development in the Imeretinskaya Lowland and its extensive mass media coverage, image of the rest of the Sochi districts has been negatively affected; media usually doesn't specify where all the work is taking place. The visual image of Sochi as an Olympic construction site affects the attractiveness of the destination which is reflected by a decrease in the number of tourists accommodated in the lodging facilities in 2011 compared to 2010 by 124000, according to the official stats provided by Sochi GosStat (a local Statistics Committee).

Only 35-40% of the total arrivals are staying in the hotels and health & wellness resorts of Sochi, others prefer private sector accommodation. Out of all accommodation options available in Sochi, only 3% could be considered as corresponding to international standards. Approximately similar numbers of tourists come to Sochi for leisure purposes as for health & wellness purposes. MICE and Business travel segments are not significantly developed; as of the end of 2011 they amounted to just 10% of total arrivals. It is worth mentioning that the amount of business segment arrivals has been increasing steadily over the past few years, which can be explained by the vast Olympic development. This trend is also expected to continue in the current year. After the main development is completed, business travel and MICE segments are expected to be growing mainly in the Imeretinskaya Lowland area. Generally speaking, development of Sochi as a MICE destination will be highly dependent on the marketing positioning and promotion of the destination on the national and international levels.

TABLE 2. OF ALL ACCOMMODATED VISITORS, BY PURPOSE OF VISIT (PAX)

Accommodation demand in Sochi is highly seasonal. Hotels are mostly filled with leisure tourists from May until September. As reflected in Table 3, average occupancy level for the past 3 years in the seaside cluster reaches 70% for the period from May until October. Highest occupancy levels of 90-95% are observed during the summer months, with further decline in September and October. For the rest of the year, occupancy levels do not exceed 40-45%. Due to climate conditions and low component of business travel in the market mix of the destination, it is hard to smooth the seasonality effects throughout the year. Even though the development of the mountain cluster into an international ski resort and the development of Sochi into a mountain-climatic resort should positively affect the number of arrivals throughout the year, it will not have drastic impact on the occupancy levels of the properties located at the seaside of Sochi during the shoulder and low seasons.

TABLE 3. OCCUPANCY LEVELS, CLUSTERS

Segments that form Sochi tourism market are:

Leisure:

These tourists prefer to stay during summer months because of better weather conditions, children's vacation and annual leave season. Feeder markets for leisure arrivals are mainly Rostov, Krasnodar, Stavropol regions, Moscow and Moscow region. This segment mainly prefers private sector or hotels as accommodation options. The choice mainly depends on the income level of the travelers.

Health & Wellness:

The majority of these tourists are staying in the health & wellness establishments of Sochi. Since the main purpose of travel is health improvement, seasonality factor does not have as much effect. During the high season those who come due to health reasons amount to 30-60% of the total stays in health & wellness resorts, while during shoulder and low seasons this segment represents 80-100% of total arrivals. There still are a few institutional health & wellness centers owned by major employers in Russian federation. Such properties are more likely to have stable occupancy levels throughout the year, due to continuous demand from the employees of those entities.

Business travel and MICE segments:

Business travel and MICE segments are mostly active during the shoulder season and mainly concentrated in the hotels that have substantial meeting facilities, such as Radisson SAS Lazurnaya, Zhemchuzhina, Marins Park and others. Due to the high average length of stay in the health & wellness centers (14 days average length of the wellness course), accommodation of MICE groups for 2-3 days, which confronts the arrival schedules of individual health &

wellness guests, is not always profitable. Therefore this segment is insignificantly presented in the business mix of health and wellness centers.

Sports Tourism:

Due to the proximity to the future Olympic arenas and the favorable climate conditions in Sochi, it allows to hold trainings for the summer sport disciplines during shoulder and winter season. Hence we can identify another segment: sports tourism. Accommodation demand of this segment is spread throughout the year depending on the sport discipline the travelers represent.

After the main development of the Imeretinskaya lowland will be completed, it is expected that the majority of the business travel and MICE will be transferred to that district of Sochi and will be developing and growing further. Several Olympic facilities will be transformed into the congress and exhibition halls after the event, and are expected to be demand generators for arrivals in the above mentioned segments.

Existing and Potential Supply in the Market

Historically, the majority of wellness & health centers and hotels have been concentrated in the Central and Khosta districts of Sochi, as most cultural and historical attractors and Macesta (hydrosulfide spring) are located there. According to the official statistics, the biggest fraction of accommodation supply is presented by health & wellness centers (80 out of 184, year end 2011), the second biggest accommodation type is hotels (45 out of 184, year end 2011). There are also many accommodation units in private sector (apartments, guest houses) which are rented out during the high season. In our analysis of accommodation supply in Sochi we consider only those properties that correspond to the international standards, therefore most of the hotels and several health & wellness centers are taken into account. Despite the fact that the bulk of the upcoming additions to supply are expected in Imeretinskaya Lowland due to the Olympics 2014, some of the existing properties in the Central and Khosta districts of Sochi are as well included in the Olympic program. Such properties are currently under renovation or reconstruction in order to correspond to the international 3* level.

Currently the health & wellness market in Sochi (Central and Khosta districts) generally offers guests accommodation that although renovated and upgraded since Soviet times, however still have a long way to go to match the growing quality expectations from the client's side. Up to date management of many wellness & health resorts are struggling to build efficient successful strategies that would generate profits under current market conditions and within existing competitive environment. Additional pressure will be felt in the market when the upcoming projects under international hotel brands will be completed. Even though the majority of branded properties will be concentrated in Imeretinskaya Lowland and the mountain cluster, development of such projects as Pullman Sochi University Plaza (4*), Courtyard by Marriott Sochi Plaza (4*), Swissotel Kamelia, Regency Hyatt Sochi, Park Inn City Centre and Park inn Riviera, should impact the improvement of the quality of the services provided in the

hospitality market in Sochi. In addition to the above mentioned projects, there are also several projects in upscale segment that are currently under development in Sochi:

TABLE 4. UPCOMING SUPPLY

Name	Brand	Category	Inventory
Park Inn Sochi City Centre		3*	160
Park Inn Riviera		3*	150
Regency Hyatt Sochi		5*	200
Swissotel Kamelia		5*	211
Pullman Sochi University Plaza		4*	150
Courtyard by Marriott Sochi Plaza		4*	345
Гостиница «Звездный-2»	NA	4*	120
Санаторий «Кавказская Ривьера»	NA	5*	250
Гостиница «Приморская»	NA	4*	210

Upcoming Opportunities & Challenges

Sochi's hospitality segment is evolving. Not only are the dynamics and specifics of demand are changing, but the supply is developing as well. With the new properties coming into the market, segmentation and focus of the hotels on specific market segments is growing. Hotels targeting specific markets can be noticed. More specialized approach will allow management and line staff to be more precise in fulfilling customers' needs and providing personalized service, thus increasing the guest satisfaction, which should lead to the increase of the competitiveness of those assets. More competition will further lead to increase of service quality within the destination. Supply growth outpacing demand in Sochi will push accommodation providers to strive further in providing better service in order to win their market share.

Besides such positive factors as increase of the service levels of and improvement of the image and competitiveness of the destination, it should be noticed that such operational indicators as

ADR and Occupancy rates will be under pressure in the medium term. However, despite the upcoming slowdown in operational performance of the properties, market will absorb the supply increase in the long term and the situation will balance out.

The pricing strategies of the accommodation facilities of Central and Khosta districts of Sochi will be affected not only by the upcoming properties within those districts, but as well a significant increase in supply in Imeretinskaya Lowland. Mostly, those districts will compete in MICE, leisure and sports segments, while health and wellness travel will not be affected, due to the different specialization of the properties in the Lowland.

Sochi's health & wellness segment has potential for further development and considering the available natural resources, could compete on the international level. Due to recent renovation and modernization of the existing health and wellness establishments and their medical facilities, they will become more attractive and competitive. However, without centralized promotion of Sochi as wellness & health destination on the national and international levels, further development of this segment to its full potential will be challenging.



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About the Authors

Alexey Korobkin joined HVS in 2010. Originally with a degree in Economics and Finance, Alexey has also obtained an MBA in Hotel and Tourism Management from one of Switzerland's top hotel universities. Alexey has held positions in various hotels across Europe, US and Russia. He has been involved in multiple feasibility and valuation studies for HVS. Since January 2011, Alexey has been based in Moscow, where he has completed feasibility and valuation studies in Russia and Ukraine.



Margarita Lobova started her career path in Hospitality by earning a Degree in Economics and Management in Tourism. At the same time she joined Petro Palace Hotel in St Petersburg as a receptionist gaining knowledge of the industry from an operational perspective. She had furthered her experience by doing postgraduate studies in Switzerland at Glion Institute of Higher Education. After successful graduation from GIHE with distinction she joined Shangri-La Hotels and Resorts in Abu Dhabi, UAE where she stayed for three years, advancing from Front Office associate to Business Development Manager. In July 2012 Margarita joined HVS Consulting & Valuation Moscow in the role of Junior Consultant.

