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ADVISOR GROUP

HOSPITALITY –
INDUSTRY PERSPECTIVE 2018

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INTRODUCTION

Travel and tourism (T&T) is a broad industry that encompasses hospitality, leisure activities, restaurants/dining and air travel. Combined, the industry directly contributed 2.6T USD to the global economy in 2017.[1]

This figure becomes more remarkable when indirect contributions are included: T&T represented >10% of 2017's global GDP.[2] Focusing on the hospitality sector, IBISWorld calculated the 2017 market size at, approximately, 0.9T USD with a 3.2% 5-year CAGR.[3] The following factors help to explain why T&T and the hospitality market have experienced strong growth over the last several years:

- **Consumer disposable income** has benefited from a strong labor market, low inflation and rising salaries. These trends should contribute to increased hospitality spending through 2018.
- **Business travel** continues to grow due to the strong economy; the Global Business Travel Association predicts corporate travel to increase by 6.1%.[4]

- **Experiential spending** on T&T has increased over the last decade to the detriment of durable goods. Gen. Y initiated and propelled the trend; Gen. Z will enhance it.
- **Airline competition** has increased in part to budget airlines and lower jet fuel prices; reduced airfares are giving way to increased travel and additional funds for lodging.
- **Digital** continues to provide richer data for consumers to tailor their experiences and greater insights for hoteliers to understand the needs of their guests, which has contributed to industry growth and improved consumer satisfaction.[5]

STRATEGIC OVERVIEW OF THE INDUSTRY

Beyond the growth factors it is important to understand hospitality in the context of the broader market – from concentration and divestures to an evolving business model that was not present 5 years ago. Taking these elements in aggregate enables an informed view of hospitality's current landscape and the ability to forecast future moves.

Hotels, Leisure and Restaurants (HRL) Index and the S&P 500

Since the great recession, HRL has outperformed the S&P 500 through 2017. 3 and 5 year deltas are greater than 10%, and the 10 year delta is over 100%.[6] YTD performance (as of 1 May 2018), however, has paralleled the broader market which has contracted thus far. How market performance may impact hospitality will be discussed in the section "Closing Thought – Applying Technology to Manage Economic Downturns".

US and Global Hospitality Performance

Analyzing US and global RevPAR data against the US industry benchmark indicates consistent growth from 2013 to 2017.[7,8] That said, AOR plateaued in 2015 which suggests lodging companies increased rates. Studying ADR data confirms this assumption and calls into question whether hoteliers can continue to raise rates to maintain RevPAR performance.[9]

Dynamic Business Model

The franchise and 'property managed by' models represent >80% of the market. Further, organizations are spinning off assets not deemed core to their long-term strategies – Hilton spun-off Park Hotels & Resorts and Hilton Grand Vacations

at the end of 2016, and Wyndham Worldwide filed with the SEC in March to spin-off its hotel group.[10]

Airbnb was viewed as a disruptor several years ago[11] but, over time, has become an established player. To illustrate its transition to industry competitor, consider the following:

- Estimated to be 5.5% of the US hotel supply in Q1 2017[12]
- Entered the luxury market with the acquisition of Luxury Retreats International, Inc.[13]
- Partnered with Niido to develop a 324 unit apartment coplex near Orlando, FL where owners can sublease to short term guests[14]

M&A Activity

Due to low returns, high savings and a volatile RMB, Chinese firms invested heavily overseas to generate earnings; to illustrate, Chinese capital outflows reached $725 billion in 2016.[15] One investment option was hospitality where target hoteliers were either acquired or had significant stakes taken in them. The capital migration, among other factors, placed pressure on the RMB which resulted in the Chinese government restricting the amount of foreign investments.[16] Consequently, a series of divestures are underway and, in one case, led to a government takeover of one Chinese insurer.[17] To provide a

Table 1: International Chinese Activity

HNA [18,19,20]	Anbang [21,22,23]	Jin Jiang [24,25,26]
2016, acquired Carlson Hospitality Group	2014, acquired Waldorf Astoria New York for $1.95B	2015, acquired Louvre Hotels Group for $1.43B
2017, purchased 25% stake in Hilton for $6.5B	2016, acquired Strategic Hotels & Resorts Inc. for $6.5B	2015, acquired 80% stake in Vienna House Grp. for $289M
2018, attempting to sell stake in Park Hotels for $1.4B	2018, Chinese Government takes over Anbang and injects $10B	2017, increased stake in Plateno Hotels to 93%
2018, sold 25% stake in Hilton Grand Vacations for $1.1B		

synapsis of what transpired over the last four years, Table 1 depicts key M&A hospitality activity by three major Chinese firms.

North America and Europe are mature and saturated hospitality markets where opportunities to organically grow are limited. Given this and the strong economy, it is understandable that established industry players have pursued acquisitions as a growth strategy.

Noteworthy M&A activity includes:

- Marriott acquired Starwood for $12.2B and Delta Hotels & Resorts for $128M in 2015[27]
- AccorHotels acquired FRHI Hotels & Resorts for $2.9B in 2016[28]
- Apollo Global Management acquired Diamond Resorts for $2.2B in 2016[29]
- Aspen Skiing Company and KSL Capital acquired IntraWest Resorts for $1.5B in 2017[30]
- Best Western acquired Sweden Hotels for undisclosed amount in 2017[31]

TECHNOLOGY'S IMPACT ON THE INDUSTRY

Hospitality leaders must be able to manage the inundation of consumer data to understand current and evolving trends, respond to social media feedback that has the propensity to go viral, and identify the right solutions to oversee global operations. Failure to be proficient at all three may lead to lower RevPAR, AOR and ADR. Accordingly, a comprehensive technology strategy is paramount in this ecosystem.

An important initiative that a sound technology strategy can enable is personalization. As discussed in the introduction, guests want to tailor their experiences and are willing to pay for it. Disaggregating customization into three categories depicts specific wants and how technology can facilitate them. Referring to Table 2, it provides an overview of each category and the corresponding technology enablers.

Table 2: Guest Personalization Through Technology

Personalization Categories	Technology Enablers	Description
Digital Communication	VR, Social Media, Mobile App.	There are numerous ways to contact guests, share offerings, ask for feedback, etc. Similarly, guests can reach out to brands with requests, questions, etc. This digital 2-way communication enhances guest relations and facilitates customization.
Guest Predictivity	IoT, Analytics, AI	IoT enables connectivity between guests and properties & brands. Resulting data streams can be analyzed via metrics to better understand guest needs, and AI presents an opportunity to predict and address future needs.
Privacy	Privacy Settings, Authentication, Encryption, Backup	Meaningful measures are needed to safeguard guests' data. Further, guests can indicate what they will and won't share. Given recent data concerns, this customized approach will positively resonate with current and new guests.

CLOSING THOUGHT – APPLYING TECHNOLOGY TO MANAGE ECONOMIC DOWNTURNS

The cyclicality of the hotel industry is understood and downturns tend to occur every 8 to 10 years. A primary reason for this trend is that hospitality is correlated with the macro-economy. Further, when the market dips and demand weakens, discretionary spending follows suit which impacts lodging. As such, managing slowdowns is an important aspect of hospitality's business model.

Liberty Advisor Group is raising a cautionary flag for the hospitality industry based on the following observations:

1. RevPAR has grown each year since 2009 but AOR plateaued in 2015. To maintain RevPAR's trajectory for the last three years, hoteliers increased rates as evidenced by benchmark ADR data. Taken together, the recent AOR and ADR data indicates potential friction for lodging.
2. 2018 stock markets are volatile; from social media privacy issues to potential US-China tariffs, investors' concerns are reflected across market indices. Prolonged uncertainty can lead to cost saving measures and travel budgets are common targets.
3. March's job data did not meet expectations; 103K jobs added[32] versus 185K predicted,[33] which further impacts market sentiment and volatility. April's results fared better, 164K actual and 195K forecasted,[34] but the unemployment rate dropped to 3.9% which creates hiring challenges for employers. If companies cannot adequately staff, strategic initiatives may be delayed or cancelled.

Considering the cautionary flag along with the market observations, technology strategies can assist with mitigating impacts from economic slowdowns. Several items of importance are:

- Direct Booking Channel: OTA (online travel agencies) are intermediaries that reduce hotel margins and detract from first connections with guests. Enhancing the direct booking channel (e.g., automatic price match strategy) returns revenue to the property and allows the brand to initiate relationships with guests prior to their arrival, which is a key step to enabling CLV (customer lifetime value)
- Focused Analytics: Use regional metrics to determine what guests value beyond the hotel; for example, understand tourist spend categories and the underlying variables. These analyses indicate potential ancillary revenue sources, such as forming partnerships with restaurants, offering personalized training, etc.
- Franchise POV: Given their intrinsic knowledge and experience, understand which previous technology initiatives were beneficial and what future solutions would assist them with RevPAR and overall operations.

Liberty Advisor Group has more than 30 years of hospitality experience, including technology strategy assessments, product strategy capability studies, IT organizational design, creating and deploying universal analytics, and ERP architecture design and implementation.

Endnotes

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