INSEAD
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Prestige & Profit
Hotel Property
Investment Insights

Special Report

The Zürich Chapter of the INSEAD Alumni Association Switzerland hosted an evening conference on the hot topic of hotel property investment this summer. Two panels with seven top executives provided insights on headline-making trophy asset deals, emerging markets, and hotel industry trends. They spoke knowledgably about the prices paid, the value-added, the mistakes made and lessons learned, as well mistakes made by rival hoteliers, the returns, and the surprising new wide range of opportunities still to be developed. It was a discussion not without controversy between the panellists. All agreed that investment is rational, but opinions were split on exactly which factors are the basis for good decisions. They were also split about 50/50 on whether or not trophy asset prices have peaked. An Apéro Riche followed, with plenty of opportunity for networking and more insights.

Prestige and Profit: Hotel Property Investments Insights

[September 15, 2014 ZUERICH] Weekly headlines about prices paid for hotel trophy assets give the impression of capital being "thrown away" on investments

based more on emotions than on rational thought, but perceptions do not necessarily reflect reality, according to a panel of industry professionals, hosted by the INSEAD Alumni Association Switzerland and moderated by INSEAD Alumnus Francesco Noseda (pictured left).

The audience included INSEAD Alumni and guests from family offices, corporate finance boutiques, investment advisory units, hoteliers, legal advisors, and alternative asset managers.

What is operable amongst hotel industry investors, but not necessarily apparent, is the notion of scarcity on several different levels. There is a scarcity of desirable investment targets worldwide, according to Bruno H. Schöpfer, a seasoned hotelier and Managing Director of The Bürgenstock Selection, Katara Hospitality Switzerland AG. "If an entity has a lot of cash, they inevitably find that it is difficult to invest that cash. What do you buy with it, Porsche, Credit Suisse, Nokia," he asked rhetorically.

Cash-rich investors favor real estate holdings, and hotels fit into that category, particularly "trophy hotels", which are typically assets with outstanding architecture and/or a prime location. They have a reputation for outstanding service. Often, the trophy asset has a cachet or a glamor, usually created over a period of time. There are only so many of them in the world today, and it is difficult to create a new one.

There is scarcity in the location of the asset. "If you look long-term at Paris, for example, there is a limited amount of top real estate, same for London. There is an intrinsic value. I was in London when The Dorchester was bought by the Sultan of Brunei. Everyone laughed at the high price. Today 30 years later, everyone would agree that it was a good investment," said Schöpfer.

(from l to r) Bruno H. Schöpfer, Managing Director, The Bürgenstock Selection, Katara Hospitality Switzerland AG; Laurent Dusonchet, Managing Partner, Avangard Advisory; Antoine Hubert, Board Delegate, Aevis Holding SA; Dr. Timo Grünert, CFO Oetker Collection

Serious investors typically want to spread the risk by owning assets in many different economies, including Europe and Switzerland. But their choice, again, is limited. "If you want to buy real estate in the Swiss market, it is either hotels or office buildings. A billion in Switzerland buys a very small asset," said Schöpfer. The price for Swiss property can be high because scarcity of well-located land is a factor.

Trophy Hotel Strategies

Trophy properties are sited in a spot is typically outstanding. "Fifth Avenue is great, but uniqueness of location is also an important factor," said Schöpfer, making the case for selecting and upgrading languishing assets in mountain resorts or tax-haven locations to tap discerning and wealthy clientele.

There is nothing random about investments in prestige assets. Good timing, smart spending on development and level-headed calculations can create prize assets. "As a trophy hunter, you can make money. But not as a trophy buyer who simply goes into a shop to acquire," said Antoine Hubert of Aevis Holding, suggesting that even today it is still possible to buy low and sell high.

In the category of hospitals and clinics there are also trophies. "In 1996 the prices for such trophies were cheap. We bought Genolier [medical clinic] for 12 million francs with no competition. We recently had an offer that far exceeded the price we paid," asserted Hubert.

Clearly, operators have shown skill in acquiring real estate at a low price in off-the-beaten track locations for hotel property development, such as a backpackers' haven, or a little known ski area, and turning them over time into a jet-setters' exclusive paradise. "For resort style trophy assets, the uniqueness of the destination can be created," said Laurent Dusonchet, Managing Partner, Avangard Advisory, referring to Oetker Collection's track record. But he warned that unlike Fifth Avenue, resorts can be subject to changes in demographics, wealth shifts, and tastes. "Trendy resorts are great holdings to develop, but fashion changes and new competition emerges," said Dusonchet.

Valuations have certain drivers, but the panelists maintained that it is cool rational calculation that underlies buying decisions for trophy assets, "Rational means financially rational. But how is that measured, is it IRR or a cash flow of 6%, or does it need to be 10%, or is the investment rational because it offers inflation protection over the next decades?" said Dr. Timo Grünert, CFO Oetker Collection, adding that there are clearly some owners that make good money on trophy assets. Panelists said that they could discuss for hours and hours the entry price, but the fact is trophy assets are scarce. Normally, similar trophy assets that are already established have similar valuations because they are easier to develop through upgrading, regardless of the country of their location.

Macroeconomics only has a partial effect on valuation calculations. “Triple A assets may reflect a subset of the economic success of the country, but not always,” said Noseda, noting that Geneva’s hotel property prices are not as high as Paris, despite Switzerland’s greater economic success compared to France. In other words, property values in Paris, London or New York are higher because they are affected to a greater degree by tourism or other drivers, independent of the economy of the country.

Rational Thinking

Trophy assets offer return, but the decision has to be thought through. “The entry price is a given. If you want the asset you have to build your story around it. The price to pay is what others are willing to pay for it,” commented Laurent Dusonchet, Managing Partner, Avangard Advisory, who added that the price can be justified by an investor who is looking for capital preservation, a haven to invest cash, as well as to generate cash flow, or returns in the 3% to 10% range, depending on the type of hotel property.

Some investors may rationalize a high price for a trophy asset as an inflationary bet. Hubert did not necessarily agree. “You should not pay more than 3 or 4 million dollars per key in any city in the world. If you pay more than that, you have to count on inflation to make it worthwhile,” he said, adding that he does not see inflation coming anytime soon. “In the time we live, this financially-driven world cannot tolerate inflation. Everybody is keeping prices and wages low so no chance for inflation," said Hubert.

Financial control and management are essential to reap returns. It is not a hobby for the world's super-wealthy. "It gets pretty serious and we look at investments very carefully, scrutinizing profitability and key variables," said Grünert whose company owns or manages eight highly successful iconic hotels, such as Le Bristol Paris, Eden Rock St Barths, Hotel du Cap-Eden-Roc on the French Riviera and L'Apogée Courchevel. He mentioned that all depends on key variables such as average daily rates (ADR) and revenue per available room (REVPAR).

Some perform better than others, according to Grünert, who adds: "It is indeed absolutely possible to achieve very healthy returns with the right trophy asset in the right market, even if a hotel is operated in a resort destination and only open for four or six months a year. For example, like the hotels of the Oetker Collection in Antibes or Courchevel.

Cash generation was mentioned as a rationale for the investment several times. "Cash flow is important," agreed Hubert, but he stressed that EBITDA has to be enough to maintain the asset. "In some cases that cannot be achieved, and if you have not gotten positive after five years, with a giant capex and maintenance costs, you are just paying and paying. Then what you have isn't a trophy, it is a dancer!" said Hubert, implying a similarity between property investments and other "trophies" that people acquire, such as a trophy wife, which may be an expensive proposition (due to the expense of divorcing the earlier wife, perhaps) but there is at least a chance for a long term rewarding relationship in return, whereas an exotic dancer tends to be just expensive.

Hunters versus Buyers

Several panelists felt that this is a good time to be selling because the market is at the end of a long period of asset inflation. Not everyone agreed. "It seems at times that cycles familiar from other industries don't apply. Right now we see the transaction size growing and growing and growing. There is always someone wealthier and richer who is willing to pay the price of an astounding exit. It has been like that for the past 30 or 50 years," said a member of the audience.

"Over the past decades, some of the prices for trophy hotels were shocking and yet they were sold again and again at a premium," responded Noseda. One of the reasons that prices remain high over time is that buyers often undertake upgrading to add value to the property. Best practices were discussed. "The idea is not to renew completely immediately. Each hotel is different. We first observe and then develop a project," said Hubert, describing how his business partner who bought La Reserve ran it for 18 months before closing it and renewing it and making it one of the "most successful hotels" in Switzerland.

Professionalism in renovation activity has increased, agreed Dusonchet. "It is a long term trend. When we acquired the Hôtel de Crillon in Paris, we could have closed six months later. Instead, we took two years to observe and learn. Each hotel has a soul or identity and positioning, and you have to understand it correctly before starting to invest in changes and upgrades," he said.

Budget overruns come as a result of moving too quickly, not taking the time pay attention to competitors, or investor arrogance, according to the panelists. "They buy and think they know what the clients expect and make a disaster like the Dolder Grande. It is a nice hotel but it missed the market in Zurich," commented Hubert.

Minding emerging trends: Eco Hotels and Developing Markets



(from l to r) Takuya Aoyama, Vice President Acquisitions & Development with Hyatt International (EAME), Benoît Etienne Domenget, COO Accor Switzerland, Jean-Gabriel Pérès, CEO Movenpick Hotels

High net worth individuals do not only focus on trophy assets. Some are also active investors in fast growing hotel chains in the mid-market. Typically, such investors partner with brand-name hoteliers, according to Jean-Gabriel Pérès, CEO Movenpick Hotels who works closely with Prince Alwaleed, a significant shareholder in Mövenpick. As a global investor, Prince Alwaleed was instrumental in establishing the Swiss hotel in Middle East and abroad.

"The company performance and success has improved by geographic clusters," said Pérès. Pérès said he could have another 150 hotels on top of the 100 under management, but he chose to grow sustainably and profitably. All of the hotels are profitable, except the Berlin property, which is hardly breaking even, but that is the case with everyone in Berlin.

Manageable Growth

There are eight big hotel brands that can expand wherever they want but medium-sized hoteliers have to be more selective and go where others do not yet have a presence, according to Pérès. In agreement was Hyatt's Takuya Aoyama, responsible for markets in Eastern Europe and the former Soviet Union, and Israel. He spoke highly of returns found by entering under-developed markets. The Chicago-based company runs 540 hotels in about 50 countries. ³We are relatively small, and we are growing in a sustainable way. We entered Moscow in 2002, and since then the market, and our revenues, have grown substantially."

Besides having a strategy to grow in less competitive markets, mid-market hotels tend to invest counter cyclically. "We are currently looking for hotel in Cairo, which may surprise you," said Pérès who is currently developing hotels in Africa and as the "next big growth" area. The Sub Saharan region is important for his company, as is Northern Africa, where a hotel in Tunis, for example, is "market leader with a

€210 average room rate and 82 percent occupancy”. According to Pérès, China is seen as too risky and the US market is less attractive because it is very competitive.

“Not all the developing markets are in regions considered to be emerging markets,” asserted Benoît-Etienne Domenget, COO Accor Switzerland. He sees Switzerland as a “developing market” because there is a very high density of hotels per capita and a “huge majority” of the hotels remain small and independent. It is similar in Italy with the chains achieving a low penetration rate of less than 15%. Domenget said that Accor, which is both an owner and operator (50% of the hotels managed by Accor are owned by partners or by operator franchises) is fast growing in these markets, growing from 40 hotels four years ago to 60 this year. “We are happy with investments in Switzerland. The market provides growth and profitability for both our own hotels, and our partner hotels,” he said.

New eco/design concepts are emerging. For example, Moxi, a joint venture between Marriott and Ikea, a kind of designed-“Lego” concept. The development costs are obviously a small fraction of those required for a luxury hotel. Other examples are M-Gallery and Ibis Style.

An audience member asked if this new category of eco/design hotels attracts different investors. What fundamentals are they looking for? Operators can attract those that are not normally interested in economy hotel investments, despite the good returns eco hotels offer. They will invest in the “touch feely” of this interesting mix. “Motel One is mixing eco and design and doing extremely well,” said Aoyama. Investors like the new style category, agreed the panelists.

For those interested in maintaining holdings of hotel assets, some investors seek a balanced portfolio approach, one that includes upscale hotels plus several Ibis style and a trophy asset or two, according to Pérès. “It is like running a portfolio of shares mix of high level of risk and others that are very balanced steady returns,” he said.