Cause for cautious optimism

After falling off a cliff three years ago, hotel vacancy rates are starting to show signs of improvement. All of the major listed stocks with an exposure to the local hotel sector have reported lower vacancy rates this year.

According to hotel consulting group STR Global, overall occupancy rates have improved to 60,1% from 57,8% in 2012.

City Lodge reported that its occupancy rate had rebounded from 59% last year to 62% in the current financial year. Tsogo Sun also reported improved occupancy rates of 64,7%, up from 61,4% while the Hospitality Property Fund said it occupancy levels had also risen.

Sun International recorded a marginal decline for its current financial year but this was largely as a result of increased room supply as its refurbished Maslow Hotel in Sandton, which opened its doors in January.

Tsogo Sun's chief executive Marcel von Aulock says the sector is definitely showing signs of improvement as corporate and business travellers return to the market. However, he does warn that the hospitality sector is still well below its long-term trend of around 67%.

PwC says in its review of the local hospitality sector that occupancy rates will continue to improve over the next three years as stay-unit nights will grow faster than available rooms. But it warns that even so the projected occupancy rate for hotels in 2016 will still be 9,7% lower than it was in 2007.

Clear signs of improvement

City Lodge's chief executive Clifford Ross agrees with Von Aulock and says things are slowly improving. "Up until May we had 20 consecutive months of better occupancies. Small increases, but nevertheless, increases."

Though City Lodge is also a long way from its long-term occupancy rate of 74% he says: "We still have enormous room to move as far as occupancies are concerned."

The challenge for the hospitality sector is less about filling up rooms than trying to improve room rates. According to Von Aulock there has been a 14% reduction in revenue per available room (revpar), a key industry measurement, since the peak of 2008.

PwC forecasts that average room rates will rise at a compound annual rate of just 4,6% over the next three years.

"We certainly do not have any pricing power. When you start going above 70% occupancy rates you can up your prices," says Von Aulock.

The inability of the hoteliers to raise rates is a legacy of the boom when 12,000 rooms were added to the market between 2007 and 2011. This, coupled with the global economic crisis, caused occupancy rates to collapse, taking with it the ability to pass on any price increases.

"We peaked at 83% and then we slammed all the way down to 56%, the lowest we have been in our 28-year history because of oversupply and lack of demand," says Ross.

But Hospitality Property Fund's chief executive Andrew Rogers says the sector is being too cautious when it comes to passing on rate increases. He says hoteliers have been caught offside by the increase in volumes and haven't acted quickly enough to push through above-inflation increases.

Room rates

"We only get one chance to push up our rates and that is now," he says.

Hospitality reported in its recent results that the fund's average room rates rose below inflation at 4,8% to R1,020 for the portion of its portfolio subject to variable rental income.

But Ross is more cautious, saying the market isn't yet in a situation where it can push above-inflation increases and certainly not in a market where everyone is discounting.

"We haven't seen rate increases in the market from the competitor set for a number of years. If there has been, it has always been discounted by the size of the discount that they give."

But what Ross says is encouraging is that there is very little new hotel development in the pipeline. "If we have 1% room growth in SA over the next couple of years it will be a lot. Even though our economic growth is only 2%, at least it is growth. That growth should filter through and result in increases in occupancies."

And this should enable the industry to start pushing up room rates.

According to Rogers, the outlook for the hospitality industry is positive, particularly in major cities where business volumes have shown a strong recovery. "The supply and demand fundamentals in the domestic trading environment are improving despite muted economic growth. As demand is improving and the oversupply of hotel rooms is dissipating with no new major hotel developments coming to market there is likely to be a situation where demand starts outstripping medium-term supply in major markets."

Good times coming back

Von Aulock says it is a case of waiting for the good times to come back. "The market will come back," he says.

There are definite signs that business tourism is improving. Bidvest SA's chief executive Lindsay Ralphs said at the company's results meeting that it had experienced quite a healthy year from the domestic corporate travel sector in its travel and aviation business.

PwC says though visitor numbers from Europe are down, the increase in visitors from other African countries and the Asia-Pacific region are a boost to the tourism sector and returns, albeit lower, are still there for the taking in SA's hospitality sector.

But investors have little choice when it comes to getting exposure to the hotel sector on the JSE.

City Lodge is the only pure hotel company, though an argument could be made for the Hospitality Property Fund being in that sector even though it is structured as a real estate investment trust. In the case of both Sun International and Tsogo Sun, their hotel operations are dwarfed by their gaming interests.

For Sun International, even though its hotels generated revenue of just under R1bn, it makes up only 9% of the group's total revenue. Tsogo Sun's SA hotels generate about 18% of the group's revenue and 15% of its earnings before interest tax, depreciation and amortisation.

All four stocks have had a credible year. City Lodge lifted headline earnings by 31% to R5,78. Sun International increased its earning by 18% to R7,14 and Tsogo Sun increased its earnings by 24% to R1,50 while Hospitality grew its A-linked unit distribution by 19,1% to R1,34 and the B-linked unit by 128,6% to 18c.

But it is City Lodge which offers the most exciting prospects. As it showed in its latest results, a three percentage point increase in occupancy rates translated into a 31% increase in after-tax profits. And according to Ross an extra R1 in room revenue will give it an additional R1m in bottom-line profits.

Source: Financial Mail via I-Net Bridge