

Management and Investment Alternatives in the Hotel Business in Argentina

ESPLENDOR
HOTELES

2nd International Workshop

Investments in the Hotel and Tourism Industries

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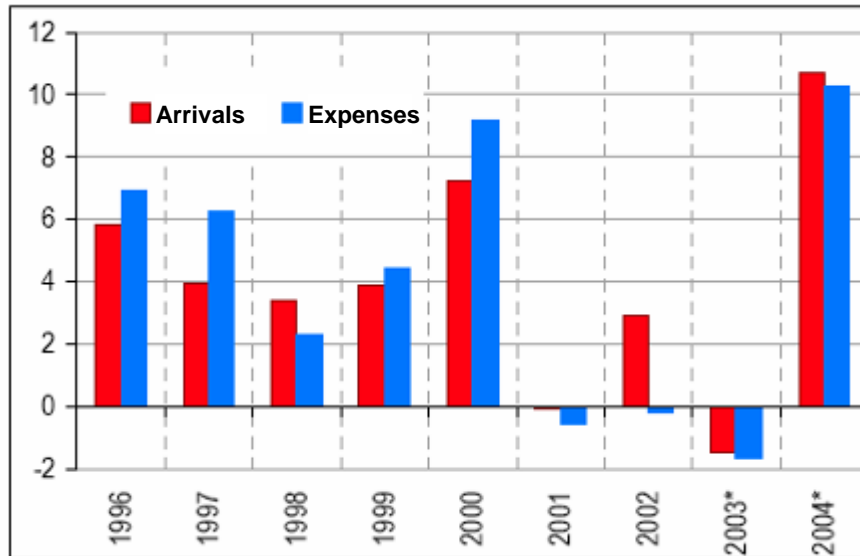
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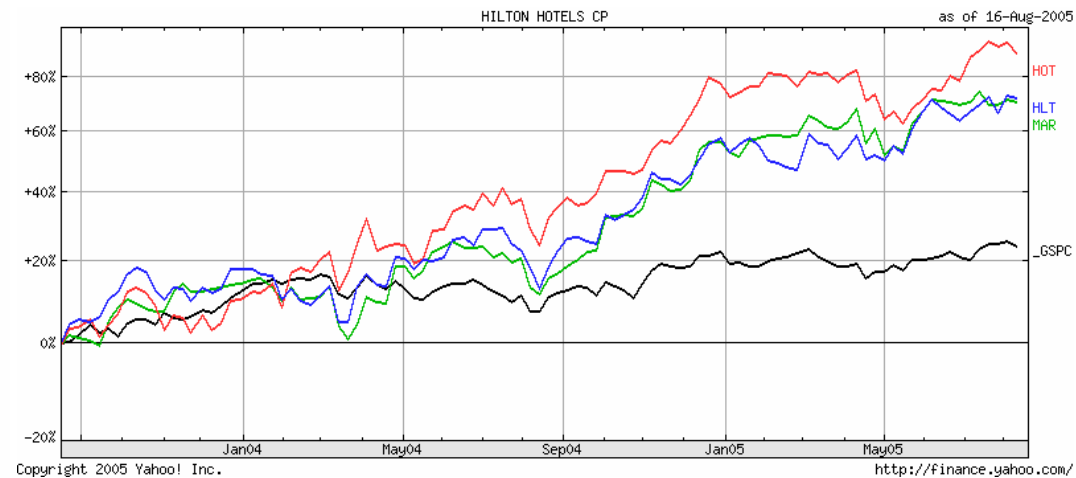
- ▶ Introduction
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- ▶ Fën Group – Who we are

World Tourism is resuming its growth rate, and in 2003 and 2004 the hotel share return has been substantial: 30% y 40%

International Arrivals and Tourists Expenses
World total, % Change vs. The Previous Year

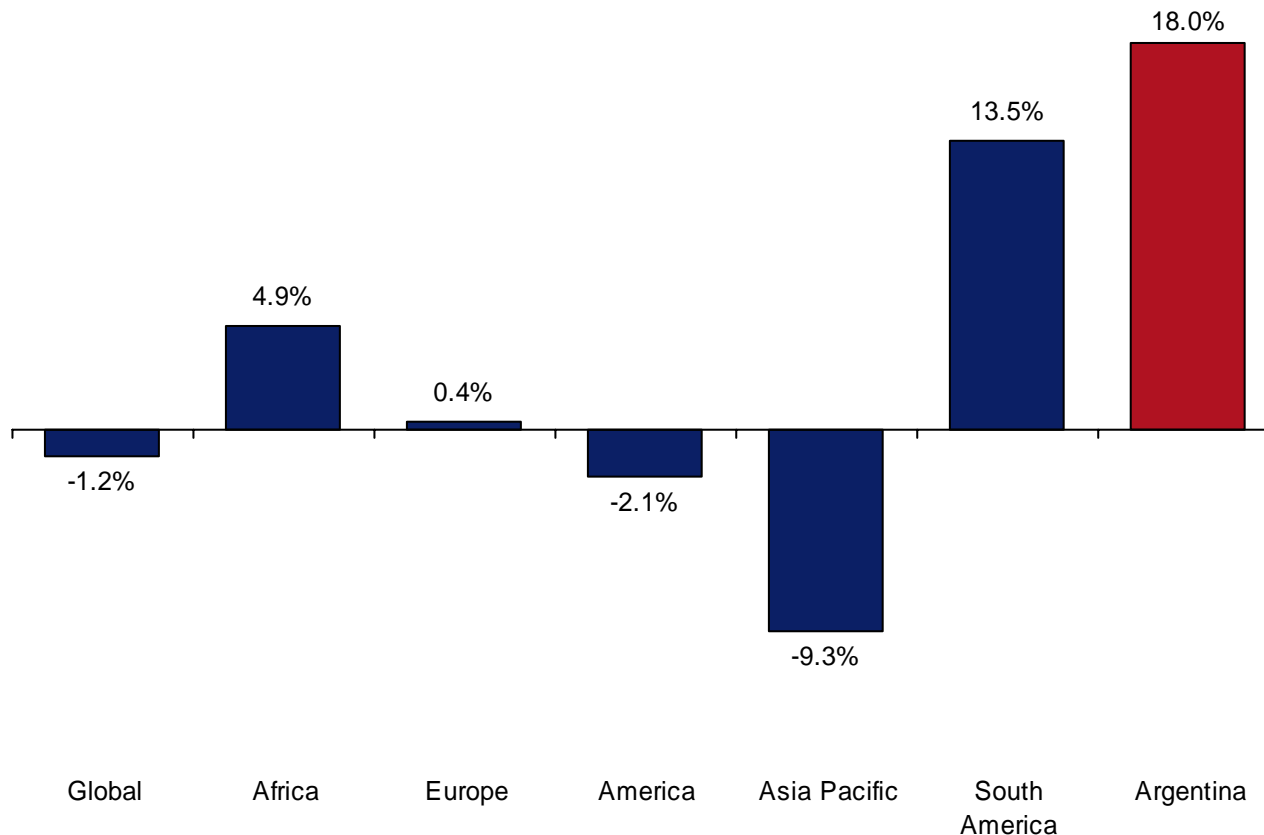


Progression of Hotel Share Value USA vs. S&P 500
Starwood (HOT), Hilton (HLT), Marriot (MAR)



A the same time, tourism in Argentina grows at a very high rate, one of the highest in the world...

International Tourist Arrival per Region
% Change 2003 vs. 2002

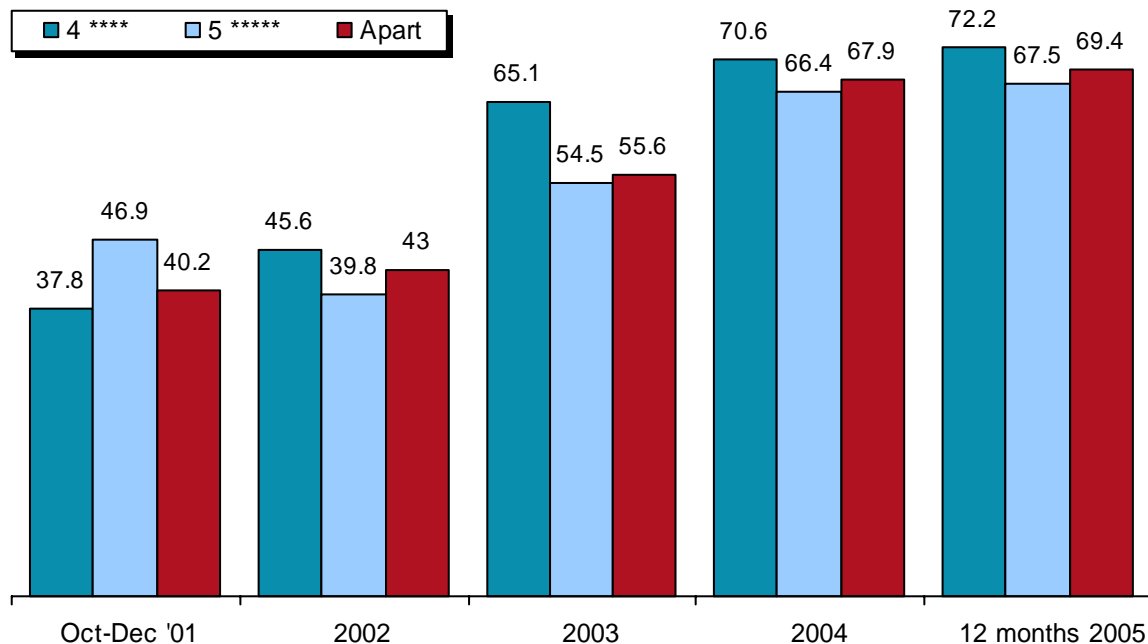


an increase of 31.5% in tourists' expenses in the country

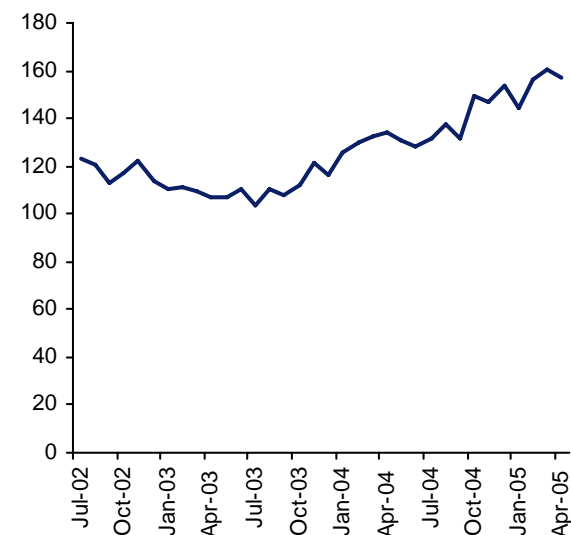
- ▶ In 2004 tourism kept on growing: 11%
- ▶ With the increase of international tourists the pre-crisis levels were surpassed
- ▶ At the same time, there was also a considerable increase in the local tourism in Argentina- the trips abroad were reduced 45%, and most of that tourist traffic was diverted to local destinations

... and the local hotel industry is experiencing an enormous increase in occupation and tariffs

Progression of the Occupation Rates in Hotels in Buenos Aires City
% Average Occupation per Type of Hotel



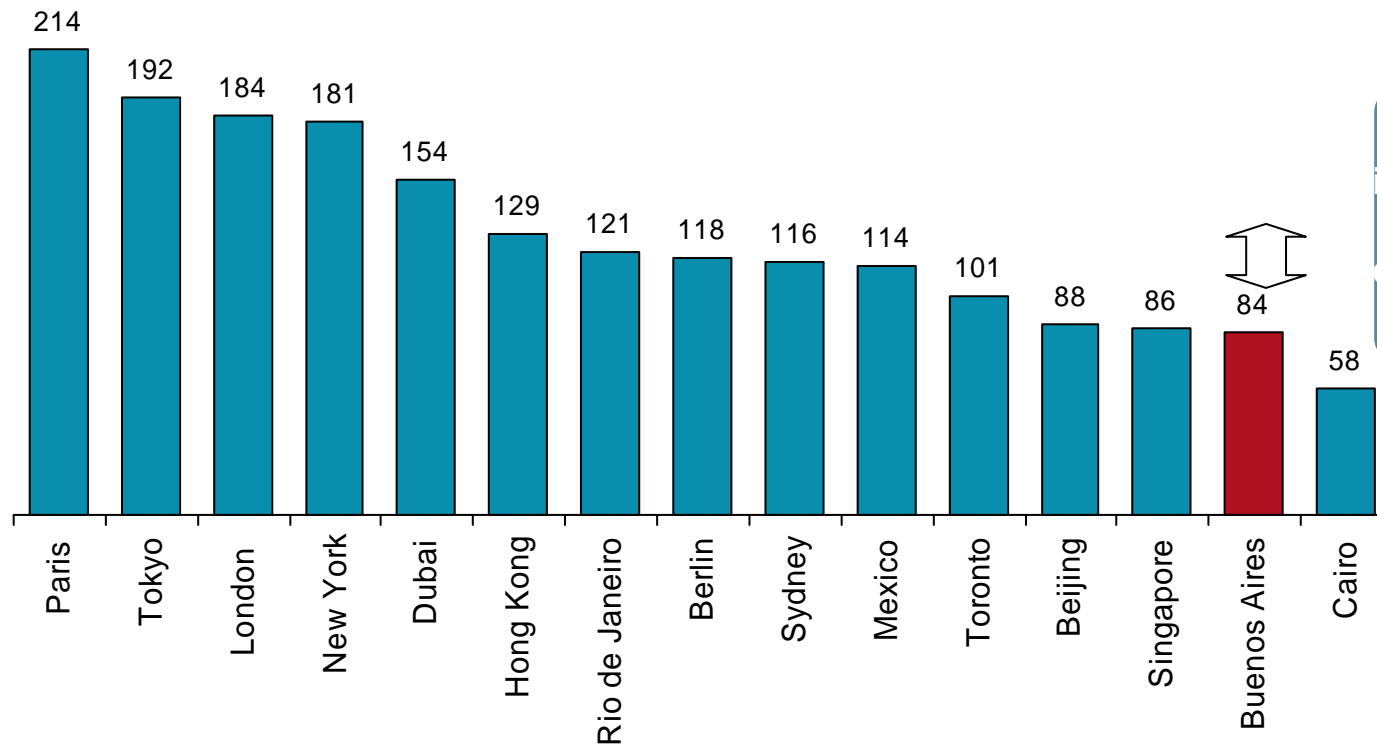
Progression of Hotel Tariffs Buenos Aires
\$ per Night -Average of all the Hotels



An increase in the Effective Tariff (REVPAR) of 48% between 2004 and 2003

And there are chances of improvement

Average Tariff Main Cities in the World, USD per Night
Average January- November 2004



Minimum space of increase – Bs As and Rio tariffs, almost 50% chance of improvement of potential tariffs

This optimistic panorama makes investors wonder about the management and investment alternatives in the hotel business in Argentina

What are the hotel management models in the world and in Argentina?

- ▶ I have a hotel or I will build one, what alternatives do I have to operate it?
- ▶ How is it done in the rest of the world?
- ▶ How can I do so in Argentina?

What are the alternatives to invest in the hotel business in Argentina?

- ▶ Which are the factors that determine and propel the value of a hotel investment?
- ▶ How is hotel investment financed?
- ▶ What alternatives are there of having private investors or bank finance? What are the available investment vehicles?

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The are three different roles in the operation of a hotel business: the ownership, the chain and the management

Roles in a Hotel Business



All over the world ownership is generally separated from management: the biggest hotel companies are not the owners of any hotel

Company	Principal Trademarks	Quantity of Hotels	% of Hotels Owned
 CENDANT	  	6,500	0%
	   	4,400	0%
	   	4,000	21%
	  	3,500	5%
	  	2,000	6%
	  	750	22%
		250	22%

Chains have valuable benefits for the owners – more than 70% of the hotels in the world belong to a chain

Principal Benefits Offered by Chains to Hotel Owners

- ▶ Immediate recognition of the hotel
 - Customers know what to expect– service, quality of the facilities, etc..
 - This increases the speed of occupation and the return on the investment

- ▶ Access to a reservation central, centralised marketing programme, frequent traveller and others – improving the tariff and occupation vs. an independent hotel

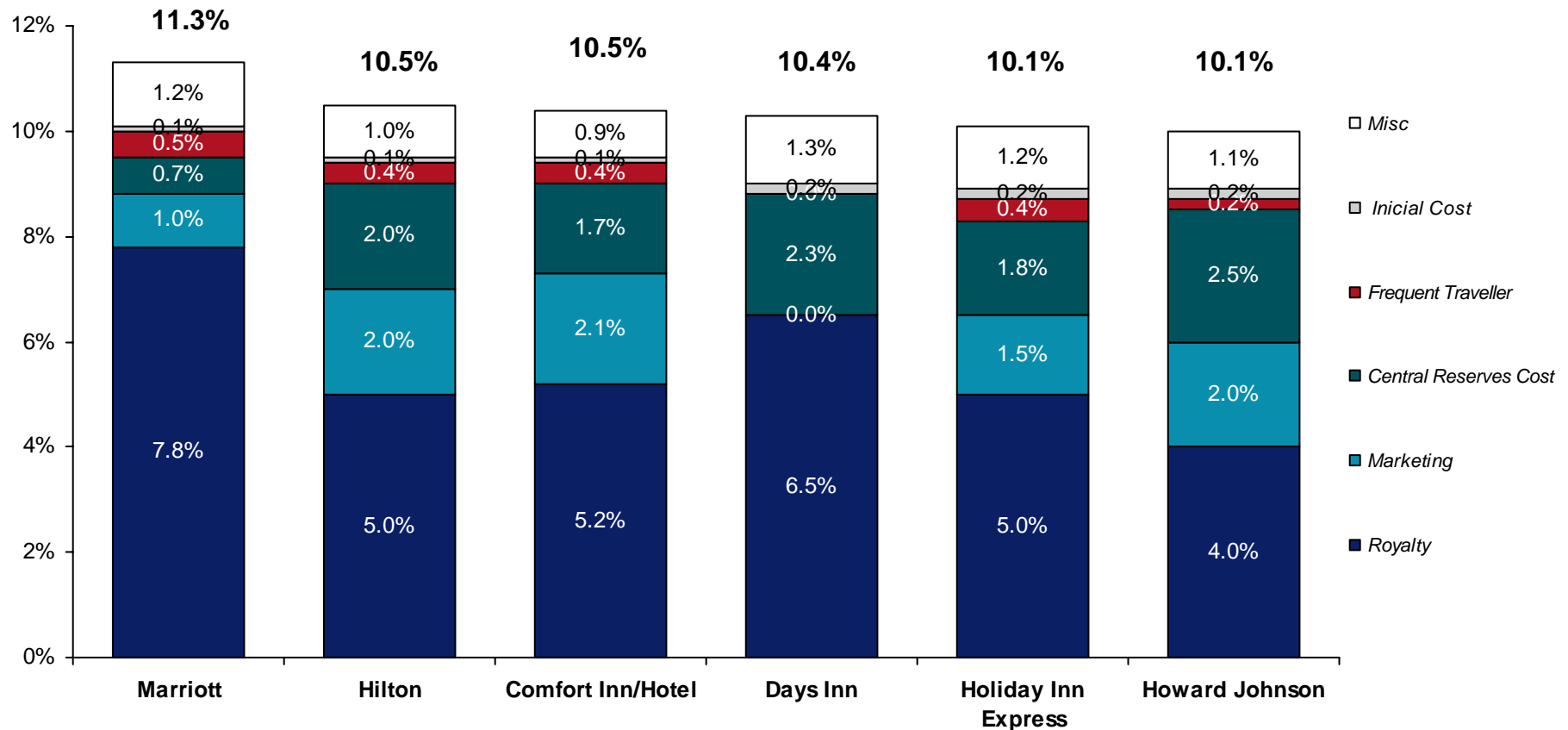
- ▶ Support in the search for finance, and in some cases direct finance

- ▶ Assistance during the opening – specifications and design of the hotel, selection of the management company, pre-opening activities, etc..

- ▶ Tested operative method, and ways to implement it
 - Service standards, procedures and training manuals
 - Information Systems (software, hardware, training, consultancy)
 - Training and Assistance in Human Resource Management
 - Supervision visits and quality control

In the USA, the contracts with chains (“Franchising”) have a cost of 10% to 11% of the sales, and are signed for 15-20 years

Cost as % of Sale Average 10 years - Principal Franchisors



In Argentina, international chains concentrated on 5 star hotels, in 3 and 4 star hotels they could not adapt to the local reality- and there are only a few valid franchising local alternatives

International 5 star chains in Argentina



International 3 and 4 star chains in Argentina



Almost 90% of the 5 star hotels in Buenos Aires belong to international chains

Only 4% (28 out of 708) of the 3 and 4 star hotels in Argentina belong to international chains

Hotel management refers to the day-to-day operations that are done in the company

Examples of Day-to-day Activities Done in a Hotel

- ▶ Opening Activities
 - Defining the specifications of the hotel in detail – defining the product
 - Detailed opening planning
 - Launching Campaigns – marketing, media and promotion
 - Selection and training of the employees
 - Taking Pre-opening reservations
 - Selection and implementation of the computer system
 - Specific design of the operative procedures (maintenance food and drinks, etc.)
 - Preparation of the annual budget
 - Construction control
 - Pre-opening purchases – coordination, execution and control
- ▶ Hotel Operations
 - Management supervision
 - Operations of maintenance (preventive and corrective)
Food and drinks (breakfast, restaurant, room service, bar)
Security, Reception (check-in, check-out, client service)
 - Operative Management Control – quality surveys, ghost guest or mystery shopper programme
 - Handling complaints or unexpected situations
 - Employees' motivation – human resource management policies
- ▶ Sales and Marketing
 - Prices strategies, tariffs, conditions and quotas per client
 - Marketing – choosing the media, budget and execution, creativity, exchange contracts, assessment of performance
 - Negotiating and dispatching contracts with clients
 - Prices for events and special groups
 - Taking individual and group reservations
 - Maintenance of quota for electronic channels
 - Coordination de FAM Tours
 - Maintenance of prizes programmes
 - Promotion trips (e.g. conferences)
- ▶ Administration
 - Management control – comparison vs. budgets, measurement of efficiency, effectiveness, costs and service level
 - Money management
 - Bank accounts management
 - Purchase of goods and services – negotiation and execution
 - Payment of salaries, accounting
 - Payments to suppliers
 - Establishment and control of credit policies
 - Payments to and from abroad – electronic channels
 - Insurance maintenance
 - Dealing with legal matters

The management may be independent or with a management company- management companies provide more security and less involvement from the owner of the hotel

Hotel Management Alternatives

Independent Management

- ▶ The owner of the hotel hires a general manager for the hotel

1st Category (1st Tier)

- ▶ The management company belongs to a chain
- ▶ Main examples in the USA: Hilton, Hyatt, Marriot, Sheraton

2nd Category (2nd Tier)

- ▶ The management company is independent – it is not part of any chain
- ▶ Main examples in the USA: Interstate Hotels, American General Hospitality, Hospitality Equity Investors

Management Companies

Advantages / Disadvantages of the Alternatives

- ▶ Hiring a general manager may be cheaper in the short term, but it may also bring about some problems
- ▶ In general, companies specialised in management offer
 - More stability (e.g. in the case of the general manager sudden resignation)
 - More expertise and experience
 - Taking advantage of economies of scale- e.g. purchases, sales, negotiation with intermediaries, media, etc.
- ▶ At the same time, they give more credibility to the business before investors and moneylenders
- ▶ 1st category companies may be more economical than an independent management company with a franchise

There are 2 contractual ways to manage: lease and management - – lease minimises the risk for the owner

“Total Lease”

- ▶ The management company leases the hotel to the owner
- ▶ The management company (lessee) is in charge of the employees and all the investments (working capital, maintenance, etc.)
- ▶ In general, the rent is either a fixed amount or a percentage of the sales: E.g. \$ 10,000 a month or 15% of the sales, whichever is higher
- ▶ The contracts are for 10 to 20 years
- ▶ As towards the end of the contract the lessee may have little interest in maintaining the hotel in good conditions, the owner has to make sure that he leases the hotel to a company with good reputation
- ▶ This modality is used in Europe and in some Latin American countries - in the USA it is no longer used since it generated risks for the management company in low periods
- ▶ This modality may be limited by legal matters - e.g. in Argentina the maximum lease period is 10 years

Management Contract

- ▶ The management company runs the hotel for the owner
- ▶ The owner is in charge of the employees and all the investments (working capital, maintenance, etc.)
- ▶ In general, the management fee is a percentage of the sales (3-11% depending on the services and franchising) and an incentive fee of the operative result (10-15%)
- ▶ The contracts are for 10 to 20 years
- ▶ As the owner is in charge of the investments of the hotel, he has to make sure that the management company understands the requirements of return on the owner's investment
- ▶ This modality is the only one used in the USA and it is becoming important in the rest of the world
- ▶ This modality may be limited by legal matters - e.g. joint liability for the employees

In Argentina, the market of professional management companies with real expertise is limited, but there are successful cases

- ▶ The 5 star hotels that become part of chains also hire their management –in some cases the managers they bring from abroad may have no experience in the country and have to go through a "learning period" during the first years
- ▶ 3 y 4 star hotels have historically been developed by medium investors (families) that invested in hotels and managed them themselves
 - That is why the market is fragmented- there are almost no national chains and the existent ones have a limited amount of hotels
 - In many cases the management of these hotels has little professionalism- in some cases the owners, who have no knowledge of the hotel business, do not even hire a general manager
- ▶ At the same time the concept of "management companies" is not well-known or developed in Argentina- only recently there have been successful cases that may serve as an example
- ▶ Fën is the management company (and franchisor) which has grown the most in the last years and it is the one with the biggest amount of hotels in Argentina

To sum up...

- ▶ There are 3 roles in hotel operation – ownership, chain and management
- ▶ In the world, ownership is generally separated from management
- ▶ 70% of the hotels in the world belong to a chain because of the benefits of doing so
- ▶ The cost of a chain is 10 to 11% of the sales, with long term contracts
- ▶ In Argentina, international chains mostly have 5 star hotels, and there are only few alternatives of local chains that are exclusively "franchisors"
- ▶ Management refers to the day-to-day operations of a hotel
- ▶ Management may be independent or with a management company- there are 1st category (with franchise) and 2nd category management companies
- ▶ The ways of contractual management may be lease or management contract
- ▶ In Argentina, there are a few alternatives of professional management, but there are successful cases

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Investment in the hotel industry has two value components – the operation business and the real estate business

Operation Business

Value = EBITDA x Multiple
or
Value = NOI “Cap Rate”

- ▶ The multiples of EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortisation) or Cap Rate is a standard valuation in every industry – they are based on the estimated flow that the business will generate
- ▶ At present, the hotel business in the USA has multiples of 12.9x for mixed companies, 13.4x for companies that are owners and 17.2x for companies that are only franchisers
- ▶ The NOI (Net Operating Income) is near the Cash Flow generated in a certain year, and when it is divided by the Cap Rate it simulates perpetuity
- ▶ In 2004, in the USA the average Cap Rate was 7.1%, very low –the historical averages are near 10%

Real Estate Business

Value = Replacement Value
(Buy or Build)

- ▶ As the underlying asset in the hotel business generally has an alternative use with relatively low investment (e.g. turn the hotel into residencies, offices or, in the worst-case scenario, use the plot of land) hotel investment value may be higher even if the hotel business does not change

Each value component is propelled by different factors, which provides diverse hotel investment strategies

Operation Business

RevPAR: revenue per available room
Hotel Supply
Tourism and Corporate Activity

Real Estate Business

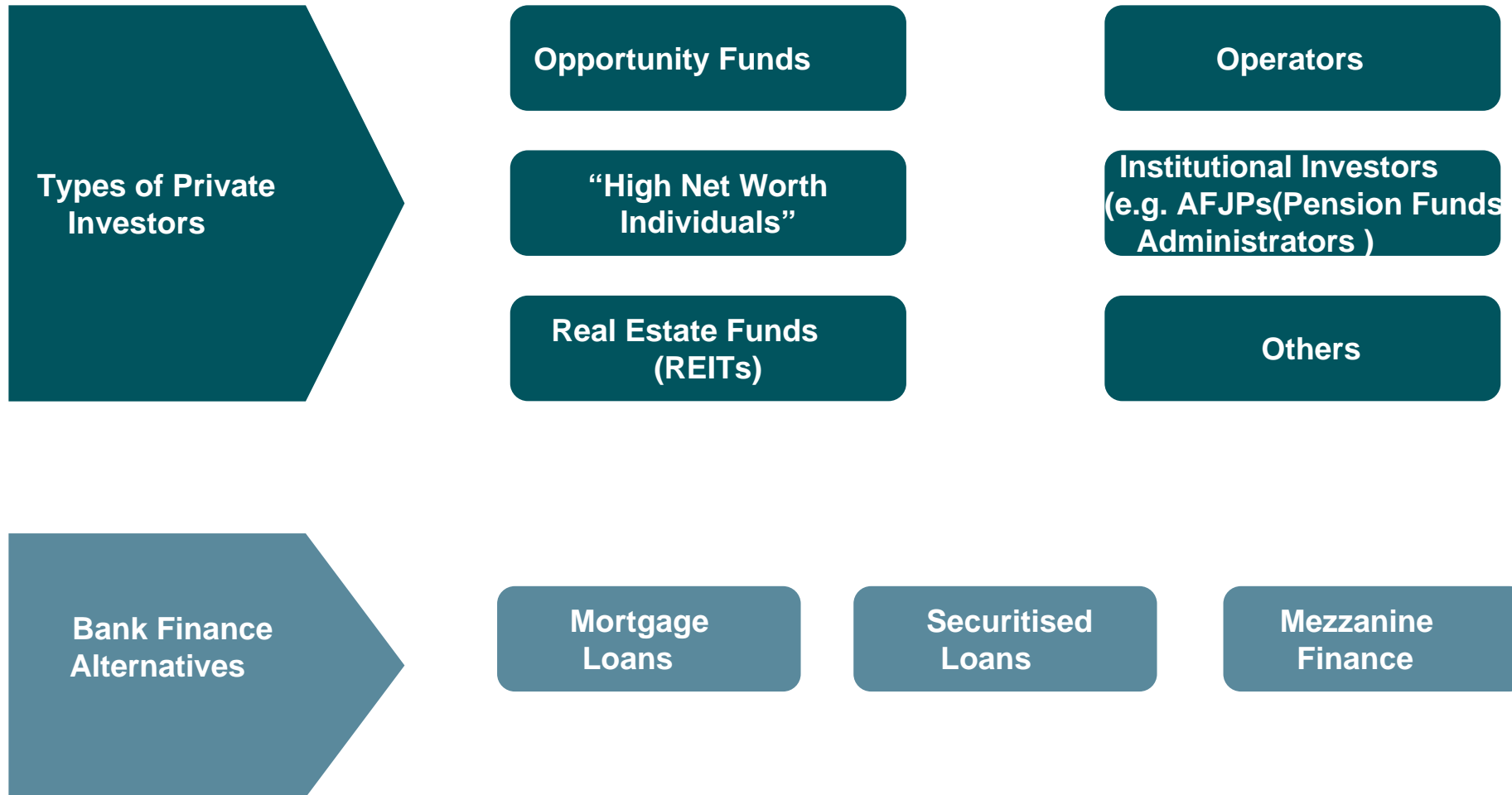
Construction Cost
Plot of Land Cost
Urban Development in the Area

Examples of value
propelling factors

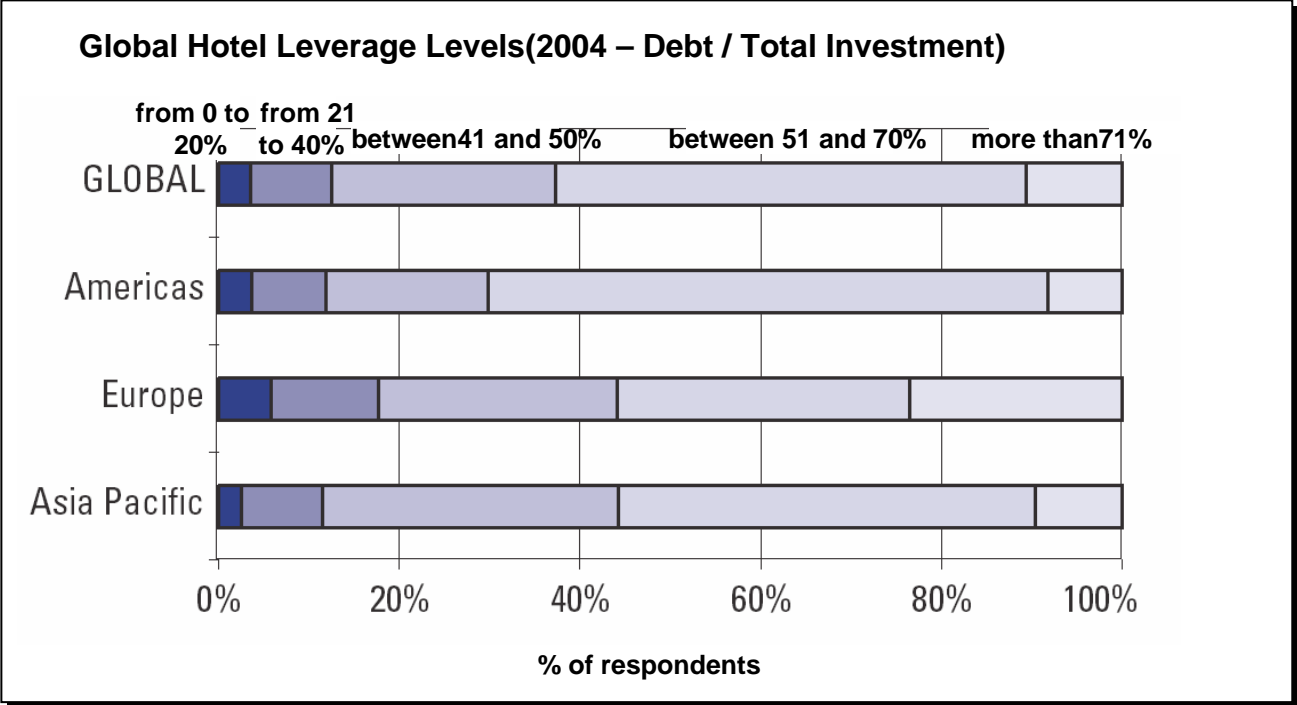
Implications for
Investment Strategies

- ▶ A valid hotel investment alternative is to think about the revaluation of the plot of land – i.e. buy a hotel, get moderate operative results and wait until the plot of land is sold to get the highest profit
- ▶ For example, if you evaluate the low level of the tariffs in Argentina at the present time the hotel business may seem unattractive if it is only evaluated from the operative point of view
- ▶ However, in many cases the sale prices of hotels per m² are historically low, and the profit is made on the value of the asset, that can be doubled or tripled in the medium term

In the world there are two ways to finance a hotel business- Private Investors and Bank Finance



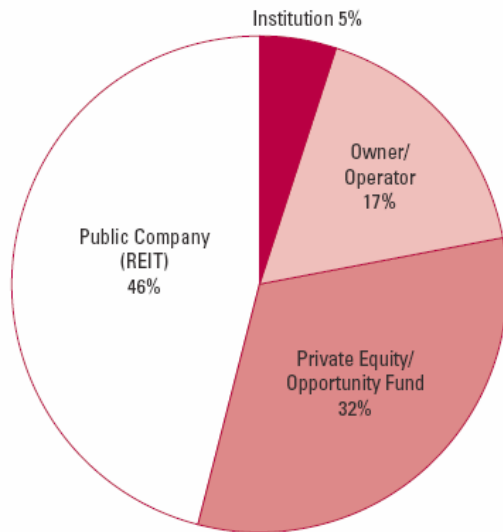
Worldwide, 50-70% of hotel finance is done with bank loans...



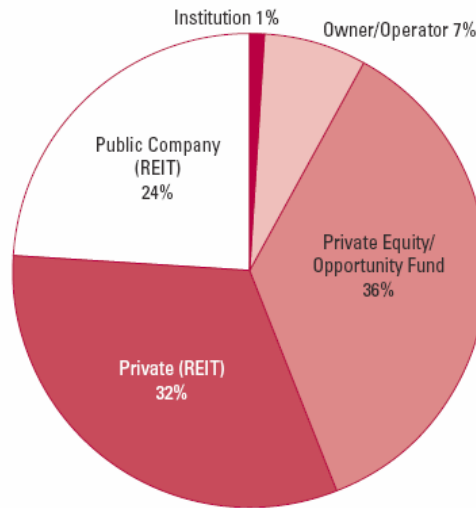
...at the same time private investors are very active – particularly Investment Funds in the last few years

Buyers and Sellers USA 2003

The Seller Groups of 2003
(Transactions over \$10m)

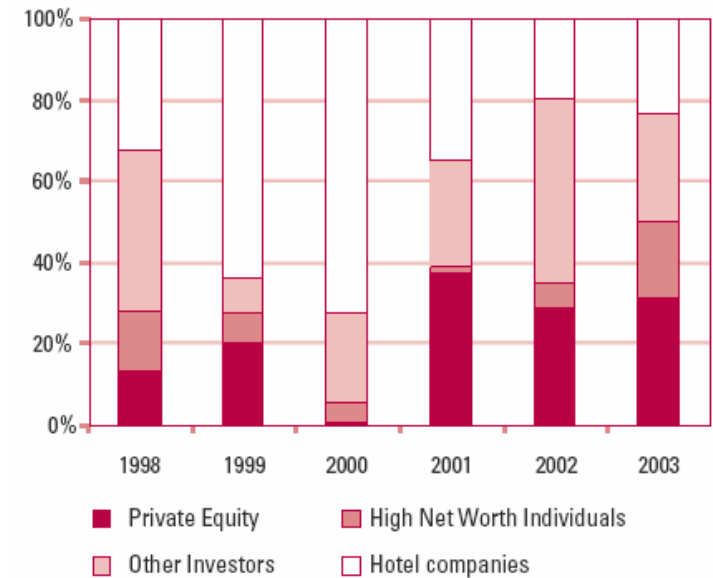


The Buyer Groups of 2003
(Transactions over \$10m)



Investors per kind Europe 1998-2003

Investor Contribution to Total Transaction Activity



Other Investors: Specialist Hotel Investors, Property Companies, Institutional Investors, Private Company, Developers

In Argentina, both private investments and bank finance are more limited

- ▶ Bank Finance is virtually nil- only this year, two local banks are evaluating mortgage loans for hotels, but there is not a certain implementation date yet
- ▶ At the same time, the possibilities of private investment are limited – the main private investors are
 - **“High Net Worth Individuals”** are the main active investors, particularly local investors: they understand the Argentinian reality and can evaluate the present opportunity correctly – e.g. Palacio Duhau, Hotel Madero, Reconquista Plaza, etc. International investors are also beginning to be interested
 - **Opportunity Funds (private equity)**. At present, the local ones are more interested in opportunity business (less repayment time). Professional foreign funds are afraid of the low level of transparency of the Argentinian real estate (4 out of 5)
 - **Real Estate Funds** – They do not exist in the country, and the international ones are not active in the region yet
 - **Operators**. International: the tendency of international operators (particularly in the USA , not so much in Europe) is to disinvest in fixed assets to concentrate on the the franchising and management business. Local – with little funds to develop their chains
 - **Institutional Investors**– Local (Pension Funds Administrators-AFJPs) are not investing- again the government has the biggest part of the funds
 - **Specific Foreign Investors** – Individual cases, evaluation period

As there is not a local hotel share market, small / medium investors that are interested in investing in the hotel business have to participate in private societies

Principal Investment Alternatives “Public” in the USA

Situation in Argentina

Company	Symbol	Market Cap (USD M)
Managers / Franchisers		
Cendant Corp.	CD	21,260
Marriott International Inc	MAR	15,101
Four Seasons Hotels Inc	FS	2,580
Choice Hotels International Inc	CHH	2,023
Owner / Operator		
Starwood Hotels & Resorts	HOT	12,614
Hilton Hotels Corp	HLT	8,902
Fairmont Hotels & Resorts Inc	FHR	2,561
Gaylord Entertainment Inc	GET	1,680
LaQuinta Corp	LQI	1,634
Orient Express Hotels Ltd	OEH	856
Lodgian	LGN	300
Real Estate Owner(REITs)		
Host Marriott Corp	HMT	5,808
LaSalle Hotel Properties	LHO	886
Felcor Lodging Trust Inc	FCH	772
Sunstone Hotel Investors Inc	SHO	742
Strategic Hotel Capital Inc	SLH	431
Highland Hospitality Corp	HIH	429
Various		
Kerzner International Ltd	KZL	2,160
Great Wolf Resorts Inc	WOLF	654
Meristar Hospitality Corp	MHX	612
Equity Inns Inc	ENN	581
Innkeepers USA Trust	KPA	546

- ▶ No hotel business quoted on the stock exchange – mainly because the existent local companies do not have the scale to have access
- ▶ Due to this situation, an investor that wants to participate in a hotel business with partners, has to be part of an anonymous corporation
 - Although societies work fairly well in Argentina, this kind of modality often requires more involvement of the investor
 - This also limits the diffusion of existent opportunities in the market – it depends on the word of mouth diffusion of intermediaries or trusted people
- ▶ There are successful cases of hotel private investments in Argentina, but there are not many yet

To sum up...

- ▶ Hotel investments have two value components –the operation business and the real estate business
- ▶ Each value component has different propelling factors, which provides diverse hotel investment strategies
- ▶ In the world there are two ways to finance a hotel investment – Private Investors and Bank Finance
- ▶ Worldwide, 50-70% of hotel finance is done with bank loans...
- ▶ ...at the same time, private investors are very active
- ▶ In Argentina, both private investment and bank finance are more limited
- ▶ At the same time, the absence of a local hotel share market requires more involvement of medium/small investors

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Fën is a hotel business development group, that manages 2 chains and provides management services

Fën Group Activities



**Developer of
Hotel
Businesses**

- ▶ Detection of opportunities of lease, remodeling and construction of hotels
- ▶ Development of business projects
- ▶ Negotiation with property/ plot of lands owners and design of investment vehicles
- ▶ Search of investors and project finance

**Management
Company
with Franchising**

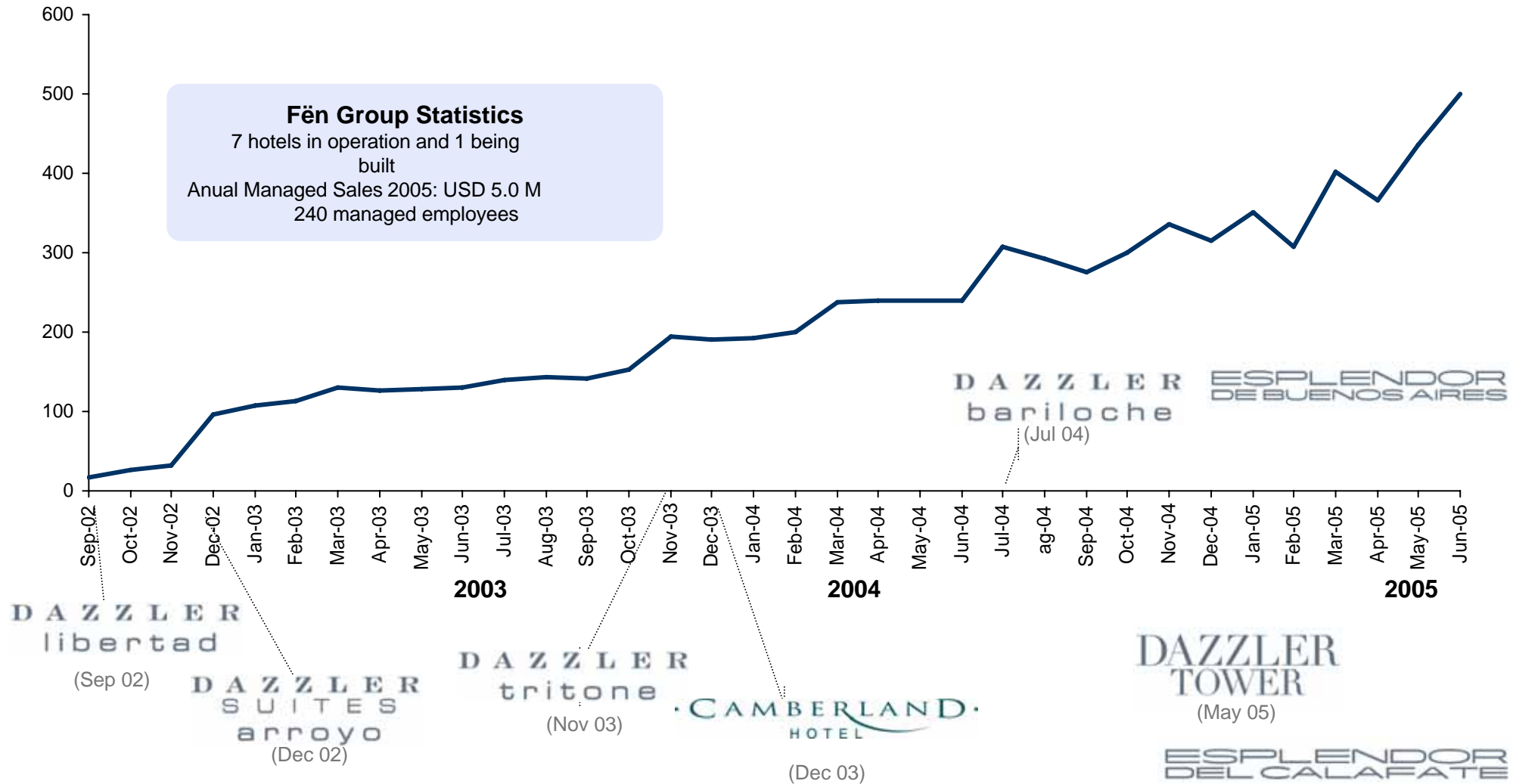
- ▶ We offer management and franchising
- ▶ 2 successful trademarks, which are well-known abroad
- ▶ Currently managing 8 hotels

Fën, mapuche word that means "seed"

Founded less than three years ago, Fën is the group that manages the biggest amount of hotels in Argentina

Business managed by Fën Group - Thousand USD Managed Sales

Fën Group Statistics
 7 hotels in operation and 1 being built
 Annual Managed Sales 2005: USD 5.0 M
 240 managed employees



Fën administers 2 chains –“ Esplendor”, design hotels, and “Dazzler”, hotels with the best price-quality relationship

ESPLENDOR HOTELES

- ▶ Design hotels in an excellent location
- ▶ 1 in Buenos Aires, 1 in Calafate
- ▶ Exclusive design done by local architects in association with Tramando



DAZZLER hoteles

- ▶ Strategically located hotels
- ▶ Excellent service, well maintained and reasonable prices
- ▶ 4 in Buenos Aires, 1 in Bariloche



Fën group manages the 8 hotels of these chains- 7 in operation and 1 in construction

Hotels Managed by Fën Group



- ▶ **Buenos Aires:** 4 star superior originally Sheraton Four Points in San Martín and M.T. de Alvear streets
- ▶ 88 rooms and lounge



- ▶ **Buenos Aires:** Ex hotel Bisonte, in Libertad and Paraguay streets
- ▶ 87 rooms, important in the T&T sector



- ▶ **Bariloche:** Boutique hotel located in the city centre
- ▶ 59 rooms and conference halls



- ▶ **Buenos Aires:** Classic Apart-hotel of 78 rooms, in Suipacha and Arroyo streets
- ▶ Important in the corporate sector



- ▶ **Buenos Aires:** Typical hotel in the city centre in Maipú y Tucumán streets
- ▶ 53 rooms, important in the T&T y corporate sectors



- ▶ **Buenos Aires:** ex Hotel Phoenix, first hotel in Bs As in the historical Galerías Pacífico building in San Martín and Cordoba streets
- ▶ 53 rooms, open as the only design hotel



- ▶ **Calafate, in construction:** Located in the city centre, with big rooms and amazing public areas
- ▶ 60 rooms, design hotel, opening December 2005



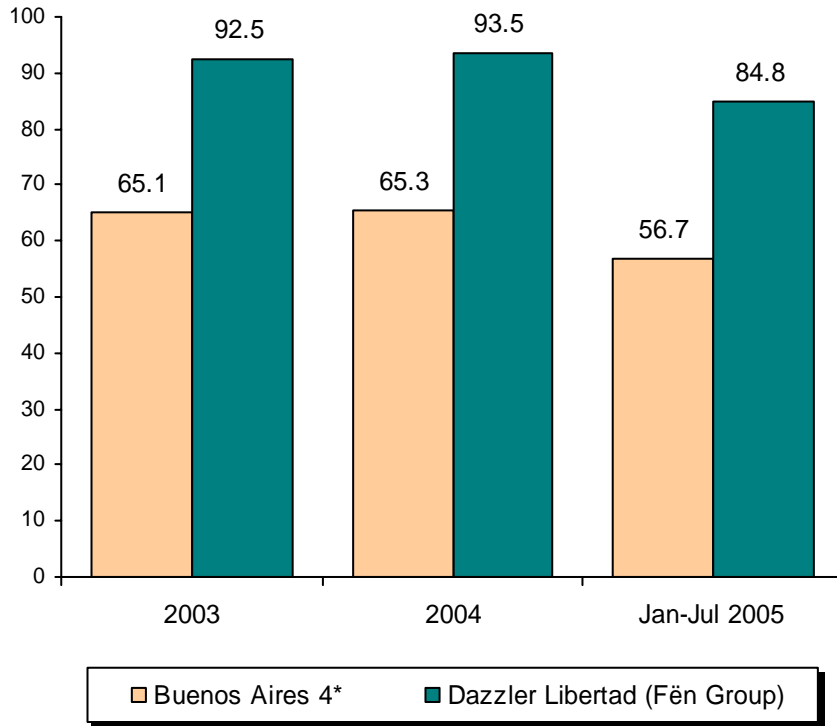
- ▶ **Buenos Aires:** Design hotel in Pilar
- ▶ 20 rooms and conference hall important in coporate and industrial sectors in Pilar

We obtain superior results by taking profit of our scale and by using modern management tools...

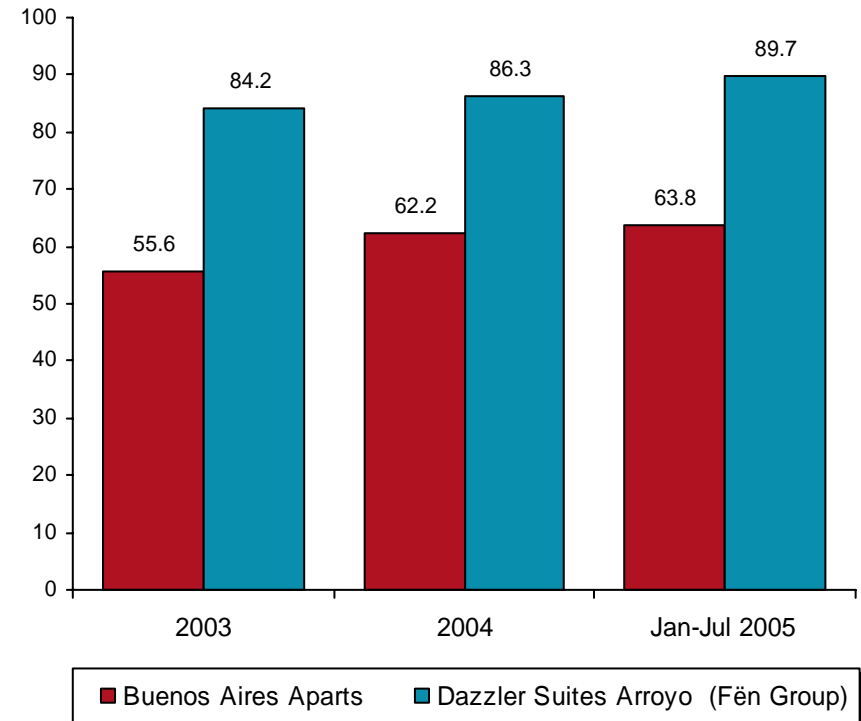


... which generates occupation and income levels that are superior to the average in the market

Occupation Comparison
Average Buenos Aires 4* vs. Dazzler Libertad



Occupation Comparison
Average Buenos Aires Apartments vs. Dazzler Suites



In both cases the tariffs are similar or even higher in Fën Group compared to the average in the city

We count on an excellent group of directors and managers, which is unique for its diversity and quality in the local hotel industry

- ▶ **Patricio Fuks, President.** He founded Achievers Publicidad when he was 22 years old. He won FIAP prizes and was in charge of very important accounts such as Correo Argentino, CTI, Coto, Unimarc, Minetti, and Fondo vitivinícola. He was also vice-president of Plaza San Martín Suites apart hotel, where he formed a marketing and sales team. He was one of the founders of Fën Group.
- ▶ **Alejandro Frenkel, General Manager.** He holds an MBA from Columbia University and graduated as an economist from Universidad Di Tella. He worked for 7 years for the consulting company of Alta Dirección called Booz Allen Hamilton. He was CFO of Salutia where he directed a capital round of USD 16 MM. He was also financial analyst of Procter & Gamble Argentina
- ▶ **Sebastián Piaggi, Administration and Finance Director.** He is an accountant and was the administration manager of Hereford Restaurants. Prior to this he did some administration jobs for the firm Santiago Alvarez Noblia y Asociados. In Fën Group, he was the general manager of Dazzler Hotel for a year and a half, and has been the person in charge of the company's finances since its foundation.
- ▶ **Ivan Kozicki, Director .** He has a degree in Business Economics from Universidad Di Tella. He was brand manager in Shell Capsa, and corporate marketing manager in CTI móvil. In Fën Group, he coordinated the openings of different hotels.

In our few years in the market we have gained excellent reputation among investors, hotel owners and employees

- ▶ We have achieved very attractive returns for our investors, who show their trust investing in our projects
- ▶ The owner of the hotels we manage have seen a considerable increase in the incomes, which is why other owners continuously offer their hotels to us
- ▶ Our employees see more potential in their careers belonging to a group that manages many hotels

In the future, we plan to be the most important hotel group in South America

- ▶ In less than three years we have developed and administered 8 important hotel businesses – we plan to at least double this number in the next twelve months
- ▶ We have two chains of differentiated identity and clear value proposals to increase the value of the group for it to be more attractive for hotel owners
- ▶ We are going through an expansion process to the whole country, and we are also looking for business opportunities in Latin America
- ▶ We successfully compete with multinational groups since we have greater capacity to adjust to the local requirements and we also have a better relationship with the owners since we are better able to meet their needs
- ▶ Therefore, in less than 5 years we plan to become the most important hotel group in South America

