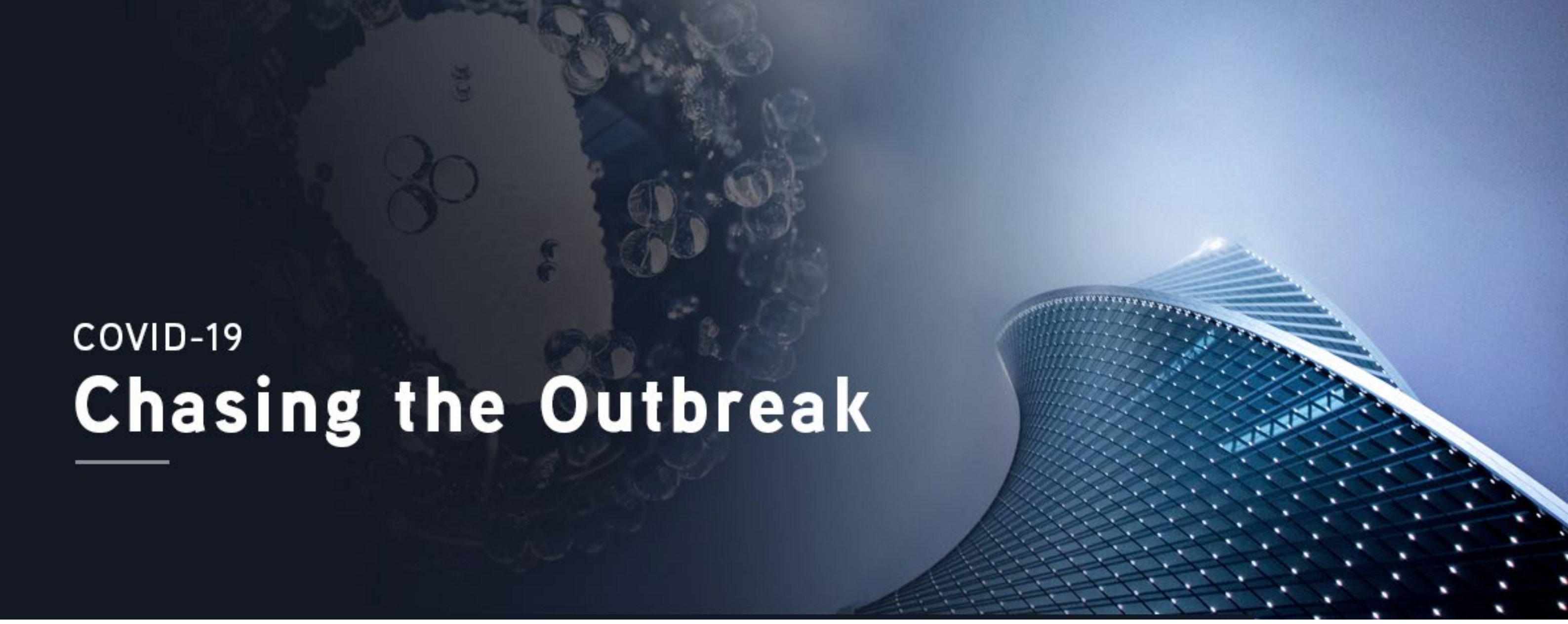

HOW HOTEL INDUSTRY IS FACING THE CORONAVIRUS

RESPONDS MIGUEL VÁZQUEZ, Managing Director Hotels

WHAT IS YOUR VIEW ON THE CURRENT SITUATION IN THE LODGING INDUSTRY CAUSED BY THE CORONA VIRUS?

The impact in the lodging industry will certainly be very significant and will depend primarily on the capacity of each individual country to hold the spread of the virus. In a globalized world like ours, the fact that measures aimed at constraining the virus are being adopted at different time periods and with diverse intensity amongst countries, will most likely entail that the effects on the hotel segment will last over time even in those countries where the spread of the virus has been controlled given their effective management of the crisis.

Once the spread of the virus has been restrained, two key aspects shall be considered:

1. The time for the population to assimilate the current situation, leaving aside the collective psychosis which discourages people from both interacting with one another and using flights as a means to travel to other countries.
2. The impact on the world's economy, given that the potential recession of some of the main global economies will most likely entail a decrease in consumption and will force companies to adopt measures aimed at rationalizing costs, including reductions in travel expenses and meetings

WHAT DO YOU THINK WILL HAPPEN IF THE CURRENT SITUATION LASTS?

1 MORE MONTH

The scenario is not easily predictable as is patent from the current situation of countries such as China or South Korea who, despite being impacted by the coronavirus crisis back in December, are starting to see positive results after almost four months.

Notwithstanding, in the hypothetical case in which the current situation lasts for only one more month worldwide (the spread of the virus is successfully constrained end of April), the impact would remain encapsulated in 2020, with visibility of a potential recovery during 4Q 2020 – 1Q 2021.

3 MORE MONTHS

Controlling the spread of the virus in a three-month period seems to be the position which prevails amongst most hotel operators. Perhaps it is more of a wish than a conviction, but, based on China's experience and the speed at which isolation measures are being adopted worldwide, it may, in fact, happen.

This would imply both the end of the "war phase", characterized by the closure of hotel establishments, restauration activities, and businesses in general, and the beginning of the "post-war phase" which could entail even worse effects for the hospitality sector.

All governments are currently focused on providing solutions of great impact on all industries. Most are fostering measures aimed at massive personnel cost reductions, bonifications in contributions of companies to Social Security, postponement in tax payments, easing access to favorable financing conditions for small and medium enterprises, etc.

The aforementioned governmental umbrella will vanish the day in which hotels reopen once the state of emergency of the different countries is lifted, and hoteliers will have to confront a scenario of slow and progressive demand recovery. This will, in turn, force them to open hotels gradually and resume their activity. However, complete return to normality will most likely not be accomplished until months later, a period in which operating margins will be weakened and cash generation limited.

We foresee that during this phase efforts will be concentrated both in increasing revenues and optimizing fixed costs, and in negotiating with banks for debt refinancing.

OR EVEN LONGER?

A scenario of longer duration would certainly increase the risk of a global recession, which will no longer produce a mere circumstantial impact but would rather lengthen its negative effects over time.

WHAT DO YOU THINK THE LONG-TERM EFFECT WILL BE ON THE HOTEL MARKET?

In a 2-years' time after the current huge drop in hotel activity (which will remain until isolation measures are gone) we shall experience a slow recovery period, which will make it quite challenging for hoteliers to reach similar RevPAR levels to those recorded in 2019.

Nevertheless, we considered that, in the long-term, tourism will return to the growth trend it has been following, without barely any interruption, during the last 20 years. If we analyze past figures, the few significant disruptions in the growth of tourist movements worldwide were caused by 2 very impacting events: the Irak war in 2003 (plus SARS the same year) and the collapse of the Lehman Brothers in 2008. In both cases tourism was able to beat pre-crisis levels in less than 18 months.

It is true that the impact of this pandemic has certainly surpassed any of other the recent ones (i.e. the SARS, the avian influenza or the swine influenza), but history proves that collective memory tends to forget.

HOW DO YOU THINK THIS WILL AFFECT THE HOTEL REAL ESTATE MARKET?

Given the extraordinary volatility experienced by most stock exchange markets during the last four weeks (with the most of the stock exchange indexes falling by more than 30%) it is most likely that real estate assets will be recognized as a safe haven by investors, once the situation turns back to normality (12 – 18 months?).

Considering that global tourism will foreseeably adopt an increasing trend as soon as the pandemic is controlled, hotels, in particular, will most likely become a winner asset class.

However, it is true that the market value of hotels will probably face some drop, given the following:

- Assuming that the 2020 season is lost, the hotels' track-record for years 2021 and 2022 will be worse that those recorded for 2019.
- Expected yields may foreseeably experience some uplift in the short-term, yet to be seen, which shall be corrected once the main global economies begin to recover.

WHAT OPPORTUNITIES DO YOU THINK WILL ARISE FROM THIS CRISIS?

Once order is restored, and considering the crisis' impact on the companies' liquidity, most likely some of them will be incentivized to sell some of their assets in order to obtain cash.

Fully loaded Reits and investment funds that have decided to put themselves in a "wait and see" mode by the moment, will face opportunities to acquire RE hotel assets with some discount in comparison with prices pre-crisis.

However, there will be few distress deals since leverage levels across the industry, in general, are more limited that it was in previous crisis and given the past years of bonanza most hotel groups and hotel owners are solvent enough to resist (if duration is not particularly long) this crisis .

There will be, though room for debt funds willing to finance opportunities which commercial banks are not willing to endure due to the current and upcoming uncertainty.

Also on the debt side, we foresee opportunities for debt refinancing to adapt amortization calendars to the new environment post-control of Covid19.

Finally, on the side of the operators we foresee some white label operators struggling, particularly those focused mainly on leases or HMA´s with minimum guaranteed schemes. They have experimented relevant growth during the last years and Balance sheets cannot be strong enough to properly afford the "post-war" era. This could lead into a consolidation of the market and an increase in M&A activity.

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