

Destination 2010: Soft Landing or Swift Take-off?



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Since the announcement of South Africa as the winning bidder of one of the most high-profile sporting events in its history, many industry participants have been a buzz of activity, hoping to capture both the economic and social benefits that the World Cup 2010 may bring.

In exploring the prospective impact on the South African tourism industry, we firstly take a brief look at the progression and salient characteristics of our hospitality industry, as well as current trends given the economic backdrop. Finally, we hope to draw some insights to the much debated question about the sustainability of the industry post 2010.

Tourism in South Africa

Growing at three times the world average, tourism has become an important sector in South Africa following the end of apartheid, creating almost one million jobs and outpacing certain commodity exports as a source of foreign currency. The liberalisation of local airspace has seen an increasing number of international airlines operating weekly flights between South Africa and other countries, thus allowing increased access to the country. The result has been a virtual doubling in tourism's contribution to South Africa's total GDP from 4.6% in 1993 to 8.5% in 2008.

Furthermore, a growing global awareness of South Africa as an international tourist destination has resulted in an upsurge in the number of tourist arrivals, especially when the global economy was thriving. A monthly average of almost 800 000 tourists visited South Africa during 2008, totalling approximately 9.6 million foreigners.

In 2008, the Visa network saw increased transaction volume and total number of transactions by international visitors in South Africa. More than 13 million transactions were made by international visitors on their Visa cards, up 11% from 2007 and representing \$1.8 billion in tourism revenues. General retail purchases, such as clothing and food, represented 49% of Visa transactions by international travellers, totalling more than \$892 million, whilst lodging accounted for 13% of Visa transaction volume in 2008.

Figure 1 overleaf depicts the 12 month rolling number of tourist arrivals in South Africa, whilst figure 2 shows that international inbound tourism comprises visitors largely from other African countries and Europe.

¹Source: <http://www.medioclubsouthafrica.com>; <http://www.southafrica.net>
²Source: <http://htrends.com>

Figure 1: Number of Tourist Arrivals

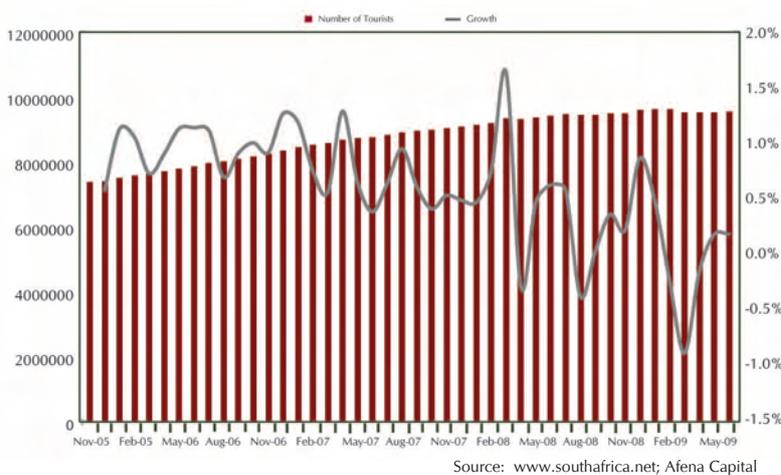
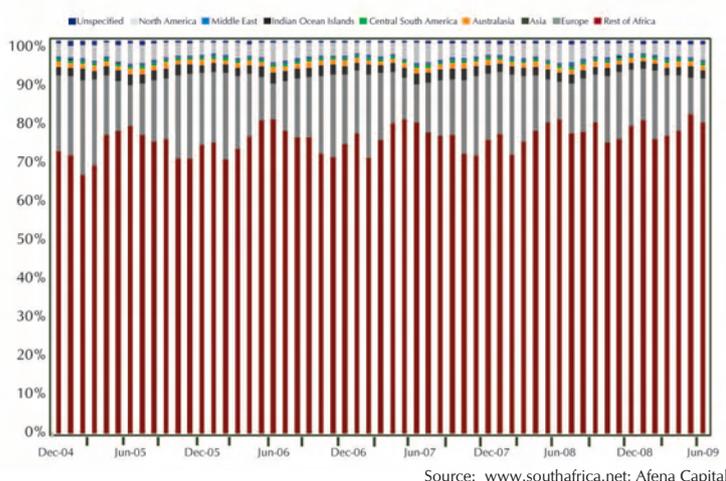


Figure 2: Composition of Tourist Arrivals



Within Africa, the largest numbers of travellers are from neighbouring Lesotho, Botswana, Swaziland and Zimbabwe, whilst the UK and Germany constitute the largest supply of tourists from Europe.

Leisure remains the primary purpose of visits by tourists to South Africa. However, according to the Department of Environmental Affairs and Tourism, business travel is a particularly lucrative sector of

the market as business travellers spend three times more on average than leisure travellers and up to 40% are likely to make a return visit to the country.

Hospitality Industry Overview

An analysis of the hospitality industry according to Porter's Five Forces points to a highly competitive and fragmented industry with numerous players from higher-end luxury to economy, resulting in differing degrees of pricing power. Upscale luxury hotels can command higher prices, though operating costs are also higher due to commensurate service levels and facilities on offer. In addition, the threat of substitutes is high in the form of B&B's, self-catering independent operators and caravan/camping sites. Needless to say, barriers to entry are low for many of the latter mentioned.

The industry is also inextricably linked to the well-being of the economy and the level of inbound tourism, making it very susceptible to business cycles.

To sum up therefore, the hotel industry is a cyclical one, where market share rivalry is rife and successful operators are generally the ones with scale, brand equity and the ability to reign in costs to boost the bottom line.

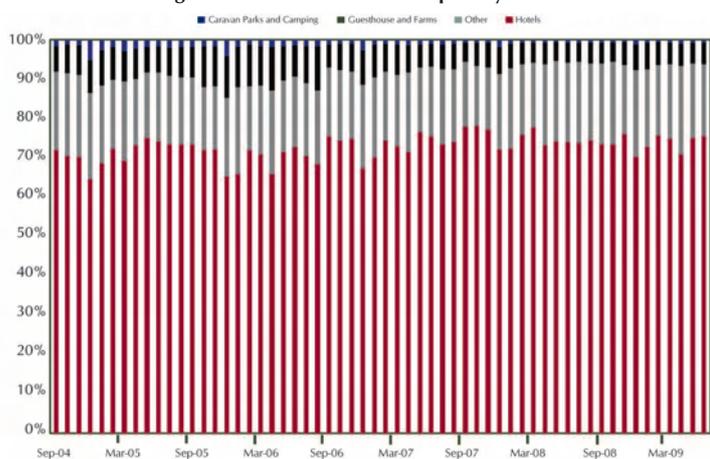
The key drivers of a hospitality operator's profitability are:

- Occupancies, defined as the % of available rooms occupied
- Average room rates charged
- Number of available rooms

Occupancies represent the level of demand, whilst the number of available rooms is reflective of supply. The average room rates that operators are able to charge depend in large part on the supply-demand imbalance.

South Africa has well in excess of 1000 conference centres and an assortment of accommodation across all segments. Hotels contribute by far the largest component of total hospitality income.

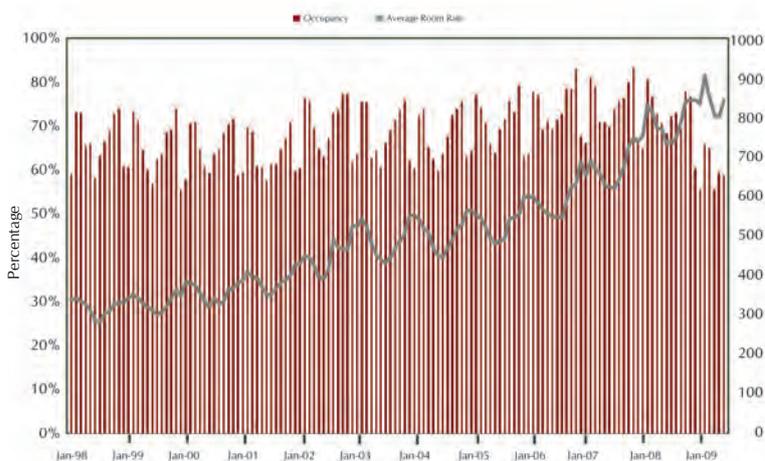
Figure 3: Contribution to Hospitality Income



Source: I-net; Afena Capital

The chart below depicts historic hotel occupancies and average room rates since 1998.

Figure 4: Historic Occupancies and Room Rates in SA



Source: UBS; Afena Capital

Within the South African landscape, there are several dominant players, with two notable domestic operators being City Lodge and Sun International Resorts.

City Lodge is positioned decidedly as an economy offering (dominant hotel formats include City Lodge, Road Lodge and Town Lodge),

whilst Sun International competes at the high-end with their Table Bay, The Palace of the Lost City and Royal Swazi Spa Valley resorts, amongst others.

Current Hospitality Trends

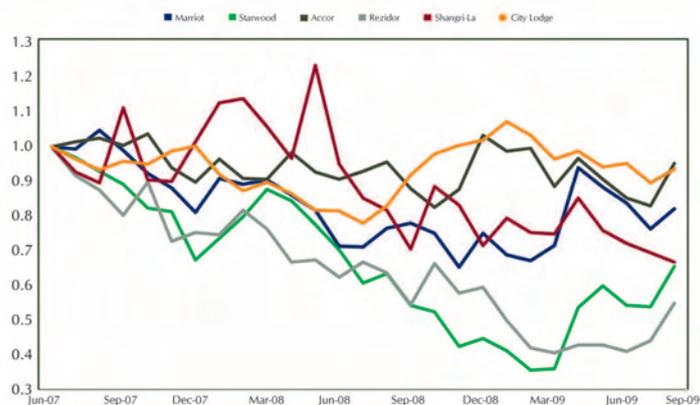
Like many other sectors that are suffering in the global-wide recession, the hospitality sector both globally and locally has endured a dramatic slowdown. Occupancy rates have plummeted in the hotel industry across the global hospitality segment.

During an economic downturn, lower demand shifts pricing power to the customer. Without an offsetting increase in occupancies, margins are easily dissipated, especially given the high fixed cost base and additional marketing and promotional spend. Full-service hotel performance normally declines at a faster rate than their limited-service counterparts.

The average price of a hotel room around the world fell by 17% in the first six months of 2009, according to the Hotels.com Hotel Price Index, driven by price drops across every continent³ due to widespread discounting, trading down in business travel and increased supply.

The relative share price performance of key hotel operators globally can be seen below:

Figure 5: Relative Price Performance (based to 1)



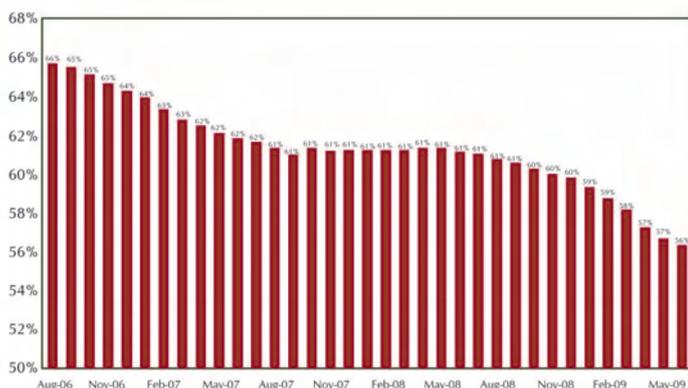
Source: Merrill Lynch; Afena Capital

³Source: <http://www.htrends.com>

Aside from Accor and City Lodge which have held up relatively well compared to their domestic markets, the cyclicity of the industry can be seen in the performance of some of the other players. The Rezidor Hotel Group has been hardest hit, losing almost 50% of its relative value since June 2007.

Recently, tourism in South Africa has also taken a severe knock in the wake of the global recession, with a sharp decline in the number of tourist arrivals from Europe. This in turn has directly affected the demand for hotel rooms, the result of which can be seen in the dramatic fall-off in national occupancies.

Figure 6: Average Annual Hotel Occupancies



Source: I-net; Afena Capital

City Lodge has posted a relatively more stable performance in occupancies due to its greater exposure to the domestic business traveller, with the most recently reported 6-month average occupancy of 73% (from a record high of 83.5% for the 6-months ended December 2007) compared to the national average of 53% for the comparable period to June 2009. The lowest occupancy achieved for City Lodge was 69% during the last economic downturn in 2001.

Despite the recent slowdown, the World Cup next year should serve to buoy the industry somewhat.

Impact of World Cup 2010

In general, the benefits arising from organising mega sporting events in a country include the following⁴:

- Attracting high-income tourists and creating a new generation of

- tourists who might visit the host country repeatedly
- Creating a favourable image of the host country as a tourism destination
- Creating and/or modernising local tourism infrastructure
- Using the international media's presence to communicate with the world
- Creating a skilled workforce in the organisation, management, and funding sectors specialising in unique, tourist-friendly sporting events

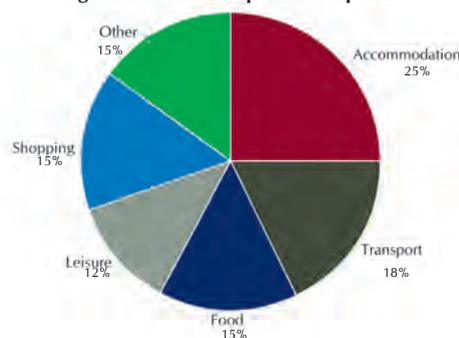
Approximately 10 million tourists are expected during 2010, underpinned by the influx of soccer fans for the World Cup, which will be held over the period 11 June 2010 to 11 July 2010, comprising 64 matches in 10 cities across South Africa. According to the Visa International tourism survey, 14% of respondents said they are likely to attend the World Cup, with the most interest coming from Brazil (46%), China (31%), South Korea (12%), Mexico (11%), Russia (11%) and the US (9%).

Grant Thornton estimates that the direct spending of foreigners could amount to around R9.3bn, whilst results from a BJM econometric study suggests that the FIFA World Cup could lift domestic economic growth by between 0.6 and 1.5 percentage points.

Spending on mega sports events is often overestimated however, as displacement of local spend occurs as residents purchase tickets to the games and business related travel is deferred due to premium hotel rates and general avoidance of the football crowds.

Nevertheless, the average soccer tourist will spend over the duration of the stay, with the largest component attributed to accommodation:

Figure 7: World Cup Tourist Spend



Source: BJM; Afena Capital

⁴Source: www.thesportjournal.org



The extent of the uplift to the local hospitality industry depends ultimately on the level of supply and demand, which should enable an increase in both occupancies and room rates over the period. The table below illustrates the capacity within the local host cities relative to the expected demand.

Table 1: World Cup Accommodation Demand

World Cup Accommodation Demand				
Venue	Formal beds available	Expected stadium capacity	Non-local attendance	% of beds to non-local attendees
Gauteng	50194	95000	57000	88%
Durban	33371	60000	36000	93%
Cape Town	61213	45000	27000	227%
Port Elizabeth	13324	40000	27000	49%
Bloemfontein	4995	40000	24000	21%
Kimberly	7392	40000	24000	31%
Nelspruit	6731	40000	24000	28%
Orkney	3856	40000	24000	16%
Polokwane	4628	40000	24000	19%
Rustenburg	3086	40000	24000	13%

Source: BJM; Department of Transport

Table 1 above illustrates that demand outstrips supply in most instances, providing strong support to increased room rates and occupancies. Travel to and from matches is likely to increase as the spectator base will be housed in areas with adequate accommodation.

In analysing the potential impact on the hospitality industry, we turn to some empirical evidence in three of the most recent World Cups.

Table 2: Empirical Evidence from Prior World Cups

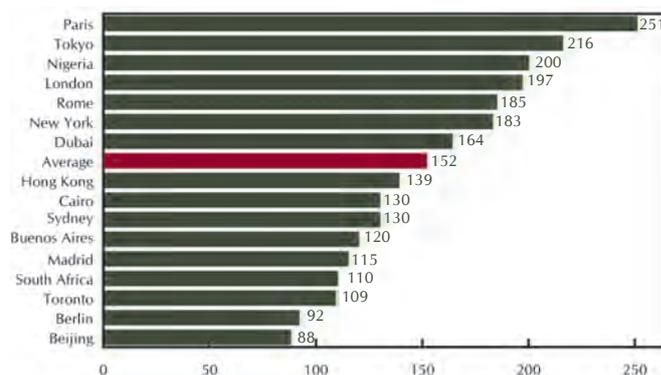
Country	World Cup Year	Change in Occupancy	Change in Room Rate
Germany	2006	2.40%	9.70%
Korea/Japan	2002	2.30%	-1.30%
France	1998	1.80%	9.40%

Source: Smith and Travel Global, UBS

Aside from Korea/Japan, the World Cups of 1998 and 2006 generated healthy increases in both room rates and occupancies. The 2002 World Cup unfortunately coincided with the last major economic downturn following the 9/11 attacks.

If one examines the average daily rates in some of the world's most popular destinations, South Africa is fairly competitive, leaving decent upside potential in pricing during the World Cup.

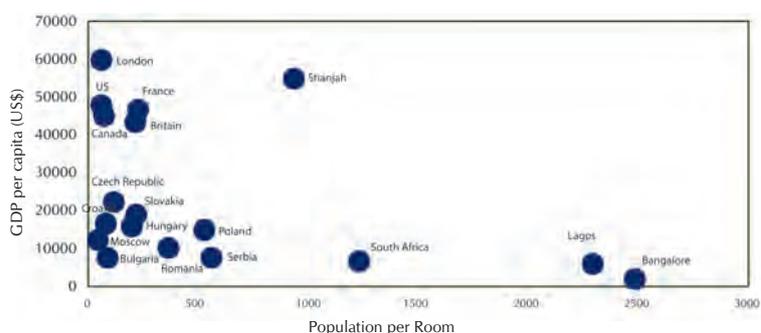
Figure 8: Average Daily Rate (US \$)



Source: Smith and Travel Guide, UBS, Afena Capital

In addition to pricing upside, the chart on the following page provides credence to a sustainable hospitality industry from a demand point of view.

Figure 9: Comparison of Population Per Room



Source: UBS, Wikipedia, International Monetary Fund, MKG Consulting database, London Media Centre

Within the sample shown above, South Africa is amongst some of the emerging markets where hotel supply is not considered excessive on a population per room basis. Despite the addition of more rooms in preparation of 2010, there is approximately one room to every 1200 people in South Africa, compared to the US and London, where there is almost one room per 100 people.

In summary therefore, the outlook for both pricing and demand is positive for South Africa in the context of the global comparisons shown above.

Conclusion

All else equal, the stance for the local hospitality industry for 2010 remains subdued, at least until the global economy shows meaningful recovery. The World Cup will however bring a welcome impetus to the industry during the traditional off-peak period. Above-average room rate increases and occupancies are not unreasonable in light of the data shown from previous World Cups, especially as South African average daily rates are substantially below the global average. Although the boost to occupancies and rates will be limited to the month of the games, the secondary benefits in terms of exposure, alleviating negative perceptions and positioning South Africa as a world class destination should create longer term benefits for the tourism industry, especially as the Department of Tourism has actively sought to use this opportunity to propel the industry to the next level. Furthermore, hotel demand and supply dynamics should continue assisting positive room rate increases.

Having spent billions renovating stadia and airports, improving transport systems and upgrading telecommunications, the supporting infrastructure in South Africa is certainly able to provide the runway for a first-class experience.

Sources:

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