



December 2010

INDIA HOTEL MARKET

Introspection & Outlook

Knight Frank

KEY TAKEAWAYS

- During 2010-13, the Indian hotel room market for 10 major cities is estimated to grow from Rs. 74 bn. to Rs.119 bn. translating to a 17% CAGR
- Supply expected to grow at a CAGR of 15% will surpass the growth in demand which is estimated to grow at a CAGR of 10.3% during 2010-13
- A total of 24211, 8709 and 3057 additional rooms is expected to become operational by 2013 across upscale, midscale and economy category of hotels
- Despite a similar quantum of room demand in Mumbai and the NCR in 2013, the size of Mumbai market, at Rs. 42 bn, will be substantially greater than the NCR market size of Rs. 28 bn
- We foresee Mumbai, followed by Goa, to be the most attractive hospitality markets in India for the next three years

EDITORIAL

Over the last decade, India has gained recognition as a key travel and tourism destination. According to the Travel and Tourism Competiveness Report 2009 published by the World Economic Forum, India ranks 11th in the Asia Pacific region and 62nd overall in the list of the world's most attractive destinations. With unparalleled growth prospects coupled with the potential to generate unlimited business quantum, the Indian travel and tourism industry is expected to become the second largest employer in the world by 2019.

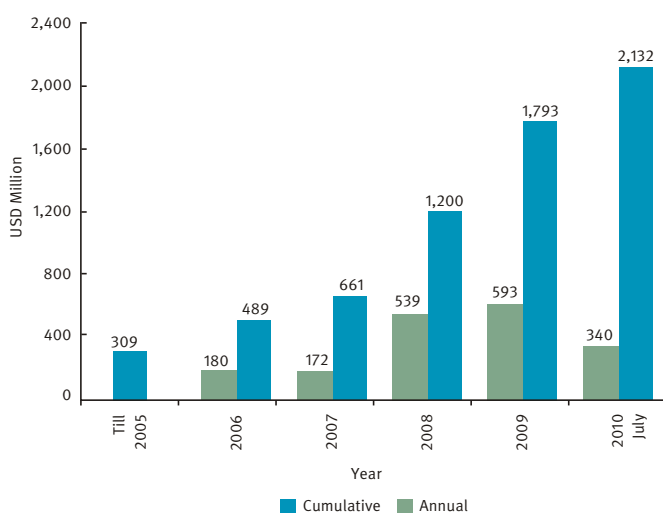
On the development front, government support to the travel and tourism sector has been one of the key factors driving the growth of this sector in India. Initiatives taken to upgrade and expand the country's infrastructure like airports, national highways, rail and ports have had a positive impact on the sector.

According to the Press Note 4 (2001 Series), released by DIPP, Ministry of Commerce and Industry, the government has allowed 100% foreign investment under the automatic route in the hotel and tourism sector. During the last five years, this sector has witnessed substantial growth in the FDI inflow in India. From USD 309 million till 2005, the cumulative FDI inflow up till 2009 has grown to USD 1,793 million.

Tourism in India is typically driven by leisure and business travellers. In recent times, the sector has witnessed newer formats. Among these formats, medical tourism and eco-tourism are fast gaining popularity. The government is taking active steps to promote such new formats. Another emerging format in Indian tourism is the cruise tourism. In June 2008, the government of India approved the Cruise Shipping Policy of the Ministry of Shipping with an objective to make

Figure 1

FDI In India - Hotel and Tourism



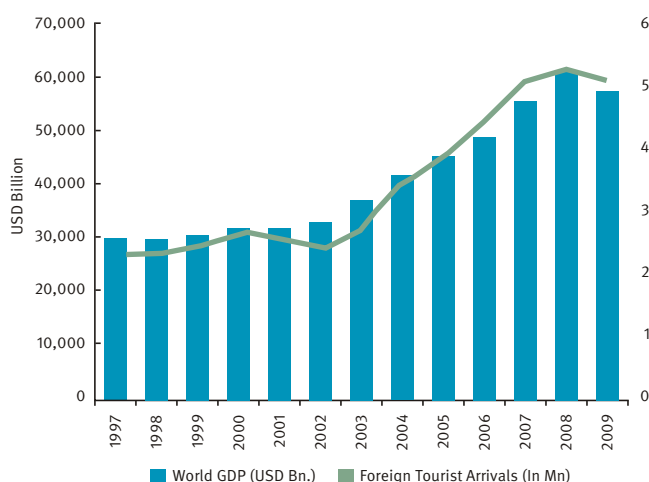
Source: DIPP, Knight Frank Research

India an attractive cruise tourism destination with state of the art infrastructure. This policy has been approved with an aim to attract the right segment of foreign tourists to cruise shipping in India and to popularize cruise shipping among domestic tourists as well.

During the last decade, many global corporations have set up their operational base in India, which has led to an increase in foreign business travel to India. Also, India, being a key leisure destination, travellers from across the world visit India on a year round basis. Increase in the number of foreign tourist arrivals in India, has been an instrumental factor driving growth of the Travel and Tourism sector in India. Similarly, the growth in domestic output has resulted in an increase in domestic tourist visits by almost three folds during 2000 and 2009. The growth in the travel and tourism sector in India has its direct positive impact on the growth of the hospitality sector in India. Growth in tourism will result in an increase in demand for hotel room and also increase in food and beverage business. The contribution of the hospitality sector in India GDP is captured under "Hotel and Restaurant" sector.

Figure 2

Foreign Tourist Arrivals in India and World GDP

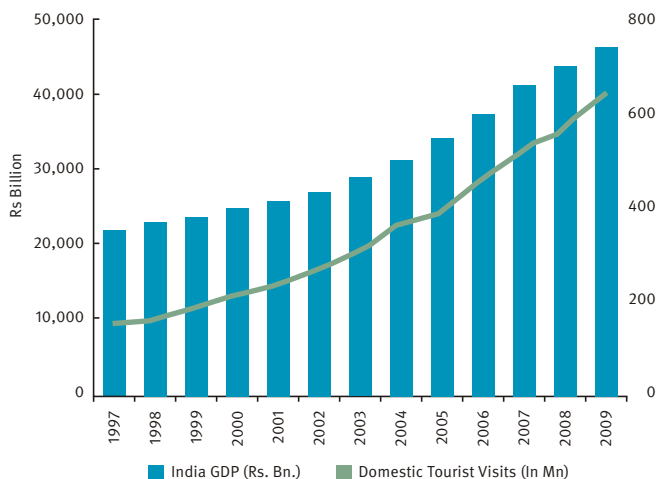


Source: Ministry of Tourism, IMF, Knight Frank Research

A number of policy initiatives taken by the government of India have facilitated the growth of investments into the hospitality sector. The Government of India in the Union Budget of 2007-08 introduced a 5 year tax holiday incentive scheme for 2, 3 and 4 Star hotels in the National Capital Region. The scheme was applicable to projects that completed construction and commenced operation between 1st April 2007 and 31st March 2010. This provision in Union Budget 2010-11, was further extended till 31st July 2010. Also, the government of India, in its Finance Act, 2009, inserted Section 35 AD to allow all hotels rated 2 Star and above in any location, a 100% deduction in capital expenditure (other than on land, goodwill and financial instrument), given the property commences operation on or after 1st April 2010. This led to many hotel brands expanding their base in India.



Figure 3
Domestic Tourist Visits and India GDP

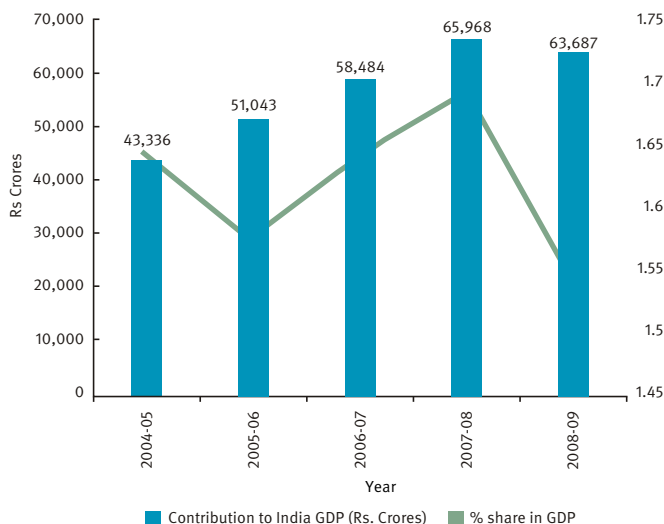


Source: Ministry of Tourism, IMF, Knight Frank Research

Besides, in November 2009, the Reserve Bank of India re-classified hotels as infrastructure companies and allowed entities in the hotel sector to avail External Commercial Borrowings (ECBs) up to USD 100 million per financial year under the “Automatic route”. In August 2010, the RBI in its move to further liberalize the hotel sector, allowed entities in the hotel sector to avail ECBs of more than USD 100 million per financial year under the “Approval Route”. Proceeds of the ECB should be used for capital expenditure for permissible end uses and not for acquisition of land. This move in effect is expected to further boost the inflow of capital in India’s hotel sector.

Figure 5 highlights the gross fixed capital formation or investment into the hotel and restaurant sector between 2004-05 and 2008-09. Due to a favorable hospitality economy in India and positive policy initiatives

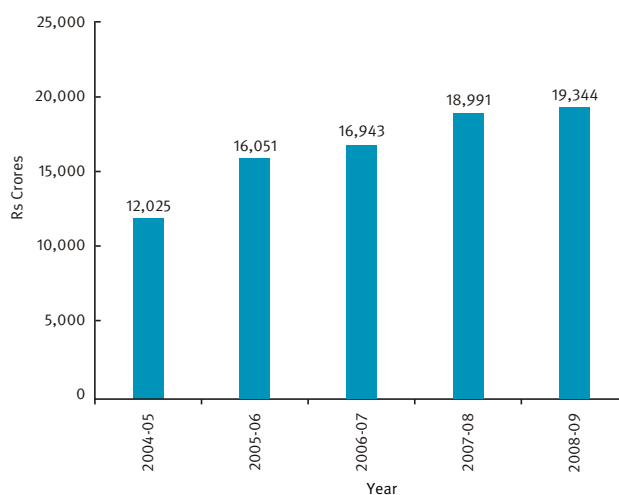
Figure 4
Contribution of Hotel and Restaurant Sector In India GDP
Constant Prices



Source: CMIE, Knight Frank Research

taken by the central government, investments in the hotel and restaurant sector have increased more than 60% between 2004-05 and 2008-09. From Rs. 12,025 crore in 2004-05 it increased to about Rs. 19,344 crore in 2008-09, registering a CAGR of approximately 13%.

Figure 5
Gross Fixed Capital Formation (Constant Prices)-Hotel and Restaurant sector, India



Source: CMIE, Knight Frank Research

Due to the growing share of corporate business travellers in the hotel sector, most of the hospitality players are also focusing on new business formats and hotels catering to the needs and requirements of corporate travellers. Meanwhile, many brands across India have come up with serviced apartments and boutique hotels with an aim to provide home like ambience in a hotel, to suit the needs of corporate travellers.

Objective of the Study

The prime objective of the study is to assess the hotel market scenario with respect to its demand and supply. There are a number of reasons behind focusing on this particular aspect of the hotel industry. It is pertinent to have a convergence between demand and supply in a particular sphere in order to attain sustainable growth. In case of the hotel market, demand is necessary to gauge the level of development required while supply denotes the development planned. Thus, the study strives to measure the performance of the existing hotels in terms of ARR, occupancy rates and other operational characteristics over the past few years, as well as analyse the present market conditions regarding hotel development. With an assessment of the operational and upcoming hotels the study has made an attempt to project the demand-supply dynamics of the industry by the end of 2013.

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A secondary objective of the study has been to identify a city's growth corridors with maximum upcoming hotel developments and to determine the impact of the demand-supply implications on the same. The study has, thus, endeavoured to present both sides of the demand and supply scenario of the hotel industry.

Coverage and Approach

In order to comprehend dynamics of the hospitality industry, the hotels were segmented into three broad categories. The 5-Star and 5-Star deluxe hotels were categorized as 'upscale', the 4-Star as 'midscale' and the 3-Star and budget hotels as 'economy'. However, exceptions may be there in some cities where the star category hotels may have different nomenclatures.

The study has covered ten key cities in the hospitality industry. It encompasses the National Capital Region (NCR), Mumbai, Bengaluru, Goa, Pune, Jaipur, Hyderabad, Chennai, Kolkata and Ahmedabad. An in-depth primary survey of select existing hotels was carried out in these aforementioned cities. A sample of 250 hotels across all these ten cities was selected in such a way that proper representation of the three categories of hotels had been maintained. The directory of the Federation of Hotels and Restaurants Association of India (FHRAI) has been the primary base of our hotel selection. However, during the field survey we took the discretion to include those hotels which were not in the FHRAI directory but were found to be important. In addition to the existing hotels, we have also surveyed the upcoming hotels in the three categories across the ten cities.

The primary survey was conducted during the period August to October 2010. This has helped us in tracking the historical trends of ARR and occupancy rates from the period 2005 to Q2 2010. The trends witnessed during the period have been of great significance while estimating the demand. The study also elucidates other important issues such as guest composition of a hotel in terms of foreign and domestic traveller, share of various expense heads in the total revenue of a hotel and average rack rates of different room formats. These have aided in capturing the past and present market scenario in the cities covered in the study. On the supply front, we have strived to include all the key upcoming hotels in the three segments, though for a few cities information on only upscale and midscale hotels could be obtained.

Outlook

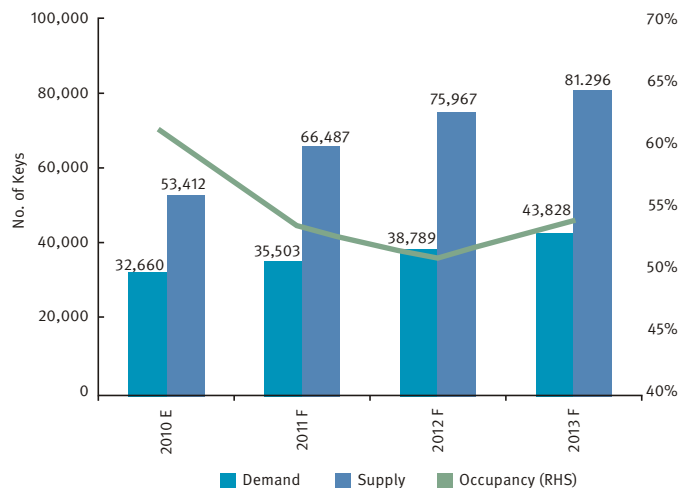
In order to augment the quality and depth of its analysis, Knight Frank Research has formulated various econometric models to forecast the demand supply dynamics in 10 major cities of the country from the period 2010 to 2013. The econometric model for each city has been developed after studying the various factors that have a significant

bearing on the hospitality market of that city. For cities like the NCR, Mumbai and Bangalore, a separate model for upscale category hotels has been developed since the factors affecting the demand for rooms in this category differ from the factors influencing room demand for midscale and economy category hotels. In all the remaining cities, upscale, midscale and economy category hotels have been clubbed together for estimating room demand.

The hospitality market of India in terms of number of rooms demanded per day is estimated to grow at a CAGR of 10.3% during the period 2010 to 2013. However, the growth in supply will surpass the growth in demand since supply is expected to grow at a CAGR of 15% during the same period. A total of 24211, 8709 and 3057 additional rooms are expected to become operational in India by 2013 across upscale, midscale and economy category hotels respectively.

Figure 6

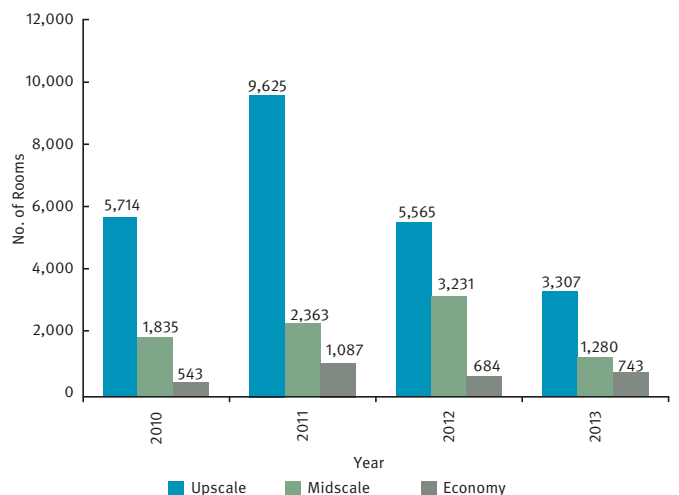
India Hospitality Market (2010-13)



Source: Knight Frank Research

Figure 7

India Upcoming Supply (2010-13)



Source: Knight Frank Research

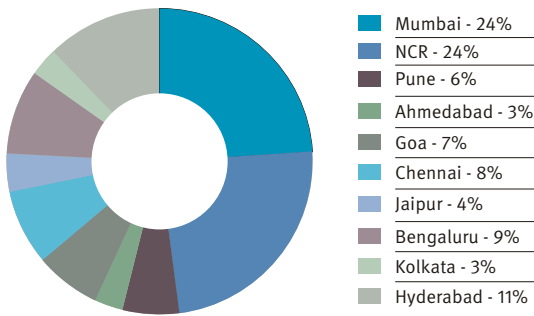


The huge influx of incremental rooms in India will result in the occupancy levels of hotels for most of the cities falling considerably over the next three years. According to our estimates, occupancy level across all the cities except Mumbai and Goa will witness a falling trend from 2010 to 2013.

Among the 10 cities considered in the report, the NCR will comprise the largest share of demand and supply followed by Mumbai, Bangalore and Hyderabad over the next three years. We foresee Mumbai, followed by Goa, to be the most attractive hospitality markets in India for the next three years. Strong growth in demand, higher occupancy level, increasing ARR and low incremental supply over the next three years are some of the reasons for the hospitality sector of both these markets to outperform other cities of India going forward.

Figure 8

City-wise Distribution of Estimated Room Demand in 2013

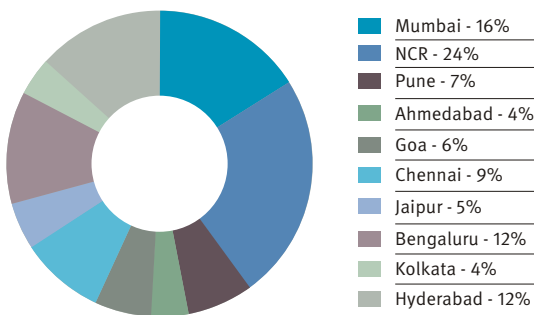


Total Room Demand: 43,828 Rooms

Source: Knight Frank Research

Figure 9

City-wise Distribution of Estimated Room Supply in 2013



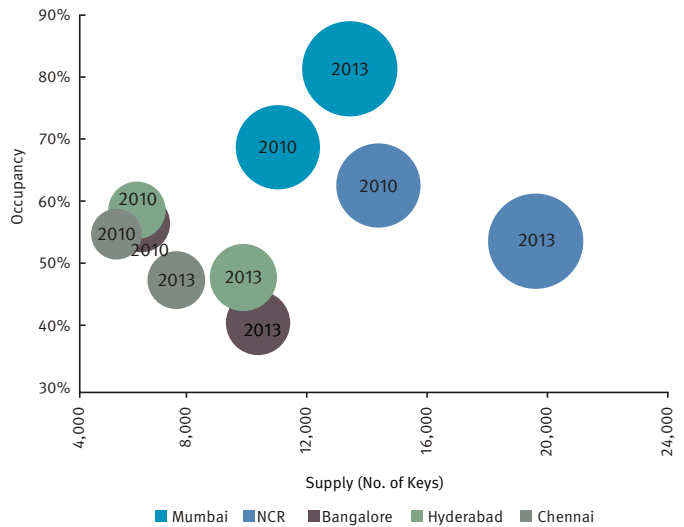
Total Room Supply: 81,296 Rooms

Source: Knight Frank Research

Figure 10 and 11 represent the estimated demand, supply and occupancy of the hotel industry for all the 10 cities in 2010 and 2013. The size of the bubble is the estimated room demand per day and the number inside the bubble signifies the year. It is evident from these figures that amongst the 10 cities covered in the report, Mumbai and Goa will be the most attractive hospitality markets by 2013. By 2013, the Mumbai hospitality market will attain the size equivalent to the NCR in terms of number of room demand. However, in terms of supply, Mumbai will be significantly behind the NCR.

Figure 10

Demand Supply Outlook (2010-13)

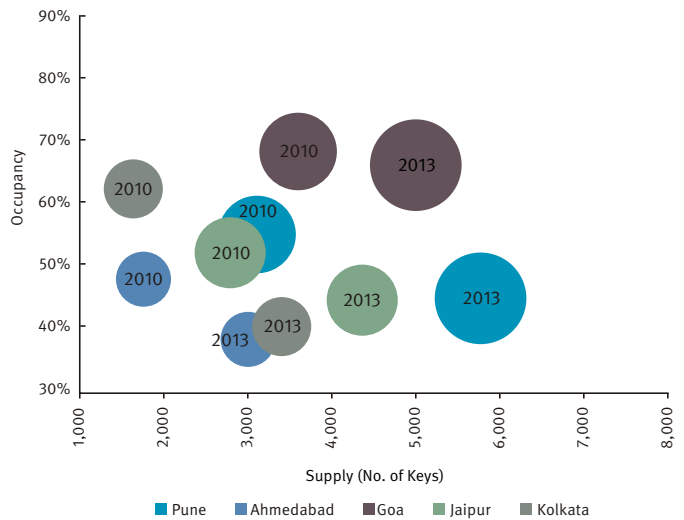


Source: Knight Frank Research

Note: 1. The size of the bubble represents the number of rooms demanded per day
2. The number in the bubble represents the year

Figure 11

Demand Supply Outlook (2010-13)



Source: Knight Frank Research

Note: 1. The size of the bubble represents the number of rooms demanded per day
2. The number in the bubble represents the year

During 2010-13, the Indian hotel room market for 10 major cities is estimated to grow from Rs. 74 bn. to Rs.119 bn. translating to a 17% CAGR. Despite a similar quantum of room demand in Mumbai and the NCR in 2013, the size of Mumbai market, at Rs 42 bn, will be substantially greater than the NCR market size of Rs 28 bn.



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