Measuring the relative values of hotels and hotel brands


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Introduction

Along with most investment bankers, equity analysts, hotel valuers and others we have, over the years, recorded single hotel and hotel brand transactions taking note of details of the hotel, its location, the number of rooms, the price and any other performance related metrics disclosed. It is one of those exercises that reveal what has happened without providing a great deal of insight into what it means for other hotels or other hotel brands. Two of the analytical tools from the Otus Hotel Brands Database that clients have found useful in making sense of why hotels merit their valuation is the Otus Hotel Asset Index (OHAI) and the Otus Hotel Portfolio Index (OHPI). The indices are yardsticks that measure the asset strength of each hotel and each brand relative to all others. In this note we will outline the gist of the indices, how we calculate them and identify some of the insights they provide.

The Otus Hotel Asset Index

At the outset we must make it clear that we are not hotel valuers. We do not value individual hotels for sale or balance sheet purposes. The OHAI is not a replacement for the professional valuation of single hotel assets, but it does enable us to assess systematically the implications of single chain hotel valuations or transaction prices for the values of other chain hotels. The OHAI is a tool for measuring the relative asset strength of any chain hotel because the valuation of a hotel needs to reflect its supply profile and its location profile. The index utilises the supply data held on the Otus Hotel Brands Database that contains a range of data about all chain hotels and the specifics of where they are in 52 countries. For each hotel we record the number of rooms, the market level, the hotel configuration, the rooms configuration and the in-room facilities. For the location of each hotel we record its address and the size of the conurbation in which it is located, measured by its population and the number of chain rooms in the conurbation. We also differentiate between the types of hotel location within cities differentiated as urban, suburban and airport. Importantly, we track the developments in the structural balance of the economies in which the hotels are located as well as the economic policies pursued and their impact on the hotel business. Thus, we are able to differentiate each hotel in terms of five hotel variables and four location variables providing each hotel with a unique supply profile.

The OHAI is based on a mathematical model that combines the key supply measures of individual hotel asset strength. The way in which the measures of hotel and location are calculated has been arrived at through classic modelling techniques, starting from a purely theoretical model and refining this against actual performance and value data so that the index is a means of evaluating hotel assets relative to each other. Scores are allocated to the hotel variables and these are averaged to compute a hotel score (H) for each hotel. Similarly, scores are allocated to the location variables and these are averaged to produce a contextual score (C) for each hotel. The Otus Hotel Asset Index (A) for a single hotel is then: $A – C*2^{(H-1).}$ Each of the 13,400 chain hotels in the database has an asset index and it is on this basis that we are able systematically to compare each hotel and to rank each hotel in terms of its asset strength. As a result, we are able to explain why the OHAI of any hotel is different from or the same as any other. Table 1 contains a selection of hotels from across the OHAI range and reveals differences in some of the hotel supply and location variables:

The CÍVIS Hotel Kárpátia has the lowest OHAI because, inter alia, it is a small budget hotel with no en suite bathrooms in a village in an economy with a structural balance reliant on industrial activities and citizen services. The Connaught has one of the highest OHAI scores because, inter alia, it is a deluxe hotel in the most structurally developed economy in Europe and located in the centre of London.

In H1 2008, one of the few chain hotels sold in London was the easyHotel, South Kensington, which achieved a price of £4 million, £118,000 per room. Table 2 shows a cluster of London hotels with similar asset indexes. The County Hotel, a constituent of Imperial London Hotels has a lower

Table 1

Hotel	City	Country	Rooms	Market level	Hotel configuration	Otus Hotel Asset Index
The Connaught	London	United Kingdom	121	Deluxe	Full Feature	250.36
Conrad Brussels	Brussels	Belgium	269	Deluxe	Full Feature	197.76
Kempinski Hotel Corvinus Budapest	Budapest	Hungary	366	Deluxe	Full Feature	149.92
Sheraton Belgravia Hotel, London	London	United Kingdom	89	Up-Market	Basic Feature	101.48
Carlton Mitre Hampton Court	London	United Kingdom	36	Up-Market	Basic Feature	75.07
Ramada Glasgow City	Glasgow	United Kingdom	90	Mid-Market	Basic Feature	50.01
Park Inn Orange	Orange	France	99	Mid-Market	Limited Feature	15
Premiere Classe Beaune	Beaune	France	45	Budget	Room Only	5
CÍVIS Hotel Kárpátia	Tiszaujvaros	Hungary	36	Budget	Basic Feature	1.61

Source: Otus & Co

index than the easyHotel, in spite of its larger size because none of the rooms are en suite. The main difference between the easyHotel and the Etap is in Location type. Our hypothesis is that other things remaining equal the hotels in the cluster ought to be valued at similar per room levels.

In the wider European context the cluster of hotels with a similar asset index to the easyHotel, South Kensington ought to be valued at similar levels, other things remaining equal. Table 3 illustrates the cluster of relevant hotels. The difference between the easyHotel and the others is in market level where the others score higher, but this is offset by the superior location profile of the easyHotel.

The issue, of course is that rarely do other things remain equal. All of the components of the OHAI are ingredients of hotel valuation, but they are not all of the ingredients. The OHAI cannot foretell the actual physical state of the hotel, that is a matter for due diligence. Nor can it foretell the actual performance of the hotel, also a matter for due diligence. However, in addition to the usual due diligence for hotel valuation, the OHAI provides a sense check against which any valuation can be tested relative to other equivalent hotels. In brief, if the valuation of a hotel is materially inconsistent with the known OHAI of other hotels, then it has to be explained. Typically, that explanation comes down to issues relating to the physical state of the building or its actual performance. Alternatively, the hotel has been mispriced.

The Otus Hotel Portfolio Index

As investment bankers we do value hotel brands and the Otus Hotel Portfolio Index (OHPI) is a tool that aids that process. As is the case with the OHAI and single hotel valuations, the OHPI is not a replacement for a full professional valuation of a hotel brand, but it does enable us to assess any chain valuation against other hotel brands. The OHPI is a progression from the OHAI since it is the consolidation of the asset indexes of all of the hotels in a brand or portfolio expressed as an average. Typically, a hotel brand will exhibit a homogeneous set of hotel supply variables and thus, within any brand there will be a narrow range of hotel scores in its OHPI. In contrast and typically, a hotel brand will exhibit a more heterogeneous set of location variables and thus within any brand there will be a wide range of context scores in the OHPI. The example of Hilton in Europe in Table 4 illustrates the point. The OHAI range of the Hilton hotels in Europe is from 129.98 to 10.61 and this range is due to the diversity of locations rather than the diversity of hotels. The London Metropole achieves the highest index due to its location in central London and is boosted higher than other Hiltons in the city centre due to its size. In contrast, the Hilton Vilamoura As Cascatas Golf Resort & Spa scores less because it is located in a quaternary village in an economy dominated by the industrial and citizen services segments. Indeed, the Hilton Vilamoura and the Hilton Metropole have hotel scores that are within a whisker of each other. The larger size of the Metropole is almost offset by the more extensive leisure facilities of the Vilamoura, but the difference in their OHAI is almost entirely down to the specifics of their locations.

Table 2

Hotel	City	Location Type	Rooms	Market level	Hotel configuration	Otus Hotel Asset Index
easyHotel London Earl's Court	London	Urban	80	Budget	Room Only	18.79
easyHotel London Victoria	London	Urban	78	Budget	Room Only	18.77
easyHotel London South Kensington	London	Urban	34	Budget	Room Only	18.33
County	London	Urban	175	Budget	Limited Feature	18.28
Etap Hotel London City Airport	London	Airport	81	Budget	Room Only	16.98

Source: Otus & Co

Table 3

Hotel	City	Country	Rooms	Market level	Hotel configuration	Otus Hotel Asset Index
Hotel RIU Helena Parc	Sunny Beach	Bulgaria	232	Mid-Market	Resort	18.33
Quality Hotel Aalborg	Aalborg	Denmark	168	Mid-Market	Limited Feature	18.33
easyHotel London South Kensington	London	United Kingdom	34	Budget	Room Only	18.33
Novotel Bordeaux Aéroport	Mérignac (Gironde)	France	137	Mid-Market	Full Feature	18.32
IFA Catarina Hotel	Playa del Ingles, Gran Canaria	Spain	402	Mid-Market	Full Feature	18.3

Source: Otus & Co

Table 4

Hotel	City	Country	Rooms	Market level	Hotel configuration	Otus Hotel Asset Index
Hilton London Metropole	London	United Kingdom	1054	Up-Market	Full Feature	129.98
The Waldorf Hilton	London	United Kingdom	299	Up-Market	Full Feature	121.16
Hilton Manchester Deansgate	Manchester	United Kingdom	279	Up-Market	Full Feature	98.5
Hilton Vienna	Vienna	Austria	579	Up-Market	Basic Feature	74
Hilton Malmo City	Malmo	Sweden	216	Up-Market	Full Feature	61.54
Athenee Palace Hilton Bucharest	Bucharest	Romania	272	Up-Market	Full Feature	50.95
Hilton Park Nicosia	Nicosia	Cyprus	194	Up-Market	Full Feature	35.26
Hilton Limerick Hotel	Limerick	Republic of Ireland	184	Up-Market	Full Feature	25.35
Hilton Imperial Dubrovnik	Dubrovnik	Croatia	147	Up-Market	Full Feature	21.01
Hilton Royal Parc Soestduinen	Soestduinen	Netherlands	113	Up-Market	Resort	15.51
Hilton Vilamoura As Cascatas Golf Resort & Spa	Vilamoura	Portugal	154	Up-Market	Resort	10.61

Source: Otus & Co

The OHPI is calculated by consolidating the OHAI for each hotel in a brand or portfolio, which measures the relative asset strength of the brand or portfolio. Table 5 presents a selection of brands across the OHPI range for their portfolios in the 52 countries of greater Europe.

Table 5

Brand	Average OHAI
Four Seasons	168
Hilton	69
Movenpick	53
Maritim	48
Jurys Inn	44
NH Hotels	36
Holiday Inn	34
Scandic	29
Ibis	16
Travelodge	13
Etap	7

Source: Otus & Co

The Four Seasons OHPI is high because of its high hotel scores, but also due to its high context scores since its hotels are positioned mainly in the centre of prominent cities in more structurally developed economies. In contrast, Etap has a very low index because its hotels produce a low score and so does its context profile due to its positioning predominantly in quaternary and suburban locations. The OHPI of a brand or portfolio reflects the total hotel supply profile and the total context profile of the hotels in the brand or portfolio. Just as the OHAI provides the relative positioning of hotels so the OHPI provides the relative positioning of hotel brands. It is a measure of the relative asset strength of a hotel brand or portfolio. The OHPI is the first system that allows for any one hotel brand to be compared systematically with any other brand in terms of the asset strength of the constituent hotels, but it does not end there.

As is the case with the OHAI, the OHPI cannot foretell the actual physical state of the hotels in any brand, that needs due diligence. Neither can it foretell the actual performance of each hotel, which also requires due diligence. However, hotel brands are so much more complex than single hotels when it comes to valuation for three reasons that hitherto have been fuzzy and reduced the effectiveness of the valuation of hotel brands. First, is the affiliation structure of a brand: the extent to which the brand owns, leases, manages or franchises the hotels in its portfolio. Thus, a refinement of the OHPI for any brand is to calculate separate portfolio indexes for the hotels that are owned, leased, managed or franchised. In this way and along with the other index tools, the relative positioning and performance of the brands can be discerned more perceptively. Secondly, there is the effectiveness of the portfolio management of hotel brands. Previously, no tools have been available for evaluating the portfolio management of hotel brands. Consequently, portfolio management in hotel chains has been reduced to broad targets for expanding a brand or even to intuition and in our analysis this has retarded the performance of hotel brands. Calculated annually, the OHPI is able to measure the impact that the development and portfolio strategies of each hotel brand have had. If the OHPI increases from one year to the next then the asset strength of the portfolio has been increased and if it declines then the asset strength has been diluted. Because it emphasises the relative positioning of each brand and because all the variables are measured consistently the OHPI additionally measures the asset strength of each hotel brand relative to the total hotel chain population. This enhances the analysis of portfolio management since it measures the positioning of each brand relative to the market as well as to its own performance the year before.

Thirdly, there is the particularly complex issue of the valuation of the brand infrastructure. An article of faith is that a hotel brand is greater than the sum of its hotels. If the valuation of a hotel brand is no more than its asset strength then the value of the brand is zero. Put another way, in addition to the asset strength of a hotel brand there is the extent of its capacity to generate consistently superior demand into its hotels and the extent to which it can produce consistently superior operating margins. Thus, there is something there to be measured and the contribution of Otus is to measure the effectiveness of each hotel brand in generating demand in a given country as well as maintaining low costs in that country. In our analysis, these are a function of the size and pattern of its presence in that country. The larger the market share of a hotel brand in the country and the greater the exposure of the brand to significant cities in that country then the greater the capacity of the brand to generate consistently superior demand relative to its equivalents. Brand infrastructure also requires investment and the cash flow generated by hotel chains in a country is also crucial. Cash flow for a hotel brand is a function of its affiliation structure. The major franchised brands in the US measure their portfolios in thousands of hotels, whereas few franchised hotel brands in Europe are able to measure their exposure across the whole region in hundreds of hotels. Thus, in Europe the franchise chains earn minor fees compared with their counterparts in the US and they have significantly smaller brand infrastructure than their US counterparts. Few franchised brands in Europe have yet come close to developing a big enough portfolio to deliver sufficient cash from franchise fees to enable the brand to generate consistently superior performance.

Conclusions

Hotel valuation depends on the known data about the hotel, its location, its performance and its medium to long term prospects. Without the OHAI the hotel business has had to rely too much on intuition in single asset pricing since the data typically available on hotel transactions do not provide sufficient insights to make effective comparisons of relative values. Similarly, hotel chain valuations have had to rely on data specific to the brand under review and have not had the benefit of the data or tools necessary to compare the asset strength of a hotel brand relative to other hotel brands and to the hotel market. As a result, the hotel business has also had to rely too much on intuition in hotel brand pricing. Over the past year, the stock market valuation of hotel brands has collapsed by an average of almost 50%, while simultaneously there has been only a gentle decline in the asset values of hotels creating a discontinuity between hotel and hotel chain valuations. A goal of buying and selling hotels and hotel brands is to try to discover mispricing. The OHAI and the OHPI provide a systematic basis on which mispricing can be identified.

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