

Executive Report

The magazine for the Tourism, Hospitality and Leisure industry

Solving the Russian riddle

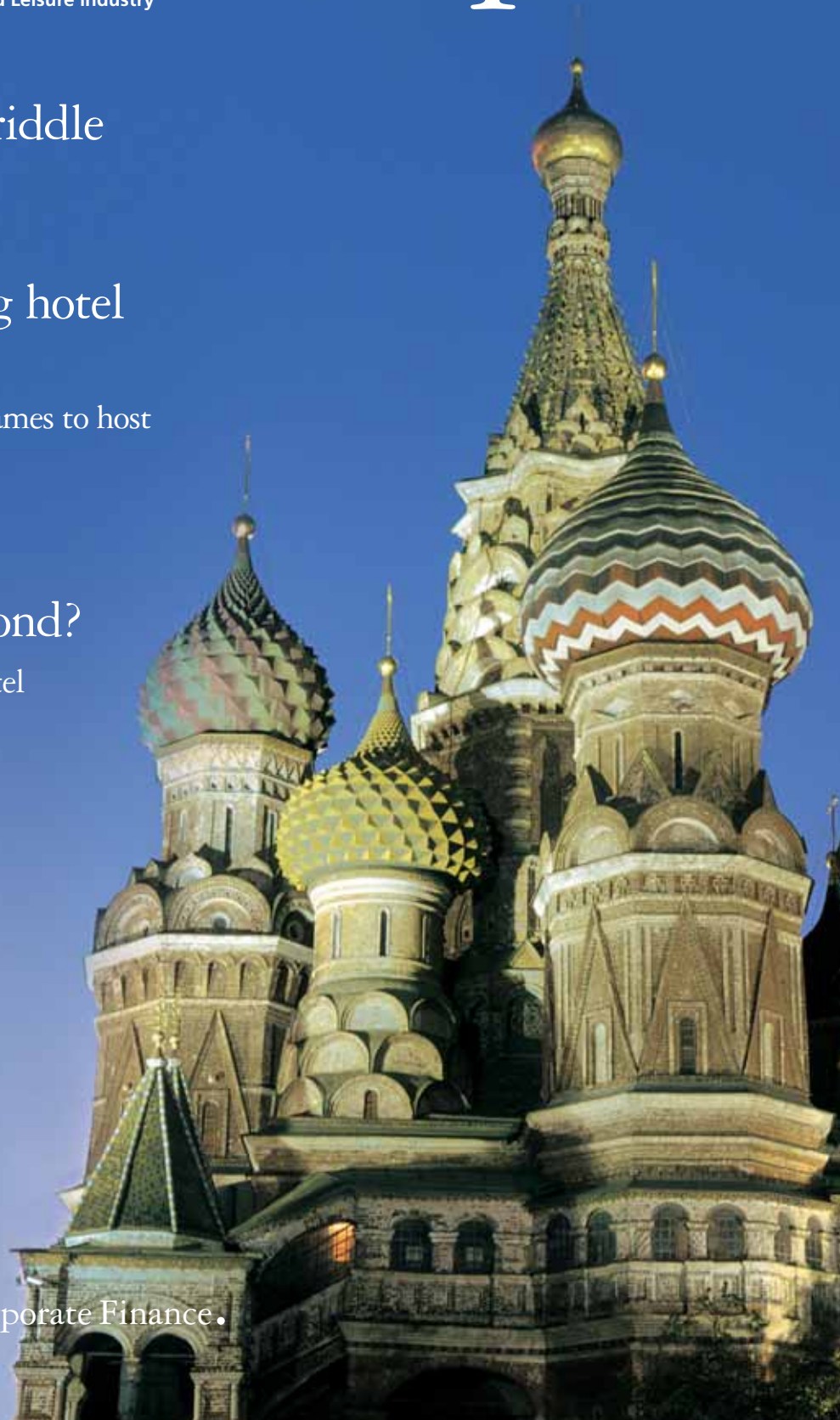
Russia's tourism potential

Why China is hoping hotel figures add up

The benefits of the Olympic Games to host cities – what can China expect?

Tough times ahead – are you ready to respond?

A clear strategy should help hotel businesses face current market uncertainties



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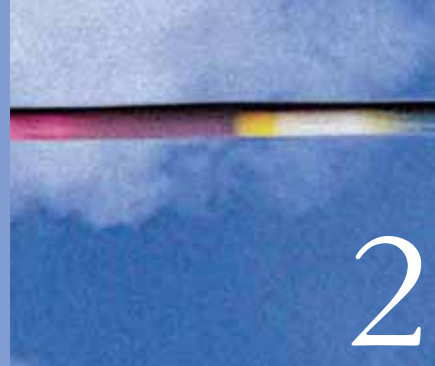
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Welcome

Economic cocktail makes cash focus imperative

Since our last Executive Report was published at the start of the year, I have travelled across the globe working with Deloitte clients and have attended conferences on four continents. With alarming frequency I am hearing people say: "...we've seen it all before."

But actually, we haven't. At no time in the history of tourism, hospitality and leisure have we faced such a deadly cocktail of spiralling global inflation, a self-inflicted credit crunch that is undermining new supply and M&A, rising food and utility costs, escalating oil prices and a resultant loss of consumer confidence. Undoubtedly, we are well into uncharted territory, and there is no 'quick fix'.

Most analysts expect the rough ride to continue into 2009 and there have been warnings of worse to come. Airlines, inexorably linked to the well being of our industry, are under severe pressure, and we have already seen the first batch of casualties in Europe.

So what's the best plan of action? First, it's worth reminding ourselves that, in this situation, every member of the team can make a difference to the survival of the business. This is the time to innovate in generating top line revenue while at the same time focusing on the lifeblood of the organisation – cash. Whether into high or low leverage, everyone must focus on turning revenue into cash as quickly as possible and challenging the status quo of spending. Unless spend is directly or indirectly generating value for the customer, it should be questioned and perhaps eliminated.

In this edition, we present an analysis of hotel performance during economic recession and share lessons learnt in responding to this environment. We also take a look at Russia and China, two of the major emerging markets, offering fresh opportunities for tourism, hospitality and leisure.

As ever, we value your feedback.

Best regards



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Why China is hoping hotel figures add up

The numbers are impressive – and they're growing. Global tourism will generate some US\$8 trillion this year and is expected to increase to around US\$15 trillion over the next ten, according to the World Travel and Tourism Council (WTTC).

Meanwhile, global tourist arrivals, just short of 900 million last year, based on World Tourism Organisation (UNWTO) reports, are expected to rise by around 4% in 2008.

Fastest growth to date is across Africa, Asia Pacific and the Middle East, which is a trend we expect to continue as emerging markets rival traditional destinations in the Americas and Europe. India and China, for instance, have expanding middle classes with more disposable income than ever, who are all eager to travel, while the Middle East continues to attract more corporate travellers as well as millions looking for year-round sun and shopping.

Figure 1. Global hotel performance for year to May 2008 v. year to May 2007

	Occupancy %	Change %	Average room rate US\$	Change %	revPAR US\$	Change %
Asia Pacific	68.9	-2.2	148	17.0	102	14.5
Central & South America	67.6	2.7	130	18.2	88	21.4
Europe	64.8	-0.2	171	17.0	111	16.7
Middle East	76.5	6.0	183	14.1	140	21.0
US	60.1	-2.2	108	4.5	65	2.2

Source: STR Global HotelBenchmark™ Survey

So far, so good

Globally, hotel businesses have been singing the same tune. As shown in the table, information supplied by the STR Global HotelBenchmark™ Survey reveals double-digit revenue per available room (revPAR) growth across all world regions – apart from the US – for the first five months of 2008. This is being driven by average room rates all well up on the year before, again, apart from the US.

The Central and South America region is on top, with revPAR up 21.4% to US\$88. The region is benefiting from the weak US dollar, which is keeping US travellers – keen to find good value for money – closer to home. In second place is the Middle East, witnessing the fifth year of double-digit revPAR growth and achieving the highest absolute revPAR in the world. This is some US\$29 higher than the next best performing region, Europe. In fourth place is Asia Pacific, achieving revPAR growth of 14.5%. The US, with growth of just 2.2%, is at the bottom. It should be noted though that the weakness of the US dollar is inflating revPAR gains elsewhere, particularly in Europe.

With the WTTC and UNWTO sharing the same optimistic outlook, hotel operators can expect a solid performance for the rest of the year.

The power of sport

World-class sport is always a powerful magnet and brings in thousands of spectators, while giving the host country an opportunity to showcase its attractions. This year sees several high profile fixtures on the calendar. In June, the European Football Championships were hosted by Austria and Switzerland, and in September, Singapore welcomes the Formula 1 Grand Prix, which is Asia's first street race and the first night-time event in the history of Formula 1. However, the main sporting spectacle of 2008 is the Olympic and Paralympic Games in Beijing.

Tourism transformation

Since July 2001, when the International Olympic Committee named Beijing as host for the Games, the city has undergone a rapid and far reaching transformation. More than US\$40 billion has been ploughed into China's capital, expanding and enhancing the tourism infrastructure, including hotels, sporting venues and special interest sites.

The public transport network has been upgraded to move visitors and athletes around the city easily, with a new express train connecting downtown Beijing to the Olympic site. A light rail line has also been built to link Beijing Capital International Airport to Dongzhimen station in the centre of the city.

A massive amount of hotel development and refurbishment has been completed to accommodate the 600,000 international and 2.5 million domestic tourists expected in Beijing during the Games. According to Lodging Econometrics, Beijing currently has 71 hotels (18,458 rooms) in the pipeline, with 51 of these (12,326 rooms) due to open during 2008.

Many of the world's major hotel brands are strengthening their presence here. Hyatt Corporation is due to open the Park Hyatt Beijing in July, down the road from its sister hotel, the Grand Hyatt Beijing. The hotel will occupy the top floors of a 66 storey tower in the mixed-use development of the Beijing Yintai Centre. Millennium and Copthorne Hotels plc opened its fourth hotel in China, the 520 room Grand Millennium Beijing, in April 2008. This is in the Beijing Fortune Plaza mixed-use development, in the heart of the new Beijing Central Business District.

Other global brands moving in include Fairmont Hotels & Resorts, Starwood Hotels & Resorts Worldwide Inc, with the aloft Beijing, plus Hilton Hotels Corporation's Hilton Beijing Wangfujing.

Before – and after

Even with the mixed publicity in the run-up to the games, Beijing tourism officials estimate that 4.5 million international



tourists will visit the city this year – before, during and after the Games – generating more than US\$4.8 billion in revenue. Domestic visitors will bring in an additional US\$20 billion, as 102 million Chinese tourists are expected to visit their capital.¹

With high demand for rooms expected throughout the rest of 2008, hotel profitability should be good, but – as other Olympic host cities have discovered – there is usually a lull just before and immediately after the competition. This could be because people are avoiding the anticipated crowds, as well as the perceived hikes in airfares and accommodation costs.

This trend has already been picked up in the year to May 2008 results from the STR Global HotelBenchmark™ Survey, which shows occupancy down 7.5% to 63.2%. However, average room rates are up 17.3% to US\$138, leading overall to revPAR of US\$87.

Extra rooms usually flood the host city ahead of the Olympics, as happened in Barcelona and Sydney, where supply rose by around 30%. Both cities suffered a crash in occupancy after the Olympic Games, an experience avoided by Athens, where the lack of building sites and high land prices kept new build to a minimum.

As a result, Athens enjoyed high occupancy and soaring average room rates during the competition schedule, when revPAR rocketed 551% to US\$406. In Sydney, revPAR increases were nowhere near as impressive, up just 80% to US\$148 – possibly due to the over-supply of rooms. Beijing will therefore be hoping its hotel business will emulate Athens, rather than Sydney. Sydney also hit a post Olympics gloom after the 2000 event, not just because of its extra hotel numbers, but through a combination of the aftermath of 9/11 and weakening economies. Barcelona felt the pain too, mainly because of the massive increase in supply both before and after the Games.

Both cities gradually recovered though, primarily by promoting themselves as world class venues for Meetings, Incentives, Conference and Exhibitions business, which is now thriving in both destinations. They also increased their appeal to leisure travellers through imaginative marketing campaigns.

Long-term legacy

At this stage, one can only guess whether the US\$40 billion invested in Beijing's tourism infrastructure will have a long-term legacy and whether a more open China, as seen during the unprecedented TV coverage following the devastating earthquakes in May, will lead to a sustainable increase in visitors.

China clearly wants the Olympic torch to light up Beijing and tourism officials will be hoping the accompanying international interest will put the country on the front pages for all the right reasons during the summer months. ●

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1. Mintel Report, 2008

Tough times ahead – are you ready to respond?

As the slowing global economy continues to make the headlines and remains high on the agenda for governments and business leaders, we examine the implications for the hotel industry.

Can the lodging sector maintain its recent strong performance and remain optimistic in the light of falling consumer and business confidence? What historical evidence is there to indicate that lodging performance suffers in a recession? And most importantly, how can hoteliers protect themselves from feeling the full impact of an economic slowdown if it does hit?

In this article, we consider the likely effect of the economic turbulence on the hotel sector across Europe and the US, and put forward a checklist of immediate actions that operators and owners could take in order to lessen the financial impact of a slowdown in demand.

Measuring consumer confidence

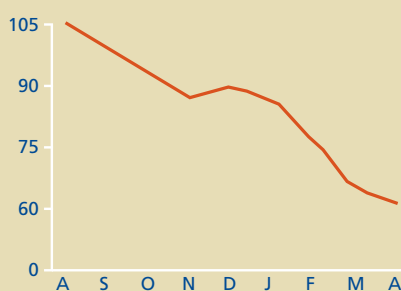
While opinion remains divided as to whether the US is heading for a recession, two key barometers of US consumer views reveal that confidence has already plummeted.

In April this year, the Index of Consumer Sentiment, compiled by the University of Michigan Surveys of Consumers, and the Index of Consumer Expectations (ICE), supplied by The Conference Board, both recorded falls in excess of 20 points since April 2007. Both are more than 30 points off their January 2007 peaks.

Interestingly, the ICE has actually fallen 39% since that early 2007 figure, compared to falls of 24% and 30% ahead of the 1990 and 2001 recessions.

The ICE is also a principal component of the overarching Consumer Confidence Index (Figure 1) which has shown a steady decline of over 40 basis points since April last year.

Figure 1. Consumer Confidence Index



Source: The Conference Board, April 2008

The European view

The US credit crunch has also bitten in Europe with a number of deals failing to complete in the last twelve months – for example, Mitchells & Butler/Punch and Sainsburys/Delta Two. We have seen a vast reduction in the availability of cheap debt, volatile share prices, and the first run on a British bank in 140 years.

The Business Climate Indicator for the euro area continues a downward trend that began in mid 2007, but it has not yet reached the troughs of the recessions of the early 90s and the beginning of this decade.

Meanwhile, the Economic Sentiment Indicator is also declining, and was below its long-term average at the end of April this year, weakened by falling business and consumer confidence, especially in the services and retail sectors.

Amongst the larger EU member states, the UK is experiencing the worst decline with a drop of more than eight basis points in a single month, compared with falls of between one and four basis points in other key EU countries.



Lessons from the past

Historical data reveals there is a degree of correlation between confidence indices and changes in Revenue Per Available Room (revPAR). This was clearly seen during the aftermath of 9/11 and at the start of the Iraq war in 2003, in both the US and in Europe (Figures 2 and 3). As confidence falters in 2008, should hotel operators and owners be concerned that revPAR will be similarly affected, even though recession may be a distant or remote prospect?

In the UK, revPAR indeed suffered in the last downturn as well as in the early 90s recession. London felt the most pain, a logical consequence of being a key economic hub, reliant on international business and leisure travellers. However, the regional revPAR rates held up somewhat better in the early part of this decade when London was experiencing a 34% drop in revPAR due to 9/11 and the Iraq crisis (Figure 4).

When we look at other hotel key performance indicators over the last ten years, such as Average Room Rate (ARR) and occupancy rates, it can be seen that the last recession was characterised by an initial decline in occupancy rates, followed by a decline in room rates, as seen in the analysis in Figure 5 of the segmented EU hotel market between 1999 and 2006.

However, it is also clear that occupancy rates are the lead indicator of market recovery.

Whether the current trends shown in the confidence indices imply that we are heading for a full global recession or just an economic slowdown, the question remains... what is likely to happen to hotel industry performance in the coming months?

Figure 2. Correlation between US revPAR and US consumer confidence

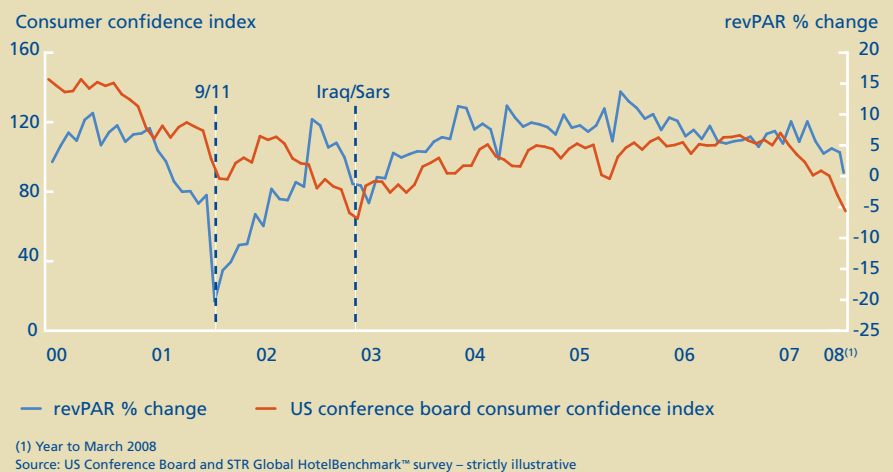


Figure 3. Correlation between European revPAR and euro area consumer confidence

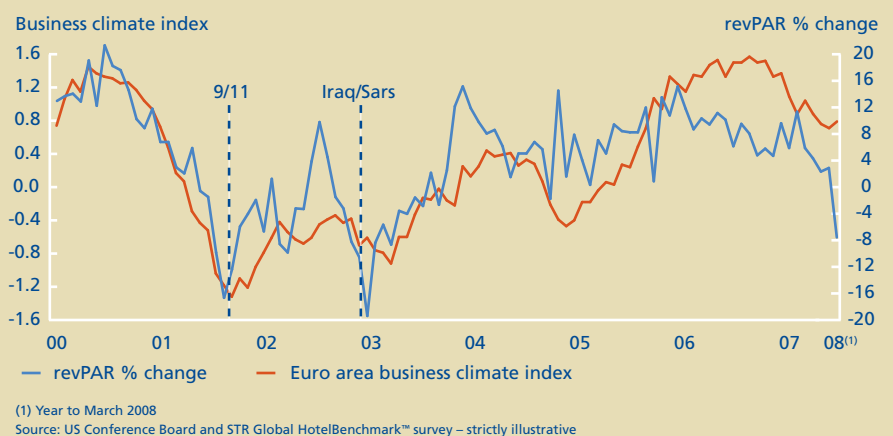
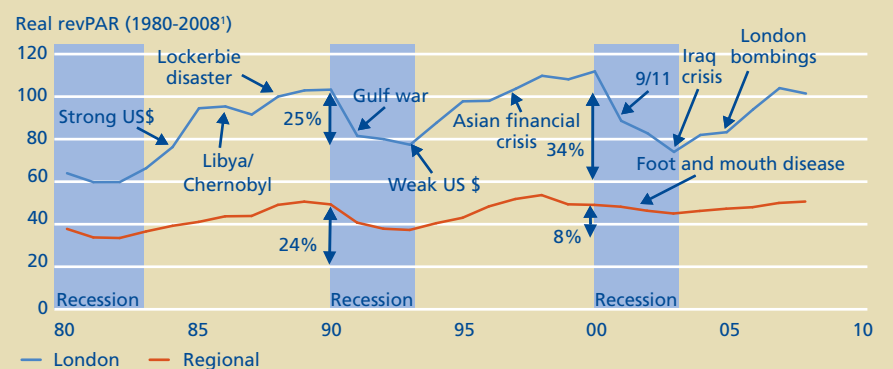


Figure 4. revPAR trends – UK example



Repeating the pattern

Analysis of the US, UK and European hotel markets from 2003 to the end of May 2008 (Figures 6 to 8) shows that occupancy rates are declining ahead of room rates, apparently following patterns seen in the last recession. This is particularly clear in the US graphs.

Whilst difficult to predict with any great accuracy, current market performance, driven by the general economic climate, suggests that the hotel industry will indeed be in for a tough time as occupancy levels begin to show decline again.

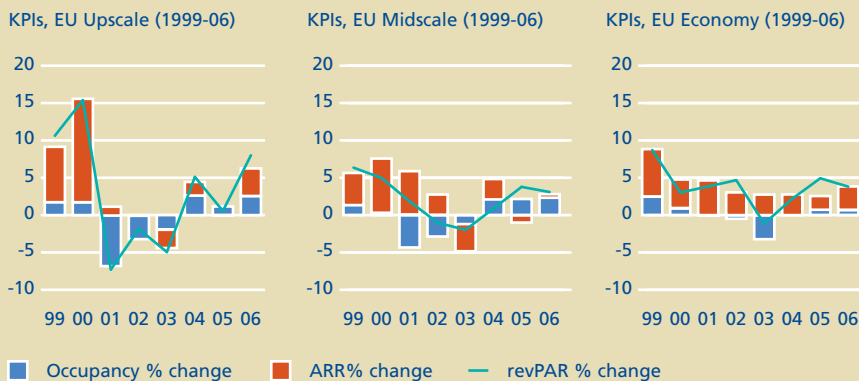
During the first five months of 2008, occupancy has fallen year-on-year in Europe and the US, and across all segments, apart from the European midscale sector. Growth continues in room rates, albeit more slowly than we have seen in the past few years.

As confidence continues to wane, consumers are likely to tighten their purse strings and curtail their discretionary spending, with an expected impact on leisure travel and weekend business for many hotels.

History tells us that reductions in occupancy levels may eventually lead to reductions in ARR as hotels discount their 'rack rates' to entice these customers back.

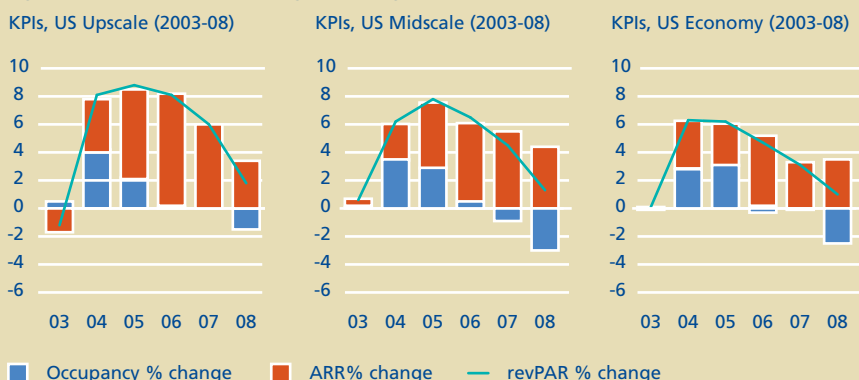
The strength of the pound and the euro against the dollar is good news for the US hotel market, as Europeans are opting for US vacations and US families are choosing to holiday closer to home. However, these benefits are most likely to be felt in the major cities, rather than across the US leisure market as a whole.

Figure 5. Lead indicators of change (% change)



Source: MKG Consulting; Deloitte Research & Analysis

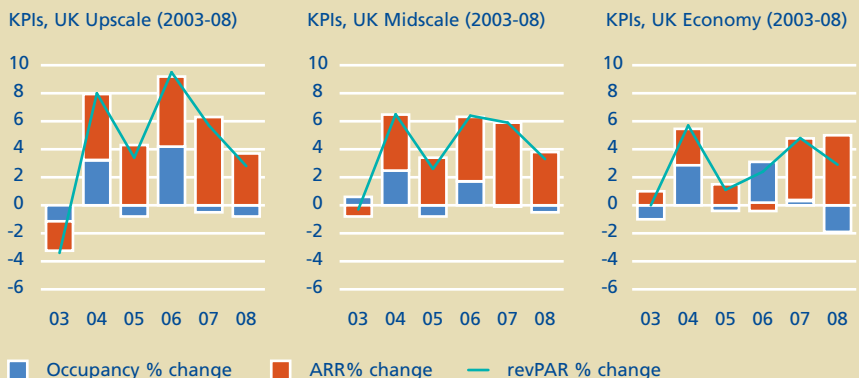
Figure 6. Lead indicators of change (% change)



Note: 2008 shows data for period to May 2008 only

Source: Smith Travel Research Inc

Figure 7. Lead indicators of change (% change)



Note: 2008 shows data for period to May 2008 only

Source: STR Global HotelBenchmark™ survey

Impact on the upscale market

While there is no evidence that occupancy rates are declining more quickly in the upscale market, we may in the longer term see consumer spending redirected towards the mid market and budget sectors.

In the event of a sustained economic slowdown, companies will be forced to cut costs in order to enhance their competitive edge. Reduced spend on meetings, entertaining, training and business travel will have an impact on room, conference and banqueting revenue for hotels operating at the top end of the market.

And, as shown in Figure 9, the greater the degree of ownership (whether owned or leased) and the more up-scale the market segment, the more sensitive the asset will be to market forces during tough trading conditions. This is driven by customers trading down, plus the burden of depreciation and interest payments on each room, driving down profit before tax per room.

However, whilst this type of property feels any downturn more acutely, it also experiences the strongest recovery as conditions improve, particularly those in primary or airport locations.

It is critical, then, for this hotel segment to act swiftly before the downturn really bites, not only to lessen the initial negative impact but also to ensure the business is well placed to benefit from future market recovery.

Pipeline threatened

While the credit crunch threatens to damage hotel performance by undermining consumer confidence in the US and Europe, we should also consider its possible impact on future hotel developments.

Hotel sites scheduled to open in the next 18 months are too far down the development path to be seriously affected but the consequences of the credit squeeze may well be felt in 2009 and beyond.

Figure 8. Lead indicators of change (% change)

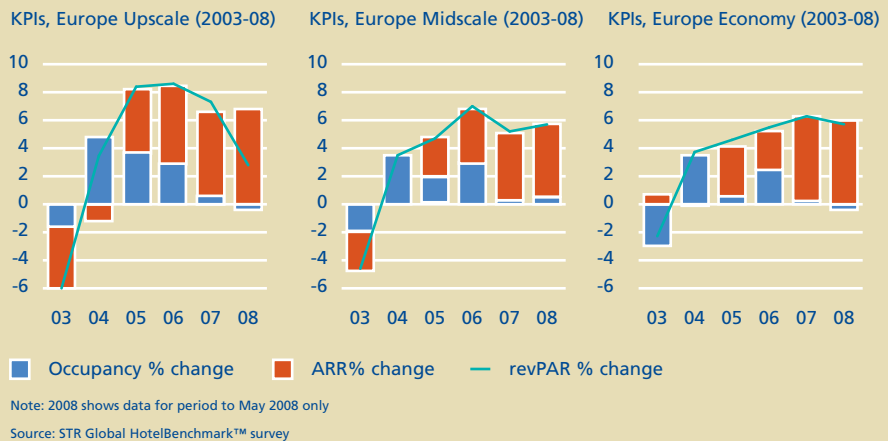
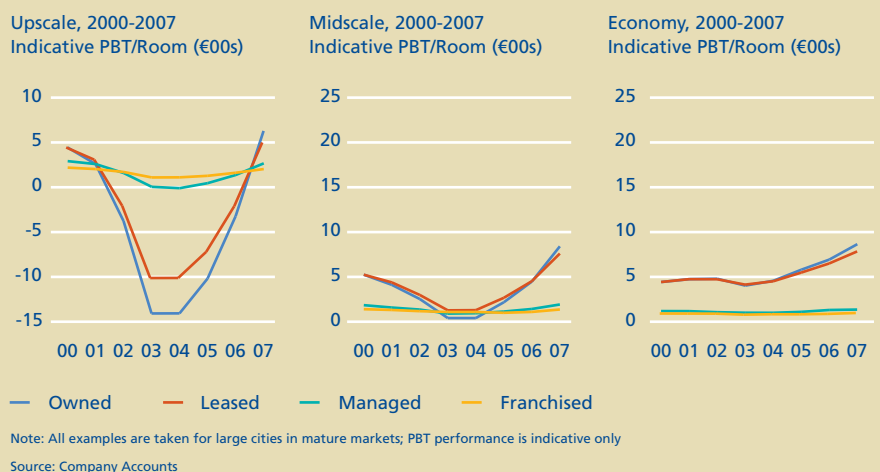


Figure 9. Recession impact by segment and ownership profile

NB these illustrative examples do not include the real estate 'churn' profits associated with the owned/leased estate, but relate to the operations of the hotel only.



As the supply of debt dries up and the cost of financing rises, profitability will be squeezed – particularly in marginal developments – and we may see fewer new hotels and major refurbishment projects. Falling consumer demand would also undermine the feasibility of development projects and impact on planned pipeline.

For the time being, major hotel brands remain optimistic and have a strong, growing pipeline of new openings, much

of which is new construction. However, given the potential for downturn, we expect to see this pipeline tail off as developers seek to protect their margins and the supply of standard lodging accommodation begins to outstrip demand.



Time to act

Given that consumer confidence indices indicate tough times ahead and that historical data suggests hotel industry performance suffers during times of economic slowdown, particularly in the upscale segment of the market, how can hoteliers respond to these potential challenges?

Smart hoteliers will undoubtedly have their own checklists of actions to take to stay profitable during uncertain times, and that list may include:

- Closely monitoring occupancy rates – critical in the coming months to identify whether a knock-on impact on revenues and profits may be imminent as the slowdown starts to bite.
- Developing cost saving plans early – particularly important for the upscale market, where quality and care is critical to customer satisfaction.
- Reviewing capital expenditure plans – delaying refurbishments to retain cash in the business where possible, as long as this does not damage the brand and the hotel's reputation. Capital expenditure plans that are well above target IRR (internal rate of return) prior to any downturn are still likely to make economic sense. It is those plans that are marginal that should be critically reviewed and reevaluated.
- Reviewing non-operational head count and reducing non-essential expenditure such as

marketing, corporate overheads, travel, mystery guest programmes and innovation projects – costs in this area tend to rise more quickly in an upturn than direct costs of running hotel operations and there may be potential to reduce such expenditure during any downturn without impacting the service offering.

- Deferring some operational costs such as non-essential maintenance or seasonal cleaning to improve cashflow, as long as this does not harm the customer experience.
- Maximising revenue generating opportunities – ensure marketing campaigns are accurately targeted and distribution channels are effectively managed.
- Pursuing new opportunities – is there scope to acquire distressed assets to reach previously untapped sectors of the market?
- Offering new packages to stimulate demand – the inclination in tough times is to respond by cutting prices. However, once rack rates fall, it becomes an increasingly difficult task to move them back to the levels a hotelier would like to see once the market has recovered. Consider whether a free night offer or a restaurant deal is more effective in the long term when trying to boost occupancy.

Monitoring trends

Industry analysts will be watching the occupancy trends seen so far this year

very closely, and checking to see whether this drop in demand leads to reduced room rates during the second half of 2008.

Optimists, however, will point to the fact that, globally, the number of international tourist arrivals is expected to increase by around 4% in 2008, up from the 900 million visitors who travelled the world in 2007.¹

As we point out elsewhere in this report, there is a shared view that revenue from tourism is still on an upward path, and in the short term at least, there are no signs that people's enthusiasm for travel is waning. While some markets are facing an economic squeeze, other destinations are expanding at a rapid pace.

Whether or not we are in for tough times ahead, smart hotel operators should take this opportunity to ensure they are in good financial shape and have a clear strategy in place in the event of continuing economic slowdown. ●

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1. World Tourism Organisation (UNWTO)



Solving the Russian riddle

“A riddle, wrapped in a mystery, inside an enigma.” Winston Churchill’s famous description of Russia still captures its exotic and elusive appeal. The country has long held a fascination for travellers, not least because of its immense size, turbulent history and rich cultural heritage.

Modern Russia is the largest country in the world, covering more than one eighth of the Earth’s land mass, crossing 11 time zones and home to 160 different nationalities, straddling European and Asiatic cultures.

Despite its vast geographic presence and significance as a major player on the global stage, the country remains a great secret for many tourists, shrouded in mystery by decades of concealment behind the Iron Curtain.

Since the end of the Soviet Union, foreign direct investment in Russia has gathered pace rapidly, rising to \$US 8 billion by 2003, then surging to an estimated \$US 55 billion in 2007 as overseas companies increasingly identify opportunities in the region.¹

Strong base

Like other Russian industries, tourism has only begun to develop commercially in the past 15 years but, with over 20 million annual visitors in 2007, Russia is already amongst the top ten most visited countries in the world.

Despite this strong base Russian tourism has vast scope for future value growth. The World Travel & Tourism Council (WTTC) ranks the Russian tourism economy 12th globally in absolute terms, but only 128th in terms of its relative contribution to its own national economy.²

International tourism receipts have more than doubled since the start of the current decade, although at around US\$7.6 billion in 2006, they remain relatively low compared to other destinations with comparable visitor volume. Germany and Turkey, for example, also have inbound tourism levels around the 20 million mark, but receipts of US\$32.8 billion and US\$16.9 billion respectively in 2006.³

Key source markets

Part of the explanation for this discrepancy lies in the composition of Russian inbound tourism. Almost two thirds of the country’s visitors originate from the countries of the former Soviet Union, with a large component of Visiting Family and Relations

travel as well as migrant workers. Further afield the key source markets are Germany, Finland, the US, the UK, Italy, France and Japan, with inbound visitor figures gradually increasing in recent years.

Attracting more of these high spending leisure and business travellers from the West, and diversifying into the fast growing Asian Pacific source markets to the East, will be vital if Russia is to realise its huge international tourism potential.

No room at the inn

Russian tourism has taken significant strides since the collapse of Communism, but faster growth remains hampered by a number of obstacles. The European Champions League Final in Moscow in May 2008 provided a telling illustration of these difficulties, with 50,000 English football fans struggling to obtain entry visas and desperately trying to locate available hotels in the capital. The authorities subsequently agreed to establish a one-off non-visa regime for the Final. However, whilst the overall system has



been simplified for business travellers, visa requirements remain a significant deterrent for most leisure tourists. This places Russia at a disadvantage compared to many of its competitors in Eastern Europe and South East Asia who have abolished such restrictions. Perhaps the biggest boost for tourism to Russia would be to build on the success of the non-visa regime for the football final by allowing for unlimited one week visits to the Moscow-St. Petersburg corridor either with no visa or one issued at the airport.

Infrastructure challenge

Entry requirements aside, the core underlying challenge for Russia is to improve the availability of high quality tourism infrastructure, particularly in the hotel sector. The legacy of the Soviet era still casts a dark shadow over the calibre of accommodation on offer in many cities and resorts, especially outside Moscow and St. Petersburg.

Moscow is emerging as a major global commercial and tourist centre attracting over 4 million overseas visitors in 2007,

projected to rise to 5 million by 2009. Rising demand is far outstripping the current hotel supply of 6,428 daily available rooms.

Scarcity in the capital has driven growth in average room rates from US\$136 in 2001 to US\$403 as at March 2008, and 27% year-on-year growth in revPar to reach \$US238 in the first quarter of this year.⁴ If anything, these averages understate the real cost of good quality tourist and business accommodation.

However, these high lodging costs discourage visitors from staying longer. According to the 2007 Mercer Cost of Living Survey, an annual ranking of expatriate costs in 143 cities worldwide, Moscow was the world's most expensive city for the second consecutive year.

Leisure asset

St. Petersburg, with its proximity to Europe and rich cultural heritage, is Russia's greatest leisure tourist asset, attracting over 4.5 million visitors, almost half of whom are from

overseas. Whilst these visitor numbers are comparable with many other European tourist magnets, the city currently has only 3,479 daily available rooms, significantly less than most major European urban centres.⁴

The dearth of high quality, independently owned accommodation in all cities offers a major opportunity for global hotel brands with the power to attract both international visitors and the growing Russian middle class.

Hotel groups with an already established presence in the Russian market include InterContinental Hotels Group PLC (IHG), Marriott International Inc, Hyatt Corporation, Radisson Hotels & Resorts, and Best Western International, with the majority of development targeted at upscale business and leisure guests. Budget/mid-market development so far remains relatively low but some interesting trends are emerging. For example, St Petersburg already has a noticeable presence of small, privately owned and medium priced hotels and guesthouses, whereas they remain rare in Moscow.



In the pipeline

Current hotel development in the country is focused heavily around these two major cities, with Moscow and St. Petersburg together accounting for almost 70% of Russia's total current development pipeline of 10,807 rooms.⁵

IHG's recently announced new-build Holiday Inn project in Moscow, with local investment partner Silkton Ltd, will be the group's 16th hotel in the country. IHG will have nine hotels in the capital, three are under construction in St. Petersburg, and further hotels are in the pipeline for the cities of Samara, Rostov, Chelyabinsk & Novosibirsk.

The opening of the Hilton Moscow Leningradskaya in May 2008 marked Hilton Hotels Corporation's first foray into the Russian market. The group plans to launch 25 new hotels under selected Hilton brands over the next ten years in partnership with a local subsidiary of London & Regional Properties.

Low cost airlift

In terms of transport, Russia is served by around 70 international airports, with air traffic dominated by the three Moscow hubs. Passenger growth here is meteoric, rising from 19 million in 2002 to 33 million in 2006. Expansion plans are expected to increase capacity to over 85 million by 2012.⁶

A refurbished Domodedovo airport has emerged as the winner over the Soviet style Sheremetevo, with many international carriers defecting to the more comfortable and service oriented alternative provided by the former. The emergence of Vnukovo airport as a new alternative will also provide much needed competition.

Air traffic is dominated by the major scheduled carriers, including the Russian market leader Aeroflot, now part of the SkyTeam alliance, which is anticipating a 16% increase in volume to 9.4 million passengers in 2008.⁷

However, inbound tourism is currently held back by a lack of low cost carriers flying into Russia. A number of central European players are beginning to offer services to Russia, including germanwings and Clickair, but neither of the two UK giants, Ryanair and easyJet, currently fly into the region. The fast growing city break market into St. Petersburg is likely to remain the most attractive and accessible route for the budget carriers.

High spending Russians

Russia's emerging middle class also offers huge potential for domestic holidays and short leisure breaks. However, many are similarly deterred by the under-supply of affordable bed stock and lack of cheap air travel. In a country of 17 million square km, long distance rail and road travel is less of an option than in other countries, in spite of an efficient rail network.

Faced with these problems a growing number of affluent Russians are opting to holiday abroad. In the first half of 2007, 13.7 million travellers left the country to go on holiday, 14% more than in 2006. According to Euromonitor, Russians are the eighth largest overseas tourism spenders worldwide, and they are even more significant in some of their preferred destinations such as Turkey and Egypt.

Domestic boost

Domestic air traffic has plummeted from over 130 million passengers at the end of the Soviet era to less than 20 million in 2007, prompted by high prices and safety concerns.⁸ However, the launch of internal airline Sky Express in January 2007 inaugurated Russia's first ever low cost carrier. Further entrants are expected to follow in a trend which is likely to provide a much needed boost for domestic tourism.

Investment in road and rail infrastructure is also increasing, with Government plans to build 640,000 km of new road network linking Russia's major towns and cities. Meanwhile the Finnish-Russian rail joint venture Oy Karelian Trains Ltd plans to open a high speed service in 2010 on the 450 km track between Helsinki and St. Petersburg.

Know your onions

In future years Moscow and St. Petersburg will inevitably remain at the core of Russia's international tourist appeal. These two major cities boast world renowned cultural and historical attractions, such as Red Square and St. Basil's Cathedral in the capital and the State Hermitage Museum and Peter and Paul Cathedral in Russia's major Baltic centre.

Beyond these two major gateway cities, only the 'Golden Ring' is well known to international visitors. This is a picturesque circuit of historic towns to the north east of Moscow, with distinctive architecture dating from the 12th century, and renowned for the famous onion domes of the Russian Orthodox Church. Domestic leisure travellers are most likely to

be drawn to the southern region of Krasnodar which attracts around 15 million Russians each summer to its Black Sea coastal resorts.⁹ The city of Sochi has been chosen to host the Winter Olympics in 2014 and this event will offer significant opportunities to showcase the Black Sea region to both international and domestic markets and open a gateway for winter sports in Russia.

Niche opportunities

A key future challenge for Russian inbound tourism is to diversify beyond its current heartlands. This could embrace secondary cities with rich cultural traditions such as Kaliningrad, Novgorod, Kirov and Kazan.

Other major growth opportunities for Russia include some of the world's fastest growing niche travel markets.

Adventure travel and wellness tourism possibilities exist in the volcanic landscapes and hot springs of the Kamchatka and Kurile Islands in the far east, in the largely undiscovered 'Golden Mountains' of Russia's Altai region and in the Caucasus region.

Potential for 'slow travel' is offered by cruises along Russia's main artery, the 3,700 km long river Volga and by iconic rail expeditions such as the Trans-Siberian railroad from Moscow to Vladivostok and the Trans-Mongolian line to Beijing.

Key question mark

Whilst Russia undoubtedly has the raw material for success, a key question mark remains over the State's commitment to tourism.

The World Economic Forum in Davos recently ranked the country as one of the top 35 tourist destinations worldwide, in terms of its natural resources and cultural treasures. However, in terms of Government tourism policy, Russia ranked only 125 out of a total of 130 countries. Security concerns relating to crime and to traffic accidents were highlighted at Davos as significant problems alongside the infrastructural deficiencies in transport and accommodation discussed earlier.

Despite the huge economic benefits to be gained from encouraging inbound tourism, the overarching political context also continues to cast clouds of uncertainty. International relations between Russia and many of its key source markets are strained, and it is not clear how the ramifications of power following the recent presidential handover will affect these relations.

Strategic approach

Nevertheless, whilst far from being a major political priority, there are signs that the Russian authorities are beginning to adopt a more strategic approach to harnessing the country's tourism potential.

The Government has created a number of special tourism economic zones to mobilise investment and attract domestic and foreign visitors. Companies operating in such zones will enjoy a number of benefits, including lower taxes.

Planned projects in one such zone include hotel construction and a water tourism centre and mineral spa in the Siberian city of Ulan Ude on the shores of Lake Baikal, the world's oldest, deepest and largest fresh water reservoir. Federal investment in the project is expected to exceed US\$390 million.¹⁰

Brand Russia

A key challenge in future years will be the development of an attractive and cohesive 'Russian brand', and the sustained deployment of marketing resources to sell Russia overseas. This will be vital to counter popular negative perceptions and to generate a sustained buzz around Russia as a high quality, welcoming, safe and 'must see' destination.

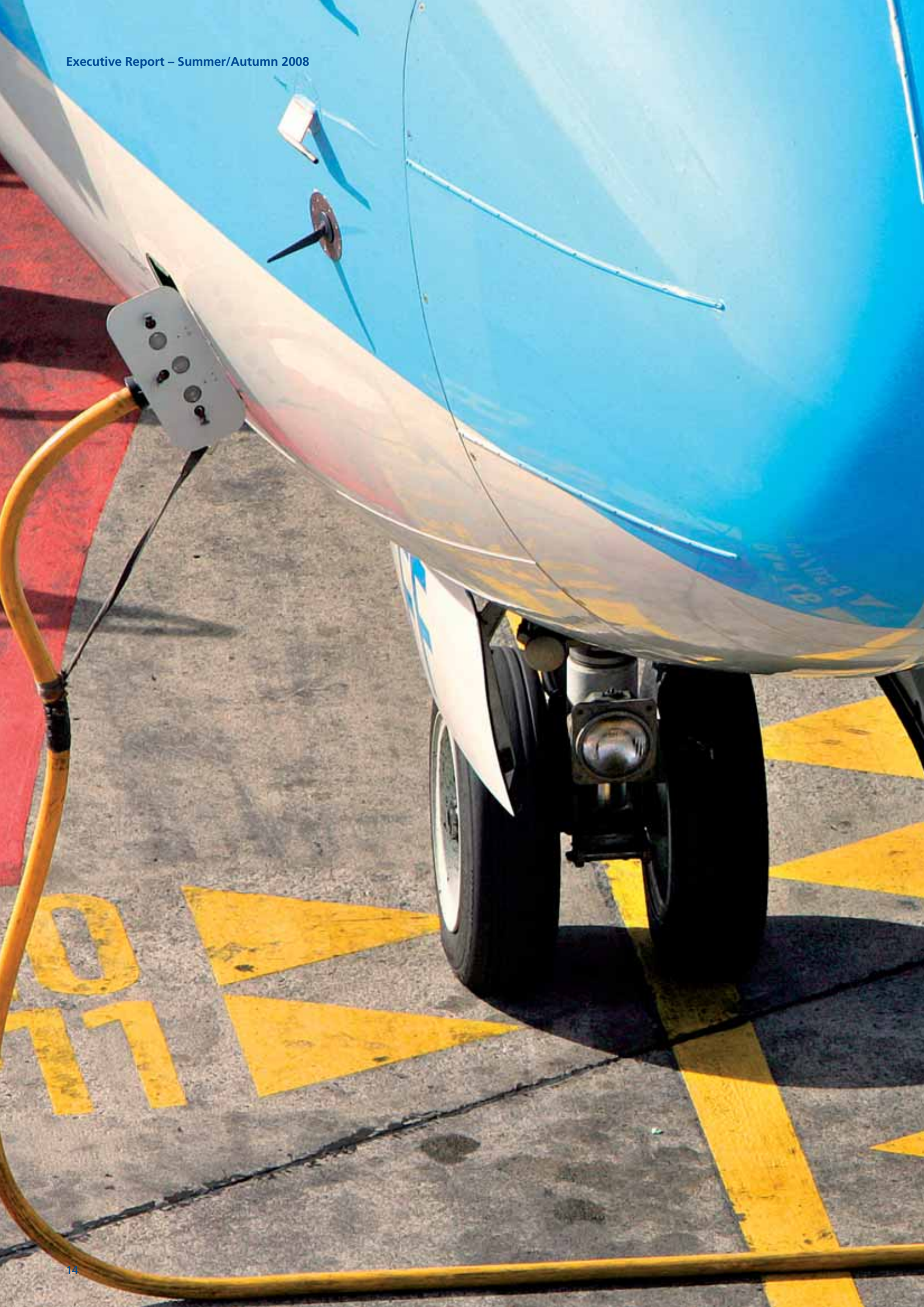
Today's international tourists are continually pushing their personal travel boundaries and are hungry to explore new destinations. Decades of secrecy and inaccessibility have helped to intensify the air of mystery and exoticism surrounding Russia in the imagination of many of these travellers.

If these challenges are met – liberalising bureaucratic restrictions, improving infrastructure, and refining and marketing the Russian brand – the country will be well placed to start releasing this pent-up demand. Like its famous wooden dolls, Russia will then begin to yield up its secrets to the gaze of international tourism. ●

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The changing landscape of US business travel

As reports of economic slowdown and record oil prices continue to flood the media, we take a closer look at the likely impact on US business travellers and consider how the hospitality and leisure industry can most effectively navigate the emerging corporate travel landscape.

In a sustained slowdown, many companies will seek to cut discretionary costs wherever possible in order to insulate themselves in a tough marketplace. Leaner operating models will impact on areas such as conference sponsorship and attendance, client entertainment, employee training and, inevitably, business travel.

Goldman Sachs analyst Steven E. Kent believes that the US corporate travel market could see overall slowdown.¹ This is borne out by a recent Global Deloitte CFO Survey in which 65% of CFOs said they were likely to cut discretionary spending such as business travel and entertainment.

Two key drivers

Travellers are traditionally divided into two categories, leisure and business, with the latter group further segmented into 'managed' and 'unmanaged' business travellers.²

Managed travellers are required or encouraged to use company designated providers, and are more likely to delegate their business travel arrangements to a corporate travel associate. Unmanaged travellers may have to follow travel policies such as daily allowances but can use whatever travel agency and supplier they wish, and are typically heavily dependent on the Internet.³

Both of these groups are affected by the rising cost of US business travel, for which there are currently two key drivers: rising commodity prices and the state of the US economy.

Supply pessimism

Oil prices surged to an all-time high of \$4.2 a gallon in May 2008, whilst US benchmark crude broke records four days in a row, reaching \$133.2 a barrel in the Spring.⁴ Rapid growth in emerging markets and weak investment in new capacity are the principal culprits behind the current price hikes.

The falling dollar may also be to blame. Oil is pegged against the dollar so as the currency gets weaker, dollar denominated oil contracts become more attractive to foreign investors. These investors have pushed oil futures to new highs, and the rest of the energy complex including gasoline futures has followed suit, inflating the price of gasoline.⁵

The Paris-based International Energy Agency (IEA) has issued a pessimistic supply outlook which could further rattle the international oil market. The IEA is preparing for a sharp downward revision of its oil supply forecast, a shift that reflects a mood of deepening gloom.

Intense pressure

As a direct result of soaring fuel prices, airlines have come under intense pressure to boost their revenues and cut costs. In May this year, jet fuel prices in New York were up 64% from the previous year.⁶

Rocketing oil prices have shattered the cost structure of the airline industry. Just a few years ago refiners charged only \$3 to \$5 a barrel to turn crude oil into jet fuel – they now charge up to \$36.⁷ The cost of pumping jet fuel into an aircraft is now estimated at \$160 a barrel, including taxes

and fees, with these higher costs inevitably passed onto the traveller.

These problems are compounded by mounting economic uncertainty in the US. In recent years, easy credit and prosperity initially concealed some investment mistakes and inefficiencies. The contraction of easily available credit, the drop in the value of home equity, and the resulting impact on consumer wealth are all now contributing to economic slowdown.

Recession planning

Most indicators suggest that the US has entered or is entering a recession, defined by economists as a decline in the gross domestic product for two or more consecutive quarters. Merrill Lynch analysts expect this to become more apparent in the second half of 2008 but in the eyes of many business leaders the US is already an economy in recession.⁸

Many US companies are struggling and some have entered bankruptcy. Others are taking a longer-term view and capitalising on the opportunities inherent in times of economic uncertainty.

When it comes to recession planning, it is wise for companies to consider putting in place a range of actions consistent with their business strategies for both the duration and aftermath of the recession. One of these strategies is curtailing business travel expenses.

The tourism, hospitality and leisure industry can expect to see a number of emerging trends as businesses explore new ways to cut travel costs.

Scrutinising employees

Corporate travel policies are likely to move away from suggested and recommended guidelines and towards mandated rules. In a softening economy, many companies will seek to control costs and curtail expenses by scrutinising the travel behaviour of employees on the road and enforcing greater compliance with corporate travel policies.

Most mid to large sized companies are now in the process of implementing a more stringent travel and expenses policy, including pre-travel and post-travel audits. We can also expect to see companies using stronger language to give concise directions about what is and what is not permissible within their policy. For example, companies are now putting in specific dollar amounts for approved spending on meals, rather than asking employees to limit spending to a 'reasonable amount'.

Talking tough

Companies may also look to online technology to help manage both the rising economic costs and the environmental impact of business travel. Online conferencing is expected to be widespread and available as a standard facility to 75% of corporate users by 2010.

As many US corporate meeting planners contend with tighter travel and entertainment budgets, operators can expect to see tougher negotiations on preferred vendor and other contracts over the coming year. In a weakening economy this may mean more leverage for company meeting planners, so understanding client needs and priorities is vital.

Seizing leadership

As the world of corporate travel faces a challenging year ahead, US hospitality providers can seize a leadership position by adopting three long-term strategic approaches: the green agenda, incentives, and cohesive branding. Each of these elements can enhance a hotel's attractiveness to business travellers.

Today's travellers are going green. The eco-conscious consumer segment has now grown large enough to spawn its own acronyms. SCUPPIES (Socially Conscious Upwardly Mobile Persons) and LOHAS (Lifestyles of Health and Sustainability), demand environmentally-friendly behaviour from hotels when travelling on business.

In Deloitte's recent survey of US business travellers, 60% said they were concerned about global warming and 55% believed they were more aware of the environment than a year ago. This awareness is helping to raise the bar of what is expected from the hotel industry in terms of environmental responsibility.⁹

Green and smart

The National Business Travel Association has added a new section on environmental questions to its standard request for proposal form (RFP). This is used by thousands of its members to select preferred properties for the upcoming 2009 bid season.

The addition of six green questions is designed to help corporate meeting planners and hotels reach a common understanding of environmental policies. This is in response to survey feedback from the corporate travel community itself. Companies can expect to see an increase in requests from corporate travel programmes for ecological credentials and green capabilities. Operators also recognise the compelling financial, regulatory, risk mitigation and broader marketplace opportunities inherent in promoting sustainability. For example, there are significant financial benefits in changing over to light bulbs that use less energy or bathroom fixtures that limit water flow. Going green is smart business.

Offering incentives

The values and behaviour of travellers often change dramatically during an economic downturn. Many customers will seek out sales and offers and one strategy open to companies is to offer cumulative incentives. This can be a particularly effective way to attract the unmanaged segment of business travellers who are booking their own travel and seeking deals online.

When oil prices spike, the impact on airlines and hotels is immediate. Instead of slashing prices upfront, hotels can lure loyal business travellers by allowing them to earn incentive points. These points can then be redeemed for a free ticket or room on future purchases in better economic times.

Brand image

Finally, branding is a great differentiator in tough times because a strong hotel brand image can help to attract first time travellers as well as generate repeat business. Brand

recognition is extremely important in winning and retaining customers in an increasingly competitive and weakening economic environment.

In today's 'experience economy' branded hotels can be promoted as part of a broader lifestyle experience – one that combines both business and leisure. Companies can also differentiate themselves by offering additional guest services such as child care, user rewards or different room features.

As the landscape of business travel grows rockier and more challenging in the months ahead, smart thinking hospitality and leisure companies will respond by devising and implementing appropriate brand strategies in order to defend their market share. ●

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Caravan holidays are back in vogue

The caravan market is booming and its changing image is adding to the sector's appeal

Choosing a caravan holiday, rather than renting a villa or staying in a hotel, was – until recently – seen as a cheap and cheerful option for families on low budgets, while having one as a permanent or second home was, typically, for the over-50s from the low to middle income demographic groups.

But, rather like camping – or 'glamping' as it's now being called – the image of caravan holidays and caravan parks in the UK is changing and its appeal is moving up the demographic scale.

Today, caravan parks cater for a wide range of consumers' price points with static caravans from around £15,000 (US\$30,000) upwards. At the top end, there are luxury static caravans and lodges with hot tubs, flat screen TVs, wi-fi broadband, en suite facilities and even a boot room to dry out the wet sports gear. Some premium lodges are being sold for more than £300,000 (US\$600,000), while up to £500,000 (US\$1 million) is being asked for mobile homes in prime locations.

Even basic caravan parks have enjoyed a surge in demand, as people look for more affordable, eco-friendly second holidays. Caravan parks have also become more attractive to different types of investors, for several reasons, and the UK caravan industry, currently estimated to be worth more

than £3 billion (US\$6 billion) a year¹, looks set for solid growth in the medium term.

Here, we consider the changing image of caravan parks and the many opportunities now offered by this alternative sector of the tourism market.

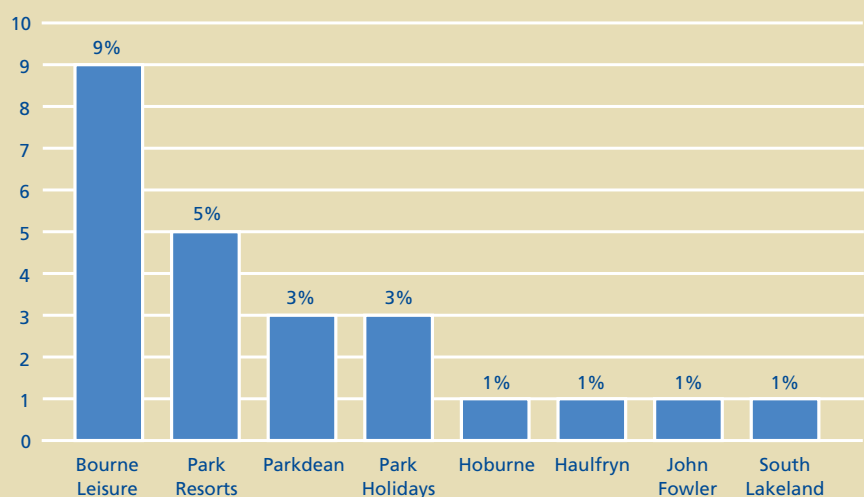
Evolutionary enterprise

There are more than 3,500 holiday parks² in the UK, offering anything from a stay on an isolated farm with a couple of washrooms

to multi-entertainment sites with over 1,000 pitches at major holiday resorts. Some of the largest, such as Trecco Bay near Tenby, South Wales have more than 2,500 static caravans and a broad offering of facilities such as indoor swimming pools, sports activities, restaurants, bars and entertainment venues.

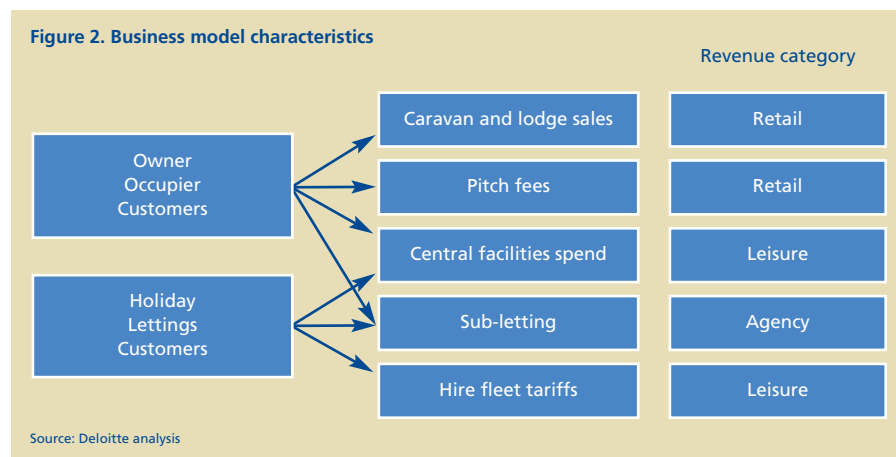
Many parks have their roots in family enterprises, and opened for business when farmers sought to diversify from traditional

Figure 1. Estimated market shares by number of pitches



Source: Company Information/British Holiday and Home Parks Association

Figure 2. Business model characteristics



agricultural backgrounds. This evolution means many sites are still independently owned, keeping the sector very fragmented. Even though we have seen a tier of major operators emerging in the past few years, with portfolios of professionally managed, well-invested parks, the top eight operators still only represent approximately 24% of the market.³

Naturally, these larger operators have access to deeper capital resources enabling them to upgrade their offerings. Their extra purchasing power also gives them greater operational and marketing efficiency than family owned concerns. As a result, there is a significant differentiation between professionally managed parks owned by a major operator and many of the individually owned sites.

The best of both business models

There are two main types of business models – owner-occupier and lettings.

With the former, operators sell caravans or lodges to customers who pay an annual pitch fee under a licence agreement. Caravan sales are driven by either 'pitch churn' or the sale of newly-developed pitches. 'Pitch churn' sales comprise those to new customers as existing owners leave or owners decide to part-exchange their current units for new ones. With well-managed parks consistently 'churning' pitches every five to seven years on average, and pitch fees paid annually in advance, the owner-occupier model has strong earnings visibility and very high rates of earnings to cash conversion, in some cases as high as 90%.

In the holiday lettings model, a fleet of caravans and/or holiday homes are let throughout the season. Revenue is generated by tariff income plus secondary spend in the central facilities. This tends to translate to better profitability per pitch, but a lower earnings to cash flow conversion, because of the capital investment needed for the hire fleet.

Many major operators use a combination of both models. This hybrid offers more flexibility as operators can switch between owner-occupier and lettings, depending on demand and pricing, to optimise their financial returns. People who rent a caravan for a holiday generally demand higher quality central facilities, and making these available not only enables operators to charge higher pitch fees to owners, it increases sales of more upmarket caravans – often to those who originally visited on holiday.

Increasingly, caravan owners are sub-letting, earning extra income that may encourage them to buy a more expensive unit. This generates a higher margin for the park operator, who also gains extra income from additional lettings, without having to invest in a larger fleet.

The table above summarises revenue streams from the hybrid business, which gives operators more options for enhancing income.

Creating shareholder value

As the sector is currently so fragmented, there is plenty of opportunity for consolidation, and larger operators benefiting

from both cost and revenue synergies can add significant value for shareholders.

Buy and build schemes are increasing, particularly by those operators backed by private equity. 2007 saw a steady stream of single park acquisitions by Bourne Leisure, Park Resorts, Park Holidays and Haulfryn. A larger bolt-on acquisition involved Parkdean Holidays acquiring Weststar Holidays – with support from Alchemy Partners – for £83 million, gaining four high-quality lettings parks and the very strong Weststar brand.

One of the largest single consolidations to date was the acquisition and subsequent merger of Park Resorts for £165 million and GB Holiday Parks for £105 million by ABN AMRO Capital in 2005. This transaction created the second largest player in the sector with 35 parks and approximately 18,000 pitches. Following their integration and a park investment programme, ABN AMRO sold Park Resorts to GI Partners for £440m in 2007. With many independent operators still remaining, this value creation route looks set to continue going forward.

Broadening investor appetite

Private equity investors have been moving into the sector over the past decade, funding operators such as Bourne Leisure, Park Resorts, GB Holiday Parks and Parkdean Holidays, and are continually looking for fresh opportunities.

Meanwhile, interest is growing from other sources, including property investors, looking for better yields than they can find among the traditional asset classes, such as retail and commercial property. Caravan parks offer freehold sites in attractive rural locations, and as planning rules restrict new developments at a time of increasing demand, investments make good business sense.

There is also scope for medium term residential development potential and the 'yield-like' earnings from the owner-occupier model, which all add to the sector's appeal for these types of investors. Recently, South Lakeland Parks was acquired for £125 million by Mountain Capital and Rockspring Hanover bought Lakeland Leisure for £40 million. Other transactions have involved Kenmore, and RREEF, Deutsche Bank's property fund arm.



In the hotel industry, we have seen a growing trend to divide asset ownership from operations, with opco/propco splits and sale and leaseback transactions. This could be replicated in the caravan sector, and last year, the Park Resorts transaction represented the first opco/propco debt structure. This trend of separating the property component could strengthen, with the possible utilisation of Real Estate Investment Trusts (REITs) also being on the cards.

Despite volatile property prices in the UK and rising yields across most real estate sub-sectors, caravan parks should continue to offer a healthy investment alternative for property investors in upcoming years.

Moving up-market

In the UK at least, holiday parks and caravans have been seen as good 'value for money' options, appealing most to the popular end of the market. But as we mentioned at the start of this article, this image is shifting, for several important reasons.

Although customers in their mid-50s from the low to middle income B/C1/C2 demographic brackets remain the core market for caravan parks business, the sector is now successfully targeting the AB, upper professional, managerial groups.

One reason for this is the increasing demand for second homes. According to The Centre for Future Studies, the number of second home owners in the UK is expected to rise by 25% from around 325,000 to 405,000 during the next decade. Second homes, particularly in highly desirable holiday destinations, can be hugely expensive and therefore a lodge or luxurious caravan is often a more affordable alternative.

This is certainly the case for the higher professional ABC1 customers, seeking a weekend or holiday retreat in a rural location within easy reach of home. These spacious units are a different breed to the traditional family caravan, in the same way that the designer tents now available at up-market campsites are much more comfortable than the traditional holiday under canvas.

Operators are successfully tapping into this market segment by developing luxury lodges and caravans on a highly selective basis, usually in up-market only parks or fully segregated areas of their existing higher quality parks. In the right locations, operators can command premium pricing. For example, South Lakeland Parks offers lodges alongside Lake Windermere for over £300,000 (US\$600,000), while a 42ft by 20ft (13m by 6m) caravan on a beachside plot at Haulfryn's Warren holiday park near Abersoch, North Wales, was offered last year at £500,000 (US\$1 million).

Home from home

With consumer confidence currently at lower levels in the UK, there is some concern that demand among owner occupiers could tail off in the short term. However, the typical owner tends to be in the 'grey' market, and therefore have sizeable equity in their property with less exposure to residential mortgage rates.

There is also a view that, due to the current state of the financial markets, the availability of debt finance that has supported investment and rising valuations in caravan parks over the past couple of years, could reduce. Although this may constrain valuation multiples in the short term, interest from alternative institutions, such as sovereign wealth funds, may compensate.

Generally though, the sector is well positioned to benefit from some key trends during the next few years.

Firstly, people in the UK, who tend to work the longest hours in Europe, have gradually pushed holidays up their list of priorities. According to Mintel, 22% of consumers now take three or more holidays each year, and with the euro strengthening against the pound, more people are likely to take these breaks at home. This extra demand for UK based holidays will not only benefit the lettings business, but in the medium term it will boost the owner-occupier market too, as customers who rent often return to buy.

Secondly, more people are opting for environmentally-friendly holidays, and getting to a caravan park in the UK is a more carbon-conscious choice than flying abroad.

And, thirdly, as caravan parks have always attracted an older clientele, it makes sense for parks to broaden the range of services they offer to ageing customers, by providing similar facilities to those in assisted care developments. This core market continues to expand and remains resilient to the overall economy.

It all adds up

Thanks to a change of image, a growing interest in eco-travel and a limited supply, the caravan parks market has never looked so appealing. With an increasing number of operators seeking to build their portfolios, competition for parks has intensified and industry analysts have seen a steady increase in pitch prices.

With a multitude of opportunities to enhance both earnings and capital returns, we expect to see more investors adding caravan parks to their asset portfolios. ●

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