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The Availability of Capital for Hospitality Transactions

November 2019

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Founded in 2001 by Andrew Harrington, AHV Associates LLP (AHV) is an award winning boutique investment bank focused on advising private companies across a range of M&A and advisory assignments

AHV Corporate Finance

Mergers & Acquisitions

- Buy-side advisory
- Company Sales
- JVs
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- Corporate Debt & Equity
- Acquisition Finance
- Dev/Exp Capital

AHV specializes in hospitality and works with companies who own and/or operate hotels, apart-hotels, serviced apartments, hostels and mixed-use resorts

AHV Associates

Recent completed transactions

AHV advised the Denmark-based hotel chain on the sale of a majority stake to Deutsche Hospitality in January 2019 for an undisclosed amount. As the lead advisor, AHV assisted the management team throughout the entire process, from sourcing potential buyers until final closing.

2019
undisclosed

AHV advised FREO, an international real estate asset manager and developer, on its strategic investment in Michels & Taylor. AHV sourced suitable hotel management companies, reviewed and analysed shared information, and advised FREO until the completion of the transaction.

2019
undisclosed

AHV is retained financial advisor to CLC World, a key player in the global resort industry. In December 2018, CLC, a pre-deal 24.5% minority stakeholder in the resort management business VRI Europe, acquired the remaining 75.5% stake from Marriott Vacations Worldwide. AHV advised on the valuation of VRI Europe and on the negotiations.

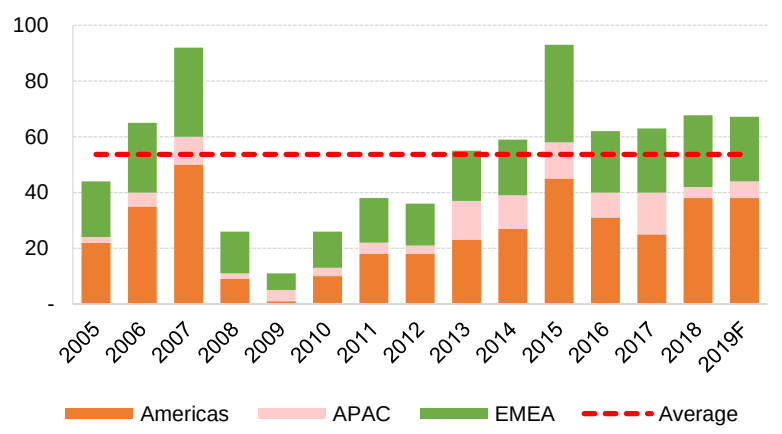
2018
$63 million

Global Hotel Investments

More capital and hospitality investments

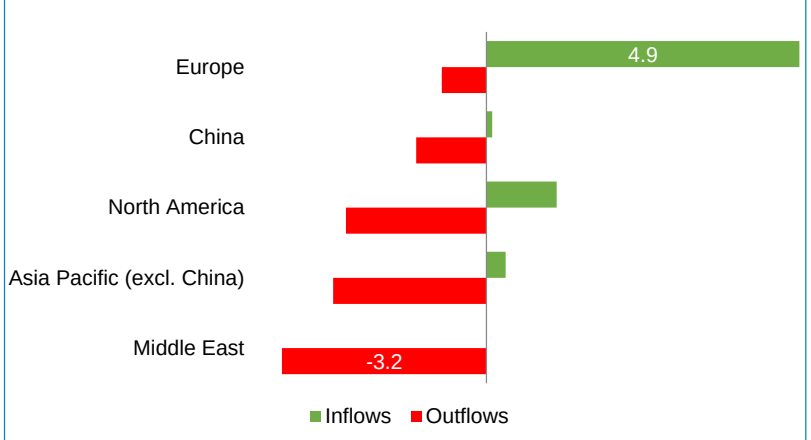
- Global hotel transaction volumes reached c.$68bn in 2018, up c.2.5% from 2017 levels
- Although global real estate markets are showing negative growth in 2019 vs 2018, global hotel investment volume levels should continue to grow due to:
  - Record levels of dry powder for acquisitions which pressures investors to deploy capital
  - Favourable secular trends (i.e. tourism growth, corporate travelling growth, etc.)
  - Hotels' attractive yields compared to prevailing interest rates and other real estate assets
- Hotel focussed closed-end funds raised $28.8bn over the course of 2018, with the composition of the capital shifting towards debt strategies
- Generalist funds have a large presence in the market, with c. 70% of global hotel investments in 2018 being made by funds that invest in multiple asset classes, rather than specializing in hotels
- Hotel investment has been defying global economic caution; it is projected that volumes will reach $67 billion in 2019
- Cross border investment is also expected to increase, due to high amounts of dry powder in the Middle East and Asia flowing into Europe and North America

Global Hotel Investment Volumes*



***in $billion**

Capital Inflow/Outflow by Region, 2018



***in €billion**

Source: JLL, CBRE, HVS, STR

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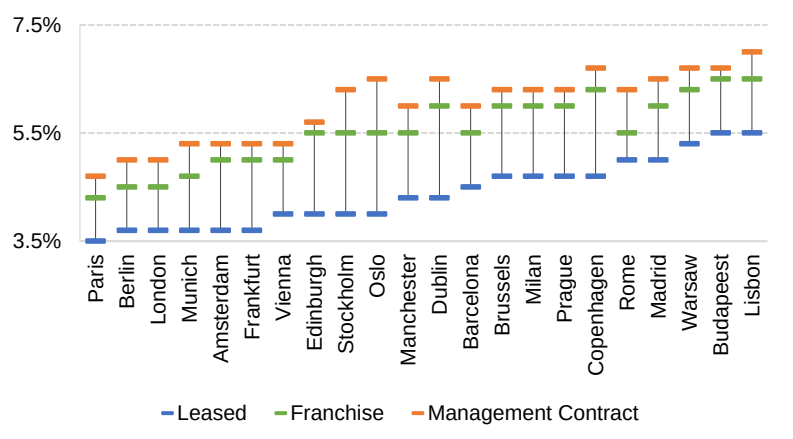
European Hotel Investments

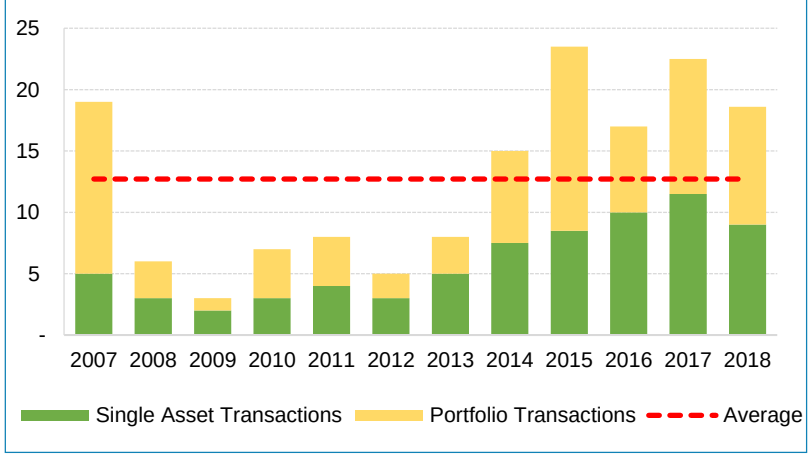
Established and emerging markets offering diverse yields

- Europe as a whole has seen acceleration in hotel development activity, with Germany and the United Kingdom accounting for nearly 60% of rooms in the construction pipeline in 2019
- Emerging tourist markets are looking increasingly attractive for investors that value higher relative yields, with the highest yields being realized in Lisbon, Budapest, Warsaw, and Madrid
- Across all major cities in Europe in 2018, management contracts had the highest yield, averaging 5.99%, followed by vacant possession/franchise at 5.52%, and lease agreements at 4.39%
- These high yields attract non-European capital, which is shown in 65.4% of European hotel transactions in 2018 being financed with foreign capital, well above the 10 year average of 54.9%
- Similarly, European hotel investments increased 5.3% in the 12-months to Q2 2019, despite the slight decline in overall European commercial real estate investments.
- Private equity funds and other investors driven by yield are expected to face more competition from investors with a lower cost of capital, which is expected to facilitate the expansion of investment in secondary markets with less investment saturation, such as Portugal and Italy

European City Hotel Prime Yield Comparison, 2018



European Hotel Investment Volumes*



***in €billion**

Source: STR, Savills, JLL

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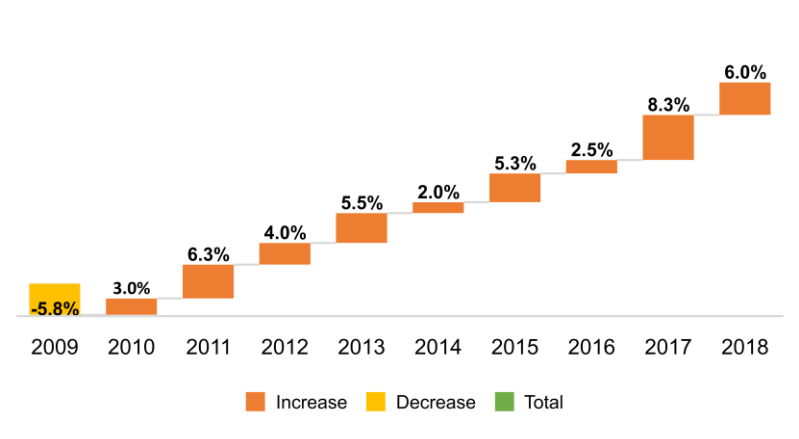
European Hospitality and Tourism Trends

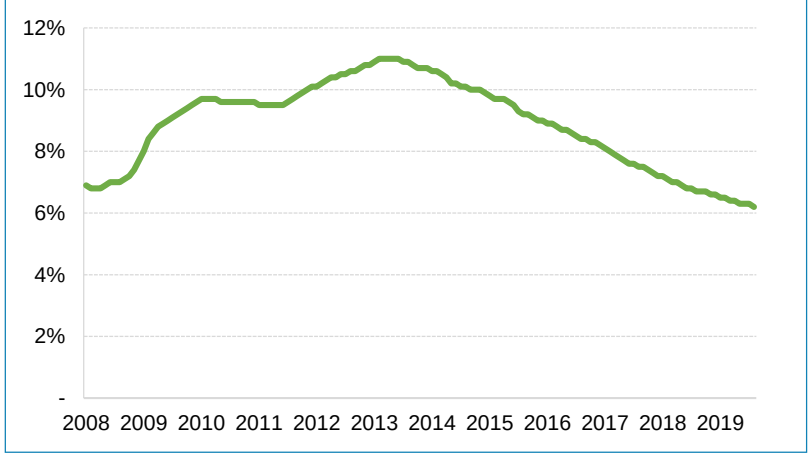
Favourable secular trends

- The low unemployment rate in the EU, which is around 6.2% compared to the 10 year average of 8.9%, is exerting upward pressure on wages, giving workers more to spend on travel and accommodation
- In the five years leading to 2018, total spent on tourist accommodation across Europe increased by 26.2%
- European Hotels have seen strong RevPAR performance in the year to Q2 2019, increasing by 4.1% compared to the ten year average of c. 2.6%
- As of 2018 Prague and London have the joint highest hotel occupancy in Europe at 82.3%, followed by Amsterdam at nearly 82%, with all other major European cities around 75%
- Europe saw the second highest growth in terms of air passenger demand in 2018 at 7.3%, only marginally behind the Asia Pacific region's 7.5% growth
  - European airlines are continuing to keep up with this demand, increasing the available seat kilometres by 48.8% since 2011
- Europe has maintained its share of over 50% of global tourist movements and receiving 713m visitors in 2018, 6% up on 2017
  - This high level of tourism is seeing some limited pushback, with some cities beginning to restrict hotel development, including Amsterdam, Barcelona, and Venice

Growth in International Tourist Arrivals in Europe, 2009-2018



European Union Unemployment Rate



Source: PWC, Savills, Eurostat

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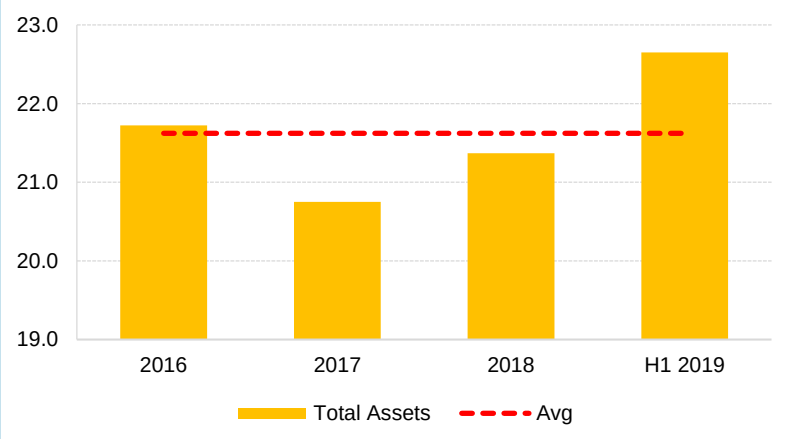
The Current Status of Commercial Banks

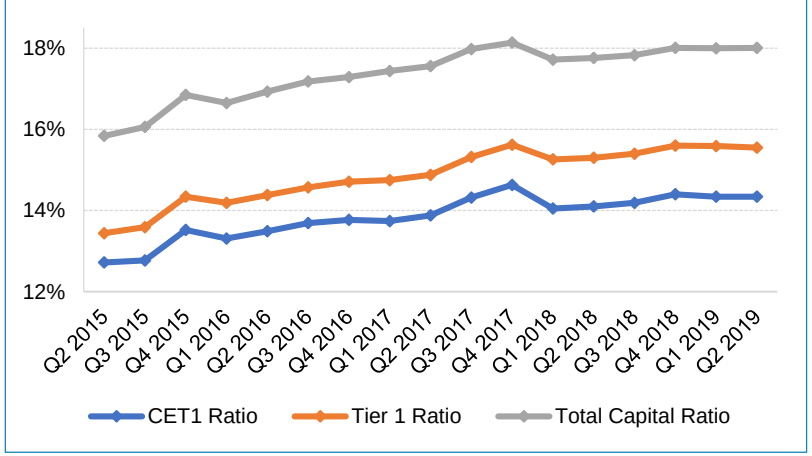
Bigger, more profitable, and more resilient

- The top 1000 world banks' assets have grown from $96.4tn in 2008 to $123.7tn in 2017, in increase of 28.3%
  - The average return on assets among these banks has increased from 0.1% to 0.9%
  - The two measurements for bank stability are the common equity tier 1 (CET1) ratio and the Tier 1 Ratio
    - CET1 ratio is CET1 capital divided by risk weighted assets and CET1 capital includes common shares outstanding and stock surplus, retained earnings, other comprehensive income, qualifying minority interest, and regulatory adjustments.
    - The tier 1 ratio is tier 1 capital divided by risk weighted assets and tier 1 capital includes everything in CET1, but it also includes certain capital instruments, any related surplus, additional qualifying interest, and regulatory adjustments.
  - As a proportion of total assets, tier 1 capital rose to 6.7% from 4.4% in 2008
- As of Q2 2019, European banks' aggregate tier 1 ratio reached 15.6%, which was driven both by an increase in CET1 capital and a decrease in risk-weighted assets and represents an overall increase in banks' tier 1 ratio of c.16% from 2015
- Stress tests conducted by central banks, which simulated a prolonged period of low economic growth in Europe, found only a moderate reduction in CET1, suggesting robust downside protection

European Commercial Bank Total Assets*



European Banks' Capital Ratios



***In €billion**

Source: Deloitte, ECB

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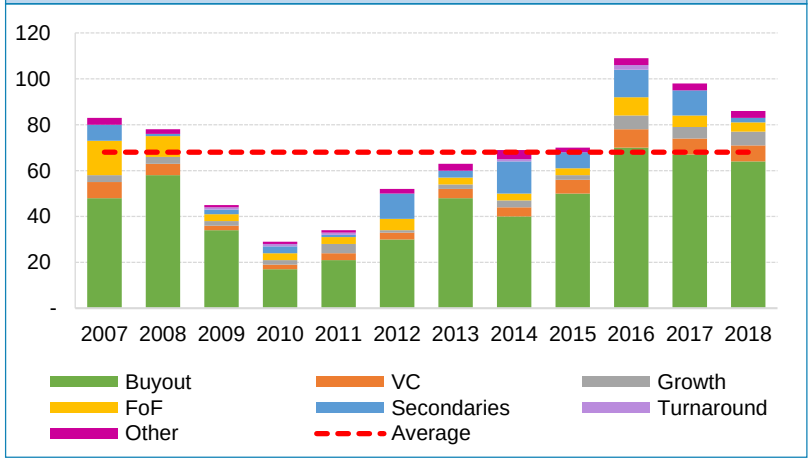
European Private Equity

Strong volume and value growth

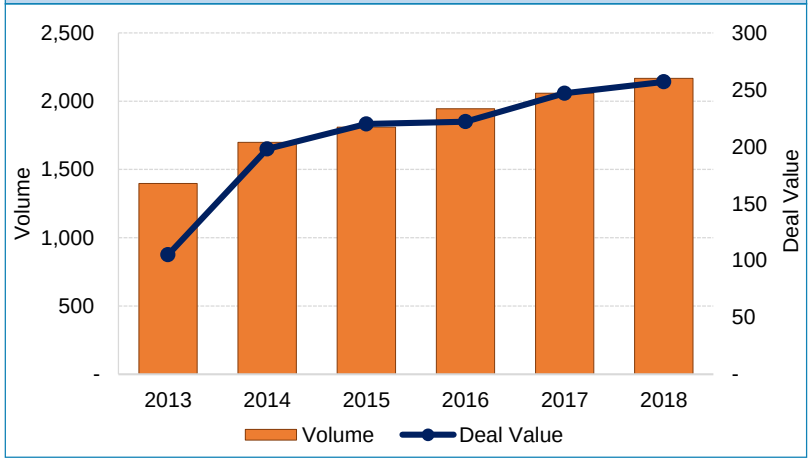
- The European private equity industry saw impressive growth in the last 5 years where deal value grew by 9% p.a. and AUM grew by c. 5.2% p.a.
- Since 2008, distressed PE funds, buyout funds, real estate funds, and funds of funds have all consistently outperformed the S&P 500 index by a wide margin
- Almost €300bn of new PE capital was raised for investment in Europe in the three years to 2019
- Between 2013 and 2018, Europe saw a total of 7,477 private equity buyout deals, with emerging markets subsuming positions of the losses of Ireland and the United Kingdom due to Brexit
- In 2018, European private equity market transaction values reached €262.1bn with a volume of 2,168 deals
  - This represents an increase of 5% over 2017 and 55% since 2013
  - This high deal volume reflects a highly competitive market with increasing asset prices
  - The uplift is mainly driven by buyouts (1,566 worth €175bn) rather than exits (945 worth €139bn), which is due to the increasing amount of dry powder and volatility in the markets

Capital Raised* by Europe-Focused Private Equity Funds



*In €billion

European Private Equity Investment Trends



*Deal value in €million

Source: Preqin, PWC, McKinsey, Bain & Co.

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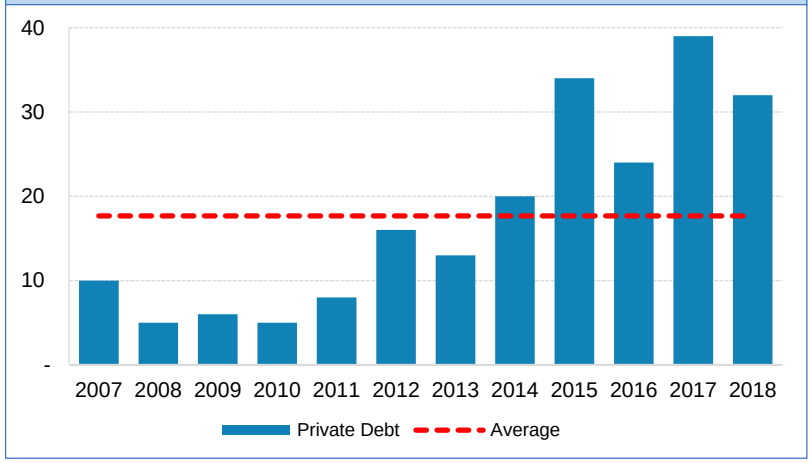
European Private Debt

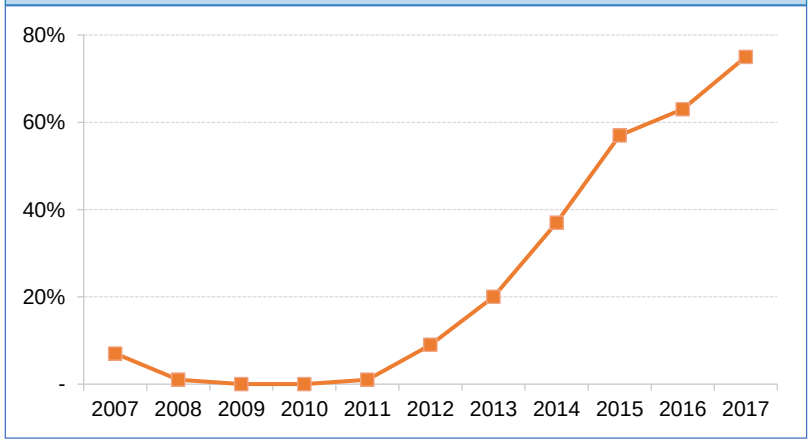
Increasing options and decreasing covenants

- Of all commercial real estate debt in Europe in 2018, banks held c.75% and private alternative lenders and insurance companies held the remaining c. 25%
- In H1 2019, nearly 80% of private debt funds in Europe that closed fundraising surpassed their goals
- More active private debt investors have been targeting Europe, increasing 15.8% in 2018, from 1,515 to 1,755
  - This European market is less saturated with private debt funds than North America, encouraging an inflow of investors
- In Q3 2019, Europe was the strongest regional fundraiser for private debt, with $13.9bn compared to North America at $6.5bn, Asia at $1.5bn, and the rest of the world at $0.1bn
- Out of the roughly $200bn in private debt currently under management in Europe, $97bn are direct lending assets, followed by distressed debt at $48bn, mezzanine at $32bn, and special situations at $23bn.
- In Europe, only 7% of loans were covenant-lite at the peak of the last credit cycle in 2007, but now they are becoming quite common with 75% of broadly syndicated leveraged loans in 2017 being covenant-lite
- The number of loans with covenants limiting the borrower from acquiring or disposing of assets has been largely reduced, with only 53% of senior facilities in 2018 placing large restrictions on such acquisitions or disposals

Annual Europe Focused Private Debt Fundraising



Covenant-Lite Leveraged Loans in Europe



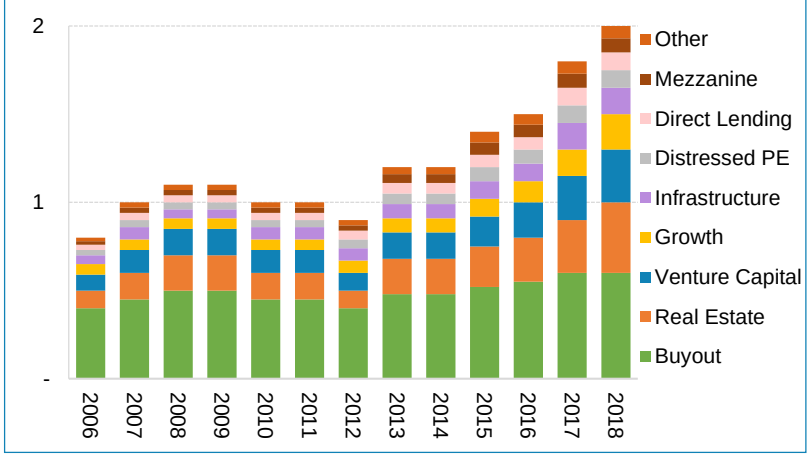
Source: PEI, PDI, S&P, Prequin

Private Equity/Debt Capital

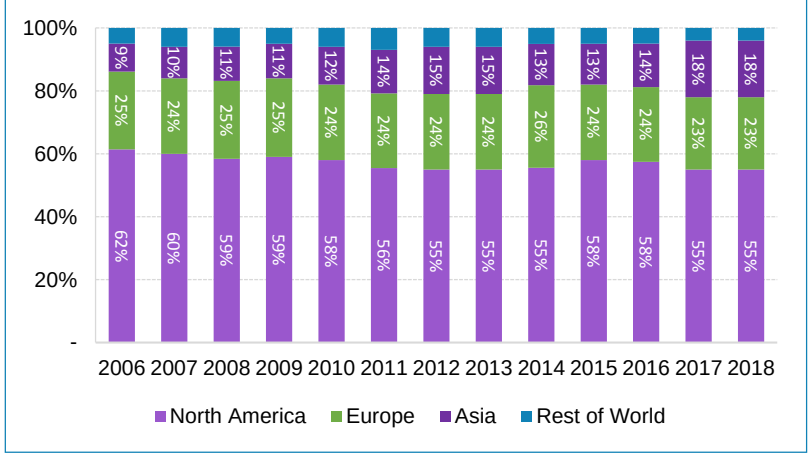
Substantial dry powder chasing limited opportunities

- The amount of dry powder available globally reached an historic high in June of 2018 at $2.1tn, with Europe accounting for roughly 24% of the market
- This has been putting heavy pressure on fund managers to deploy this capital to earn management fees
- An aggregate of at least €100bn of private equity-backed buyout and venture capital deals have been completed in Europe every year since 2013
- Between 2006 and 2013 private equity was a diminishing section of dry powder to the benefit of private debt and infrastructure; however, the trend has been reversing in the past 6 years, with private equity now accounting for 58% of all available capital, its post 2012 peek
- In addition, debt funds' dry powder to deploy across all asset classes reached its highest peak of €50bn in 2018, a rise of approximately 46% over the last 5 years
- Deal activity in Europe has seen a corresponding increase, with the average European private equity-backed buyout deal increasing in value from €211mn in 2014 to €328mn in 2018, in increase of 55%

Global Dry Powder* Trend



Private Capital Dry Powder by Geographic Focus



***in $trillion**

Source: Prequin, Bain & Co.

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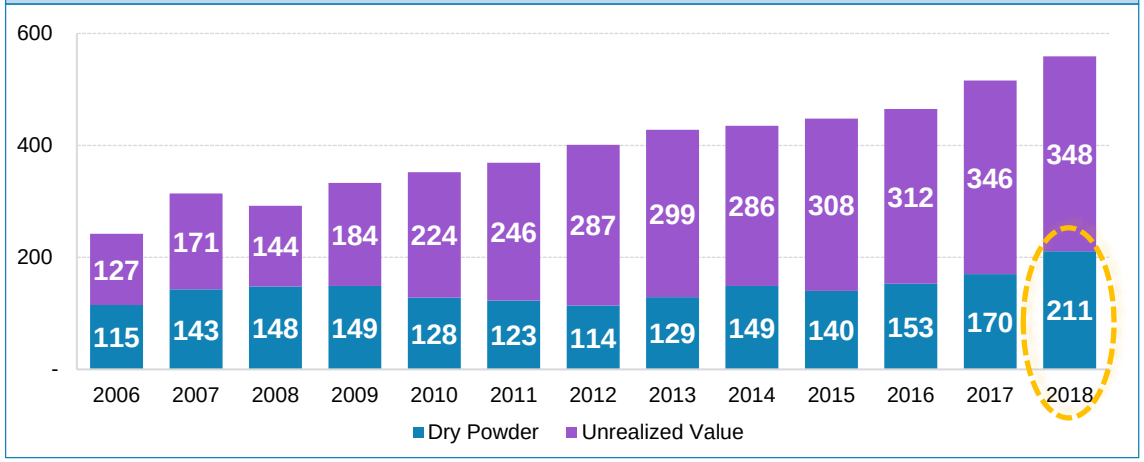
Private Equity/Debt Capital

A focus on the amount of dry powder in Europe

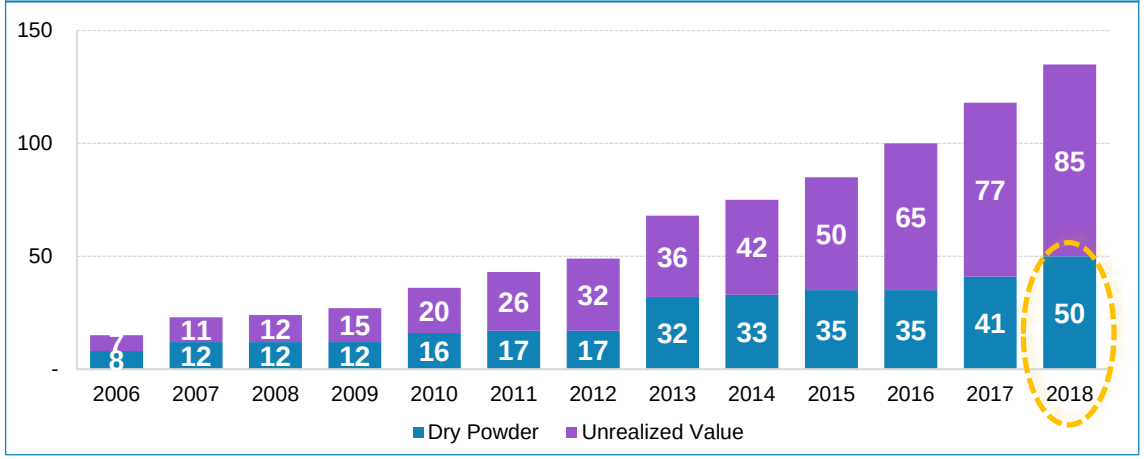
European Dry Powder* Trend – Private Equity



*in €billion

- AUM for European private equity firms hit a record of €559bn in 2018
- Dry powder particularly rose in the last two years and reached €211bn in 2018
- A large amount of capital is now available across the risk reward spectrum which is supporting high asset prices

European Dry Powder* Trend – Private Debt



*in €billion

- The European private debt industry has seen substantial growth since 2012
- In 2018 private debt assets reached c.$183bn (€135bn) out of which $126 (€85bn) was unrealized value and $57bn (€50bn) was dry powder
- Private debt-backed deals in the UK have increased 88% between 2016 and 2018, from €50m to €94m
- 68% of total debt deals in 2018 consisted of uni-tranche, with the first quarter of 2019 following this trend

Source: Preqin.

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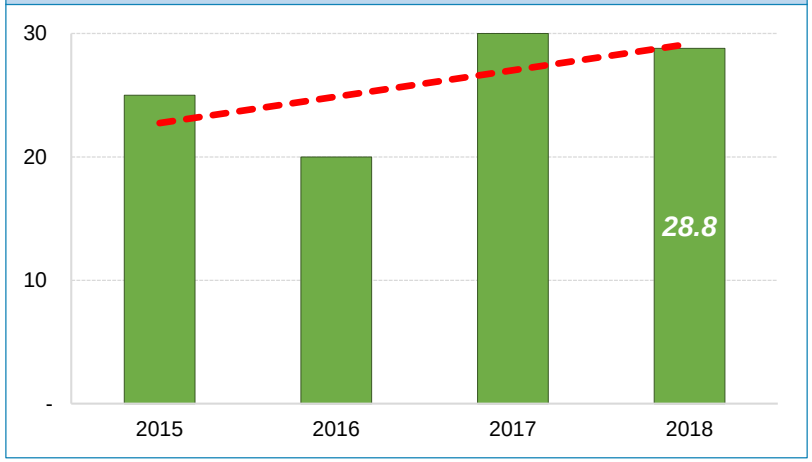
Availability of Capital for Hotel Transactions

Why is attention moving to the hospitality industry?

- Capital for hotel investments has continued to increase, with 2018 seeing closed-end private funds raising $28.8bn globally in both hotel-focused vehicles and diversified funds which invest in hotels.
- Consequently, private equity buyers were the most dominant buyer group of the hotel transactional activity in 2018, accounting for almost 40% of all activity, which is reflective of buyers' need to deploy capital
- The composition of the overall fundraising though is shifting towards debt strategies with 21% comprised of debt funds in 2018, compared to 17% in 2017
- In addition, debt funds dry powder to deploy across all asset classes reached its highest peak of €50bn in 2018, a rise of approximately 46% over the last 5 years
- This is underpinned by the perception that debt can provide better protection against potential falls in property values and be overperform as interest rates rise and yields come under pressure
- In general, private equity hospitality transactions are expected to increase due to:
  - Record levels of fundraising for hospitality transactions
  - Attractive secular and cyclical operating trends
  - Hotels' attractive yields (between 4.5% and 8.5%) compared to prevailing interest rates
  - Variety of different risk/reward profiles in hospitality
  - Innovative acquisition financing structures
- There is now a wide range of debt and equity funds with different risk reward profiles. This has led to new investment strategies such as Opco/Propco, ground rent, structured debt financing and strategic joint venture emerging across the real estate investment universe, but especially in hotel real estate

Closed-end funds with hotel focus



***in $billion**

Source: Preqin, JLL, Bain & Co, PWC

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Relevant Transactions

Innovative acquisition financing

Queensgate Investments, in March 2019, made a £1bn acquisition of four Grange Hotels. Alpha Real Capital, a London based financial services company, invested in the ground rents of three of the four hotels.

Queensgate made this acquisition because of the hotels' location in Central London, one of the most consistent markets in hospitalities, and projections of high cash on cash returns. These properties will be operated by the Fattal Hotel Group who intend on implementing rolling refurbishments to drive performance and growth.

In May of 2016, London & Regional acquired Atlas Hotels and their 46 Holiday Inn Express hotels from Lone Star for £575m.

L&R were able to obtain £345m in debt financing, equating to around 60% loan-to-value. The remaining £230m was a combination of equity and a £73m mezzanine loan with a five-year term and a floating rate of interest.

L&R used this acquisition to diversify its holdings into budget hotels. InterContinental Hotels Group under the Holiday Inn Express brand was willing to extend their operating contract for 15 years, allowing a smooth transition of owners.

In December 2017 Pandox Hotels purchased 21 Jurys Inn hotels from Lone Star for £680m. Out of the 21 hotels, 20 will be operated by Fattal. Pandox financed the deal with bank loans at 85% leverage and a £120m loan from Fattal, which was set-off after the reorganization.

Pandox acquired Jurys Inn as they belong to the profitable upper mid-market segment and Pandox projected Fattal would bring an immediate and substantial contribution to earnings. Fattal contributed due to former work with Pandox, and to gain access to the UK and Irish markets

Relevant Transactions

Recent acquisitions of emerging brands

In June 2019, Blackrock acquired a pan-European portfolio of 9 hostels owned by Amistat International. The portfolio will continue to be operated by Amistat.

Blackrock's European head of value-added real estate said "This transaction presents an opportunity to gain early mover access into an increasingly institutional but undersupplied asset class." This upholds the assertion that there is enough dry powder in the market to allow traditional investment management companies to make non-traditional investments, such as hostels

In March of 2017, Queensgate Investments Fund II LP purchased Generator Hostels for €450m.

This acquisition of Generator Hostels targets the growing sector of millennial customers that want an low-cost but attractive lifestyle brand. Queensgate Investments plans on keeping this portfolio over a long term, during which it intends to spend €300m to enhance its operation by expansion into new cities throughout Europe and impove its current locations.

In January of 2017, California based TPG Real estate purchased A&O Hostels for an undisclosed amount. The agreement includes 31 leased and owned hostels that were located primarily in Germany.

A partner at TPG noted: "A&O is a strong operator that is well positioned to capitalize on favourable global and European travel trends." Key members of A&O's management team continued to lead the company after the buyout, allowing for a smooth transition of owners.

Relevant Transactions

Minority growth equity investments

Last year, the American company Starwood Capital Group acquired a 30% stake in the UK based hotel firm Yotel for $250m. Yotel is known for its pod hotels which are low priced and are able to be built in airports.

This acquisition allows Starwood Capital to diversify its holdings in the European hospitalities market away from only luxury hotels. Starwood Capital's CEO and chairman stated, "Yotel has global appeal and can be easily scaled up with key strategic acquisitions and developments in desired city centre and airport locations." Starwood also saw Yotel as a suitable operator for some of its previous investments.

February of 2017, French private equity group Siparex acquired a 37% stake in H. N. H. Hospitality for €8m. H. N. H.'s portfolio at the time of purchase included 10 hotels, which are traditional 4- and 5- star luxury business and resort hotels in Northern Italy.

HNH developed a business plan to use this new capital to double both turnover and number of rooms in the following five years. Siparex intends to add value in excess of their investments to support HNH's ambitious performance goals.

In March of this year, Singaporean investor GIC acquired a 25% stake in CitizenM hotels for €500m. CitizenM operates 20 locations around Europe, America, and Asia and feature automated self-check in. They are an 'affordable luxury' brand thanks to their lean operational cost structure.

GIC wanted to facilitate CitizenM's promising brand's expansion through this investment. With the new capital, Citizen M plans on expanding into 'gateway cities' across the three major markets which they already occupy.

Relevant Transactions

Acquisitions of multi-brand platform businesses

In November 2018, Apollo Global Management purchased Tifco Hotel Group from Goldman Sachs for €233m. Tifco is the second largest hotel chain in Ireland. At the time of purchase, Tifco owned 18 hotels, two new hotels sites in Dublin that were under construction, and managed a number of other high-profile hotels around Ireland.

Apollo raised sufficient capital to pay off all of Tifco's funding debt with new debt at lower interest rates, allowing the distressed debt fund to achieve a high return on equity.

In July of last year, LRC Group agreed to acquire Amaris Hospitality and seven Hilton-branded hotels from Lone Star for $832m. Amaris became LRC group's hotel management and investment platform.

LRC Group intend to continue expanding their portfolio through this new management and investment vehicle, aided by Amaris's extensive experience in the consitent UK and Irish markets.

In January of 2015, Thai company FICO Corporation acquired Jupiter Hotels in the UK for £160m. At the time of purchase, Jupiter Hotels consisted of 30 properties, 26 of which are under management contract with AccorHotels until 2031.

FICO corporation entered the European hospitalities market with this purchase. They also saw potential to increase yield by refurbishing and rebranding the hotels to increase the value of their acquisitions.

Conclusions

1. Hotels are still a strong investment asset even though the economy is slowing down, because of
   - Record levels of fundraising for hospitality transactions
   - Attractive secular and cyclical operating trends
   - Hotels' attractive yields (between 4.5% and 8.5%) compared to prevailing interest rates and other real estate assets
   - Variety of different risk/reward profiles in hospitality
   - Innovative acquisition financing structures
2. The European market is one of the best locations for hotel investments, with solid established hospitality markets like London and Paris, and the opportunity to gain higher yields in emerging tourist markets like Budapest and Warsaw
3. Hotel operating and tourism trends also helps Europe attract so much outside capital, as low unemployment and high wages encourage more travelling, and hotel occupancy and RevPAR growth remains strong
4. European commercial banks are bigger and safer than ever before, helping to minimize downside risk, and increase the availability of capital
5. European private equity remains highly competitive, with transaction volumes and deal values reaching record highs in 2018
6. European private debt is also highly competitive, resulting in more private debt financing options as well as more competitive covenant-lite loans with low costs of capital
7. The extremely high amount of dry powder allows for innovative transaction structures such as mezzanine, ground rent, and OpCo/PropCo

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Appendix

Appendix

Complete list of recent transactions

Acquirer(s)	Location of Buyer	Date	Target	Location of Target	Deal Size
KSL Capital Partners	US	2019	Les Hôtels d'en Haut	FR	Undisclosed
Goldman Sachs	US	2019	B&B Hotels	EU	£ 1,680
Bregal Freshstream LLP	UK	2019	Away Resorts	UK	Undisclosed
Oaktree	US	2019	15 Castello sgr. Hotels	IT	£ 300
GIC Pte Ltd, KRC Capital, APG Asset Management	Various	2019	CitizenM Holding BV	NL	£ 845
Proprium Capital Partners	US	2019	Motel One	NL	Pending
Jin Jiang International Ltd.	CN	2018	Radisson Hospitality Ltd	US	£ 2,000
Gaw Capital	HK	2018	Hospes Hotel Group	ES	£ 55
LRC Group	CY	2018	Amaris Hospitality	IE	£ 832
Schroders	UK	2018	Algonquin	BE	Undisclosed
Oaktree Capital Management, Goldman Sachs, Hermes GPE	Various	2018	Sani SA, Ikos SA	GR	Undisclosed
Brookfield	CA	2018	SACO	UK	£ 430
Platinum Equity Capital Partners	US	2018	Wyndham European Rentals	EU	$ 1,300
Apollo Global Management	US	2018	TiFCO	IE	$ 234
Starwood Capital	US	2017	Yotel	UK	£ 250
Pandox	SE	2017	Jurys Inn Hotels	UK	£ 800
Onex Corporation	CA	2017	Parkdean Resorts Topco Ltd.	UK	£ 1,656
KKR-led Venture	US	2017	Intertur Hotels Group	ES	Undisclosed
Värde	UK	2017	Boscolo Hotels	IT	£ 310
TPG Real Estate	US	2017	A&O Hotels and Hostels	DE	Undisclosed
Siparex Midcap 2	FR	2017	HNH Hospitality	IT	£ 8
Queensgate Investments	UK	2017	Generator Hostels	UK	$ 489

*in million

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Appendix

Complete list of recent transactions

Acquirer(s)	Location of Buyer	Date	Target	Location of Target	Deal Size
Cerberus Capital Management LP	US	2017	Qbic Hotels Ltd	UK	$ 20
Hua Kee	TH	2017	Cycas Hospitality	UK	Undisclosed
Palatine Private Equity	UK	2016	Verdant Leisure Group	UK	$ 57
Terra Firma	UK	2016	Welcome Hotels	DE	Undisclosed
Goldman Sachs	US	2016	Travelodge Ireland	IE	Undisclosed
London And Regional	UK	2016	Atlas Hotels	UK & EU	£ 575
Permira Funds	FR	2015	Vacalians Group	FR	Undisclosed
Starwood Capital	US	2015	The Town House Collection	UK	Undisclosed
Lone Star Global	UK	2015	Jurys Inn	UK	£ 680
Phoenix Equity Partners	UK	2015	Bridge Leisure	UK	Undisclosed
Louvre Hotels SAS	FR	2015	Nordic Hotels AG Portfolio of 25 Hotels	DE	Undisclosed
Fico Holding & Tiesco	UK	2015	Jupiter Hotels	UK	£ 160
KSL Capital Partners	US	2014	Village Urban Resorts	UK	Undisclosed
Starwood Capital	US	2014	Four Pillars Hotels	UK	Undisclosed
Electra Partners	UK	2013	South Lakeland Parks	UK	£ 47
Starwood Capital	US	2013	Principal Hayley Group Ltd.	UK & EU	Undisclosed
Caledonia Investments	UK	2013	Park Holidays	UK	£ 172
Topland Group	UK	2013	Hallmark Hotels	UK	£ 75
Starwood Capital	US	2009	Golden Tulip Hospitality	EU	Undisclosed
Oman Investment Fund	OM	2008	Jurys Inn	UK	£ 200
TVC Holdings	IE	2007	Quality Hotel/Comfort Inn Hotel Chain	IE	£ 41
Moorfield Real Estate Fund	UK	2007	MacDonald Hotels & Resorts	UK	£ 400

*in million

AHV

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